
恒生銀行
HANG SENG BANK
言以衷
CONVERSATIONS
聽以誠
Annual Report 2014

Founded in 1933, Hang Seng is one of Hong Kong's largest listed companies. Our market capitalisation as at 31 December 2014 was HK$247.0bn.

With more than 10,000 employees, we serve over half the adult population of Hong Kong – more than 3 million people – through about 240 service outlets. We also maintain branches in Macau and Singapore and a representative office in Taipei.

Established in 2007 and headquartered in Shanghai, our wholly owned mainland China subsidiary Hang Seng Bank (China) Limited operates a network of around 50 outlets in Beijing, Shanghai, Guangzhou, Shenzhen, Fuzhou, Nanjing, Dongguan, Hangzhou, Ningbo, Tianjin, Kunming, Xiamen, Chengdu, Foshan, Zhongshan, Huizhou, Zhuhai, Jiangmen and Shantou.

Hang Seng is a principal member of the HSBC Group, one of the world's largest banking and financial organisations.

Contents

* Where possible, percentages in this section have been rounded to the nearest percentage point to facilitate 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

FOR THE YEAR

Operating profit excluding loan impairment charges

20,594 HK$m

2013 : 18,946 HK$m

Operating profit

19,450 HK$m

2013 : 18,410 HK$m

Profit before tax[1]

18,049 HK$m

2013 : 28,496 HK$m

Profit attributable to shareholders[1]

15,131 HK$m

2013 : 26,678 HK$m

Return on average shareholders' funds[1]

13.4%

2013 : 25.4%

Cost efficiency ratio

31.8%

2013 : 32.4%

Average liquidity ratio

34.7%

2013 : 34.9%

Earnings per share[1]

7.91 HK$

2013 : 13.95 HK$

Dividends per share

5.60 HK$

2013 : 5.50 HK$

[1] **Industrial Bank Co., Ltd. ("Industrial Bank") impairment and reclassification**
Reported results for 2014 include an impairment loss of HK$2.1bn on the Bank's investment in Industrial Bank. Reported results for 2013 include a non-distributable accounting gain on the reclassification of Industrial Bank from an associate to a financial investment of HK$8.5bn before tax (HK$9.5bn attributable profit). Figures quoted as "excluding the Industrial Bank impairment and reclassification" have been adjusted for the above items. Excluding the Industrial Bank impairment and reclassification, key financial results and performance metrics are set out below for comparison purpose:

	2014	2013
Profit before tax (HK$m)	**20,152**	20,042
Profit attributable to shareholders (HK$m)	**17,234**	17,161
Earnings per share (HK$)	**9.01**	8.98
Return on average shareholders' funds (%)	**16.3**	17.6

AT YEAR-END (AT 31 DECEMBER)

Shareholders' funds

139,193 HK$m

2013 : 107,778 HK$m

Total assets

1,263,990 HK$m

2013 : 1,143,730 HK$m

Capital ratios
under Basel III

Common Equity Tier 1 ("CET1") Capital Ratio

15.6%

2013 : 13.8%

Tier 1 Capital Ratio

15.6%

2013 : 13.8%

Total Capital Ratio

15.7%

2013 : 15.8%

RATINGS

HANG SENG BANK

Moody's

Long-term Bank Deposit (local and foreign currency)	Aa2
Short-term Bank Deposit (local and foreign currency)	Prime -1
Bank Financial Strength	B
Outlook	Stable

Standard & Poor's

Long-term Counterparty Credit (local and foreign currency)	AA-
Short-term Counterparty Credit (local and foreign currency)	A-1+
Outlook	Stable

HANG SENG CHINA

Moody's

Long-term Bank Deposit (local and foreign currency)	A2
Short-term Bank Deposit (local and foreign currency)	Prime -1
Bank Financial Strength	D+
Outlook	Stable

Standard & Poor's

Long-term Counterparty Credit (local and foreign currency)	AA-
Short-term Counterparty Credit (local and foreign currency)	A-1+
Outlook	Stable

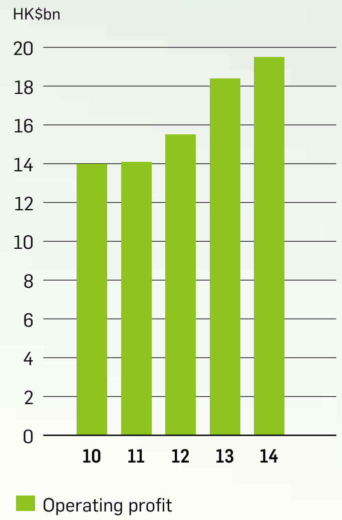
Five-Year Financial Summary

	2010 (restated)	2011 (restated)	2012 (restated)	2013	2014
FOR THE YEAR	HK$bn	HK$bn	HK$bn	HK$bn	**HK$bn**
Operating profit	14.0	14.1	15.5	18.4	**19.5**
Profit before tax[1]	17.2	19.2	22.0	28.5	**18.0**
Profit attributable to shareholders[1]	14.9	16.8	19.3	26.7	**15.1**
AT YEAR-END	HK$bn	HK$bn	HK$bn	HK$bn	**HK$bn**
Shareholders' funds	70.7	79.6	92.3	107.8	**139.2**
Issued and paid up capital	9.6	9.6	9.6	9.6	**9.7**
Total assets	917.1	975.7	1,077.1	1,143.7	**1,264.0**
Total liabilities	846.4	896.1	984.8	1,035.9	**1,124.8**
PER SHARE	HK$	HK$	HK$	HK$	**HK$**
Earnings per share[1]	7.80	8.80	10.11	13.95	**7.91**
Dividends per share	5.20	5.20	5.30	5.50	**5.60**
RATIOS	%	%	%	%	**%**
Return on average shareholders' funds[1]	22.6	22.6	22.8	25.4	**13.4**
Post-tax return on average total assets	1.7	1.8	1.9	2.4	**1.3**
Capital ratios under Basel III					
– Common Equity Tier 1 ("CET1") Capital Ratio	–	–	–	13.8	**15.6**
– Tier 1 Capital Ratio	–	–	–	13.8	**15.6**
– Total Capital Ratio	–	–	–	15.8	**15.7**
Capital ratios under Basel II					
– Core capital ratio	10.8	11.6	12.2	–	**–**
– Capital adequacy ratio	13.6	14.3	14.0	–	**–**
Cost efficiency ratio	34.2	35.3	34.9	32.4	**31.8**

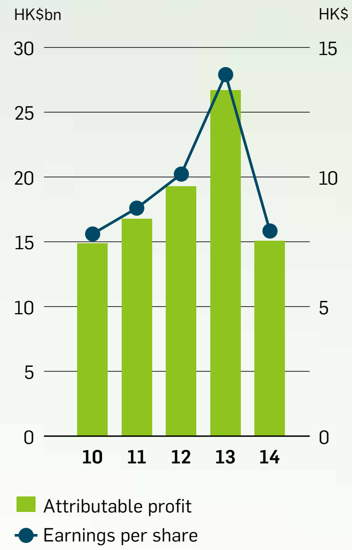
[1] Industrial Bank Co., Ltd. ("Industrial Bank") impairment and reclassification
Reported results for 2014 include an impairment loss of HK$2.1bn on the Bank's investment in Industrial Bank. Reported results for 2013 include a non-distributable accounting gain on the reclassification of Industrial Bank from an associate to a financial investment of HK$8.5bn before tax (HK$9.5bn attributable profit). Figures quoted as "excluding the Industrial Bank impairment and reclassification" have been adjusted for the above items. Excluding the Industrial Bank impairment and reclassification, key financial results and performance metrics are set out below for comparison purpose:

	2014	2013
Profit before tax (HK$bn)	**20.2**	20.0
Profit attributable to shareholders (HK$bn)	**17.2**	17.2
Earnings per share (HK$)	**9.01**	8.98
Return on average shareholders' funds (%)	**16.3**	17.6

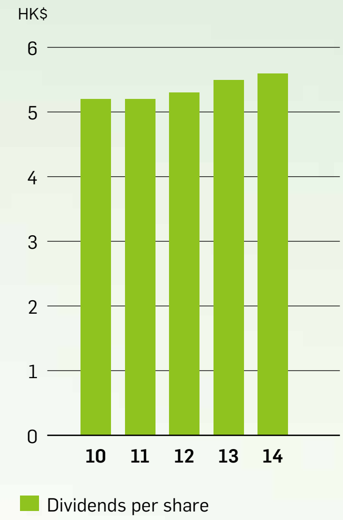
Results



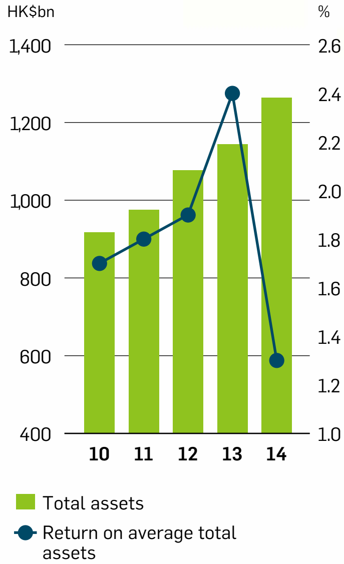
Attributable Profit and Earnings per Share



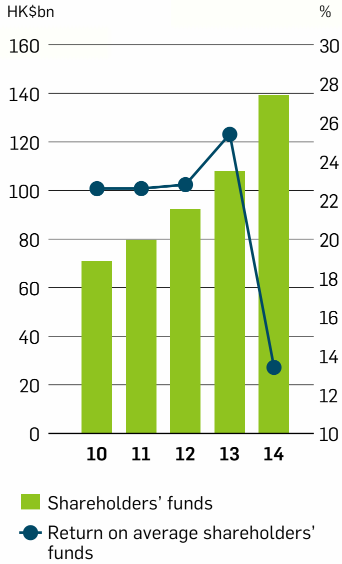
Dividends per Share



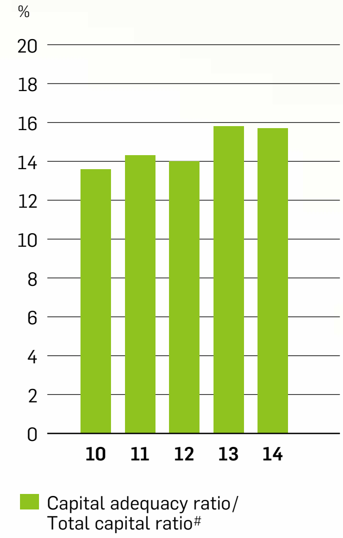
Total Assets and Return on Average Total Assets



Shareholders' Funds and Return on Average Shareholders' Funds



Capital Adequacy Ratio/ Total Capital Ratio



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 effective from 2013 under Basel III are, therefore, not directly comparable with the disclosure prepared under Basel II basis before.

Chairman's Statement

In a challenging economic environment, Hang Seng maintained good growth momentum in 2014. Capitalising on our strong market position and brand, we leveraged our competitive strength to improve efficiency and provide an enhanced service experience for customers.

The impact of the Industrial Bank reclassification in 2013 and impairment loss in 2014 saw profit attributable to shareholders and earnings per share both fall by 43% to HK$15,131m and HK$7.91 respectively. Excluding these items, profit attributable to shareholders increased by 0.4% to HK$17,234m and earnings per share rose by 0.3% to HK$9.01.

Return on average shareholders' funds for 2014 was 13.4%, compared with 25.4% in the previous year. Excluding the Industrial Bank reclassification in 2013 and impairment loss in 2014, return on average shareholders' funds was 16.3%, compared with 17.6% in 2013.

The Directors have declared a fourth interim dividend of HK$2.30 per share, bringing the total distribution for 2014 to HK$5.60 per share, up from HK$5.50 per share in 2013.

Economic Environment

The global economy grew at a modest pace in 2014. Underpinned by stronger domestic demand, improved GDP growth in the US offset relatively slower growth in the Eurozone. In Japan, an increase in the value-added tax rate dampened domestic demand during the second half of the year.

Hong Kong's economy expanded by 2.4% during the first three quarters of the year, supported by buoyant labour market conditions and improvement in the balance of trade. Stronger US demand and the continuing health of the domestic balance sheet should enable the city to withstand economic headwinds and remain on a growth track. We forecast real GDP growth of 2.6% for 2015 – a modest increase on the 2.2% we expect for 2014.

In mainland China, the property market correction and the overhang of surplus capacity have led to a slowdown in economic expansion. GDP growth for 2014 was 7.4%, compared with 7.7% in 2013. Economic challenges will persist in 2015, but resilient domestic consumption and government efforts to stimulate economic activity will provide support for growth. We expect GDP growth to be lower in 2015 compared with 2014, but still above 7.0%.

The normalisation of US monetary policy and the possibility of a structural slowdown on the Mainland will continue to create uncertainty and downside risk in the Asian region. However, initiatives to further strengthen economic ties between Hong Kong and the Mainland, including the launch of the Shanghai-Hong Kong Stock Connect scheme in November 2014, and steps to further promote the internationalisation of the renminbi, continue to create opportunities for sustainable business growth.

Board Developments

There were a number of changes to Hang Seng's Board in 2014. Ms Anita Fung stepped down as a Non-executive Director of the Bank in January. On behalf of the Board, I wish to thank Ms Fung for her contributions during her tenure. Mr Nixon Chan, Hang Seng's Head of Retail Banking and Wealth Management, was appointed Executive Director with effect from 31 January 2014. We also welcomed Mr Kenneth Ng as a Non-executive Director and Ms Irene Lee and Dr Henry Cheng as Independent Non-executive Directors during the year. Details of our Board members can be found in the 'Biographical Details of Directors' section of this Annual Report and on the Hang Seng Bank website.

The Board is greatly saddened by the passing of former Hang Seng Directors Dr Marvin Cheung and Mr Jenkin Hui last year. Both Directors served the Bank with distinction and we are deeply grateful to have benefited from their wise counsel and expertise.

I wish to extend my thanks to all staff for their invaluable contributions to the sustainable growth of our business, and to our customers and shareholders for their strong support and trust over the years.

Supported by our extensive network of service channels, loyal customer base and strong cross-border capabilities, we will take full advantage of new business opportunities and continue to deliver excellence.

Raymond Ch'ien
Chairman
Hong Kong, 23 February 2015

Chief Executive's Report

In increasingly challenging operating conditions, Hang Seng made good progress with its customer-centred strategy for growth, achieving increases in income and profit across core business groups to return respectable results for 2014.

Operating profit excluding loan impairment charges increased by 9% to HK$20,594m compared with 2013. Operating profit rose by 6% to HK$19,450m.

Following the 2013 reclassification of our holding in Industrial Bank, we recorded a significant accounting gain in 2013 and an impairment loss in 2014. These two factors led to the 43% drop in profit attributable to shareholders to HK$15,131m. Excluding these items, profit attributable to shareholders rose by 0.4%, with the increase in operating profit offset by lower gains on the disposal and revaluation of properties.

Profit before tax fell by 37% to HK$18,049m. Excluding the Industrial Bank accounting gain and impairment loss, profit before tax rose by 0.5%, reflecting the impact of the aforementioned lower property-related gains.

We grew quality assets and further diversified our revenue base to achieve balanced growth, recording a 7% rise in net interest income and a 9% increase in non-interest income.

Our commitment to enhance the customer experience across our diverse range of service channels saw the implementation of further initiatives to optimise our network coverage, provide personalised wealth management solutions and offer our clients greater convenience and choice.

We opened new outlets for key customer segments and upgraded existing branches with a fresh design and service enhancements. New investments in technology and digital platforms enhanced our e-Banking penetration rate among retail customers.

An exclusive 10-year medical insurance distribution agreement was entered into with international healthcare company Bupa to provide a holistic health management and insurance service to our clients. Our Hong Kong operations continued to work in close collaboration with Hang Seng Bank (China) Limited (Hang Seng China), strengthening our connectivity and network to capture a greater share of cross-border business and acquire new customers in target segments. Business initiatives that capitalise on the Shanghai-Hong Kong Stock Connect scheme and relaxation of controls on the renminbi reinforced our market position in wealth management and cross-border services.

Hang Seng China opened two new outlets and successfully launched a RMB1bn dim sum bond to support growth.

Net interest income grew by HK$1,267m to HK$19,871m, driven mainly by the 6% increase in average interest-earning assets. Net interest margin increased by one basis point to 1.90%. Focused customer acquisition strategies and prudent portfolio management led to a 10% increase in average customer lending and a 7% rise in average customer deposits. Non-interest income increased by HK$878m to HK$10,336m with a 6% increase in net fee income.

With the 8% increase in net operating income before loan impairment charges outpacing the 6% rise in operating expenses, our cost efficiency ratio improved by 60 basis points to 31.8%.

Loan impairment charges rose by HK$608m to HK$1,144m. Gross impaired loans and advances as a percentage of gross loans and advances to customers stood at 0.32%, compared with 0.22% at the end of 2013. The challenging credit environment in mainland China led to an increase in impaired loans and related impairment charges on Mainland loan portfolios from a low base. We remained vigilant concerning asset quality and overall credit quality remained stable.

On 31 December 2014, our Total capital ratio under Basel III was 15.7%, compared with 15.8% at the end of 2013. Our Common Equity Tier 1 and Tier 1 capital ratios were both 15.6%, compared with 13.8% a year earlier.

Charting Future Growth

As the leading domestic bank in Hong Kong with a history that spans more than 80 years, we have earned customer loyalty and trust with our service excellence and client-driven strategies. We are well positioned to benefit from the continuing growth of our city and its deepening economic ties with the Mainland.

We will continue to enhance efficiency and strategically deploy capital and other resources to continue to reinforce our market position in wealth management and cross-border business.

Slower economic growth, excess capacity in certain industries and the impact of continuing market reforms will create complex credit conditions on the Mainland in the year ahead. We will leverage our good cross-border connectivity to further enhance Hang Seng China's service proposition and take advantage of favourable policy developments and initiatives to support the internationalisation of the renminbi.

Engaging in active dialogue with customers and other stakeholders allows us to respond promptly to market changes and new business opportunities. Leveraging our strong brand, extensive service network and customer base, and diverse portfolio of products, we will continue to strengthen our platform to achieve balanced and sustainable growth in our core business.

We will uphold high standards of corporate governance and provide our staff with development opportunities to enhance their professional and leadership skills. Our investment and participation in a diverse range of corporate sustainability programmes remain key elements of our commitment to promoting the well-being of the communities that support us.

I wish to thank my colleagues for their dedication in driving our strategic initiatives to cater to the needs of our retail and corporate customers to achieve sustainable growth and maximise value for shareholders.

Rose Lee
Vice-Chairman and Chief Executive
Hong Kong, 23 February 2015

"CONVERSATIONS"

言以衷
聽以誠

This year's theme reflects Hang Seng's commitment to engaging with the community in various aspects of life, work and leisure. As the leading domestic bank in Hong Kong, serving half the city's adult population and a growing number of customers in mainland China, conversations are at the heart of our values, services and strategy for growth.

Business in Hong Kong

Evolving economic and credit conditions, intense market competition, and ongoing renminbi-related and cross-border trade policy developments created a complex operating environment in 2014. Leveraging our strong market position, including our extensive service network and trusted brand, we took further steps to meet the changing needs of our large and diverse customer base.

We enhanced our service channels, made greater use of technology to improve efficiency and customer convenience, and enriched product and service offerings with a strong emphasis on providing tailored wealth management solutions.

We used our good cross-border connectivity to capitalise on further financial policy reforms and to continue to support customers with financial needs in Hong Kong and mainland China.

Customer deposits, including certificates of deposit and other debt securities in issue, grew by 10.7% to HK$870.3bn. Customer advances grew by 13.0% to HK$595.0bn.

Retail Banking and Wealth Management

Retail Banking and Wealth Management recorded a 0.9% increase in profit before tax to HK$9,017m. Operating profit excluding loan impairment charges rose by 3.7% to HK$9,302m. Operating profit increased by 3.4% to HK$8,771m.

In a competitive market, we maintained net interest income in line with 2013 – recording a 0.8% year-on-year increase to HK$10,036m. Customer deposits and customer lending rose by 5.0% and 9.1% respectively.

Non-interest income increased by 11.0% to HK$4,811m. Backed by our strong brand and customer-centred focus, the upgrade and expansion of our wide range of service channels supported efforts to further diversify our revenue base, with a 7.7 % rise in net fee income.

We took further steps to tailor our services for specific customer segments, opening more Prestige and Preferred Banking Centres in strategic locations and refurbishing existing branches with

KEY INITIATIVES

Speaking to the aesthetic sense of our customers

With a widely respected brand that is among our most valuable competitive advantages, we understand the importance of non-verbal communication in building customer trust. In 2014, we refined our corporate look to strengthen our market positioning and support our business growth objectives while remaining true to our core values.

DIGITAL DADS.

PREFERENCES ARE AS INDIVIDUAL AS A FINGERPRINT, AND EVOLVE OVER THE COURSE OF A LIFETIME.

The Bank provides convenient channels, including advanced online platforms, that empower customers to achieve their financial goals – from saving for their children's education to planning for a secure retirement.

a fresh design. To better serve tech-savvy clients, we opened more 'iPoint' sales and service centres and enhanced our online and mobile platforms to improve financial management convenience and choice for customers. The number of Personal e-Banking users increased by 7.7% year on year.

We significantly enhanced our ability to provide comprehensive insurance solutions for a wide range of customers.

Wealth management

We maintained good growth momentum in wealth management business, achieving a 3.7% increase in related income to HK$6,474m.

We reinforced our position as a market leader by enhancing the features of existing investment and insurance offerings and launching new products and services for target client segments. We strengthened customer analytics and leveraged our reputation for cross-border expertise to capitalise on new opportunities, including the launch of the Shanghai-Hong Kong Stock Connect scheme.

Alongside strong performances by many of our Hang Seng retail investment funds against their market peers and the new capabilities provided by our partnership with Bupa, our wealth management initiatives earned us the continuing trust of existing clients and won us new business.

Investment-related income rose by 8.2% to HK$3,081m. We launched several renminbi-denominated structured products during the year as well as our Shanghai-Hong Kong Stock Connect Northbound Trading services, through which customers can take advantage of new cross-border investment opportunities across a broad range of online, phone and physical channels.

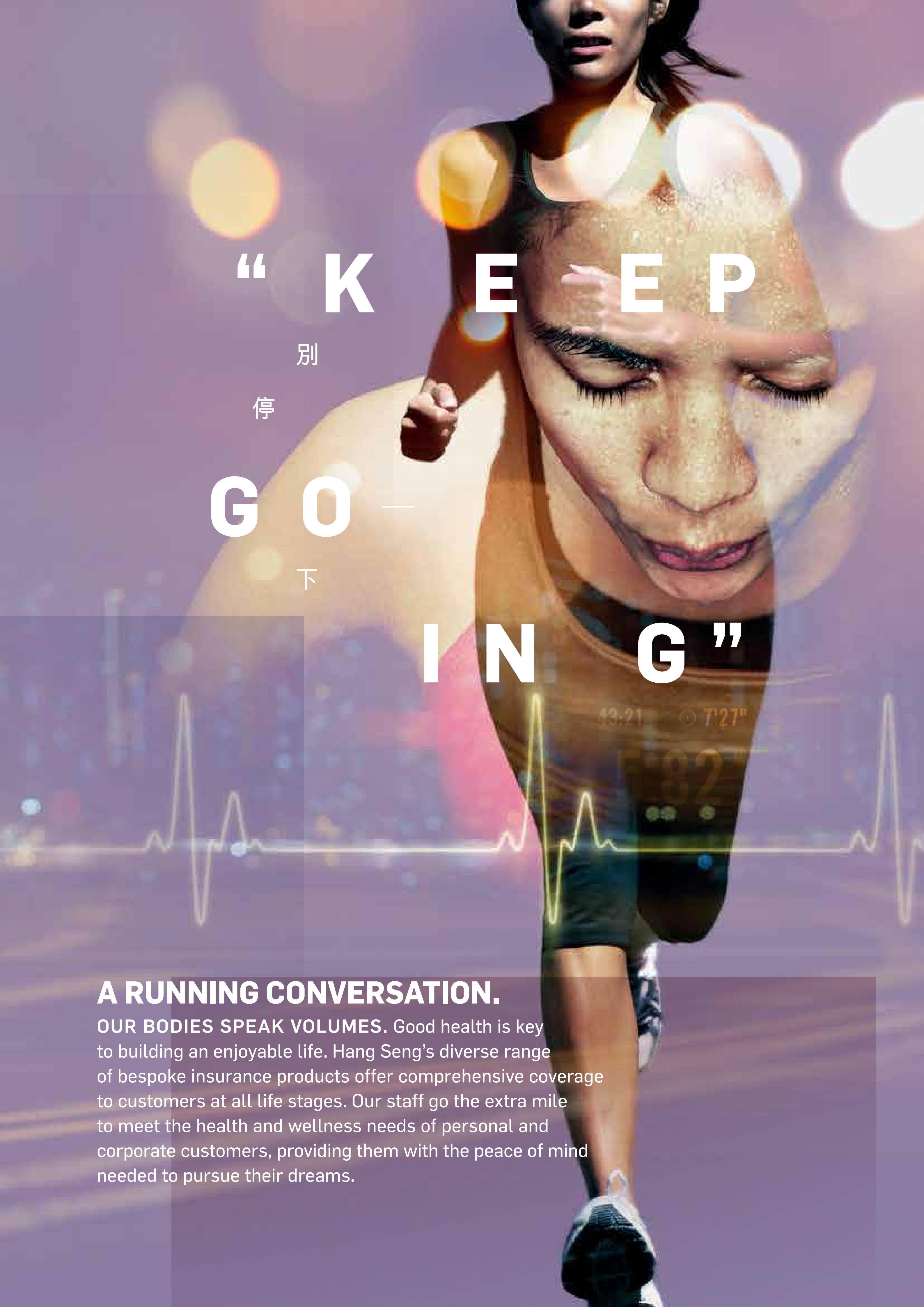
Income from investment funds business increased by 8.3% and we recorded a 15.3% rise in turnover. Securities-related activity was subdued during the first half of the year, but picked up in the second half, with year-on-year increases in income and turnover of 9.0% and 9.5% respectively.

Insurance business income was broadly in line with 2013 at HK$3,393m, due mainly to lower gains from property revaluation under the insurance funds investment portfolio. We enriched our product range with the launch of the Hang Seng Bupa Precious Health Series, the Exquisite Universal Life Insurance Plan to cater for the legacy planning needs of high-net-worth individuals and a number of renminbi-denominated life insurance offerings.

KEY INITIATIVES

A trusted partner for life

Strong partnerships provide the foundation for personal well-being and professional success. In joining hands with international healthcare specialist Bupa to provide a range of innovative medical insurance products and services – including the HealthPro Concierge Service, a first-of-its-kind 24-hour healthcare support service – we are strengthening relationships with customers at all stages of life. This is just one way in which we work to ensure our clients enjoy the protection they need to plan ahead, deal with the unexpected, and live their lives to the full.



“KEEP GOING” 別停下

A RUNNING CONVERSATION.

OUR BODIES SPEAK VOLUMES. Good health is key to building an enjoyable life. Hang Seng’s diverse range of bespoke insurance products offer comprehensive coverage to customers at all life stages. Our staff go the extra mile to meet the health and wellness needs of personal and corporate customers, providing them with the peace of mind needed to pursue their dreams.

Consumer finance

Loans and advances to individuals grew by 9.1% to HK$224.8bn.

Unsecured lending remained a key revenue driver. Effective use of marketing and customer loyalty programmes underpinned a 9.4% year-on-year rise in card spending. Our improved analytics capabilities supported the 26.8% expansion of the personal loans portfolio to HK$8,408m compared with 2013 year-end.

Enhancements to our range of home loan products and services and the opening of a new mortgage centre in Yuen Long to better serve the New Territories market helped us achieve an 8.0% year-on-year increase in the home loans portfolio and maintain our top three position for mortgage business, with a market share of 17.1% in terms of new mortgage registrations in 2014.

Commercial Banking

Commercial Banking achieved a 9.6% year-on-year increase in profit before tax to HK$5,079m. Operating profit excluding loan impairment charges rose by 11.5% to HK$5,206m. Operating profit was up 9.7% at HK$5,078m.

Net interest income rose by 17.3% to HK$4,894m, underpinned by balanced growth in customer advances and customer deposits. The loans portfolio increased by 20.2%, with effective cross-border collaboration supporting growth in a variety of industry sectors. Customer deposits rose by 14.8% – in part reflecting continuing success with acquiring more quality Mainland customers, which represented 45.2% of newly acquired clients in 2014.

We continued to uphold asset quality, with the impaired loan balance contained at a low level of 0.34% against gross customer advances. We further enhanced our portfolio management to optimise returns on risk-weighted assets through effective bundling of transaction banking and wealth management products.

Non-interest income fell by 2.6% to HK$2,066m, due mainly to subdued client appetite for currency hedging solutions with the depreciation of the renminbi and our strategic repositioning of trade finance business to support the needs of core corporate customers. Targeted marketing helped us capture more cross-border trade flows to achieve a 22.2% increase in remittance income.

KEY INITIATIVES

A customised approach to service excellence

Our continual efforts to strengthen our capabilities ensure that our customers enjoy a service experience that is as individualised as their financial priorities and wealth management needs. Leveraging the market knowledge that comes from our deep roots in Hong Kong and active engagement with our clients, we are providing more customer-centric service offerings and taking further steps to optimise our multi-channel platforms to deliver excellence.

Additions to our growing number of outlets in 2014 include several new Prestige and Preferred Banking Centres, which offer a pleasant environment for customers to develop a tailor-made financial management strategy in close consultation with our wealth management professionals.

Investment fund income enjoyed good growth of 15.3% as part of our tailored wealth management solutions. Insurance income rose by 8.6%, underpinned by solid increases in both life insurance and general insurance businesses, supported by our new partnership arrangement with international healthcare company Bupa and strengthened collaboration with existing general insurance partner QBE. Further penetration of the SME sector led to a 12.9% rise in life insurance income.

Initiatives to attract new customers in target segments – including upgrades to our physical outlets, cross-border services and online platform – yielded positive results. We expanded our Business Banking Centres in Causeway Bay and Sheung Shui to enhance the client experience and launched Shanghai-Hong Kong Stock Connect Northbound Trading services on our Business e-Banking platform to enable customers to capitalise on investment opportunities with speed, convenience and ease.

WHERE IDEAS FLOWER.

WHILE EACH OF US BRINGS A UNIQUE PERSPECTIVE TO OUR SURROUNDINGS, OUR WORK AND OUR RESPONSIBILITIES, we share a common pride in what we have achieved. Our staff are committed to further enhancing customer engagement and experience – both as individuals and as a team.

“BE—TWEEN US”

同心同行

New customers were the primary drivers of growth in SME deposits and the 14.8% rise in non-interest income from SME business.

We continue to enjoy independent recognition for our efforts to support local business and provide our clients with financial solutions that are tailored to their needs. We are a nine-year winner of a 'Best SME's Partner Award' from The Hong Kong General Chamber of Small and Medium Business and have been named 'Hong Kong Domestic Trade Finance Bank of the Year' by *Asian Banking & Finance* for three consecutive years. Other awards in 2014 include 'Best Local Cash Management Bank – Hong Kong' from *Asiamoney*.

Global Banking and Markets

Global Banking and Markets reported a 2.8% increase in profit before tax to HK$4,185m. Operating profit excluding loan impairment charges rose by 2.7% to HK$4,186m. Operating profit was up 2.8% at HK$4,181m.

Global Banking

Global Banking recorded a 3.3% rise in profit before tax to HK$1,682m. Operating profit excluding loan impairment charges grew by 3.1% to HK$1,684m. Operating profit was up 3.3% at HK$1,679m.

Net interest income rose by 4.7% to HK$1,681m, in part reflecting a 5.5% increase in lending across a wide range of industries. Our efforts to offer total cash management solutions to customers supported a 38.1% rise in current and savings account deposit balances, driving the 54.1% increase in total deposits compared with the end of 2013.

Non-interest income increased by 3.4% to HK$243m compared with the previous year.

Drawing on the strengths provided by our well-established business operations in Hong Kong, the Mainland and Singapore, we stepped up efforts to provide customers with regional support, focusing in particular on the provision of renminbi deposit, lending and trade finance services.

Global Markets

Global Markets recorded a 2.5% rise in profit before tax to HK$2,503m. Operating profit excluding loan impairment charges rose by 2.5% to HK$2,502m. Operating profit increased by 2.5% to HK$2,502m.

Effective management of the balance sheet portfolio drove a 4.1% increase in net interest income to HK$1,697m. We proactively managed the interest rate risk and made good use of market opportunities to enhance yields on the commercial surplus.

Our e-Banking platform and other frontline channels were enhanced to facilitate straight-through processing, enabling better position management. To strengthen our market standing as the leading domestic bank in Hong Kong, Hang Seng will join OTC Clearing Hong Kong Limited as a direct member for central clearing of its over-the-counter derivatives in 2015.

Non-interest income was up 3.8% at HK$1,160m, due mainly to the 2.2% rise in net trading income.

Closer collaboration with Retail Banking and Wealth Management and Commercial Banking colleagues supported further revenue diversification through increased cross-selling of Global Markets products. We made good progress with efforts to broaden our customer base and capture new investment and hedging-side business.

AWARDS

Best Domestic Bank in Hong Kong
(for 15th consecutive year)
The Asset

Ranked No. 14 in The World's Top 50 Safest Commercial Banks
Global Finance

Best SME's Partner Award
Hong Kong General Chamber of Small and Medium Business

Best Local Cash Management Bank – Hong Kong
Asiamoney

Trusted Brands Gold Award – Bank (Hong Kong)
Reader's Digest

Trusted Brands Gold Award – Credit Card Issuing Bank (Hong Kong)
Reader's Digest

Enhancements to retail margin trading and renminbi investment deposit products reinforced our reputation as a leading provider of offshore renminbi services and have us well placed to capitalise on new business opportunities being generated by the further relaxation of controls on the renminbi in Hong Kong and developments such as the Shanghai-Hong Kong Stock Connect scheme.

Hang Seng Indexes

Wholly owned subsidiary Hang Seng Indexes Company Limited (Hang Seng Indexes) licensed four new index-linked funds and introduced two new index series with partners and one new sub-index in 2014. In September, a large cocktail reception was held to celebrate the 50th anniversary of the Hang Seng Index base date.

The Hang Seng iBond 1708 Total Return Index sub-index was launched in July under the Hang Seng iBond Composite Total Return Index following the listing of the HKGB iBond 1708.

In October, Hang Seng Indexes launched the Hang Seng Markit iBoxx Offshore RMB Bond Index family in partnership with global financial information services provider Markit. The index family tracks the performance of offshore renminbi sovereign and corporate debt. The index family includes more than 600 indices covering sovereign, sub-sovereign and corporate debt issuers across sectors, ratings and maturity segments.

In November, Hang Seng Indexes joined hands with Mainland index company China Securities Index Company Limited to launch the Hang Seng CSI Shanghai-Hong Kong AH Smart Index. The index is designed to help global investors capture the investment opportunities arising from Shanghai-Hong Kong Stock Connect by providing a benchmark that reflects a price arbitrage strategy.

Four asset/fund management companies were licensed to launch index-linked funds on the Mainland during the year. China Universal Asset Management Co., Ltd. launched a Hang Seng Index-linked qualified domestic institutional investor (QDII) classification fund in January and Yinhua Fund Management Co., Ltd. launched a Hang Seng China Enterprises Index-linked QDII classification fund in March. In December, China Asset Management Co., Ltd. and China Southern Asset Management Co., Ltd. launched the first batch of exchange-traded funds (ETFs) to be issued on the Mainland under the Shanghai-Hong Kong Stock Connect scheme. The ETFs are linked to the Hang Seng Index.

At 31 December 2014, the number of Hang Seng Family of Indexes-linked exchange traded products worldwide was 31 – with listings on 17 different stock exchanges and a total of more than US$17 billion assets under management. The total number of futures and options contracts traded on the Hang Seng Index and the Hang Seng China Enterprises Index in 2014 was over 57 million, and the open interest of futures and options of these two indexes on 31 December 2014 was over 1.54 million, representing an increase of 11.8% compared with a year earlier.

Hang Seng Indexes now compiles 416 indexes – 63 real-time and 353 daily indexes – under 78 different index series, including eight cross-border series offering eight real-time and 53 daily indexes. In addition to the Hang Seng Family of Indexes, the company also compiles customised indexes to serve the specific needs of various clients.

KEY INITIATIVES

Connecting to new investment opportunities

Our strong cross-border connectivity and wealth management expertise enable our customers to benefit from new wealth management opportunities arising from financial market reforms in mainland China and initiatives to internationalise the renminbi.

Available across a wide range of service channels, our Shanghai-Hong Kong Stock Connect Northbound Trading services – which include insightful market commentary – provide customers with the information, flexibility and choice required to meet their wealth management needs in a rapidly evolving investment landscape.

Business on the Mainland

Changes in the policy environment, economic slowdown and more challenging credit conditions all had an impact on our mainland China business in 2014. We continued with our long-term development strategy through Hang Seng Bank (China) Limited, strengthening our franchise through close cooperation with Hang Seng colleagues in Hong Kong and further investments in our service channels, product range and the professional development of our staff.

In a highly competitive market, we capitalised on favourable policy developments with a new sub-branch in Shanghai Free Trade Zone (Shanghai FTZ), bringing our number of outlets in this strategically important municipality to 11. We opened a new branch in Chengdu to capture a greater share of business in the fast-developing central and western regions. Hang Seng China now has around 50 outlets in 19 cities. A Hang Seng China branch in Jinan in Shandong Province and a second sub-branch at Shanghai Jing An Kerry Centre are expected to open in the first half of 2015. Upgrades to our infrastructure placed particular emphasis on enhancing the service experience for customers using our call centre and online banking platform.

The competitive strengths of our Hong Kong operations supported our continuing efforts to expand our wealth management and cross-border capabilities. We introduced Greater China Prestige Banking Services and a Qualified Domestic Institutional Investor service with the aim of acquiring more high-end retail customers with financial needs in Hong Kong and outside China. Good progress was made with cross-border lending to support businesses located in Qianhai special economic zone and Shanghai FTZ, as well as with renminbi cross-border two-way cash pooling for companies in the FTZ and guaranteed and deposit-backed lending to Mainland-owned entities in Hong Kong.

In June 2014, Hang Seng China successfully launched a RMB1bn offshore bond to help fund future growth.

KEY INITIATIVES

Funding our future growth

In June 2014, Hang Seng China's debut offshore renminbi bond issue raised RMB1 billion in Hong Kong. The three-year senior unsecured bonds enjoyed a positive response from a diverse group of investors. The proceeds will be used for general financing purposes, including investments in new outlets and other service delivery channels to support the sustainable growth of our Mainland business.

"SAME HERE"

同一天空

ON THE SAME PAGE.

BENEFITS ARE BEST WHEN THEY ARE MUTUAL.

This is the principle behind Hang Seng's suite of cross-border investment offerings. Hang Seng is fully conversant in the languages of its clients' businesses, and is a prominent voice in the global conversation about China's financial markets.

Mr Gordon W C Lam, Vice-Chairman and Chief Executive of Hang Seng China (centre photo, standing), and members of Hang Seng China management team.

Net interest income rose by 20.6%, supported by an increase in average interest-earning assets. In the more challenging credit conditions, we grew total assets by 8.0% to HK$127.9bn – mainly reflecting the 6.7% increase in the loan balance. Loan growth was primarily driven by residential mortgage lending and advances to auto-finance companies. Customer deposits grew more modestly – increasing by 3.6% – in response to the official relaxation of the loans-to-deposits ratio. Our Mainland business recorded solid capital and liquidity levels for 2014.

Excluding the revaluation of structured deposits, non-interest income grew by 74.9%, benefiting from strong growth in fees and commissions income, better balance sheet management and treasury business. Effective cooperation between our Hong Kong and Mainland operations in areas such as the promotion of financing and trade business helped support the 34.7% rise in net fees and commissions income and further diversified our revenue base.

Hang Seng China's total operating income grew by 24.4%. Despite continuing investment in our network and system developments to support future growth, operating expenses were well managed – recording a year-on-year rise of 2.3%.

Hang Seng China's profit before tax was HK$114m, down 44.9% compared with a year earlier. Operating profit excluding loan impairment charges rose by 175.9% to HK$596m. Operating profit fell by 44.2% to HK$116m.

KEY INITIATIVES

Expanding our network to support customers

Our network expansion is helping us acquire new business by bringing financial service excellence to where our customers live and work. In 2014, we opened a Chengdu branch to better meet the growing demand for financial services in central and western China, and a Shanghai Free Trade Zone sub-branch that further leverages our cross-border strengths. In the first half of 2015, we will open a branch in Jinan in Shandong Province, a 'Closer Economic Partnership Arrangement (CEPA) Demonstration City' that offers preferential policies for companies engaged in business between the Mainland, Hong Kong and Macau.

AWARDS

Most Trustworthy Bank
CFO World

Best Foreign Bank
CNFOL.COM

Best Cross Border Trade Settlement
CFO World

Best Risk Control Foreign Bank of the Year
21st Century Business Herald

Best Financial Service Provider for SME of the Year
Nanfang Daily

Our commitment to tailoring our financial services and product propositions to meet the needs of a diverse range of customers continued to win external recognition, including 'Most Trustworthy Bank' and 'Best Cross Border Trade Settlement' awards from *CFO World* and 'Best Financial Service Provider for SME of the Year' from *Nanfang Daily*.

Future Growth

Looking ahead, a more moderate pace of economic growth, the need to adjust for excess industrial capacity in certain sectors and various reform initiatives will create a complex credit environment in 2015. Against this backdrop, we will take further steps to leverage our cross-border and wealth management strengths and enhance our ability to capitalise on the new opportunities for business growth being driven by favourable policy developments, continuing financial market reforms and initiatives to promote the internationalisation of the renminbi.

We will continue to strategically deploy resources to acquire new Mainland customers in target segments, capture a growing share of cross-border business flows, and further strengthen our infrastructure for the long-term expansion of our business and to achieve sustainable growth.

Financial Review

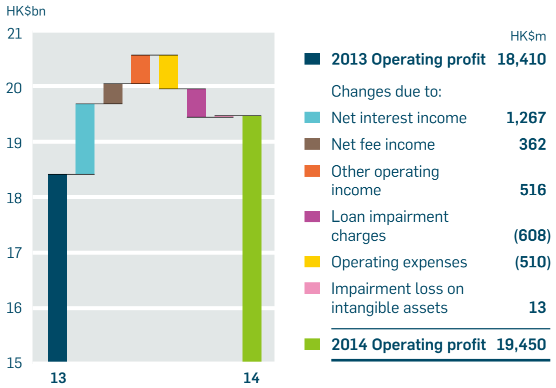
Financial Performance
Income Statement
Summary of Financial Performance

Figures in HK$m	2014	2013
Total operating income	**42,949**	39,836
Operating expenses	**9,613**	9,103
Operating profit	**19,450**	18,410
Profit before tax	**18,049**	28,496
Profit attributable to shareholders	**15,131**	26,678
Earnings per share (in HK$)	**7.91**	13.95

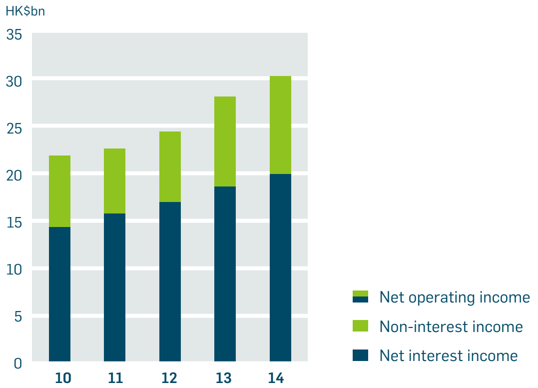
Hang Seng Bank Limited ('the Bank') and its subsidiaries ('the Group') reported a profit attributable to shareholders of HK$15,131m for 2014, down 43.3% compared with 2013. Earnings per share were down 43.3% at HK$7.91. The results included an impairment of HK$2,103m on the Bank's investment in Industrial Bank Co., Ltd ('Industrial Bank') in 2014 and an accounting gain of HK$9,517m on the reclassification of Industrial Bank in 2013. Excluding these items, attributable profit was up by 0.4%.

Operating profit excluding loan impairment charges grew by HK$1,648m, or 8.7%, to HK$20,594m, mainly driven by increases in net interest income and net fee income. Against a backdrop of continuing low interest rates and challenging operating environment, the Group achieved solid growth, with increases in operating profit across core businesses lines. Operating expenses also rose, but at a slower pace than income growth.

Operating Profit Analysis



Net Operating Income
(Before loan impairment charges)



Net interest income rose by HK$1,267m, or 6.8%, to HK$19,871m, driven mainly by the 6.1% increase in average interest-earning assets and an improvement in the net interest margin.

Figures in HK$m	2014	2013
Net interest income/(expense) arising from:		
– financial assets and liabilities that are not at fair value through profit and loss	**21,888**	20,242
– trading assets and liabilities	**(2,014)**	(1,697)
– financial instruments designated at fair value	**(3)**	59
	19,871	18,604
Average interest-earning assets	**1,047,154**	986,606
Net interest spread	**1.77%**	1.77%
Net interest margin	**1.90%**	1.89%

Effective balance sheet management drove income growth as Treasury has been actively managing the interest rate risk and assessing different market opportunities for better yield enhancement. Partially offsetting this increase was a lower contribution from the insurance debt securities portfolios as the Group re-balanced assets under the low interest rate environment.

Average interest-earning assets increased by HK$60.5bn or 6.1%, compared with last year. Average customer lending grew by 9.7%, notably in corporate and commercial and mortgage lending, while financial investments increased by 5.1%.

Net interest margin widened by one basis point to 1.90% whilst the net interest spread remained at 1.77%. In Hong Kong, the spread on customer lending improved, notably on corporate and commercial term lending, though this was offset in part by the spread compression in mortgage lending. On the back of the Group's flexible deposit acquisition strategy to support balanced growth, average customer deposit balances increased, though the benefit of this growth was more than offset by narrower deposit spreads. On the Mainland, the net interest margin and net interest spread widened, reflecting improved deposit spread which coupled with a less volatile interbank market, outweighed the compression of loan spreads.

The contribution from net free funds grew by one basis point to 0.13%, benefiting from the modest increase in the average interest rate.

Net interest income in the second half of 2014 grew by HK$529m, or 5.5%, compared with the first-half of 2014, mainly supported by 5.9% increase in average interest earning assets, widening loan spreads and more calendar days in the second-half. However, net interest margin and net interest spread in the second half were under continuous downward pressure in light of strong competition for deposits and the low interest rate environment.

The HSBC Group reports interest income and interest expense arising from financial assets and financial liabilities held for trading as 'Net trading income'. Income 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	2014	2013
Net interest income and expense reported as "Net interest income"		
– Interest income	**26,037**	23,613
– Interest expense	**(4,155)**	(3,371)
– Net interest income	**21,882**	20,242
Net interest income and expense reported as "Net trading income"	**(2,014)**	(1,697)
Net interest income and expense reported as "Net income from financial instruments designated at fair value"	**3**	59
Average interest-earning assets	**1,013,705**	951,178
Net interest spread	**2.05%**	2.03%
Net interest margin	**2.16%**	2.13%

Net fee income rose by HK$362m, or 6.1%, to HK$6,249m when compared with 2013.

Securities broking and related services income rose by 9.2%, benefiting from increased market trading activity. Stock market trading turnover was lower in the first half but gradually picked up in the second half, coupled with the launch of the Shanghai-Hong Kong Stock Connect in late 2014.

Retail investment products drove increases in 15.3% of fund sales and 8.6% in investment funds income.

Insurance-related fee income rose by 5.7%, reflecting growth in life re-insurance commission income and increased distribution commission from non-life insurance products during the year.

Fees from remittances recorded encouraging growth of 16.1%, underpinned by increased business volumes as a result of the Bank's effort in capturing cross-border fund transactions.

Account services fee income increased by 10.7% while gross fee income from credit card business grew by 2.5%.

Credit facilities fee income rose by 8.9%, due mainly to higher fees from increased corporate lending.

Trade-related service income was down by 10.9%, reflecting the decrease in trade finance lending business.

Net trading income decreased by HK$101m, or 4.9%, to HK$1,944m compared with 2013.

Dealing profits fell by HK$99m, or 4.8%, to HK$1,953m. Foreign exchange income was lower, affected by subdued customer activity levels as market volatility was low. Income from foreign exchange option-linked structured products fell, with reduced arbitrage opportunities reducing customer appetite for renminbi-denominated products. Dealing profits included a revaluation loss on foreign currency derivatives and a foreign exchange loss from insurance business. However, these unfavourable factors were partly offset by higher net income from funding swaps* activities.

Income from interest rate derivatives, debt securities, equities and other trading activities rose by HK$41m, or 46.6%, to HK$129m. Debt securities recorded a revaluation gain compared with a revaluation loss in last year, reflecting the movement in market interest rates. These increases were partly offset by a lower gain from interest rate derivatives trading.

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

Net income from financial instruments designated at fair value increased by HK$856m, or 248.1%, to HK$1,201m, reflecting the fair value changes of assets held by the life insurance business due mainly to favourable equity market movements during the year. To the extent that this fair value gain is attributable to policyholders, there is an offsetting movement reported under 'net insurance claims and benefits paid and movement in liabilities to policyholders' or 'movement in present value of in-force long-term insurance business ('PVIF')'.

Dividend income was HK$1,210m compared with HK$1,014m in 2013, mainly due to the dividend from Industrial Bank following its reclassification as a financial investment in 2013.

Net insurance premium income increased by HK$774m, or 7.7% while net insurance claims and benefits paid and movement in liabilities to policyholders increased by HK$968m, or 8.2%.

Other operating income was HK$241m, or 12.4% lower than 2013 due to lower revaluation gains on a property held by the insurance business, and the decrease in the movement in present value of in-force long-term insurance business. The decrease in the movement in PVIF was mainly due to the change in product mix and an update of actuarial assumptions. These were partly offset by the increase in rental income.

Analysis of income from wealth management business

Figures in HK$m	2014	2013 (restated)
Investment income:		
– retail investment funds	1,681	1,548
– structured investment products*	746	965
– securities broking and related services	1,322	1,209
– margin trading and others	102	151
	3,851	3,873
Insurance income:		
– life insurance	3,489	3,479
– general insurance and others	219	207
	3,708	3,686
Total	7,559	7,559

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

Wealth management business income remained in line with 2013. Investment income was broadly in line with 2013, with higher fees from retail investment funds and increased brokerage income largely offset by lower structured investment product income due to weaker customer appetite for renminbi-denominated products. Insurance business income grew by 0.6% with increases in both life and general insurance businesses.

Analysis of insurance business income

Figures in HK$m	2014	2013
Life insurance:		
– net interest income and fee income	3,048	3,033
– investment returns on life insurance funds (including share of associate's profit and surplus on property revaluation backing insurance contracts)	1,339	1,020
– net insurance premium income	10,779	10,005
– net insurance claims and benefits paid and movement in liabilities to policyholders	(12,742)	(11,774)
– movement in present value of in-force long-term insurance business	1,065	1,195
	3,489	3,479
General insurance and others	219	207
Total	3,708	3,686

Life insurance business achieved strong investment portfolios return and business growth. This was largely offset by a lower share of associate's profit and property revaluation gains and movement in PVIF, resulting in a slight increase of life insurance income to HK$3,489m.

Supported by our diversified range of life insurance products, the Group achieved a 4.1% increase in new annualised life insurance premiums when compared with 2013.

Net interest income and fee income from the life insurance investment portfolio grew slightly as the Group re-balanced assets under the low interest rate environment. Investment returns on life insurance increased strongly by 31.3%, benefiting from the favourable movement in equity markets, though partly offset by lower property revaluation gains and share of profit from an associate in the year. To the extent that the investment return is attributable to policyholders, there is an offsetting movement reported under 'net insurance claims and benefits paid and movement in liabilities to policyholders' or PVIF. Net insurance premium income rose by 7.7% as a result of increased renewals of existing policies, partly offset by lower new business premiums written. The growth in insurance premium income resulted in a corresponding increase in 'net insurance claims and benefits paid and movement in liabilities to policyholders'. The decrease in the PVIF was due to the change in product mix and updated actuarial assumptions.

General insurance income increased by 5.8%, reflecting higher distribution commission income.

Loan impairment charges increased by HK$608m, or 113.4%, reflecting the more challenging credit environment in mainland China.

Figures in HK$m	2014	2013
Net charge for impairment of loans and advances to customers:		
Individually assessed impairment allowances:		
– new allowances	(699)	(191)
– releases	131	91
– recoveries	36	16
	(532)	(84)
Net charge for collectively assessed impairment allowances	(612)	(452)
Loan impairment charges	(1,144)	(536)

Individually assessed impairment charges increased from a low base of HK$84m to HK$532m, mainly due to the downgrade of certain corporate and commercial customers in mainland China, reflecting the challenging credit environment. This was partly offset by higher releases and recoveries from corporate and commercial customers in 2014.

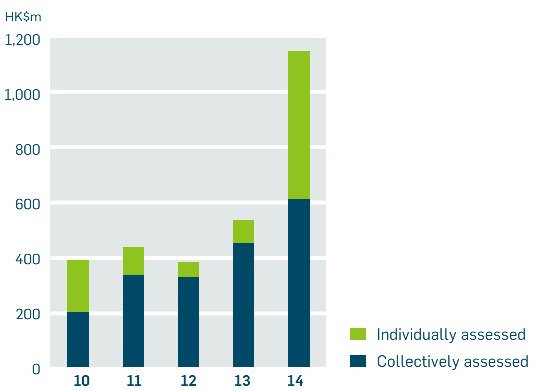
Collectively assessed loan impairment charges increased by HK$160m, or 35.4%. Impairment allowances for loans not individually identified as impaired recorded a charge compared with a release in 2013 as a result of the increase in customer loan balances and updated assumptions in the assessment model. Impairment charges for credit card and personal loan portfolios remained relatively stable when compared with last year.

Overall credit quality remained relatively stable with gross impaired loans and advances as a percentage of gross loans and advances to customers stood at 0.32% compared with 0.22% at the end of 2013. The Group remains cautious on the credit outlook.

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

	At 31 December 2014 %	At 31 December 2013 %
Loan impairment allowances:		
– individually assessed	**0.15**	0.12
– collectively assessed	**0.13**	0.13
Total loan impairment allowances	**0.28**	0.25

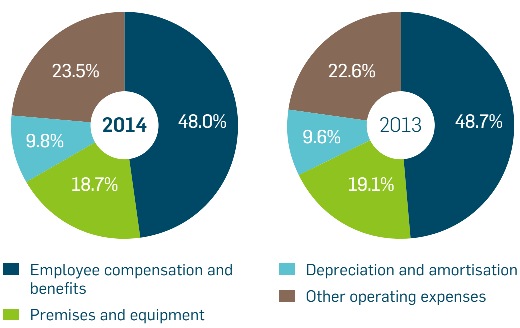
Loan Impairment Charges



Loan Impairment Allowances as a Percentage of Gross Loans and Advances to Customers

Operating expenses increased by HK$510m, or 5.6%, compared with 2013, reflecting the Bank's continued investment in new business platforms, servicing capabilities and mainland operations to support business growth. Mainland-related operating expenses increased by 2.3%, reflecting strong cost management while continuing to invest for future growth.

Operating Expenses



Employee compensation and benefits increased by HK$184m, or 4.2%. Salaries and other costs increased by 4.1%, reflecting the annual salary increment and higher staff numbers, notably in Hong Kong to support business growth. General and administrative expenses were up 6.8%, due mainly to the rise in marketing expenditure to support business growth. Rental expenses rose as a result of increased rents for branches in Hong Kong and the mainland. Other operating expenses also increased as a result of higher processing charges and office expenses. Depreciation charges were up 9.1%, reflecting higher depreciation charges on business premises following the upward commercial property revaluation in Hong Kong.

Full time equivalent staff numbers by region

	2014	2013
Hong Kong and others	**8,278**	8,001
Mainland	**1,914**	1,855
Total	**10,192**	9,856

At 31 December 2014, the Group's number of full-time equivalent staff was up by 336 compared with the end of 2013.

The Bank continued to focus on enhancing operational efficiency while maintaining growth momentum. With the increase in net operating income before loan impairment charges outpacing the growth in operating expenses, the cost efficiency ratio lowered by 0.6 percentage points to 31.8%.

Operating profit rose by HK$1,040m, or 5.6%, to HK$19,450m.

Profit before tax fell by HK$10,447m, or 36.7%, to HK$18,049m after taking into account the following major items:

- the accounting gain of HK$8,454m on **the reclassification of Industrial Bank** and the accounting loss of HK$297m on **the reclassification of Yantai Bank** in 2013;
- a HK$2,338m decrease in **gains less losses from financial investments and fixed assets**, the combined effect of the impairment loss of HK$2,103m on the Bank's investment in Industrial Bank in September 2014 and lower property disposal gains compared with 2013.
- a 56.1% (or HK$667m) decrease in **net surplus on property revaluation**; and
- a 57.8% (or HK$325m) reduction in **share of profits from associates**, mainly due to the reclassification of Yantai Bank in December 2013, coupled with a lower property revaluation gain in a property investment holding associate in 2014.

Net surplus on property revaluation decreased by 56.1% to HK$521m when compared with 2013.

Figures in HK$m	**2014**	2013
Surplus of revaluation on investment properties	**521**	1,058
Surplus of revaluation on assets held for sale	**–**	133
Reversal of revaluation deficit on premises	**–**	(3)
	521	1,188

The Group's premises and investment properties were revalued at 30 November 2014 and updated for any material changes at 31 December 2014 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 takes 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$1,457m and was credited to the premises revaluation reserve. The related deferred tax provision for Group premises was HK$244m. Revaluation gains of HK$521m on investment properties (excluding the revaluation gain on properties backing insurance contracts) were recognised through the income statement.

The revaluation exercise also covered business premises and investment properties reclassified as properties held for sale. There was no revaluation gain recognised through the income statement on properties held for sale during the year.

Segmental Analysis

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

	Hong Kong & other businesses						
Figures in HK$m	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Other	Total	Mainland China business	Total
Year ended 31 December 2014							
Profit/(loss) before tax	**9,017**	**5,079**	**4,185**	**(336)**	**17,945**	**104**	**18,049**
Share of profit before tax	**50.0%**	**28.1%**	**23.2%**	**(1.9%)**	**99.4%**	**0.6%**	**100.0%**
Share of profit before tax as a % of Hong Kong & other businesses	**50.2%**	**28.3%**	**23.3%**	**(1.8%)**	**100.0%**		
Year ended 31 December 2013 (restated)							
Profit before tax	8,939	4,634	4,070	2,384	20,027	8,469	28,496
Share of profit before tax	31.4%	16.3%	14.3%	8.3%	70.3%	29.7%	100.0%
Share of profit before tax as a % of Hong Kong & other businesses	44.6%	23.2%	20.3%	11.9%	100.0%		

Retail Banking and Wealth Management ('RBWM') in Hong Kong reported a profit before tax of HK$9,017m in 2014, a 0.9% increase compared with 2013. Operating profit excluding loan impairment charges reached HK$9,302m, an increase of 3.7%. Operating profit grew by 3.4% to HK$8,771m.

Net interest income grew by 0.8% to HK$10,036m. Customer deposits and the lending portfolio recorded year-on-year growth of 5.0% and 9.1% respectively. Strong market competition put downward pressure on deposit business.

Non-interest income was up 11.0% at HK$4,811m reflecting growth in net fee income and net income from financial instruments at fair value. With strategic initiatives to enhance our wealth management capabilities, we were able to maintain growth momentum in the wealth management business, resulting in a 3.7% increase in income to HK$6,474m.

Our unsecured lending business continued to be a stable growth driver. Effective card usage programmes helped us to achieve a 9.4% year-on-year increase in card spending. We maintained our market position as the third-largest issuer of VISA and MasterCard cards. With improved analytic capabilities, we grew the personal loan portfolio by 26.8% from our existing customer base.

We maintained our top-three position for mortgage business, with a market share of 17.1% in terms of new mortgage registrations and grew our mortgage lending portfolio by 8.0% compared to 2013 year-end.

Amid volatile investment market conditions in 2014, we grew investment income by 8.2%. Investment fund income rose by 8.3% year-on-year, with an increase in turnover by 15.3% compared with 2013. The securities market turnover was subdued in the first half of 2014, but picked up towards the end of the year. Overall, securities income and turnover recorded a year-on-year growth of 9.0% and 9.5% respectively. To capitalise on the launch of the Shanghai-Hong Kong Stock Connect scheme and the relaxation of the renminbi daily conversion limit for personal customers, we launched A-share Northbound Trading services via Shanghai-Hong Kong Stock Connect and enriched our renminbi investment product suite.

With lower gains from property revaluation held in the insurance funds investment portfolio, income from insurance business was broadly in line with the previous year. We further diversified our product range to strengthen our ability to provide one-stop wealth and health propositions. Following the signing of a 10-year exclusive distribution agreement between the Bank and international healthcare company Bupa, we launched the Hang Seng Bupa Precious Health Series, a series of bespoke health insurance services and schemes. We also introduced the Exquisite Universal Life Insurance Plan to cater for the legacy planning needs of high-net-worth customers.

With concerted efforts to enhance our Prestige and Preferred Banking propositions, we grew the number of Prestige and Preferred Banking customers by 7.3% year-on-year. In 2014, we opened more Prestige and Preferred Banking Centres in strategic locations, bringing the total number of outlets to 18. We launched a series of awareness campaigns to communicate our Prestige and Preferred Banking propositions and product features based on the wealth management needs of customers.

We continued to strengthen our infrastructure to support sustainable growth, with improvements to our digital capabilities and greater use of social media tools to enrich customer experience. We launched a dedicated Hang Seng Youtube channel to provide timely financial information and commentaries and enhanced our digital presence through better search engine optimisation. At 31 December 2014, the number of Personal e-Banking customers grew by 7.7% compared to 2013 year-end.

Commercial Banking ('CMB') in Hong Kong achieved a 9.6% increase in profit before tax to HK$5,079m. Operating profit excluding loan impairment charges grew by 11.5% to HK$5,206m. Operating profit rose by 9.7% to HK$5,078m.

Net interest income increased by 17.3% to HK$4,894m, supported by balanced growth in both customer advances and deposits. With continued emphasis on cross-border collaboration, we achieved a 20.2% increase in customer advances.

Deposits grew by 14.8%, mainly resulting from our continued acquisition of quality mainland China customers and the focus of customer-centric propositions targeting professional firms, listed companies, hospitals, schools and retailers.

Non-interest income declined by 2.6% to HK$2,066m due to reduced renminbi hedging activity with the depreciation of the renminbi, and our strategic repositioning of trade finance business to support the needs of core corporate customers.

We recorded remittance income growth of 22.2%, driven in part by targeted marketing efforts to capture more cross-border fund flows. Investment fund income also achieved good growth of 15.3%, reflecting our strong capabilities in offering timely and tailor-made corporate wealth management solutions.

Insurance income grew by 8.6%, underpinned by satisfactory growth in both life insurance and general insurance businesses. General insurance income increased, supported by our strengthened collaboration with QBE Insurance. Leveraging the Bank's exclusive distribution agreement with international healthcare company Bupa, we enriched our employee wellness coverage with new off-the-shelf and bespoke corporate employee insurance products. Increased penetration of the SME sector led to a 12.9% rise in life insurance income.

With effective credit risk management and enhanced post-approval monitoring, asset quality remained stable, with an impaired loan balance as a percentage of gross customer advances remaining at a low level of 0.34%. We continued to enhance our portfolio management to optimise the return on risk-weighted assets through effective bundling of transaction banking and wealth management products.

Quality commercial customer acquisition remained one of our strategic focuses. Mainland companies represented 45.2% of newly acquired customers in 2014. New customers were the primary drivers of SME deposits and contributed to the 14.8% growth in non-interest income from SME business. We expanded our Business Banking Centres in Causeway Bay and Sheung Shui to enhance customer experience. Our Business e-Banking platform was further enriched with the addition of Shanghai-Hong Kong Stock Connect Northbound Trading services that enable commercial customers to capitalise on cross-border investment opportunities in a timely manner. For the ninth consecutive year, we received the 'Best SME's Partner Award' from the Hong Kong General Chamber of Small and Medium Business.

We were named the 'Hong Kong Domestic Trade Finance Bank of the Year' by *Asian Banking & Finance* for the third consecutive year, and were rated as the 'Best Local Cash Management Bank – Hong Kong' by *Asiamoney*.

Capitalising on our strong ability to tailor customer-focused propositions, good industry knowledge and closely connected relationship teams in Hong Kong and mainland China, we will continue to drive sustainable growth in customer deposits and capture new cross-border business opportunities arising from the ongoing liberalisation of renminbi business and the development of special economic zone in Qianhai and the Shanghai Free Trade Zone.

Global Banking and Markets ('GBM') in Hong Kong recorded a 2.8% increase in profit before tax to HK$4,185m. Operating profit excluding loan impairment charges grew by 2.7% to HK$4,186m. Operating profit rose by 2.8% to HK$4,181m.

Global Banking ('GB') in Hong Kong achieved a 3.3% increase in profit before tax to HK$1,682m. Operating profit excluding loan impairment charges grew by 3.1% to HK$1,684m. Operating profit grew by 3.3% to HK$1,679m.

Net interest income rose by 4.7% to HK$1,681m compared with 2013. Total loans increased by 5.5% year-on-year, with growth across a wide range of industries. Total deposits grew by 54.1%, underpinned by the 38.1% increase in current and saving account deposit balances achieved primarily by offering customers total cash management solutions.

Leveraging our well-established business infrastructure on the Mainland, Hong Kong and Singapore, we stepped up efforts to provide regional support for customers, with a focus on renminbi-related services including deposits, loans and trade finance.

Global Markets ('GM') in Hong Kong recorded a 2.5% increase in profit before tax to HK$2,503m. Operating profit excluding loan impairment charges increased by 2.5% to HK$2,502m. Operating profit increased by 2.5% to HK$2,502m.

Net interest income increased by 4.1% to HK$1,697m, reflecting concerted efforts by the balance sheet management team to actively manage interest rate risk and enhance yields.

Non-interest income increased by 3.8% to HK$1,160m, driven by a 2.2% increase in net trading income to HK$1,148m.

Front-line channels (including e-Banking) and trading systems were enhanced to facilitate straight-through processing, enabling better position management. To strengthen our market standing as the leading domestic bank, Hang Seng will join OTC Clearing Hong Kong Limited as a direct member for central clearing of its over-the-counter derivatives in 2015.

To further diversify revenue, we increased cross-selling of GM products to RBWM and CMB customers through collaboration with RBWM and CMB to identify cross-selling opportunities and specific needs of customers.

Our enhancement of retail margin trading and various investment products strengthened our position as a provider of renminbi services for retail customers and to help us capitalise on growing opportunities for business in the offshore renminbi market.

Looking ahead, we will further develop our foreign exchange, gold, interest rate and fixed-income services and sales efforts to capture both investment and hedging business. We will explore opportunities for new business that will help us broaden our customer base.

With the launch of the Shanghai-Hong Kong Stock Connect scheme and further relaxation of controls on the renminbi exchange in Hong Kong, we will continue to develop new products to meet the needs of our customers.

Mainland China business

Hang Seng China's operating profit excluding loan impairment charges grew by 175.9% to HK$596m, underpinned by increases in net interest income and non-interest income. Operating profit fell by 44.2% to HK$116m, reflecting the increase in loan impairment charges in the challenging credit environment. Profit before tax fell by 44.9% to HK$114m.

Net interest income increased by 20.6%, mainly driven by growth in average interest-earning assets.

At 31 December 2014, total assets were up 8.0% at HK$127.9bn, driven mainly by the 6.7% increase in loan balances, whilst deposits increased by 3.6%.

Excluding the revaluation of structured deposits, non-interest income increased due to better treasury performance and a growth in fee and commission income. Cross-border collaboration in financing and trade activities and treasury sales drove a 34.7% rise in net fee and commission income.

With continuing investment in the enhancement of the service network and systems, operating expenses were well controlled, increasing by 2.3%.

RBWM and GBM recorded good business growth; whilst CMB was affected by the more challenging credit environment, resulting in a rise in loan impairments charges.

Benefiting from Hang Seng's strong cross-border capabilities, Hang Seng China continued to develop its franchise with the expansion of its product range and improvements to customer service channels. Hang Seng China's launch of Greater China Prestige Services and a Qualified Domestic Institutional Investor service enhanced the Bank's cross-border proposition for high-end retail customers with financial needs in Hong Kong and in mainland China. Good progress was made in cross-border lending to companies in the special economic zone in Qianhai and in the Shanghai Free Trade Zone, cross-border renminbi cash pooling for entities in the Shanghai Free Trade Zone, and guarantee or deposit-backed lending to Mainland-owned entities in Hong Kong.

The Shanghai Free Trade Zone sub-branch and Chengdu branch were opened in early 2014 to take advantage of favourable development policies to better serve the fast-growing demand for quality financial services in western China, bringing the total number of Hang Seng China outlets to 50. Both new outlets generated a profit in 2014. Regulatory approval to set up a new branch in Jinan in Shandong Province has also been obtained, with the new outlet scheduled to open in the first half of 2015.

Hang Seng China's core banking system was upgraded in the second half of 2014 with the aim to place more emphasis on direct service channels, including its online platform, call centre, SMS and Wechat to improve the service experience for customers.

In June 2014, Hang Seng China successfully launched a RMB1bn dim sum bond in Hong Kong to support future growth. The bond enjoyed a positive response from a diverse group of investors.

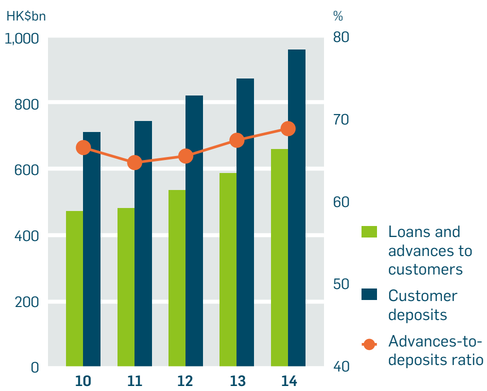
Balance Sheet

Total assets rose by HK$120.3bn, or 10.5%, to HK$1,264.0bn, reflecting the Group's strategy to enhance profitability through sustainable growth. Customer loans and advances increased by HK$72.2bn, or 12.3%, to HK$658.4bn, driven largely by growth in corporate and commercial lending, with notable demand from customers in the property-related, wholesale and retail trade, and manufacturing industry sectors. Despite subdued activity in the property market, the Group successfully grew residential mortgage lending by 9.3% when compared with the end of 2013. Hang Seng China's lending portfolio grew by 6.3%, mainly in corporate customer lending business. Overall loan quality remained stable with gross impaired loans and advances as a percentage of gross loans and advances to customers stood at 0.32% compared with 0.22% at the end of 2013. Customer deposits, including certificates of deposit and other debt securities in issue, rose by HK$86.8bn, or 10%, to HK$956.5bn. In June 2014, Hang Seng China successfully raised RMB1bn in Hong Kong through its debut offshore renminbi bond issue with a positive response from a diverse group of investors. At 31 December 2014, the advances-to-deposits ratio was 68.8%, compared with 67.4% at 31 December 2013.

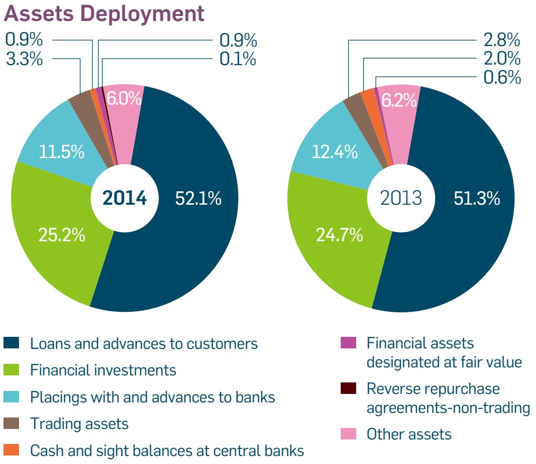
Assets Deployment

Figures in HK$m	2014	%	2013	%
Cash and sight balances at central banks	11,311	0.9	22,717	2.0
Placings with and advances to banks	145,731	11.5	141,940	12.4
Trading assets	41,823	3.3	31,996	2.8
Financial assets designated at fair value	11,112	0.9	6,987	0.6
Reverse repurchase agreements – non-trading	1,296	0.1	–	0.0
Loans and advances to customers	658,431	52.1	586,240	51.3
Financial investments	318,032	25.2	282,845	24.7
Other assets	76,254	6.0	71,005	6.2
Total assets	1,263,990	100.0	1,143,730	100.0
Return on average total assets		1.3%		2.4%
Return on average total assets (excluding the Industrial Bank impairment and reclassification)		1.4%		1.5%

Loans and Advances to Customers and Customer Deposits



Assets Deployment



Loans and Advances to Customers

Gross loans and advances to customers grew by HK$72.6bn, or 12.4%, to HK$660.3bn compared with the end of 2013.

Loans and advances for use in Hong Kong increased by HK$55.3bn, or 13.8%. Lending to the industrial, commercial and financial sectors grew by 16.7%. Lending to property development and property investment remained active, increasing by 36.5% and 11.6% respectively whilst lending to financial concerns grew by 98.3%. The Bank's continued efforts to support local business saw lending to wholesale and retail trade and manufacturing sectors grew by 25.7% and 23.8% respectively.

Lending to individuals increased by 10.4% compared with the last year end. The Bank was able to maintain its market share for the mortgage business based on its comprehensive product suite and thus residential mortgage lending to individuals rose by 9.3% compared with the end of 2013. Credit card advances increased by 12.9% compared with last year end. Other loans to individuals grew by 18.1%, reflecting the success of the Bank in expanding its consumer finance business.

Trade finance declined by 20.3% against last year end as certain cross-border documentary credit loans matured and repaid during the year, partly offset by the growth in other trade finance loan products as a result of the Group strategic repositioning to focus on core trade business.

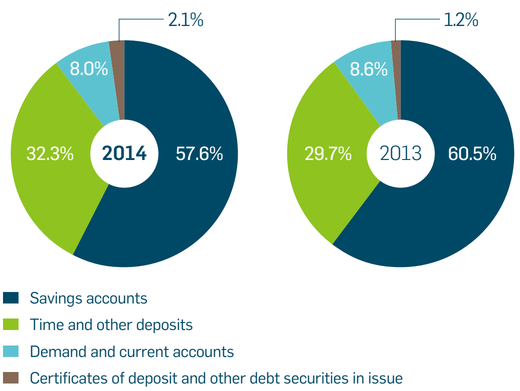
Loans and advances for use outside Hong Kong rose by 20.5%, compared with the end of 2013, partly driven by lending on the Mainland. Lending by Hang Seng China increased by 6.7% to HK$65.3bn, underpinned by the expansion of renminbi lending to corporate and commercial customers as well as residential mortgages. 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 challenging credit environment in mainland China.

Customer Deposits

Customer deposits, including current, savings and other deposits accounts, certificates of deposit and other debt securities in issue recorded growth of HK$86.8bn, 10.0% to HK$956.5bn at 31 December 2014 from last year end. 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 3.6%, driven mainly by renminbi deposits. In June 2014, Hang Seng China successfully raised RMB1bn in Hong Kong through its debut offshore renminbi bond issue with a positive response from a diverse group of investors.

At 31 December 2014, the advances-to-deposits ratio was 68.8%, compared with 67.4% at 31 December 2013.

Customer Deposits



Subordinated Liabilities

The outstanding subordinated loans serve to help the Bank maintain a balanced capital structure and support business growth.

Shareholders' funds

Figures in HK$m	**At 31 December 2014**	At 31 December 2013
Share capital	**9,658**	9,559
Retained profits	**83,667**	78,679
Other equity instruments	**6,981**	–
Premises revaluation reserve	**15,687**	14,904
Cash flow hedging reserve	**(11)**	6
Available-for-sale investment reserve		
– on debt securities	**261**	(113)
– on equity securities	**16,751**	(1,505)
Capital redemption reserve	**–**	99
Other reserves	**1,802**	1,943
Total reserves	**125,138**	94,013
	134,796	103,572
Proposed dividends	**4,397**	4,206
Shareholders' funds	**139,193**	107,778
Return on average shareholders' funds	**13.4%**	25.4%

At 31 December 2014, shareholders' funds (excluding proposed dividends) were HK$134.8bn, an increase of HK$31.2bn, or 30.1%. Retained profits rose by HK$5.0bn, resulting from the 2014 attributable profit after the appropriation of interim dividends during the year. In December 2014, the Bank issued an Additional Tier 1 ('AT1') perpetual capital instrument of HK$6,981m reported under 'other equity instruments' and repaid part of its subordinated liability to enhance capital efficiency. The premises revaluation reserve increased by HK$783m, or 5.3%, due to the increase in fair value of the Bank's premises.

The available-for-sale investment reserve recorded a surplus of HK$17.0bn, compared with a deficit of HK$1.6bn at the end of 2013, primarily reflecting the unrealised revaluation gain on the Bank's investment in Industrial Bank at the end of 2014, subsequent to the recognition of impairment loss in September 2014.

The capital redemption reserve of HK$99m has been included in share capital under the Hong Kong New Companies Ordinance (Cap. 622) which became effective on 3 March 2014. Please refer to note 60 'The New Hong Kong Companies Ordinance (Cap. 622)' on financial statement.

The return on average shareholders' funds was 13.4%, compared with 25.4% for 2013. Excluding the Industrial Bank reclassification in 2013 and impairment loss in 2014, the return on average shareholders' funds was 16.3%, compared with 17.6% for 2013.

There was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank's listed securities during 2014.

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

All the Group's activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. The principal types of risk faced by the Group are credit risk, liquidity risk, market risk, insurance risk, operational risk and reputational 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").

The Risk Committee monitors the effectiveness of the Bank's risk management and internal controls, other than controls over financial reporting, which are monitored by the Audit Committee. As part of the monitoring process, the Risk Committee requires risk management reports from management which enable the Risk Committee to assess the risks involved in the Group's business and how they are controlled and monitored by management. It also requires reports that give clear, explicit and dedicated focus to current and forward-looking aspects of risk exposure which may require a complex assessment of the Group's vulnerability to previously unknown or unidentified risks.

Risk appetite statement is a key component of risk management framework. The Group's Risk Appetite Statement for 2014 was approved by the Board as advised by the Risk Committee, which describes the types and amount of risk that the Bank is prepared to accept in executing our business strategy.

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

– 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

– Risk diversification

These core characteristics are applied to define the Risk Appetite Statement on a Bank-wide and individual risk and business level, which cover key risk types and exposures that are faced by the Group's business activities.The RMC undertook regular reviews and monitors the Group'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.

Description of risks – banking operations

(audited)

Risks	Arising from	Measurement, monitoring and management of risk
Credit risk		
The risk of financial loss if a customer or counterparty fails to meet an obligation under a contract.	Credit risk arises principally from direct lending, trade finance and leasing business, but also from certain other products such as guarantees and derivatives.	Credit risk: – is measured as the amount which could be lost if a customer or counterparty fails to make repayments. In the case of derivatives, the measurement of exposure takes into account the current mark to market value to the Group of the contract and the expected potential change in that value over time caused by movements in market rates; – is monitored within limits, approved by individuals within a framework of delegated authorities. These limits represent the peak exposure or loss to which the Group could be subjected should the customer or counterparty fail to perform its contractual obligations; and – is managed through a robust risk control framework which outlines clear and consistent policies, principles and guidance for risk managers.
Liquidity and funding risk		
The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due or that it can only do so at excessive cost.	Liquidity risk arises from mismatches in the timing of cash flows. Funding risk arises when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.	Liquidity and funding risk: – is measured using internal metrics including stressed operational cash flow projections, coverage ratio and advances to core funding ratios; – is monitored against the Group's liquidity and funding risk framework and overseen by the Group's ALCO and the RMC; and – is managed on a standalone basis with no reliance on any Group entity (unless pre-committed) or central bank unless this represents routine established business as usual market practice.
Market risk		
The risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios.	Exposure to market risk is separated into two portfolios: – Trading portfolios comprise positions arising from market-making and warehousing of customer derived positions. – Non-trading portfolios comprise positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, financial investments designated as available-for-sale and held-to-maturity, and exposures arising from our insurance operations.	Market risk: – is measured in terms of value at risk ("VAR"), which is used to estimate potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence, augmented with stress testing to evaluate the potential impact on portfolio values of more extreme, though plausible, events or movements in a set of financial variables; – is monitored using measures including the sensitivity of net interest income and the sensitivity of structural foreign exchange which are applied to the market risk positions within each risk type; and – is managed using risk limits approved by the Group. These limits are allocated across business lines and to the Group's legal entities.

Risks	Arising from	Measurement, monitoring and management of risk
Operational risk		
The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk (along with accounting, tax, compliance, security and fraud, people, systems, projects, operations and organisational change risk).	Operational risk arises from day to day operations or external events, and is relevant to every aspect of our business.	Operational risk: – is measured using the risk and control assessment process, which assess the level of risk and effectiveness of controls; – is monitored using key indicators and other internal control activities; and – is primarily managed by business and functional managers. They identify and assess risks, implement controls to manage them and monitor the effectiveness of these controls utilising the operational risk management framework. The Operational Risk function is responsible for the framework and for overseeing the management of operational risks within businesses and functions.
Other material risks		
Reputational risk		
The risk that illegal, unethical or inappropriate behaviour by the Group itself, members of staff or clients or representatives of the Group will damage Hang Seng's reputation, leading, potentially, to a loss of business, fines or penalties.	Reputational risk encompasses negative reaction not only to activities which may be illegal or against regulations, but also to activities that may be counter to societal standards, values and expectations. It arises from a wide variety of causes, including how we conduct our business and the way in which clients to whom we provide financial services, and bodies who represent Hang Seng, conduct themselves.	Reputational risk: – is measured by reference to our reputation as indicated by our dealings with all relevant stakeholders, including media, regulators, customers and employees; – is monitored through a reputational risk management framework, taking into account the results of the compliance risk monitoring activity outlined above; and – is managed by every member of staff and is covered by a number of policies and guidelines. There is a clear structure of committees and individuals charged with mitigating reputational risk, including the Group Reputational Risk Policy Committee and regional/ business equivalents.
Pension risk		
The risk that contributions from Group companies and members fail to generate sufficient funds to meet the cost of accruing benefits for the future service of active members, and the risk that the performance of assets held in pension funds is insufficient to cover existing pension liabilities.	Pension risk arises from investments delivering an inadequate return, economic conditions leading to corporate failures, adverse changes in interest rates or inflation, or members living longer than expected (longevity risk). Pension risk includes operational risks listed above.	Pension risk: – is measured in terms of the schemes' ability to generate sufficient funds to meet the cost of their accrued benefits; – is monitored through the specific risk appetite that has been developed at Group level; and – is managed locally through the appropriate pension risk governance structure and through the Bank Investment Committee.

Our insurance manufacturing subsidiaries are separately regulated from our banking operations. Risks in the insurance entities are managed using methodologies and processes appropriate to insurance activities, but remain subject to oversight at Group level. Our insurance operations are also subject to the operational and other material risks presented in relation to the banking operations, and these are covered by the Group's risk management processes.

Description of risks – insurance manufacturing operations

Risks	**Arising from**	**Measurement, monitoring and management of risk**
Insurance risk		
The risk that, over time, the cost of acquiring and administering a contract, claims and benefits may exceed the aggregate amount of premiums received and investment income.	The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, lapse and surrender rates and, if the policy has a savings element, the performance of the assets held to support the liabilities.	Insurance risk: – is measured in terms of life insurance liabilities; – is monitored by the RMC, which reviews the risk profile of the insurance operations against a risk appetite for insurance business; and – is managed both centrally and locally using product design, underwriting, reinsurance and claims-handling procedures.
Financial risks		
Our ability to effectively match the liabilities arising under insurance contracts with the asset portfolios that back them are contingent on the management of financial risks such as market, credit and liquidity risks, and the extent to which these risks are not borne by the policyholders. Liabilities to policyholders under unit-linked contracts move in line with the value of the underlying assets, and as such the policyholder bears the majority of the financial risks. Contracts with discretionary participating feature ("DPF") share the performance of the underlying assets between policyholders and the shareholder in line with the type of contract and the specific contract terms..	Exposure to financial risks arises from: – market risk of changes in the fair values of financial assets or their future cash flows from fluctuations in variables such as interest rates, foreign exchange rates and equity prices; – credit risk and the potential for financial loss following the default of third parties in meeting their obligations; and – liquidity risk of entities not being able to make payments to policyholders as they fall due as there are insufficient assets that can be realised as cash.	Financial risks: – are measured separately for each type of risk: - market risks are measured in terms of exposure to fluctuations in key financial variables; - credit risk is measured as the amount which could be lost if counterparty fails to make required payments; and - liquidity risk is measured using internal metrics including stressed operational cash flow projections; – are monitored within limits approved by individuals within a framework of delegated authorities; – are managed through a robust risk control framework which outlines clear and consistent policies, principles and guidance for risk managers. Subsidiaries manufacturing products with guarantees are usually exposed to falls in market interest rates and equity prices to the extent that the market exposure cannot be managed by utilising any discretionary participation (or bonus) features within the policy contracts they issue; and – can be mitigated through sharing of risk with policyholders under the discretionary participation features for participating products..

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

(a) Credit risk

(audited)

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.

Impaired loan management and recovery

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

Risk rating framework

A sophisticated risk rating framework on counterparty credit risk based on default probability and loss estimates is 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, applied to credit approval, credit monitoring, pricing, loan classification and capital adequacy assessment. The Group 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.

(a) Credit risk continued

Collateral and other credit enhancements

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

– in the personal sector, charges over the properties, securities, investment funds and deposits;

– in the commercial and industrial sector, charges over business assets such as properties, stock, debtors, investment funds, deposits and machinery; 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.

Concentration of credit risk

Concentration of credit risk exists when changes in geographic, economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is material in relation to the Group's total exposures. The Group's portfolio of financial instrument is diversified along geographic, industry and product sectors. Analysis of geographical concentration of the Group's assets is disclosed in note 23 to the financial statements and credit risk concentration of respective financial assets is disclosed in notes 28, 29, 31 and 32.

(a) Credit risk continued

The below analysis shows the exposures to credit risk in accordance with HKFRS 7 "Financial Instruments: Disclosures".

(i) Maximum exposure to credit risk before collateral held or other credit enhancements

(audited)

Our credit exposure is spread across a broad range of asset classes, including derivatives, trading assets, loans and advances to customers, loans and advances to banks and financial investments.

The following table presents the maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements (unless such credit enhancements meet accounting offsetting requirements). For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees and similar contracts granted, it is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, it is generally the full amount of the committed facilities.

	Group		Bank	
	2014	2013	**2014**	2013
Cash and sight balances at central banks	**11,311**	22,717	**9,246**	20,405
Placings with and advances to banks	**145,731**	141,940	**111,656**	106,392
Trading assets	**41,783**	31,968	**38,120**	30,449
Financial assets designated at fair value	**75**	812	**–**	–
Derivative financial instruments	**7,421**	6,646	**7,039**	5,837
Reverse repurchase agreements-non-trading	**1,296**	–	**1,296**	–
Loans and advances to customers	**658,431**	586,240	**588,131**	519,135
Financial investments	**273,983**	254,849	**179,096**	167,812
Amounts due from subsidiaries	**–**	–	**28,195**	23,553
Other assets	**17,219**	16,483	**10,870**	10,481
Financial guarantees and other credit related contingent liabilities	**14,272**	18,970	**13,270**	14,618
Loan commitments and other credit related commitments	**432,274**	394,080	**419,124**	363,897
	1,603,796	1,474,705	**1,406,043**	1,262,579

(ii) Collateral and other credit enhancements

Loans and advances

(audited)

Although collateral can be an important mitigant of credit risk, it is the Group's practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured. However, for certain lending decisions a charge over collateral is usually obtained, and is important for the credit decision and pricing, and it is the Bank's practice to obtain that collateral and sell it in the event of default as a source of repayment. Such collateral has a significant financial effect and the objective of the disclosure below is to quantify these forms. We may manage our risk further by employing other types of collateral and credit risk enhancements but these are harder to evaluate and subject to a greater uncertainty in the event of default, these have been described below.

We have quantified below the value of fixed charges we hold over a specific asset (or assets) of a borrower for which we have a practical ability and history of enforcing in satisfying a debt in the event of a borrower failing to meet their contractual obligations and where the asset is cash or can be realised in the form of cash by sale in an established market.

(a) Credit risk continued

Personal lending

(audited)

For personal lending the collateral held has been analysed below separately for residential mortgages and other personal lending due to the different nature of collateral held on the portfolios.

Residential mortgages

(audited)

The following table shows residential mortgage lending including off-balance sheet loan commitments by level of collateralisation.

Residential mortgages

	2014	2013
Unimpaired loans		
Uncollateralised	–	–
Fully collateralised	184,139	174,806
– Less than 25% LTV	34,694	28,306
– 25% to 50% LTV	100,697	95,095
– 51% to 75% LTV	40,705	45,296
– 76% to 90% LTV	7,383	4,061
– 91% to 100% LTV	660	2,048
Partially collateralised		
– Greater than 100% LTV (A)	–	20
– Collateral value on A	–	20
	184,139	174,826
Impaired loans		
Fully collateralised	196	120
– Less than 25% LTV	41	59
– 25% to 50% LTV	135	24
– 51% to 75% LTV	19	37
– 76% to 90% LTV	1	–
– 91% to 100% LTV	–	–
Uncollateralised	–	10
Total	184,335	174,956

The collateral included in the table above consists of fixed first charges on residential real estate.

The loan-to-value ("LTV") ratio in the table above is calculated as the gross on-balance sheet carrying amount of the loan and any off-balance sheet loan commitment at the balance sheet date as a percentage of the current value of collateral. The current value of collateral is determined through a combination of professional valuations, physical inspections or house price indices. The collateral valuation excludes any adjustments for obtaining and selling the collateral.

Other personal lending

(audited)

The remainder of our personal lending consists primarily of credit cards, instalment loan, overdraft or revolving loan. Credit cards are generally unsecured. Instalment loan, overdraft and revolving loan could be partially secured by cash or marketable securities.

(a) Credit risk continued

Corporate and commercial and financial (non-bank) lending

(audited)

For corporate and commercial and financial (non-bank) lending, the collateral held has been analysed below separately for commercial real estate and other corporate and commercial and financial (non-bank) lending due to the different nature of collateral held on the portfolios.

Commercial real estate

(audited)

The following table shows commercial real estate lending including off-balance sheet loan commitments by level of collateralisation.

Commercial real estate loans and advances

	2014	2013
Rated – CRR/EL* 1 to 7	**99,330**	91,354
Uncollateralised	**21,005**	16,605
Fully collateralised	**76,514**	67,064
Partially collateralised (A)	**1,811**	7,685
– Collateral value on A	**1,232**	7,077
	99,330	91,354
Rated CRR/EL 8		
Uncollateralised	**–**	2
Fully collateralised	**13**	–
– Less than 25% LTV	**3**	–
– 25% to 50% LTV	**–**	–
– 51% to 75% LTV	**10**	–
– 76% to 90% LTV	**–**	–
– 91% to 100% LTV	**–**	–
Partially collateralised (B)	**–**	–
– Collateral value on B	**–**	–
	13	2
Rated CRR/EL 9 to 10		
Uncollateralised	**7**	–
Fully collateralised	**31**	1
– Less than 25% LTV	**11**	–
– 25% to 50% LTV	**20**	1
– 51% to 75% LTV	**–**	–
– 76% to 90% LTV	**–**	–
– 91% to 100% LTV	**–**	–
Partially collateralised (C)	**6**	–
– Collateral value on C	**4**	–
	44	1
Total	**99,387**	91,357

* For details of CRR/EL, please refer to section (iii) Credit Quality.

(a) Credit risk continued

The collateral included in the table above consists of fixed first charges on real estate and charges over cash for the commercial real estate sector. The table includes lending to major property developers which is typically secured by guarantees or is unsecured.

The value of commercial real estate collateral is determined through a combination of professional and internal valuations and physical inspection. Due to the complexity of collateral valuations for commercial real estate, local valuation policies determine the frequency of review based on local market conditions. Revaluations are sought with greater frequency where, as part of the regular credit assessment of the obligor, material concerns arise in relation to the transaction which may reflect on the underlying performance of the collateral, or in circumstances where an obligor's credit quality has declined sufficiently to cause concern that the principal payment source may not fully meet the obligation (i.e. the obligor's credit quality classification indicates it is at the lower end e.g. sub-standard, or approaching impaired).

Other corporate and commercial and financial (non-bank) lending
(audited)

The following table shows corporate, commercial and financial (non-bank) lending including off-balance sheet loan commitments by level of collateralisation.

Corporate, commercial and financial (non-bank) loans and advances

	2014	2013
Rated CRR/EL 8		
Uncollateralised	267	13
Fully collateralised	100	112
– Less than 25% LTV	–	5
– 25% to 50% LTV	100	107
– 51% to 75% LTV	–	–
– 76% to 90% LTV	–	–
– 91% to 100% LTV	–	–
Partially collateralised (A)	58	–
– Collateral value on A	38	–
	425	125
Rated CRR/EL 9 to 10		
Uncollateralised	1,237	826
Fully collateralised	102	235
– Less than 25% LTV	–	2
– 25% to 50% LTV	20	23
– 51% to 75% LTV	59	56
– 76% to 90% LTV	23	21
– 91% to 100% LTV	–	133
Partially collateralised (B)	346	112
– Collateral value on B	107	31
	1,685	1,173
Total	2,110	1,298

(a) Credit risk continued

The collateral used in the assessment of the above primarily includes first legal charges over real estate and charges over cash in the commercial and industrial sector and charges over cash and marketable financial instruments in the financial sector. Government sector lending is typically unsecured.

It should be noted that the table above excludes other types of collateral which are commonly taken for corporate and commercial lending such as unsupported guarantees and floating charges over the assets of a customer's business. While such mitigants have value, often providing rights in insolvency, their assignable value is insufficiently certain. They are assigned no value for disclosure purposes.

As with commercial real estate the value of real estate collateral included in the table above is generally determined through a combination of professional and internal valuations and physical inspection. The frequency of revaluation is undertaken on a similar basis to commercial real estate loans and advances; however, for financing activities in corporate and commercial lending that are not predominantly commercial real estate-oriented, collateral value is not as strongly correlated to principal repayment performance. Collateral values will generally be refreshed when an obligor's general credit performance deteriorates and it is necessary to assess the likely performance of secondary sources of repayment should reliance upon them prove necessary. For this reason, the table above reports values only for customers with CRR 8 to 10, reflecting that these loans and advances generally have valuations which are of comparatively recent vintage. For the purposes of the table above, cash is valued at its nominal value and marketable securities at their fair value.

Loans and advances to banks

(audited)

The following table shows loans and advances to banks including off-balance sheet loan commitments by level of collateralisation.

Loans and advances to banks

	2014	2013
Rated CRR/EL 1 to 8		
Uncollateralised	**145,731**	141,940
Fully collateralised	**–**	–
Partially collateralised (A)	**–**	–
– Collateral value on A	**–**	–
	145,731	141,940
Rated CRR/EL 9 to 10		
Uncollateralised	**–**	–
Fully collateralised	**–**	–
Partially collateralised (B)	**–**	–
– Collateral value on B	**–**	–
	–	–
Total loans and advances to banks	**145,731**	141,940

(a) Credit risk continued

Derivatives

(audited)

The International Swaps and Derivatives Association ("ISDA") Master Agreement is our preferred agreement for documenting derivatives activity. It provides the contractual framework within which dealing activity across 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 another pre-agreed termination event occurs. It is common, and the Group's preferred practice, for the parties to execute a Credit Support Annex ("CSA") in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between the parties to mitigate the counterparty risk inherent in outstanding positions. The majority of our CSAs are with financial institutional clients.

Other credit risk exposures

(audited)

In addition to collateralised lending described above, other credit enhancements are employed and methods used to mitigate credit risk arising from financial assets. These are described in more detail below.

Government, bank and other financial institution issued securities may benefit from additional credit enhancement, notably through government guarantees that reference these assets. Corporate issued debt securities are primarily unsecured. Debt securities issued by banks and financial institutions include covered bonds, which are supported by underlying pools of financial assets.

Trading assets include loans and advances held with trading intent, the majority of which consist of reverse repos and securities borrowing which by their nature are collateralised. Collateral accepted as security that the Group is permitted to sell or repledge under these arrangements is described in Note 53 "Assets pledged as security for liabilities and collateral accepted as security for assets".

The Group's maximum exposure to credit risk includes financial guarantees and similar arrangements that it issues or enters into, and loan commitments to which it is irrevocably committed. Depending on the terms of the arrangement, the Bank may have recourse to additional credit mitigation in the event that a guarantee is called upon or a loan commitment is drawn and subsequently defaults. The risks and exposures from these are captured and managed in accordance with the Group's overall credit risk management policies and procedures.

Collateral and other credit enhancements obtained

(audited)

The Group obtained assets by taking possession of collateral held as security, or calling other credit enhancement.

The carrying amount outstanding as at the year end was as follows:

	Group		Bank	
	2014	2013	**2014**	2013
Nature of assets:				
Residential properties	**4**	9	**3**	8
Commercial and industrial properties	**2**	–	**–**	–
Other	**–**	–	**–**	–
	6	9	**3**	8

(a) Credit risk continued

(iii) Credit quality

(audited)

Four broad classifications describe the credit quality of the Group's lending and debt securities portfolios. These classifications each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending business, as well as the external ratings attributed by external agencies to debt securities.

There is no direct correlation between the internal and external ratings at granular level, except insofar as both fall within one of the four classifications.

(unaudited)

Quality classification	Wholesale lending and derivatives	Retail lending	Debt securities/other
Strong	CRR 1 to CRR 2	EL 1 to EL 2*	A- and above
Medium	CRR 3 to CRR 5	EL 3 to EL 5*	B+ to BBB+ and unrated
Sub-standard	CRR 6 to CRR 8	EL 6 to EL 8*	B and below
Impaired	CRR 9 to CRR 10	EL 9 to EL 10 and all EL 1 to EL 8 exposures past due 90 days and above	Individually identified

* All retail exposures past due 90 days and above are classified as "impaired".

Quality classification definitions:

(audited)

– Strong: Exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss. Retail accounts operate within product parameters and only exceptionally show any period of delinquency.

– Medium: Exposures require closer monitoring, with low to moderate default risk. Retail accounts typically show only short periods of delinquency, with losses expected to be minimal following the adoption of recovery process.

– Sub-standard: Exposures require varying degrees of special attention and default risk of greater concern. Retail accounts show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate through security realisation or other recovery processes.

– Impaired: Exposures have been assessed, individually or collectively, as impaired. The Group observes the conservative disclosure convention, reflected in the quality classification definitions above, that all retail accounts delinquent by 90 days or more are considered impaired. Such accounts may occur in any retail expected loss ("EL") grade, whereby in the higher quality grades the grading assignment will reflect the offsetting of the impact of delinquency status by credit risk mitigation in one form or another.

The Group's policy in respect of impairment on loans and advances and debt securities is set out in note 3 on the financial statements. Analysis of impairment allowances as at 31 December 2014 and the movement of such allowances during the year are disclosed in note 31.

Granular risk rating scales:

(unaudited)

The customer risk rating ("CRR") 10-grade scale maps to a more granular underlying 23-grade scale of obligor probability of default. These scales are used Group-wide for all individually significant customers, depending on which regulatory approach is adopted for the assets in question. The expected loss ("EL") 10-grade scale for retail business summarises a more granular 29-grade scale combining obligor and facility/product risk factors in a composite measure, used Group-wide. The external ratings cited above have for clarity of reporting been assigned to the quality classifications defined for internally-rated exposures, although there is no fixed correlation between internal and external ratings.

Impairment is not measured for financial investments held in trading portfolios or designated at fair value, as assets in such portfolios are managed according to movements in fair value, and the fair value movement is taken directly through the income statement. Consequently, all such balances are reported under "neither past due nor impaired".

(a) Credit risk continued

Distribution of financial instruments by credit quality

(audited)

	Group						
	Neither past due nor impaired						
	Strong	Medium*	Sub-standard	Past due but not impaired	Impaired	Impairment allowances	Total
2014							
Items in the course of collection from other banks	4,625	557	–	–	–	–	5,182
Trading assets:							
– treasury and eligible bills	24,228	–	–	–	–	–	24,228
– debt securities	11,875	1,624	–	–	–	–	13,499
– loans and advances to banks	1	4,000	–	–	–	–	4,001
– loans and advances to customers	55	–	–	–	–	–	55
	36,159	5,624	–	–	–	–	41,783
Financial assets designated at fair value:							
– treasury and eligible bills	–	–	–	–	–	–	–
– debt securities	71	4	–	–	–	–	75
– loans and advances to banks	–	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–	–
	71	4	–	–	–	–	75
Derivatives	4,561	2,797	63	–	–	–	7,421
Reverse repurchase agreements – non-trading	1,296	–	–	–	–	–	1,296
Loans and advances held at amortised cost:							
– balances/placings with and advances to banks	145,623	6,403	–	–	–	–	152,026
– loans and advances to customers	316,935	335,416	1,269	4,534	2,115	(1,838)	658,431
	462,558	341,819	1,269	4,534	2,115	(1,838)	810,457
Financial investments:							
– treasury and similar bills	107,503	–	–	–	–	–	107,503
– debt securities	157,242	9,238	–	–	–	–	166,480
	264,745	9,238	–	–	–	–	273,983
Other assets:							
– acceptances and endorsements	866	4,827	22	–	–	–	5,715
– other	2,468	3,754	6	94	–	–	6,322
	3,334	8,581	28	94	–	–	12,037

(a) Credit risk continued

	Group						
	Neither past due nor impaired						
	Strong	Medium*	Sub-standard	Past due but not impaired	Impaired	Impairment allowances	Total
2013							
Items in the course of collection from other banks	4,349	394	–	–	–	–	4,743
Trading assets:							
– treasury and eligible bills	18,336	–	–	–	–	–	18,336
– debt securities	5,268	203	–	–	–	–	5,471
– loans and advances to banks	5,950	2,200	–	–	–	–	8,150
– loans and advances to customers	11	–	–	–	–	–	11
	29,565	2,403	–	–	–	–	31,968
Financial assets designated at fair value:							
– treasury and eligible bills	–	–	–	–	–	–	–
– debt securities	569	243	–	–	–	–	812
– loans and advances to banks	–	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–	–
	569	243	–	–	–	–	812
Derivatives	5,880	727	39	–	–	–	6,646
Reverse repurchase agreements – non-trading	–	–	–	–	–	–	–
Loans and advances held at amortised cost:							
– balances/placings with and advances to banks	142,745	15,907	–	–	–	–	158,652
– loans and advances to customers	305,724	274,793	1,589	4,271	1,311	(1,448)	586,240
	448,469	290,700	1,589	4,271	1,311	(1,448)	744,892
Financial investments:							
– treasury and similar bills	91,811	–	–	–	–	–	91,811
– debt securities	155,040	7,998	–	–	–	–	163,038
	246,851	7,998	–	–	–	–	254,849
Other assets:							
– acceptances and endorsements	879	5,420	52	–	–	–	6,351
– other	2,232	3,081	3	73	–	–	5,389
	3,111	8,501	55	73	–	–	11,740

(a) Credit risk continued

	Bank						
	Neither past due nor impaired						
	Strong	Medium*	Sub-standard	Past due but not impaired	Impaired	Impairment allowances	Total
2014							
Items in the course of collection from other banks	4,625	557	–	–	–	–	5,182
Trading assets:							
– treasury and eligible bills	24,228	–	–	–	–	–	24,228
– debt securities	9,836	–	–	–	–	–	9,836
– loans and advances to banks	1	4,000	–	–	–	–	4,001
– loans and advances to customers	55	–	–	–	–	–	55
	34,120	4,000	–	–	–	–	38,120
Financial assets designated at fair value:							
– treasury and eligible bills	–	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–	–
	–	–	–	–	–	–	–
Derivatives	4,466	2,511	62	–	–	–	7,039
Reverse repurchase agreements – non-trading	1,296	–	–	–	–	–	1,296
Loans and advances held at amortised cost:							
– balances/placings with and advances to banks	114,672	1,443	–	–	–	–	116,115
– loans and advances to customers	294,329	288,811	965	3,980	1,280	(1,234)	588,131
	409,001	290,254	965	3,980	1,280	(1,234)	704,246
Financial investments:							
– treasury and similar bills	107,503	–	–	–	–	–	107,503
– debt securities	70,866	727	–	–	–	–	71,593
	178,369	727	–	–	–	–	179,096
Other assets:							
– acceptances and endorsements	722	2,307	–	–	–	–	3,029
– other	703	1,945	1	10	–	–	2,659
	1,425	4,252	1	10	–	–	5,688

(a) Credit risk continued

	Bank						
	Neither past due nor impaired						
	Strong	Medium*	Sub-standard	Past due but not impaired	Impaired	Impairment allowances	Total
2013							
Items in the course of collection from other banks	4,348	394	–	–	–	–	4,742
Trading assets:							
– treasury and eligible bills	18,336	–	–	–	–	–	18,336
– debt securities	3,952	–	–	–	–	–	3,952
– loans and advances to banks	5,950	2,200	–	–	–	–	8,150
– loans and advances to customers	11	–	–	–	–	–	11
	28,249	2,200	–	–	–	–	30,449
Financial assets designated at fair value:							
– treasury and eligible bills	–	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–	–
	–	–	–	–	–	–	–
Derivatives	5,342	459	36	–	–	–	5,837
Reverse repurchase agreements – non-trading	–	–	–	–	–	–	–
Loans and advances held at amortised cost:							
– balances/placings with and advances to banks	113,406	7,649	–	–	–	–	121,055
– loans and advances to customers	281,619	232,617	1,317	3,629	1,097	(1,144)	519,135
	395,025	240,266	1,317	3,629	1,097	(1,144)	640,190
Financial investments:							
– treasury and similar bills	91,811	–	–	–	–	–	91,811
– debt securities	74,460	1,541	–	–	–	–	76,001
	166,271	1,541	–	–	–	–	167,812
Other assets:							
– acceptances and endorsements	471	2,783	–	–	–	–	3,254
– other	923	1,550	2	10	–	–	2,485
	1,394	4,333	2	10	–	–	5,739

* Includes HK$6,135 million (2013: HK$5,437 million) and HK$727 million (2013: HK$745 million) of debt securities that have been classified as BBB- to BBB+ for the Group and the Bank respectively in 2014, 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.

(a) Credit risk continued

Aging analysis of financial instruments which were past due but not impaired

(audited)

Examples of exposures designated past due but not impaired include loans that have missed the most recent payment date but on which there is no evidence of impairment; loans fully secured by cash collateral; residential mortgages in arrears more than 90 days, but where the value of collateral is sufficient to repay both the principal debt and all potential interest for at least one year; short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

	Group					
	Up to 29 days	30-59 days	60-89 days	90-180 days	Over 180 days	Total
2014						
Items in the course of collection from other banks	–	–	–	–	–	–
Trading assets:	–	–	–	–	–	–
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Financial assets designated at fair value:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Derivatives	–	–	–	–	–	–
Reverse repurchase agreements – non-trading	–	–	–	–	–	–
Loans and advances held at amortised cost:						
– balances/placings with and advances to banks	–	–	–	–	–	–
– loans and advances to customers#	3,990	324	220	–	–	4,534
	3,990	324	220	–	–	4,534
Financial investments:						
– treasury and similar bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
	–	–	–	–	–	–
Other assets:						
– acceptances and endorsements	–	–	–	–	–	–
– other	53	7	6	13	15	94
	53	7	6	13	15	94

(a) Credit risk continued

	Group					
	Up to 29 days	30-59 days	60-89 days	90-180 days	Over 180 days	Total
2013						
Items in the course of collection from other banks	–	–	–	–	–	–
Trading assets:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Financial assets designated at fair value:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Derivatives	–	–	–	–	–	–
Reverse repurchase agreements – non-trading	–	–	–	–	–	–
Loans and advances held at amortised cost:						
– balances/placings with and advances to banks	–	–	–	–	–	–
– loans and advances to customers#	3,731	467	72	1	–	4,271
	3,731	467	72	1	–	4,271
Financial investments:						
– treasury and similar bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
	–	–	–	–	–	–
Other assets:						
– acceptances and endorsements	–	–	–	–	–	–
– other	63	5	2	3	–	73
	63	5	2	3	–	73

(a) Credit risk continued

	Bank					
	Up to 29 days	30-59 days	60-89 days	90-180 days	Over 180 days	Total
2014						
Items in the course of collection from other banks	–	–	–	–	–	–
Trading assets:	–	–	–	–	–	–
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Financial assets designated at fair value:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Derivatives	–	–	–	–	–	–
Reverse repurchase agreements – non-trading	–	–	–	–	–	–
Loans and advances held at amortised cost:						
– balances/placings with and advances to banks	–	–	–	–	–	–
– loans and advances to customers#	3,541	294	145	–	–	3,980
	3,541	294	145	–	–	3,980
Financial investments:						
– treasury and similar bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
	–	–	–	–	–	–
Other assets:						
– acceptances and endorsements	–	–	–	–	–	–
– other	9	1	–	–	–	10
	9	1	–	–	–	10

(a) Credit risk continued

	Bank					
	Up to 29 days	30-59 days	60-89 days	90-180 days	Over 180 days	Total
2013						
Items in the course of collection from other banks	–	–	–	–	–	–
Trading assets:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Financial assets designated at fair value:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Derivatives	–	–	–	–	–	–
Reverse repurchase agreements – non-trading	–	–	–	–	–	–
Loans and advances held at amortised cost:						
– balances/placings with and advances to banks	–	–	–	–	–	–
– loans and advances to customers#	3,203	365	60	1	–	3,629
	3,203	365	60	1	–	3,629
Financial investments:						
– treasury and similar bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
	–	–	–	–	–	–
Other assets:						
– acceptances and endorsements	–	–	–	–	–	–
– other	9	1	–	–	–	10
	9	1	–	–	–	10

The majority of the loans and advances to customers that are operating within revised terms following restructuring are excluded from this table.

Impaired loans and advances

(audited)

The Group's policy for recognising and measuring impairment allowances on both individually assessed advances and those which are collectively assessed on a portfolio basis is described in note 3(d) to the financial statements.

Analysis of impairment allowances at 31 December 2014 and the movement of such allowances during the year are disclosed in note 31 to the financial statements.

(a) Credit risk continued

Impaired loans and advances are those that meet any of the following criteria:

- wholesale loans and advances classified as CRR 9 or CRR 10. These grades are assigned when the bank considers that either the customer is unlikely to pay its credit obligations in full, without recourse to security, or when the customer is past due 90 days or more on any material credit obligation to the Group;
- retail loans and advances:
  - classified as EL 9 or EL 10; or
  - classified as EL 1 to EL 8 with 90 days and over past due; or
  - that have been with either 90 days and over past due or with economic loss incurred by the Group irrespective of the delinquency status
- renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet its contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment. For loans that are assessed for impairment on a collective basis, the evidence to support reclassification as no longer impaired typically comprises a history of payment performance against the original or revised terms, depending on the nature and volume of renegotiation and the credit risk characteristics surrounding the renegotiation. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case by case basis.

Impairment assessment

(audited)

It is Group's policy that each operating company in the Group creates impairment allowances for impaired loans promptly and appropriately.

For details of our impairment policies on loans and advances and financial investments, see notes 3(d) and 3(s) to the financial statements.

Impairment and credit risk mitigation

The existence of collateral has an impact when calculating impairment on individually assessed impaired loans. When we no longer expect to recover the principal and interest due on a loan in full or in accordance with the original terms and conditions, it is assessed for impairment. If exposures are secured, the current net realisable value of the collateral will be taken into account when assessing the need for an impairment allowance. No impairment allowance is recognised in cases where all amounts due are expected to be settled in full on realisation of the security.

Personal lending portfolios are generally assessed for impairment on a collective basis as the portfolios typically consist of large groups of homogeneous loans. Two methods are used to calculate allowances on a collective basis: a roll-rate methodology or a more basic formulaic approach based on historical losses.

The historical loss methodology is typically used to calculate collective impairment allowances for secured, or low default portfolios such as mortgages, until the point at which they are individually identified and assessed as impaired. For loans which are collectively assessed using historical loss methodology, the historical loss rate is derived from the average contractual write-off net of recoveries over a defined period. The net contractual write-off rate is the actual amount of loss experienced after the realisation of collateral and receipt of recoveries.

A roll-rate methodology is more commonly adopted for unsecured portfolios when there are sufficient volumes of empirical data to develop robust statistical models.

(a) Credit risk continued

The nature of the collective allowance assessment prevents individual collateral values or LTV ratios from being included within the calculation. However, the loss rates used in the collective assessment are adjusted for the collateral realisation experiences which will vary depending on the LTV composition of the portfolio.

For wholesale collectively assessed loans historical loss methodologies are applied to measure loss event impairments which have been incurred but not reported. Loss rates are derived from the observed contractual write-off net of recoveries over a defined period of at least 60 months. The net contractual write-off rate is the actual amount of loss experienced after realisation of collateral and receipt of recoveries. These historical loss rates are adjusted by an economic factor which adjusts the historical averages to better represent current economic conditions affecting the portfolio. In order to reflect the likelihood of a loss event not being identified and assessed an emergence period assumption is applied. This reflects the period between a loss occurring and its identification. The emergence period is estimated by local management for each identified portfolio. The factors that may influence this estimation include economic and market conditions, customer behavior, portfolio management information, credit management techniques and collection and recovery experiences in the market. A fixed range for the period between a loss occurring and its identification is not defined across the Group and as it is assessed empirically on a periodic basis, it may vary over time as these factors change.

(b) Liquidity and funding risk

(audited)

The purpose of liquidity and funding 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.

As part of our Asset, Liability and Capital Management structure, we have established ALCO at Group level and in major operating entities. The terms of reference of all ALCOs include the monitoring and control of liquidity and funding. Management of liquidity is carried out both at Group and Bank levels 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 ALCO. Liquidity is managed on a daily basis by the Bank's treasury functions and overseas treasury sites.

The Board is ultimately responsible for determining the types and magnitude of liquidity risk that the Group is able to take and ensure that there is an appropriate organisation structure for managing this risk. Under authorities delegated by the Executive Committee, the Group ALCO is responsible for managing all Asset, Liability and Capital Management issues including liquidity and funding risk management.

The Group ALCO delegates to the Group Tactical Asset and Liability Management Committee ("TALCO") the task of reviewing various analyses of the Group pertaining to site liquidity and funding. TALCO's primary responsibilities include but are not limited to:

- reviewing the funding structure of operating entities and the allocation of liquidity among them;
- reviewing operating entities' list of liquid securities and documented proof that a deep and liquid market exists; and
- monitoring liquidity and funding limit breaches and providing direction to those operating entities that have not been able to rectify breaches on a timely basis.

(b) Liquidity and funding risk continued

Compliance with liquidity and funding requirements is monitored by the ALCO and is reported to the RMC, Executive Committee, Risk Committee and the Board of Directors on a regular basis. This process includes:

– maintaining compliance with 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 contingency funding plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises, while minimising adverse long-term implications for the business.

The management of liquidity and funding risk

(audited)

Inherent liquidity risk categorisation

The Group places its significant operating entities into one of two categories (normal risk and higher risk) to reflect the assessment of their inherent liquidity risk, considering political, economic and regulatory factors within the host country and factors specific to the significant 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 the significant 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 the Group risk appetite and is used to determine the prescribed stress scenario that the Group requires its significant 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 and inherent liquidity risk categorisation to which the deposit is associated.

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

(b) Liquidity and funding risk continued

Advances to core funding ratio

The Group's liquidity and funding risk management framework ("LFRF") employs two key measures to define, monitor and control the liquidity and funding risk of each of the Group's operating entities. The advances to core funding ratio is used to monitor the structural long-term funding position, and the stressed coverage ratio, incorporating Group standard stress scenarios, is used to monitor the resilience to severe liquidity stresses.

Core customer deposits are an important source of funds to finance lending to customers, and mitigate against reliance on short-term wholesale 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 for the most significant operating entities. 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.

Stressed coverage ratio

Stressed coverage ratios tabulated below 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 under the stress scenario being monitored. Group operating entities are required to maintain a ratio of 100% or greater up to three months under the Group standard stress scenario defined by the inherent risk categorisation of the operating entity concerned.

Advances to core funding ratios and the stressed one-month and three-month coverage ratios for the Group for 2014 and 2013 are provided in the following table based on month end figures.

	Advances to core funding ratio *(unaudited)*		**Stressed one month covering ratio** *(unaudited)*		**Stressed three month covering ratio** *(unaudited)*	
	2014 %	2013 %	**2014 %**	2013 %	**2014 %**	2013 %
Year-end	**85.8**	83.9	**145.7**	147.6	**142.8**	148.1
Maximum	**88.8**	86.9	**150.6**	155.6	**145.6**	150.2
Minimum	**84.5**	82.0	**135.7**	136.0	**135.1**	135.9
Average	**86.3**	84.3	**142.7**	146.8	**140.0**	145.3

(b) Liquidity and funding risk continued

Stressed scenario analysis

(audited)

The Group uses a number of standard and local stress scenarios designed to model:

- institution-specific crisis scenarios;
- general market crisis scenarios; and
- combined scenarios.

These scenarios are modelled by the relevant operating entities. The appropriateness of the assumptions for each scenario is reviewed regularly and formally approved by the ALCO, RMC, Risk Committee and the Board annually as part of the liquidity and funding risk appetite approval process.

Stressed cash outflows are determined by applying a standard set of prescribed stress assumptions to the Group's cash flow model. In addition to the standard stress scenarios, individual operating entities are required to design their local scenarios to reflect specific local market conditions, products and funding bases.

Liquid assets

(unaudited)

Any unencumbered asset held as a consequence of a reverse repo transaction with a residual contractual maturity within the stressed coverage ratio time period and unsecured interbank loans maturing within three months are not included in liquid assets, as these assets are reflected as contractual cash inflows.

Liquid assets are held and managed on a standalone operating entity basis. Most of the liquid assets shown are held directly by each operating entity's Balance Sheet Management function, primarily for the purpose of managing liquidity risk, in line with the LFRF.

Internal categorisation	Cash inflow recognised	Asset classes	Eligibility Criteria
Level 1	Within one month	– Central government – Central bank (including confirmed withdrawable reserves) – Supranationals – Multilateral development banks	0% and 20% Risk Weighted
Level 2	Within one month but capped	– Local and regional government – Public sector entities – Secured covered bonds and pass-through ABSs – Gold	20% Risk Weighted
Level 3	From one to three months	– Unsecured non-financial entity securities – Equities listed on recognised exchanges and within liquid indices	Internally rated 2.2 CRR or better

Any entity owned and controlled by central or local/regional government but not explicitly guaranteed is treated as a public sector entity. Any exposure explicitly guaranteed is reflected as an exposure to the ultimate guarantor.

(b) Liquidity and funding risk continued

The table below shows the estimated liquidity value (before assumed haircuts) of assets categorised as liquid used for the purposes of calculating the three-month stressed coverage ratios, as defined under the LFRF.

Liquid assets of the Group

(unaudited)

	2014	2013
Level 1	**167,150**	140,964
Level 2	**16,973**	19,825
Level 3	**3,585**	3,296
	187,708	164,085

All assets held within the liquid asset portfolio are unencumbered.

Liquid assets held by the Group at 31 December 2014 increased as compared with 31 December 2013 as surplus fund resulting from the growth in customer deposits were deployed to high quality level 1 central government and central bank debt securities.

Stressed scenario analysis and the numerator of the coverage ratio include the assumed cash inflows that would be generated from the realisation of liquid assets, after applying the appropriate stressed haircut. These assumptions are made based on management's expectation of when an asset is deemed to be realisable.

Liquid assets are unencumbered assets that meet the Group's definition of liquid assets and are either held outright or as a consequence of a reverse repo transaction with a residual contractual maturity beyond the time horizon of the stressed coverage ratio being monitored.

The Group's liquidity framework defines the asset classes that can be assessed locally as high quality and realisable within one month and between one month and three months. ALCO has to be satisfied that any asset which may be treated as liquid in accordance with the Group's liquid asset policy will remain liquid under the stress scenario being managed to.

Inflows from the utilisation of liquid assets within one month can generally only be based on confirmed withdrawable central bank deposits, gold or the sale or repo of government and quasi-government exposures generally restricted to those denominated in the sovereign's domestic currency. Covered bonds are also included but inflows assumed for these assets are capped.

Inflows after one month are also reflected for high quality non-financial and non-structured corporate bonds and equities within the most liquid indices.

Wholesale debt monitoring

(unaudited)

Where wholesale debt term markets are accessed to raise funding, ALCO is required to ensure that there is no concentration of maturities of these term debts.

Sources of funding

(unaudited)

The Group's primary sources of funding are customer current accounts and customer savings deposits payable on demand or at short notice. The Group also accesses wholesale funding markets by issuing senior unsecured debt securities (publicly and privately) and borrowing from the secured repo markets against high quality collateral, in order to supplement our customer deposits, change the currency mix and maturity profile, and maintain a presence in local wholesale markets.

(b) Liquidity and funding risk continued

Encumbered and unencumbered assets

(unaudited)

An asset is defined as encumbered, from a liquidity perspective, if it has been pledged as collateral against an existing liability, and as a result is no longer available to the bank to secure funding, satisfy collateral needs or be sold to reduce the funding requirement. An asset is therefore categorised as unencumbered if it has not been pledged against an existing liability.

The disclosure is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

Analysis of on-balance sheet encumbered and unencumbered assets

(unaudited)

The table below presents an analysis of on-balance sheet holdings only, and shows the amounts of balance sheet assets that are encumbered. The table therefore excludes any available off-balance sheet holdings received in respect of reverse repo, stock borrowing or derivatives.

	Encumbered	Unencumbered		Unencumbered – cannot be pledged as collateral		
At 31 December 2014	Assets pledged as collateral	Readily realisable assets	Other realisable assets	Reverse repo/stock borrowing receivable & derivative assets	Cannot be pledged as collateral	Total
Cash and sight balances at central banks	–	11,311	–	–	–	11,311
Placings with and advances to banks	–	–	124,262	–	21,469	145,731
Trading assets	8,290	29,477	4,056	–	–	41,823
Financial assets designated at fair value	–	–	–	–	11,112	11,112
Derivative financial instruments	–	–	–	7,421	–	7,421
Reverse repurchase agreements – non-trading	–	–	–	1,296	–	1,296
Loans and advances to customers	–	–	658,198	–	233	658,431
Financial investments	19,793	223,486	1,221	–	73,532	318,032
Interest in associates	–	–	20	–	2,198	2,218
Investment properties	–	–	9,777	–	1,955	11,732
Premises, plant and equipment	–	–	21,074	–	824	21,898
Intangible assets	–	–	–	–	9,053	9,053
Other assets	–	3,681	15,178	–	5,073	23,932
Total assets	28,083	267,955	833,786	8,717	125,449	1,263,990

(b) Liquidity and funding risk continued

At 31 December 2013	Encumbered Assets pledged as collateral	Unencumbered Readily realisable assets	Unencumbered Other realisable assets	Unencumbered – cannot be pledged as collateral Reverse repo/stock borrowing receivable & derivative assets	Unencumbered – cannot be pledged as collateral Cannot be pledged as collateral	Total
Cash and sight balances at central banks	–	22,717	–	–	–	22,717
Placings with and advances to banks	–	–	123,288	–	18,652	141,940
Trading assets	3,758	20,077	8,161	–	–	31,996
Financial assets designated at fair value	–	–	–	–	6,987	6,987
Derivative financial instruments	–	–	–	6,646	–	6,646
Reverse repurchase agreements – non-trading	–	–	–	–	–	–
Loans and advances to customers	–	–	586,007	–	233	586,240
Financial investments	20,908	189,441	964	–	71,532	282,845
Interest in associates	–	–	30	–	2,032	2,062
Investment properties	–	–	8,998	–	1,920	10,918
Premises, plant and equipment	–	–	20,510	–	490	21,000
Intangible assets	–	–	–	–	7,974	7,974
Other assets	–	4,184	14,675	–	3,546	22,405
Total assets	24,666	236,419	762,633	6,646	113,366	1,143,730

Cash collateral posted to satisfy margin requirements on derivatives, is reported as encumbered under trading assets within loans or advances to banks and loans and advances to customers.

Liquidity behaviouralisation
(unaudited)

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
(unaudited)

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
(unaudited)

A contingency funding plan ("CFP") 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 CFP 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 CFP 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 CFP 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.

(b) Liquidity and funding risk continued

Liquidity regulation

(unaudited)

In December 2010, the Basel Committee published the "International framework for liquidity risk measurement, standards and monitoring". The framework comprises two liquidity metrics: the liquidity coverage ratio ("LCR") and the net stable funding ratio ("NSFR"). The ratios are subject to an observation period that began in 2011, and are expected to become established standards by 2015 and 2018, respectively.

In January 2013, the Basel Committee announced several changes to the calibration of the LCR which included reducing the outflow applied to non-operational non-financial corporate deposits from 75% to 40% and reducing the outflow applied to committed liquidity facilities from 100% to 30%.

In January 2014, the Basel Committee issued a further consultation paper in respect of the NSFR.

The Hong Kong Monetary Authority ("HKMA") has issued a consultation paper in May 2014 on the returns for reporting of Liquidity Maintenance Ratio and Liquidity Monitoring Tool. In response to the updated Basel standard on liquidity, the HKMA's consultation in respect of the LCR has been completed. The final version of the LCR returns and completion instruction have been rolled out in December 2014 and the actual reporting starting from 1 January 2015.

Liquidity ratio under the Hong Kong Banking Ordinance

(unaudited)

The Hong Kong Banking Ordinance also requires banks operating in Hong Kong to maintain a minimum liquidity ratio. The average liquidity ratio for the year, calculated in accordance with the Fourth Schedule of the Hong Kong Banking Ordinance, is as follows:

	2014	2013
The Bank and its subsidiaries designated by the HKMA	**34.7%**	34.9%

The below tables are an analysis of undiscounted cash flows on the Group's financial liabilities including future interest payments on the basis of their earliest possible contractual maturities.

The balances in the below tables will not agree with the balances in the balance sheet as the tables incorporate, on an undiscounted basis, all cash flows relating to principal and all future coupon payments (except for trading liabilities and trading derivatives). Also, loans commitments and financial guarantee contracts are generally not recognised on the balance sheet. Trading liabilities and trading derivatives have been included in the "On demand" time bucket, and not by contractual maturity, because trading liabilities are typically held for short periods of time. The undiscounted cash flows on hedging derivative liabilities are classified according to their contractual maturities.

Cash flows payable in respect of customer accounts are primarily contractually repayable on demand or at short notice. However, in practice, short-term deposit balances remain stable as inflows and outflows broadly match and a significant portion of loans commitments expire without being drawn upon. The undiscounted cash flows potentially payable under loan commitments and financial guarantee are classified on the basis of the earliest date they can be called.

(b) Liquidity and funding risk continued

	Group					
	Repayable on demand	Three months or less but not on demand	Over three months but within one year	Over one year but within five years	Over five years	Total
At 31 December 2014						
Current, savings and other deposit accounts	**630,303**	**219,498**	**45,757**	**3,304**	**–**	**898,862**
Deposits from banks	**3,797**	**3,171**	**2,127**	**–**	**–**	**9,095**
Financial liabilities designated at fair value	**2**	**13**	**39**	**3,105**	**493**	**3,652**
Trading liabilities	**72,587**	**–**	**–**	**–**	**–**	**72,587**
Derivative financial instruments	**5,914**	**133**	**142**	**317**	**11**	**6,517**
Certificates of deposit and other debt securities in issue	**–**	**22**	**7,201**	**5,440**	**–**	**12,663**
Other financial liabilities	**6,706**	**8,507**	**1,903**	**30**	**46**	**17,192**
Subordinated liabilities	**–**	**46**	**139**	**742**	**6,186**	**7,113**
	719,309	**231,390**	**57,308**	**12,938**	**6,736**	**1,027,681**
Loan commitments	**283,366**	**43,461**	**129**	**–**	**–**	**326,956**
Financial guarantee and credit risk related guarantee contracts	**11,906**	**101**	**–**	**–**	**–**	**12,007**
	295,272	**43,562**	**129**	**–**	**–**	**338,963**
At 31 December 2013						
Current, savings and other deposit accounts	601,609	185,495	36,641	3,334	1	827,080
Deposits from banks	3,868	7,958	–	–	–	11,826
Financial liabilities designated at fair value	2	–	–	–	487	489
Trading liabilities	62,117	–	–	–	–	62,117
Derivative financial instruments	4,525	204	311	301	–	5,341
Certificates of deposit and other debt securities in issue	–	24	3,973	4,663	–	8,660
Other financial liabilities	5,877	8,507	2,773	100	22	17,279
Subordinated liabilities	–	125	227	1,209	12,649	14,210
	677,998	202,313	43,925	9,607	13,159	947,002
Loan commitments	262,674	28,415	148	47	–	291,284
Financial guarantee and credit risk related guarantee contracts	15,104	88	2	–	–	15,194
	277,778	28,503	150	47	–	306,478

(b) Liquidity and funding risk continued

	Bank					
	Repayable on demand	Three months or less but not on demand	Over three months but within one year	Over one year but within five years	Over five years	Total
At 31 December 2014						
Current, savings and other deposit accounts	**612,229**	**208,359**	**30,569**	**57**	**–**	**851,214**
Deposits from banks	**3,713**	**427**	**–**	**–**	**–**	**4,140**
Financial liabilities designated at fair value	**–**	**13**	**39**	**3,105**	**–**	**3,157**
Trading liabilities	**34,373**	**–**	**–**	**–**	**–**	**34,373**
Derivative financial instruments	**5,676**	**133**	**142**	**317**	**11**	**6,279**
Certificates of deposit and other debt securities in issue	**–**	**22**	**7,201**	**4,067**	**–**	**11,290**
Amounts due to subsidiaries	**10,219**	**5,271**	**–**	**–**	**–**	**15,490**
Other financial liabilities	**6,545**	**6,549**	**789**	**30**	**46**	**13,959**
Subordinated liabilities	**–**	**46**	**139**	**742**	**6,186**	**7,113**
	672,755	**220,820**	**38,879**	**8,318**	**6,243**	**947,015**
Loan commitments	**253,874**	**48,943**	**10,135**	**–**	**–**	**312,952**
Financial guarantee and credit risk related guarantee contracts	**11,759**	**101**	**–**	**–**	**–**	**11,860**
	265,633	**49,044**	**10,135**	**–**	**–**	**324,812**
At 31 December 2013						
Current, savings and other deposit accounts	585,612	168,172	21,183	59	–	775,026
Deposits from banks	3,868	6,144	–	–	–	10,012
Financial liabilities designated at fair value	–	–	–	–	–	–
Trading liabilities	29,914	–	–	–	–	29,914
Derivative financial instruments	3,766	204	311	301	–	4,582
Certificates of deposit and other debt securities in issue	–	24	3,973	4,663	–	8,660
Amounts due to subsidiaries	3,400	10,926	–	–	–	14,326
Other financial liabilities	5,806	5,714	1,833	100	22	13,475
Subordinated liabilities	–	125	227	1,209	12,649	14,210
	632,366	191,309	27,527	6,332	12,671	870,205
Loan commitments	231,588	28,414	148	47	–	260,197
Financial guarantee and credit risk related guarantee contracts	11,666	78	2	–	–	11,746
	243,254	28,492	150	47	–	271,943

(c) Market risk

(unaudited)

Market risk is the risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios.

There were no significant changes to our policies and practices for the management of market risk in 2014.

Exposure to market risk is separated into two portfolios:

– Trading portfolios comprise positions arising from market-making and warehousing of customer-derived positions.

– Non-trading portfolios comprise positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, and financial investments designated as available-for-sale.

Where appropriate, the Group applies similar risk management policies and measurement techniques to both trading and non-trading portfolios. The Group's objective is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the status as a professional banking and financial services organisation.

The nature of the hedging and risk mitigation strategies range from the use of traditional market instruments, such as interest rate swaps, to more sophisticated hedging strategies to address a combination of risk factors arising at portfolio level.

Market risk governance

(unaudited)

Market risk is managed and controlled through limits approved by the Group's Risk Management Committee. These limits are allocated across business lines and to the Group's legal entities, including Hang Seng Bank (China) Limited.

The management of market risk is principally undertaken in Global Markets using risk limits allocated from the risk appetite, which is subject to the Board's approval. Limits are set for portfolios, products and risk types where appropriate, with market liquidity being a primary factor in determining the level of limits set.

An independent market risk management and control function is responsible for measuring, monitoring and reporting market risk exposures against the prescribed limits on a daily basis.

The Group is required to assess the market risks arising on each product in its business and to transfer them to either the Global Markets unit for management, or to separate books managed under the supervision of ALCO.

The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to manage them professionally. In certain cases where the market risks cannot be fully transferred, the Group identifies the impact of varying scenarios on valuations or on net interest income resulting from any residual risk positions.

Model risk is governed through Model Oversight Committee ("MOC") at the Wholesale Credit and Market Risk ("WCMR") level. The MOC has direct oversight on traded risk models utilised for risk measurement and management and stress testing to ensure that they remain within our risk appetite and business plans.

Our control of market risk in the trading and non-trading portfolios is based on a policy of restricting trading within a list of permissible instruments authorised for each business lines, of enforcing new product approval procedures, and of restricting trading in the more complex derivative products only to business line with appropriate levels of product expertise and robust control systems.

Monitoring and limiting market risk exposures

The Group's objective is to manage and control market risk exposures while maintaining a market profile consistent with the Group's risk appetite.

The Group uses a range of tools to monitor and limit market risk exposures including sensitivity analysis, value at risk ("VAR"), and stress testing.

(c) Market risk continued

Sensitivity analysis

(unaudited)

Sensitivity analysis measures the impact of individual market factor movements on specific instruments or portfolios including interest rates, foreign exchange rates and equity prices. The Group uses sensitivity measures to monitor the market risk positions within each risk type, for example, the present value of a basis point movement in interest rates for interest rate risk.

Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

Value at risk ("VAR")

(audited)

VAR is a technique that estimates the potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. The use of VAR is integrated into market risk management and is calculated for all trading positions regardless of how the Group capitalises those exposures. Where there is not an approved internal model, the Group uses the appropriate local rules to capitalise exposures.

In addition, the Group calculates VAR for non-trading portfolios in order to have a complete picture of risk. Where VAR is not calculated explicitly, alternative tools are used.

Standard VAR is calculated at a 99% confidence level for a one-day holding period while stressed VAR uses a 10-day holding period and a 99% confidence interval based on a continuous one-year historical significant stress period. The VAR models used by the Group are based predominantly on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates such as interest rates and foreign exchange rates. The models also incorporate the effect of option features on the underlying exposures.

The historical simulation models used incorporate the following features:

– historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities;

– potential market movements utilised for VAR are calculated with reference to those historical data; and

– Standard VAR is calculated to a 99% confidence level and use a one-day holding period scaled to 10 days.

The nature of the VAR models means that an increase in observed market volatility will lead to an increase in VAR without any changes in the underlying positions.

VAR model limitations

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 holding period assumes that all positions can be liquidated or the risks offset during that period. This may not fully reflect the market risk arising at times of severe illiquidity, when the holding period may be insufficient to liquidate or hedge all positions fully;

– the use of a 99% confidence level, by definition does not take into account losses that might occur beyond this level of confidence;

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

– Standard VAR is unlikely to reflect loss potential on exposures that only arise under significant market movements.

(c) Market risk continued

Risk not in VAR ("RNIV") framework

(unaudited)

The Group's VAR model is designed to capture significant basis risks such as asset swap spreads and cross-currency basis. Other basis risks which are not completely covered in VAR, such as the LIBOR tenor basis, are complemented by calculations and are integrated into the capital framework.

The RNIV framework aims to manage and capitalise material market risks that are not adequately covered in the VAR model. In such instances the RNIV framework uses stress tests to quantify the capital requirement. In Q4 2014, the capital requirement derived from these stress tests represented 3.0% of the total internal model-based market risk requirement.

RNIV is not viewed as being a material component of the Group's market risk capital requirement. Risks covered by RNIV represent 2.6% of market risk RWAs for models with regulatory approval.

Risk factors are reviewed on a regular basis and either incorporated directly in the VAR models, where possible, or quantified through the VAR-based RNIV approach or a stress test approach within the RNIV framework. The severity of the scenarios is calibrated to be in line with the capital adequacy requirements.

Level 3 assets

(unaudited)

The fair value of Level 3 assets in trading portfolios, comprising trading derivatives, is immaterial. Market risk arising from Level 3 assets is captured properly in the system and managed by various market risk techniques such as VAR and stress testing.

Stress testing

(unaudited)

Stress testing is an important tool that is integrated into the Group's market risk management tool to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. In such abnormal scenarios, losses can be much greater than those predicted by VAR modelling.

Stress testing is implemented at the legal entity and the overall Group levels. Scenarios are tailored in order to capture the relevant events or market movements. The risk appetite around potential stress losses for the Group is set and monitored against referral limits.

The process is governed by the HSBC Stress Testing Review Group forum which the Group being a participating member determines the scenarios to be applied at portfolio and consolidated level, as follows:

- single risk factor stress scenarios that are unlikely to be captured within the VAR models, such as the break of a currency peg;
- technical scenarios consider the largest move in each risk factor without consideration of any underlying market correlation;
- hypothetical scenarios consider potential macroeconomic events, for example, the slowdown in mainland China and the potential effects of a sovereign debt default, including its wider contagion effects; and
- historical scenarios incorporate historical observations of market movements during previous periods of stress which would not be captured within VAR.

Market Risk Reverse stress tests are undertaken based upon the premise that there is a fixed loss. The stress test process identifies which scenarios lead to this loss. The rationale behind the reverse stress test is to understand scenarios which are beyond normal business settings that could have contagion and systemic implications.

Stressed VAR and stress testing, together with reverse stress testing, provide management with insights regarding the "tail risk" beyond VAR for which the Group appetite is limited.

(c) Market risk continued

Trading portfolios

(audited)

VAR of the trading portfolios

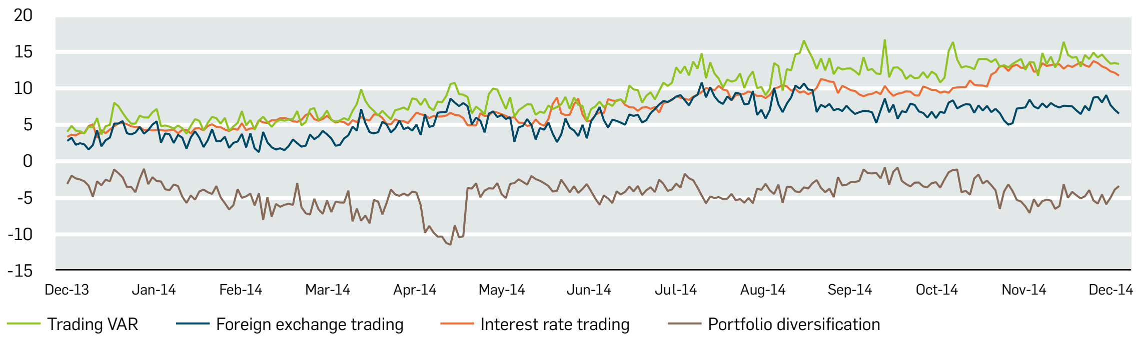
Trading VAR predominantly resides within Global Markets. The VAR for trading activity at 31 December 2014 was higher than at 31 December 2013, mainly driven by foreign exchange and interest rate trading activities.

The daily levels of total trading VAR over the last year are set out in the graph below.

Daily VAR (trading portfolios), 99% 1 day (HK$m)

(unaudited)

Daily VAR (trading portfolios), 99% 1 day (HK$m)



The Group's trading VAR for the year is shown in the table below.

Trading, 99% 1 day

(audited)

	At 31 December 2014	Minimum during the year	Maximum during the year	Average for the year
VAR				
Trading	13	4	17	9
Foreign exchange trading	7	1	11	6
Interest rate trading	12	3	14	8
Portfolio diversification *(unaudited)*	(5)	–	–	(4)
Stressed VAR				
Trading	40	23	157	65
Foreign exchange trading	18	1	32	17
Interest rate trading	64	26	173	77

(c) Market risk continued

	At 31 December 2013	Minimum during the year	Maximum during the year	Average for the year
VAR				
Trading	4	4	17	7
Foreign exchange trading	3	2	15	6
Interest rate trading	3	3	9	4
Portfolio diversification *(unaudited)*	(2)	–	–	(3)
Stressed VAR				
Trading	27	14	80	33
Foreign exchange trading	13	5	48	17
Interest rate trading	37	16	82	40

Backtesting

(unaudited)

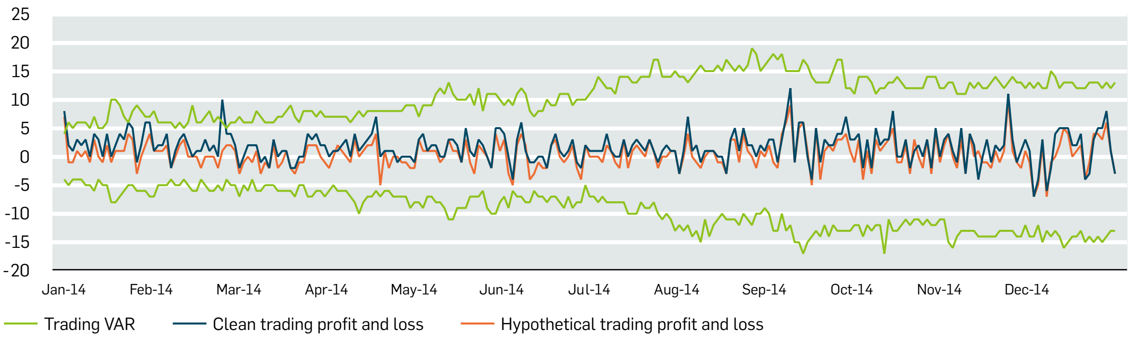
In 2014, there was no loss exception for the Group. However, there were two profit exceptions during the year.

The first profit exception happened in January 2014 on both clean and hypothetical profit and loss basis. The trigger of the exception was due to trading profit from exposures to foreign exchange and interest rates. The second profit exception was in February 2014 with a clean profit excess driven by intra-day transactions.

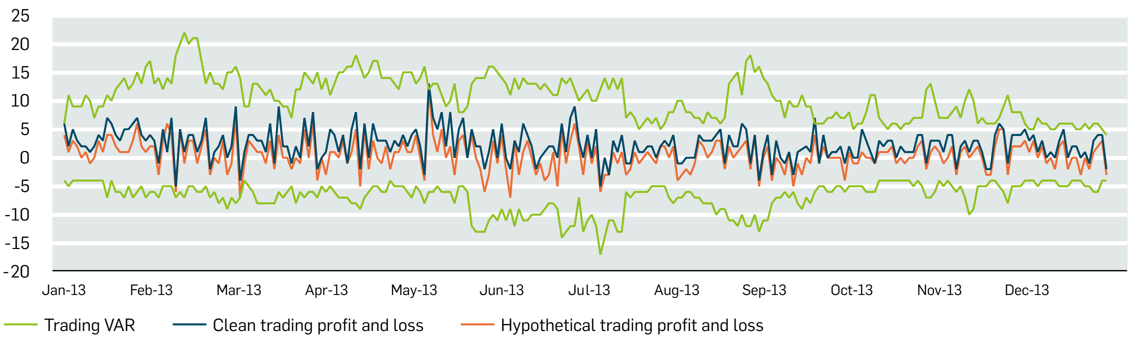
The graph below shows the daily trading VAR against clean and hypothetical profit and loss for the Group during 2014.

Backtesting of trading VAR against clean and hypothetical profit and loss for the Group (HK$m)
(unaudited)

Backtesting of trading VAR against clean and hypothetical profit and loss for 2014 (HK$m)



Backtesting of trading VAR against clean and hypothetical profit and loss for 2013 (HK$m)



(c) Market risk continued

The Group routinely validates the accuracy of the VAR models by back-testing them against the clean and hypothetical profit and loss. Hypothetical profit and loss excludes non-modelled items such as fees, commissions and revenues of intra-day transactions from the actual reported profit and loss, while clean profit and loss includes both.

The Group would expect on average to see two or three profits, and two or three losses, in excess of VAR at the 99% confidence level over a one-year period. The actual number of profits or losses in excess of VAR over this period can therefore be used to gauge how well the models are performing. To ensure a conservative approach to calculating our risk exposures, it is important to note that profits in excess of VAR are only considered when back-testing the accuracy of models and are not used to calculate the VAR numbers used for risk management or capital purposes.

Non-trading portfolios

(unaudited)

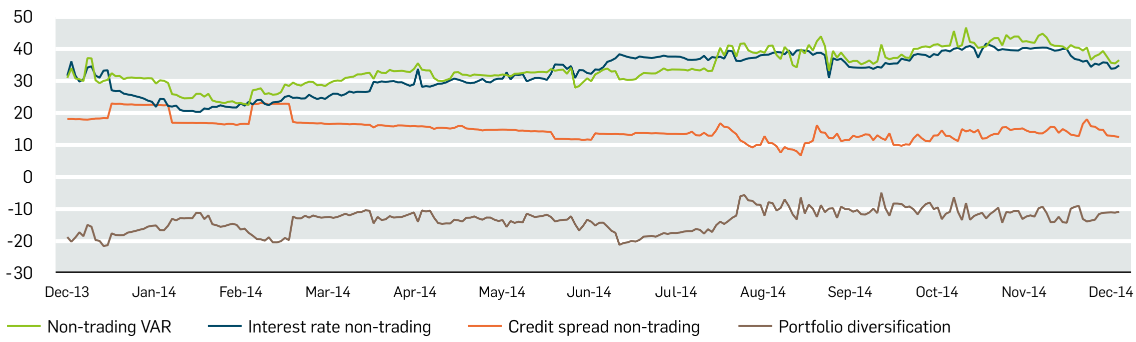
VAR of the non-trading portfolios

Non-trading VAR of the Group predominantly relates to Balance Sheet Management ("BSM"). Contributions to non-trading VAR are driven by interest rates and credit spread risks. There is no commodity risk in the non-trading portfolios. The daily levels of total non-trading VAR over the last year are set out in the graph below.

Daily VAR (non-trading portfolios), 99% 1 day (HK$m)

(unaudited)

2014 Daily VAR (non-trading portfolios), 99% 1 day (HK$m)



The Group's non-trading VAR for the year is shown in the table below.

Non-trading VAR, 99% 1 day

(audited)

	At 31 December 2014	Minimum during the year	Maximum during the year	Average for the year
VAR				
Non-trading	36	22	47	34
Interest rate non-trading	35	20	42	32
Credit spread non-trading *(unaudited)*	12	7	23	15
Portfolio diversification *(unaudited)*	(11)	–	–	(13)

(c) Market risk continued

	At 31 December 2013	Minimum during the year	Maximum during the year	Average for the year
VAR				
Non-trading	31	22	60	36
Interest rate non-trading	32	21	40	28
Credit spread non-trading *(unaudited)*	18	18	49	30
Portfolio diversification *(unaudited)*	(19)	–	–	(22)

In measuring, monitoring and managing risk in our non-trading portfolios, VAR is just one of the tools used. The management of interest rate risk in the banking book is described further in "Non-trading interest rate risk" below, including the role of BSM.

Non-trading VAR excludes equity risk on available-for-sale securities, structural foreign exchange risk, and interest rate risk on fixed rate securities issued by HSBC Holdings, the management of which is described in the relevant sections below.

The Group's control of market risk in the non-trading portfolios is based on transferring the assessed market risk of non-trading assets and liabilities created outside BSM or Global Markets, to the books managed by BSM, provided the market risk can be neutralised. The net exposure is typically managed by BSM through the use of fixed rate government bonds (liquid asset held in available-for-sale books) and interest rate swaps. The interest rate risk arising from fixed rate government bonds held within available-for-sale portfolios is reflected within the Group's non-trading VAR. Interest rate swaps used by BSM are typically classified as either a fair value hedge or a cash flow hedge and included within the Group's non-trading VAR. Any market risk that cannot be neutralised in the market is managed by local ALCO in segregated ALCO books.

Credit spread risk for available-for-sale debt securities

(unaudited)

The risk associated with movements in credit spreads is primarily managed through sensitivity limits, stress testing and VAR. The credit spread VAR is derived from a one-day movement in credit spreads over a two-year period, calculated to a 99% confidence interval.

The credit spreads VAR on our available-for-sale debt securities was HK$12 million (2013: HK$18 million) at 31 December 2014.

The decrease in credit spread VAR at 31 December 2014 compared with 31 December 2013 was due mainly to the effect of smaller credit spread delta exposure, lower volatilities and credit spread baselines observed during the year.

Interest rate exposure

(audited)

Interest rate risks comprise those originating from Global Markets activities, both trading and non-trading portfolios which include structural interest rate exposures. Global Markets manages interest rate risks within the limits approved by the RMC and under the monitoring of both ALCO and RMC.

Trading interest rate risk

(audited)

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 limits and option limits, and a list of permissible instruments authorised by the RMC, 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.

(c) Market risk continued

Non-trading interest rate risk

(audited)

Non-trading 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.

Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas, such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand, such as current accounts, and the re-pricing behaviour of managed rate products. These assumptions around behavioural features are captured in our interest rate risk behaviouralisation framework, which is described below.

We aim, through our management of market risk in non-trading portfolios, to mitigate the effect of prospective interest rate movements which could reduce future net interest income, while balancing the cost of such hedging activities on the current net revenue stream.

Interest rate risk behaviouralisation

(unaudited)

Unlike liquidity risk which is assessed on the basis of a very severe stress scenario, non-traded market interest rate risk is assessed and managed according to “business-as-usual” conditions. In many cases the contractual profile of non-traded assets/liabilities arising from assets/liabilities created outside Markets or BSM does not reflect the behaviour observed.

Behaviouralisation is therefore used to assess the market interest rate risk of non-traded assets/liabilities and this assessed market risk is transferred to BSM, in accordance with the rules governing the transfer of interest rate risk from the global businesses to BSM.

Behaviouralisation is applied in three key areas:

– the assessed re-pricing frequency of managed rate balances;

– the assessed duration of non-interest bearing balances, typically capital and current accounts; and

– the base case expected prepayment behaviour or pipeline take-up rate for fixed rate balances with embedded optionality.

Interest rate behaviouralisation policies have to be formulated in line with the Group’s behaviouralisation policies and approved at least annually by ALCO, regional ALCM and Group ALCM, in conjunction with local, regional and Group market risk monitoring teams.

The extent to which balances can be behaviouralised is driven by:

– the amount of the current balance that can be assessed as “stable” under business-as-usual conditions; and

– for managed rate balances the historic market interest rate re-pricing behaviour observed; or

– for non-interest bearing balances the duration for which the balance is expected to remain under business-as-usual conditions. This assessment is often driven by the re-investment tenors available to BSM to neutralise the risk through the use of fixed rate government bonds or interest rate derivatives, and for derivatives the availability of cash flow hedging capacity.

(c) Market risk continued

Sensitivity of net interest income

A principal part of the Group's management of non-trading interest rate risk in non-trading portfolios is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling).

The table below sets out the impact on future net interest income of a 100 basis points parallel fall or rise in all-in yield curves at the beginning of year from 1 January 2015 and 25 basis points parallel fall or rise in all-in yield curves at the beginning of each quarter during the 12 month period from 1 January 2015.

Assuming no management actions, such a series of incremental parallel rises in all-in yield curves would increase planned net interest income for the year ending 31 December 2015 by HK$2,982 million for 100 basis points case and by HK$2,107 million for 25 basis points case, while such a series of incremental parallel falls in all-in yield curves would decrease planned net interest income by HK$3,278 million for 100 basis points case and by HK$2,682 million for 25 basis points case. These figures incorporate the impact of any option features in the underlying exposures and take into account the change in pricing of retail products relative to change in market interest rates.

Projected Net Interest Income

(audited)

The sensitivity of projected net interest income is described as follows:

	100bp parallel increase	100bp parallel decrease	25bp increase at the beginning of each quarter	25bp decrease at the beginning of each quarter
Change in 2015 projected net interest income				
– HKD	**1,543**	**(1,960)**	**1,053**	**(1,625)**
– US$	**753**	**(648)**	**511**	**(606)**
– other	**686**	**(670)**	**543**	**(451)**
Total	**2,982**	**(3,278)**	**2,107**	**(2,682)**
Change in 2014 projected net interest income				
– HKD	1,432	(1,498)	963	(1,259)
– US$	598	(471)	427	(403)
– other	707	(709)	571	(532)
Total	2,737	(2,678)	1,961	(2,194)

The interest rate sensitivities set out in the table above represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and the Group's current interest rate risk profile. This effect, however, does not incorporate actions that would be taken by BSM or in the business units to mitigate the impact of this interest rate risk. In reality, BSM seeks proactively to change the interest rate risk profile to minimise losses and optimise net revenues. The net interest income sensitivity calculations assume that interest rates of all maturities move by the same amount in the "up-shock" scenario. Rates are not assumed to become negative in the "down-shock" scenario which may, in certain currencies, effectively result in non-parallel shock. In addition, the net interest income sensitivity calculations take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates over which the entity has discretion in terms of the timing and extent of rate changes.

(c) Market risk continued

Sensitivity of reserves

(audited)

The Group monitors the sensitivity of reported reserves to interest rate movements at least on a quarterly basis by assessing the expected reduction in valuation of available-for-sale portfolios and cash flow hedges due to parallel movements of plus or minus 100 basis points in all-in yield curves. The table below describes the sensitivity to these movements at the balance sheet dates indicated below and the maximum and minimum month figures during the year:

	At 31 December 2014	Maximum impact	Minimum impact
+ 100 basis points parallel move in all-in yield curves	**(1,031)**	**(1,031)**	**(663)**
As a percentage of shareholders' funds at 31 December 2014 (%)	**(0.7)**	**(0.7)**	**(0.5)**
– 100 basis points parallel move in all-in yield curves	**455**	**461**	**311**
As a percentage of shareholders' funds at 31 December 2014 (%)	**0.3**	**0.3**	**0.2**

	At 31 December 2013	Maximum impact	Minimum impact
+ 100 basis points parallel move in all-in yield curves	(855)	(987)	(855)
As a percentage of shareholders' funds at 31 December 2013 (%)	(0.8)	(0.9)	(0.8)
– 100 basis points parallel move in all-in yield curves	350	377	314
As a percentage of shareholders' funds at 31 December 2013 (%)	0.3	0.3	0.3

The sensitivities included in the table are illustrative only and are based on simplified scenarios. Moreover, the table shows only those interest rate risk exposures arising in available-for-sale portfolios and from cash flow hedges. These particular exposures form only a part of the Group's overall interest rate exposures.

Foreign exchange exposure

(audited)

The Group's foreign exchange exposures mainly comprise foreign exchange dealing by Global Markets and currency exposures originated by its banking business. The latter are transferred to Global Markets where they are centrally managed within foreign exchange position limits approved by the RMC. The net options position is calculated on the basis of delta-weighted positions of all foreign exchange options contracts.

The Group's gross structural foreign exchange exposure is represented by the net asset value of the Group's foreign currency investments in subsidiaries, branches and associates, and the fair value of the Group's long-term foreign currency equity investments. The Group's structural foreign currency exposures are managed by the Group's ALCO with the primary objective of ensuring, where practical, that the Group's and the Bank's capital ratios are protected from the effect of changes in exchange rates.

At 31 December 2014, the US dollar ("USD"), was the currency in which the Group had non-structural foreign currency positions that were not less than 10% of the total net position in all foreign currencies. The Group also had a China Renminbi ("RMB") structural foreign currency position, which was not less than 10% of the total net structural position in all foreign currencies.

(c) Market risk continued

The tables below summarise the net structural and non-structural foreign currency positions of the Group.

(unaudited)

	Group					
	USD	RMB	EUR	AUD	Other foreign currencies	Total foreign currencies
2014						
Non-structural position						
Spot assets	**188,559**	**163,709**	**16,256**	**14,516**	**52,824**	**435,864**
Spot liabilities	**(157,303)**	**(159,501)**	**(8,877)**	**(23,523)**	**(32,474)**	**(381,678)**
Forward purchases	**325,133**	**147,597**	**6,725**	**13,587**	**49,354**	**542,396**
Forward sales	**(347,341)**	**(151,149)**	**(14,100)**	**(4,505)**	**(69,855)**	**(586,950)**
Net options position	**205**	**(276)**	**(2)**	**(115)**	**191**	**3**
Net long/(short) non-structural position	**9,253**	**380**	**2**	**(40)**	**40**	**9,635**
Structural position	**–**	**52,993**	**–**	**–**	**669**	**53,662**
2013						
Non-structural position						
Spot assets	176,324	157,293	4,807	20,569	44,217	403,210
Spot liabilities	(154,695)	(137,449)	(7,621)	(26,347)	(32,777)	(358,889)
Forward purchases	287,769	132,637	7,320	13,358	28,817	469,901
Forward sales	(310,493)	(150,555)	(4,610)	(7,658)	(40,072)	(513,388)
Net options position	404	(146)	–	(15)	(215)	28
Net long/(short) non-structural position	(691)	1,780	(104)	(93)	(30)	862
Structural position	205	37,530	–	–	535	38,270

Equities exposure

(audited)

The Group's equities exposures in 2014 and 2013 are mainly long-term equity investments which are reported as "Financial investments" set out in note 32 to the financial statements. Equities held for trading purpose are included under "Trading assets" set out in note 28 to the financial statements. These are subject to trading limit and risk management control procedures and other market risk regime.

(d) Insurance risk

(audited)

Risk management objectives and policies for management of insurance risk

Through its insurance subsidiaries, the Group offers comprehensive insurance products, including life and non-life insurance, to both personal and commercial customers. These insurance operating subsidiaries are subject to the supervision of the Office of the Commissioner of Insurance and are required to observe the relevant compliance requirements stipulated by the Insurance Commissioner.

The Group is exposed to the uncertainty surrounding the timing and severity of insurance claims under its insurance contracts. The Group also has exposure to market risk through its insurance and investment activities.

The Group manages its insurance risk through underwriting limits, approval procedures for transactions that involve new products or that exceed set limits, risk diversification, pricing guidelines, reinsurance and monitoring of emerging issues, taking into account where appropriate local market conditions and regulatory requirements that apply.

The Group uses several methods to assess and monitor insurance risk exposures for both individual types of risks insured and overall risks. These methods include internal risk measurement models, sensitivity analyses, scenario analyses and stress testing.

The theory of probability is applied to the pricing and provisioning for a portfolio of insurance contracts. The principal risk is that the frequency and severity of claims is greater than expected. Insurance events are, by their nature, incorporated with a certain degree of randomness, and the actual number and size of events during any one year may vary from those estimated using established statistical techniques.

Asset/liability management

The Group actively manages its assets using an approach that considers asset quality, risk profile, diversification, asset/liability matching, liquidity and target investment return. The goal of the investment process is to achieve the target level of investment return with minimum volatility. The Investment Committee and Risk Management Committee of the Group's insurance subsidiaries review and approve the investment policy including asset allocation, investment guidelines and limits on a periodic basis, while the Asset and Liability Management Committee provides oversight of the asset/liability management process.

The Group establishes the investment policy for each major insurance product category according to specific product requirements and local regulatory requirement. The investment policy defines the asset allocations and restrictions with an aim to achieve the target investment return in the long term. The estimates and assumptions used in determining the approximate amounts and timing of payments to or on behalf of policyholders for insurance liabilities are regularly re-evaluated. Actual results may deviate from the estimate and assumption and could impact the Group's ability to achieve its asset/liability management goals and objectives.

(d) Insurance risk continued

The following table shows the composition of assets and liabilities for each major insurance product category.

Balance sheet of insurance subsidiaries by type of contract

	Linked contracts[1]	Non-linked contracts[2]	Other assets[3]	Total
2014				
Financial assets:				
– financial assets designated at fair value	**232**	**10,880**	**–**	**11,112**
– derivatives	**–**	**86**	**–**	**86**
– financial investments	**–**	**66,734**	**6,292**	**73,026**
– other financial assets	**15**	**9,596**	**1,523**	**11,134**
Total financial assets	**247**	**87,296**	**7,815**	**95,358**
Reinsurance assets	**–**	**2,820**	**–**	**2,820**
Present value of in-force long-term insurance contracts	**–**	**–**	**8,263**	**8,263**
Other assets	**–**	**4,321**	**1,446**	**5,767**
Total assets	**247**	**94,437**	**17,524**	**112,208**
Liabilities under investment contracts designated at fair value	**160**	**335**	**–**	**495**
Liabilities under insurance contracts	**86**	**92,356**	**–**	**92,442**
Deferred tax	**–**	**–**	**1,453**	**1,453**
Other liabilities	**–**	**–**	**749**	**749**
Total liabilities	**246**	**92,691**	**2,202**	**95,139**
Shareholders' equity	**–**	**–**	**17,069**	**17,069**
Total liabilities and shareholders' equity	**246**	**92,691**	**19,271**	**112,208**
2013				
Financial assets:				
– financial assets designated at fair value	233	6,754	–	6,987
– derivatives	–	3	–	3
– financial investments	–	66,672	4,853	71,525
– other financial assets	13	7,963	2,129	10,105
Total financial assets	246	81,392	6,982	88,620
Reinsurance assets	–	1,465	–	1,465
Present value of in-force long-term insurance contracts	–	–	7,198	7,198
Other assets	–	4,893	758	5,651
Total assets	246	87,750	14,938	102,934
Liabilities under investment contracts designated at fair value	155	335	–	490
Liabilities under insurance contracts	88	85,756	–	85,844
Deferred tax	–	–	1,239	1,239
Other liabilities	–	–	554	554
Total liabilities	243	86,091	1,793	88,127
Shareholders' equity	–	–	14,807	14,807
Total liabilities and shareholders' equity	243	86,091	16,600	102,934

1 Comprises life linked insurance contracts and linked investment contracts
2 Comprises life non-linked insurance contracts and non-linked investment contracts
3 Comprises shareholder assets

(d) Insurance risk continued

Underwriting strategy

The Group's underwriting strategy seeks diversity to ensure a balanced portfolio and is based on a large portfolio of similar risks over a number of years and, as such, it is believed that this reduces the variability of the outcome.

Reinsurance strategy

The Group reinsures a portion of the insurance risks it underwrites in order to control its exposures to losses and protect capital resources. These reinsurance agreements transfer part of the risk and limit the exposure from each life insured. The amount of each risk retained depends on the Group's evaluation of the specific risk, subject in certain circumstances, to maximum limits based on characteristics of coverage. Under the terms of the reinsurance agreements, the reinsurer agrees to reimburse the ceded amount in the event the claim is paid.

Nature of risks covered

The following gives an assessment of the nature of risks inherent in the Group's main products.

(i) Long-term insurance contracts – non-linked products

The basic feature of long-term non-linked insurance business is to provide guaranteed death benefit determined at the time of policy issue. For insurance products with a savings element, guaranteed surrender and maturity benefit are usually provided. Most of the Group's non-linked products include a discretionary participating feature which allows policyholders to participate in the profits of the life fund. These plans offer a discretionary annual bonus in the form of dividend payable to the policyholders on each policy anniversary date.

In particular, a major block of non-linked products provides policyholders with an option to receive monthly guaranteed and discretionary bonus during a predefined period before maturity.

The principles for the distribution of profits among the policyholders are:

(i) to recognise the financial condition of the Group's insurance subsidiaries;
(ii) to take into consideration the reasonable expectation of policyholders and to provide a smooth and stable return over the long term; and
(iii) to balance the interests between the shareholders and policyholders.

Investment risks are managed through matching assets and liabilities. Investment strategy is to predominantly invest in high quality bonds with some portion in growth assets for return enhancement. Mortality risks are managed through reinsurance and proper underwriting.

The Group has contractual discretion on the dividend declared. In practice the Group considers policyholders' reasonable expectations when declaring dividend levels. It is the Group's intention to maintain a smooth and stable dividend scale which is set based on the long-term expected investment return. An annual review is performed to confirm whether the current dividend scale is supportable taking into account the actual and expected experiences on investment return, policy persistency, claims and expenses.

(ii) Long-term insurance contracts – linked products

The Group writes linked life insurance policies, which provide policyholders with life insurance protection and investment in a variety of funds. Premiums received are deposited into the chosen funds after deduction of premium fees. Other charges for the cost of insurance and administration will be deducted from the funds accumulated.

Although the policyholders bear the market risk on linked products, the Group assumes reputational risk for any undue market risk taken by the policyholders. Consequently, it is in the Group's interest to ensure that the policyholders' exposure to market risk is consistent with any market risk information that the Group has communicated to the policyholders.

Claims and expenses experiences are reviewed regularly to ensure current charges are sufficient to cover the costs.

(d) Insurance risk continued

(iii) Long-term investment contracts – non-linked products

The Group underwrites retirement fund business which gives rise to contracts that are classified as investment contracts. Under each retirement scheme, employers and employees are given a choice of funds to place their contributions. The accumulated fund balance will be payable to scheme members upon retirement or termination of employment. The Group provides capital and minimum return guarantees on these funds. Guaranteed risks are managed through investment in good quality fixed rate bonds. Investment strategy is set with the objective of providing return that is sufficient to meet at least the minimum guarantee.

(iv) Long-term investment contracts – linked products

The Group underwrites retirement fund business which gives rise to contracts that are classified as investment contracts. Under each retirement scheme, employers and employees are given a choice of funds to place their contributions. The accumulated fund balance will be payable to scheme members upon retirement or termination of employment. Although the scheme members bear the market risk on linked products, the Group assumes reputational risk for any undue market risk taken by the scheme members. Consequently, it is in the Group's interest to ensure that the scheme members' exposure to market risk is consistent with any market risk information that the Group has communicated to the scheme members.

Concentration of insurance risks

Within the insurance process, concentrations of insurance risk may arise where a particular event or series of events could impact the Group's liabilities. Such concentrations may arise from a single insurance contract or through a number of related contracts, and related circumstances where liabilities could arise.

The Group is subject to concentration risk arising from claims relating to common carriers, epidemics, natural disasters, etc, that affect the lives of the policyholders insured by the Group. To mitigate some of these risks, catastrophe reinsurance arrangements have been made by the Group.

For contracts where death is the insured risk, the most significant factors that could increase the overall frequency of claims are epidemics (such as acquired immunodeficiency syndrome ("AIDS"), severe acute respiratory syndrome ("SARS") or a human form of avian flu) or widespread changes in lifestyle, resulting in earlier or more claims than expected. For contracts where survival is the insured risk, the most significant factor is improvement in medical science and social conditions that would increase longevity. The insurance contracts issued by the Group are issued in Hong Kong.

To determine the concentration of insurance risks, analyses are performed to investigate the potential financial impact on the Group. Total loss is estimated based on the chosen stress level. Details of the Group's reinsurance strategy are disclosed in the above.

Life business tends to be longer-term in nature than non-life business and frequently involves an element of savings and investment in the contract. An analysis of life insurance liabilities are therefore an appropriate overall measure of insurance exposure, because provisions for life contracts are typically set by reference to expected future cash outflows relating to the underlying policies. Details of the analysis of life insurance liabilities are disclosed in note 45 to the financial statements.

(d) Insurance risk continued

Financial risks

Transactions in financial instruments may result in the Group assuming financial risks. These include market risk, credit risk and liquidity risk. Each of these financial risks is described below, together with a summary of the ways in which the Group manages these risks.

The Group is also exposed to investment return guarantee risk for certain investment contracts issued to policyholders. The risk is that the yield on the assets held by the Group to meet these guarantees may fall short of the guaranteed return. The framework for the management of this risk is to adopt a matching approach whereby assets held are managed to meet the liability to policyholders. An additional provision is established where analysis indicates that, over the life of the contracts, the returns from the designated assets may not be adequate to cover the related liabilities.

The following table analyses the assets held in the Group's insurance underwriting subsidiaries at balance sheet dates by type of liability, and provides a view of the exposure to financial risk:

Financial assets held by insurance operations

	Group			
	Linked contracts	Non-linked contracts	Other assets	Total
2014				
Financial assets designated at fair value:				
– debt securities	–	75	–	75
– equity securities	232	10,805	–	11,037
	232	10,880	–	11,112
Financial investments				
Held-to-maturity:				
– debt securities	–	61,967	6,269	68,236
	–	61,967	6,269	68,236
Available-for-sale:				
– debt securities	–	4,767	–	4,767
– equity securities	–	–	23	23
	–	4,767	23	4,790
Derivatives	–	86	–	86
Other financial assets	15	9,596	1,523	11,134
	247	87,296	7,815	95,358

(d) Insurance risk continued

	Group			
	Linked contracts	Non-linked contracts	Other assets	Total
2013				
Financial assets designated at fair value:				
– debt securities	–	812	–	812
– equity securities	233	5,942	–	6,175
	233	6,754	–	6,987
Financial investments				
Held-to-maturity:				
– debt securities	–	66,672	4,833	71,505
	–	66,672	4,833	71,505
Available-for-sale:				
– debt securities	–	–	–	–
– equity securities	–	–	20	20
	–	–	20	20
Derivatives	–	3	–	3
Other financial assets	13	7,963	2,129	10,105
	246	81,392	6,982	88,620

The table demonstrates that for linked contracts, the Group typically designates assets at fair value. For non-linked contracts, the classification of the assets is driven by the nature of the underlying contract. The assets held to support linked liabilities represented 0.3% of the total financial assets of the Group's insurance manufacturing subsidiaries at the end of 2014 (2013: 0.3%). The table also shows that approximately 76.6% of financial assets was invested in debt securities at 31 December 2014 (2013: 81.6%) and 11.6% (2013: 7.0%) invested in equity securities.

Market risk

Market risk can be described as the risk of change in fair value of a financial instrument due to change in interest rate, equity prices and foreign currency exchange rates. Each of these categories is discussed further below.

Interest rate risk

The insurance subsidiaries of the Group are exposed to interest rate risk because there is a chance that the yields earned on its debt securities holding are lower than the investment returns implied by the guarantees payable to policyholders. The held-to-maturity debt securities account for a significant portion of the debt securities holding which is managed to match expected liability payments. The Group monitors this exposure through periodic reviews of its asset and liability position. Estimates of cash flows, as well as the impact of interest rate fluctuations relating to the investment portfolio and insurance reserves, are modelled and reviewed regularly. The overall objective of these strategies is to manage the net changes in the value of assets and liabilities arising from interest rate movements.

For participating products, interest rate risk can also be mitigated through sharing of risk with policyholders under the discretionary participation feature.

(d) Insurance risk continued

An immediate and permanent movement in interest yield curves as at 31 December 2014 in all territories in which the Group's insurance subsidiaries operate would have the following impact on the aggregated profit after tax for the year and shareholders' equity at that date:

	2014		2013	
	Impact on profit after tax for the year	Impact on shareholders' equity	Impact on profit after tax for the year	Impact on shareholders' equity
+ 100 basis points shift in yield curves	**427**	**84**	383	383
– 100 basis points shift in yield curves	**(491)**	**(93)**	(450)	(450)

The interest rate sensitivities set out above are illustrative only and employ simplified scenarios. It should be noted that the effects may not be linear and therefore the results cannot be extrapolated. The effects are calculated taking into account the sharing of investment returns with policyholders through the discretionary participating feature. Other than that, they do not incorporate other actions that could be taken by management to mitigate the effect of the interest rate movements, nor do they take into account any resultant changes in policyholder behaviour.

Equity price risk

The portfolio of marketable securities (including collective investment schemes) backing non-linked insurance contracts and shareholders' fund, which the insurance subsidiaries of the Group carries in the balance sheet at fair value, has exposure to price risk. This risk is defined as the potential loss in market value resulting from an adverse change in prices. The risks are mainly mitigated through tactic asset allocation or hedging strategy and sharing the risk with policyholders through the discretionary participation feature. The Group's objective is to earn competitive returns by investing in a diversified portfolio of high quality and liquid securities. Portfolio characteristics are analysed regularly and equity price risk is regularly reviewed. The Group's investment portfolios are diversified across countries and industries, and concentrations in any one company or industry are limited by parameters established by senior management, as well as by statutory requirements.

The following table illustrates the impact on the aggregated profit after tax for the year and shareholders' equity of a reasonably possible 10 per cent variance in equity prices:

	2014		2013	
	Impact on profit after tax for the year	Impact on shareholders' equity	Impact on profit after tax for the year	Impact on shareholders' equity
10 per cent increase in equity prices	**337**	**337**	162	162
10 per cent decrease in equity prices	**(300)**	**(300)**	(144)	(144)

These equity sensitivities are illustrative only and employ simplified scenarios. It should be noted that the effects may not be linear and therefore the results cannot be extrapolated. The impact is estimated taking into account the sharing of risk through the discretionary participation feature.

Foreign currency risk

The assets and liabilities of the insurance subsidiaries of the Group are mainly denominated in USD, RMB and Hong Kong dollar ("HKD"). The Group adopts a policy of predominately matching the assets with liabilities in the same currency, effectively reducing the foreign currency exchange rate exposure. Limits are set to ensure that the net foreign currency exposure is kept to an acceptable level. The Group uses foreign exchange forward contracts to manage its foreign currency risk. Most of the foreign exchange forward contracts have maturities of less than one year after the balance sheet date.

(d) Insurance risk continued

Credit risk

The insurance subsidiaries of the Group's credit risk is primarily attributable to the portfolio of debt securities and loans and receivables. This risk is defined as the potential loss in market value resulting from adverse changes in a borrower's ability to repay the debt. The Group's objective is to earn relative competitive returns by investing in a diversified portfolio of securities. Management has a credit policy in place. Limits are established to manage credit quality and concentration risk. The following table presents the analysis of treasury bills, other eligible bills and debt securities within the Group's insurance operations.

Treasury bills, other eligible bills and debt securities in insurance operations

	Neither past due nor impaired						
	Strong	Medium	Sub-standard	Past due but not impaired	Impaired	Impairment allowances	Total
2014							
Supporting liabilities under non-linked insurance and investment contracts							
Financial assets designated at fair value:							
– treasury and other eligible bills	–	–	–	–	–	–	–
– debt securities	70	5	–	–	–	–	75
	70	5	–	–	–	–	75
Financial investments:							
– treasury and other similar bills	–	–	–	–	–	–	–
– debt securities	58,263	8,471	–	–	–	–	66,734
	58,263	8,471	–	–	–	–	66,734
Supporting shareholders funds							
Financial assets designated at fair value:							
– treasury and other eligible bills	–	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–	–
	–	–	–	–	–	–	–
Financial investments:							
– treasury and other similar bills	–	–	–	–	–	–	–
– debt securities	6,229	40	–	–	–	–	6,269
	6,229	40	–	–	–	–	6,269
Total							
Financial assets designated at fair value:							
– treasury and other eligible bills	–	–	–	–	–	–	–
– debt securities	70	5	–	–	–	–	75
	70	5	–	–	–	–	75
Financial investments:							
– treasury and other similar bills	–	–	–	–	–	–	–
– debt securities	64,492	8,511	–	–	–	–	73,003
	64,492	8,511	–	–	–	–	73,003

(d) Insurance risk continued

	Neither past due nor impaired						
	Strong	Medium	Sub-standard	Past due but not impaired	Impaired	Impairment allowances	Total
2013							
Supporting liabilities under non-linked insurance and investment contracts							
Financial assets designated at fair value:							
– treasury and other eligible bills	–	–	–	–	–	–	–
– debt securities	569	243	–	–	–	–	812
	569	243	–	–	–	–	812
Financial investments:							
– treasury and other similar bills	–	–	–	–	–	–	–
– debt securities	60,284	6,388	–	–	–	–	66,672
	60,284	6,388	–	–	–	–	66,672
Supporting shareholders funds							
Financial assets designated at fair value:							
– treasury and other eligible bills	–	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–	–
	–	–	–	–	–	–	–
Financial investments:							
– treasury and other similar bills	–	–	–	–	–	–	–
– debt securities	4,763	70	–	–	–	–	4,833
	4,763	70	–	–	–	–	4,833
Total							
Financial assets designated at fair value:							
– treasury and other eligible bills	–	–	–	–	–	–	–
– debt securities	569	243	–	–	–	–	812
	569	243	–	–	–	–	812
Financial investments:							
– treasury and other similar bills	–	–	–	–	–	–	–
– debt securities	65,047	6,458	–	–	–	–	71,505
	65,047	6,458	–	–	–	–	71,505

(d) Insurance risk continued

The Group also has insurance and other receivables subject to credit risk. The most significant of these arise from the inability to honor their debtor balances when due and their share of liabilities under insurance contracts. To mitigate the risk of reinsurers, the Group has established certain business and financial guidelines for reinsurer approval, incorporating ratings by major agencies and considering currently available market stability of reinsurers and other sources and the settlement trend of amounts due from reinsurers. The split of liabilities ceded to reinsurers and outstanding reinsurance recoveries was as follows:

Reinsurers' share of liabilities under insurance contracts

	Neither past due nor impaired						
	Strong	Medium	Sub-standard	Past due not impaired	Impaired	Impairment allowances	Total
2014							
Linked insurance contracts	–	–	–	–	–	–	–
Non-linked insurance contracts	**2,776**	–	–	–	–	–	**2,776**
Total	**2,776**	–	–	–	–	–	**2,776**
Reinsurance Debtors	**4**	–	–	**40**	–	–	**44**
2013							
Linked insurance contracts	–	–	–	–	–	–	–
Non-linked insurance contracts	1,446	–	–	–	–	–	1,446
Total	1,446	–	–	–	–	–	1,446
Reinsurance Debtors	7	–	–	12	–	–	19

Liquidity risk

The Group has to meet daily calls on its cash resources, notably from claims arising on its insurance and investment contracts and early surrender of policies for surrender value. There is a risk that cash will not be available to settle liabilities when due at a reasonable cost. The Group manages this risk by monitoring and setting an appropriate level of operating funds to settle these liabilities. The risk monitoring includes stress testing and the Group's credit rating. Investment portfolios are also structured with regard to the liquidity requirements of each underlying fund, and early surrender penalties and market adjustment clauses are used to defray costs of unexpected cash requirements.

(d) Insurance risk continued

The following table shows the expected maturity of insurance contract liabilities at balance sheet dates:

Expected maturity of insurance contract liabilities

	Expected cash flows (undiscounted)				
	Within 1 year	Over 1 year but within 5 years	Over 5 years but within 15 years	Over 15 years	Total
2014					
Non-linked insurance	**7,918**	**36,983**	**84,607**	**59,937**	**189,445**
Linked insurance	**9**	**40**	**110**	**502**	**661**
	7,927	**37,023**	**84,717**	**60,439**	**190,106**
2013					
Non-linked insurance	9,091	32,326	81,196	57,573	180,186
Linked insurance	11	42	116	618	787
	9,102	32,368	81,312	58,191	180,973

Remaining contractual maturity of investment contract liabilities

	Linked investment contracts	Non-linked investment contracts	Total
2014			
Remaining contractual maturity:			
– due within 1 year	**2**	**–**	**2**
– due over 1 year but within 5 years	**–**	**–**	**–**
– due over 5 years but within 10 years	**–**	**–**	**–**
– due over 10 years	**–**	**–**	**–**
– undated	**158**	**335**	**493**
	160	**335**	**495**
2013			
Remaining contractual maturity:			
– due within 1 year	2	–	2
– due over 1 year but within 5 years	–	–	–
– due over 5 years but within 10 years	–	–	–
– due over 10 years	–	–	–
– undated	153	335	488
	155	335	490

(d) Insurance risk continued

Present value of in-force long-term insurance business ("PVIF")

The Group's life insurance business is accounted for using the embedded value approach, which, inter alia, provides a comprehensive framework for the evaluation of insurance and related risks. The value of the PVIF asset at 31 December 2014 was HK$8,263 million (31 December 2013: HK$7,198 million). The present value of the shareholders' interest in the profits expected to emerge from the book of in-force policies at balance sheet dates can be stress-tested to assess the sensitivity of the value of life business to adverse movement of different risk factors.

The following table shows the effect on the PVIF at balance sheet date of reasonably possible changes in the main economic and business assumptions:

	2014	2013
+ 100 basis points shift in risk-free rate	**516**	496
– 100 basis points shift in risk-free rate	**(594)**	(576)

The effects on PVIF shown above are illustrative only and employ simplified scenarios. It should be noted that the effects may not be linear and therefore the results cannot be extrapolated. The effects are calculated taking into account the sharing of investment returns with policyholders through the discretionary participation feature. Other than that, they do not incorporate other actions that could be taken by management to mitigate effects nor do they take into account the consequential changes in policyholder behaviour.

Non-economic assumptions

The sensitivity of profit for the year and net assets to reasonably possible changes in assumptions used in respect of insurance businesses is as follows:

	Impact on 2014 results		Impact on 2013 results	
	Profit for the year	**Net assets**	Profit for the year	Net assets
10 per cent increase in mortality and/or morbidity rates	**(66)**	**(66)**	(62)	(62)
10 per cent decrease in mortality and/or morbidity rates	**65**	**65**	61	61
10 per cent increase in lapse rates	**(13)**	**(13)**	(11)	(11)
10 per cent decrease in lapse rates	**15**	**15**	12	12
10 per cent increase in expense rates	**(104)**	**(104)**	(95)	(95)
10 per cent decrease in expense rates	**104**	**104**	95	95

Process used to determine assumptions for long-term insurance contracts

The process used to determine the assumptions is intended to result in stable and prudent estimates of future outcome. This is achieved by adopting relatively conservative assumptions which can withstand a reasonable range of fluctuation of actual experience. Annual review of the relevant experience is performed to assess the adequacy of margin between the assumptions adopted and the best estimate of future outcome. The assumptions that are considered include the probability of claims and investment returns.

For non-linked life business, the policy reserve is generally calculated on a modified net premium basis. The net premium is the level of premium payable over the premium payment period whose discounted value at the outset of the policy would be sufficient to exactly cover the discounted value of the original guaranteed benefits at maturity or at death if earlier. The net premium is then modified to allow for deferral of acquisition costs. The policy reserve is then calculated by subtracting the present value of future modified net premiums from the present value of the benefits guaranteed at maturity or death up to the balance sheet date, subject to a floor of the cash value. The modified net premium basis makes no allowance for voluntary discontinuance by policyholders as this would generally result in a reduced level of policy reserve.

For linked life business, the policy reserve is generally determined as the total account balance of all in-force policies with an additional provision for the unexpired insurance risk.

(d) Insurance risk continued

Assumptions

The principal assumptions underlying the calculation of the long-term insurance business provision are:

(i) Mortality

A base mortality table which is most appropriate for each type of contract is selected. An adjustment is included to reflect the Group's own experience with an annual investigation performed to ascertain the appropriateness of overall assumption.

(ii) Morbidity

The morbidity incidence rates, which mainly cover major illness and disability, are generally derived from the reinsurance costs which also form the pricing basis. A loading is generally added as a provision for adverse deviation. An annual investigation is performed to ascertain the appropriateness with the Group's insurance subsidiary's actual experience.

(iii) Discount rates

Rate of interest

	2014	2013
Policies denominated in HKD	**3%**	3%
Policies denominated in USD	**4%**	4%
Policies denominated in RMB	**2%-4%**	2%

Under the modified net premium method, the long-term business provision is sensitive to the interest rate used when discounting.

Sensitivity to changes in variables

The Group's insurance subsidiary re-runs its valuation models on various bases. An analysis of sensitivity around various scenarios provides an insight to the key risks which the Group's insurance company is exposed to. The table presented below demonstrates the sensitivity of insured liability estimates to particular movements in assumptions used in the estimation process. Certain variables can be expected to impact on life insurance liabilities more than others, and consequently a greater degree of sensitivity to these variables may be expected.

Impact on reported profit to changes in key variable

	Change in variable	**Change in liabilities**	
	%	**2014**	2013
Base run		**82,608**	77,897
Discount rate	**+1**	**(1,452)**	(1,430)
Discount rate	**-1**	**5,839**	5,335
Mortality/Morbidity	**+10**	**32**	30
Mortality/Morbidity	**-10**	**(19)**	(19)

The analysis above has been prepared for a change in variable with all other assumptions remaining constant and ignores changes in values of the related assets.

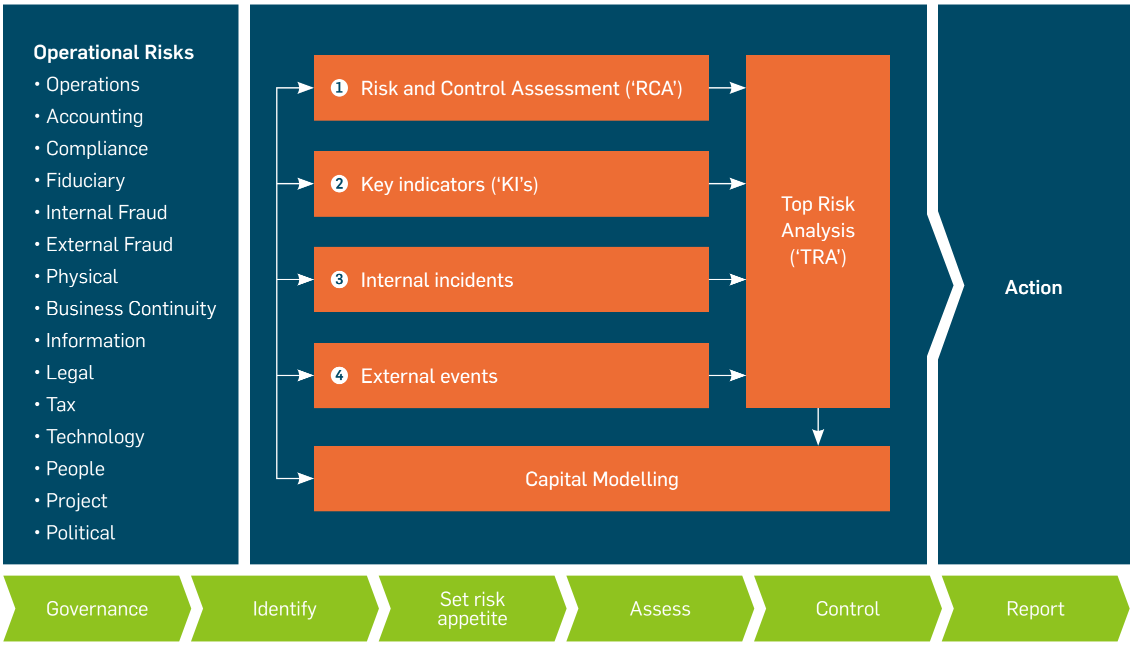
For the sensitivity in discount rate, an absolute +/-1% of the discount rate is used. For the Mortality/ Morbidity sensitivity, a relative +/-10% (i.e. multiply the assumption by 110% or 90%) is used.

(e) Operational risk

Operational risk management framework

(audited)

The Operational Risk function and the operational risk management framework ("ORMF") assist business management in discharging their responsibilities. The ORMF defines minimum standards and processes, and the governance structure for operational risk and internal control across the Group.



- RCAs are used to inform the evaluation of the effectiveness of controls over top risks.
- KIs are used to help monitor the risks and controls.
- TRAs (scenarios) provide management with a quantified view of our top and emerging operational risks.
- Internal incidents are used to forecast typical losses.
- External sources are used to inform the assessment of extreme TRAs.

Articulating our risk appetite for material operational risks helps business understand the level of risk our organisation is willing to accept. Monitoring operational risk exposure against risk appetite on a regular basis and implementing our risk acceptance process drives risk awareness in a more forward-looking manner. It assists management in determining whether further action is required.

In addition, an enhanced Top Risk Analysis process will be implemented across material legal entities of the Group to improve the quantification and management of material risks through scenario analysis.

The trend for increased regulatory proceedings and other adversarial proceedings against financial service firms continues. Changes which have been inaugurated as well as those in the pipeline relating to capital and liquidity requirements, remuneration and/or taxes could increase our cost of doing business, reducing future profitability. Various regulators and competition authorities around the world are also investigating and reviewing certain past submissions made by panel banks and the process for making submissions in connection with the setting of benchmark interest and foreign exchange rates. In response, we have undertaken a number of initiatives which seek to address the issues identified, including enhancing our governance and oversight, increasing our compliance function resource, emphasising the Group's Values and implementing new global standards.

(e) Operational risk continued

Other featured operational risks

(unaudited)

- Fraud risks: the threat of fraud perpetrated by or against our customers, especially in retail and commercial banking, may increase during adverse economic conditions. We have increased monitoring, root cause analysis and review of internal controls to enhance our defences against external attacks and reduce the level of loss in these areas. In addition, Security and Fraud Risk is working closely with the businesses to continually assess these threats as they evolve and adapt our controls to mitigate these risks.
- Information security: the security of our information and technology infrastructure is crucial for maintaining our banking applications and processes while protecting our customers and the Hang Seng brand. A failure of our defences against such attacks could result in financial loss, loss of customer data and other sensitive information which could undermine both our reputation and our ability to retain the trust of our customers.

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

(audited)

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 capital plan, which determines level of risk-weighted asset ("RWA") 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 equity instruments, other reserves and subordinated liabilities. Capital also includes the collectively impairment allowances and regulatory reserve for general banking risks as allowed under Banking (Capital) Rules.

Externally imposed capital requirements

(audited)

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.

The Group uses the advanced internal ratings-based approach ("IRB") 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 bullion) 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.

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

Basel III

(unaudited)

The Basel III rules set out the minimum capital requirements, to be phased in sequentially from 1 January 2013, becoming fully effective on 1 January 2019 with ultimate CET1 capital ratio and capital conservation buffer minimum requirements at 4.5% and 2.5% respectively. In addition to the criteria detailed in the Basel III proposals, 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 that meet the grandfathering conditions will be phased out over a 10-year period commencing on 1 January 2013.

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 Banking (Capital) (Amendment) Rules 2014 came into effect on 1 January 2015 to implement the Basel III capital buffer requirements in Hong Kong. The changes include the phasing-in from 2016 to 2019 of the Capital Conservation Buffer ("CCB") which is designed to ensure banks build up capital outside periods of stress of 2.5% of RWAs, the Countercyclical Capital Buffer ("CCyB") which is set on an individual country basis and is built up during periods of excess credit growth to protect against future losses, and the Higher Loss Absorbency requirements for Domestic Systemically Important Banks of up to 2.5% of RWAs. On 27 January 2015, the HKMA announced a CCyB for Hong Kong of 0.625% from 1 January 2016, under the phase-in arrangements of Basel III equivalent to 2.5% of RWAs in Hong Kong once fully phased in.

In addition, the Bank will be required to set further buffers to reflect risks not included in the regulatory capital calculation, arising from internal assessment of risks and the results of stress tests. As a consequence of the developments outlined above, there remains uncertainty over the timing and trajectory of implementation of the full Basel III capital requirements and residual uncertainty as to the minimum levels of capital that the Bank will be required to hold.

Leverage ratio

(unaudited)

The leverage ratio was introduced into the Basel III framework as a non-risk-based backstop limit, to supplement risk-based capital requirements. It aims to constrain the build-up of excess leverage in the banking sector, introducing additional safeguards against model risk and measurement errors. The ratio is a volume-based measure calculated as Basel III tier 1 capital divided by total on- and off-balance sheet exposures. Basel III provides for a transitional period for the introduction of this ratio, comprising a supervisory monitoring period that started in 2011 and a parallel run period from January 2013 to January 2017. The parallel run will be used to assess whether the proposed minimum ratio of 3% is appropriate, with a view to migrating to a Pillar 1 requirement from 1 January 2018.

RWA planning

(unaudited)

Pre-tax return on RWAs is an operational metric by which the global businesses are managed on a day-to-day basis. The metric combines return on equity and regulatory capital efficiency objectives. RWA targets, approved annually by the Board, are established for our global businesses and regions in accordance with the Group's strategic direction and risk appetite.

Business performance against the targets is monitored through reporting to the Asset and Liability Committee of the Bank. A range of analysis is employed in the RWA monitoring framework to identify the key drivers of movements in the position, such as book size and book quality. Particular attention is paid to identifying and segmenting items within the day-to-day control of the business and those items that are driven by changes in risk models or regulatory methodology.

Capital base

(unaudited)

The following tables show the capital base, risk-weighted assets and capital ratios as contained in the "Capital Adequacy Ratio" return required to be submitted to the HKMA by the 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 31 December 2014, the effect of this requirement is to restrict the amount of reserves which can be distributed to shareholders by HK$6,229 million (31 December 2013: HK$5,440 million).

The following table sets out the composition of the Group's capital base under Basel III at 31 December 2014 and 31 December 2013. These positions benefit from transitional arrangements which will be phased out. A more detailed breakdown of the capital position is available in the Regulatory Disclosures section of our website www.hangseng.com.

	2014	2013
Common Equity Tier 1 ("CET1") Capital		
Shareholders' equity	120,407	98,068
– Shareholders' equity per balance sheet	139,193	107,778
– Additional Tier 1 ("AT1") perpetual capital instrument	(6,981)	–
– Unconsolidated subsidiaries	(11,805)	(9,710)
Regulatory deductions to CET1 capital	(47,201)	(41,329)
– Cash flow hedging reserve	–	(6)
– Changes in own credit risk on fair valued liabilities	(4)	(4)
– Property revaluation reserves[1]	(21,784)	(20,481)
– Regulatory reserve	(6,229)	(5,440)
– Intangible assets	(417)	(401)
– Defined benefit pension fund assets	(35)	(33)
– Deferred tax assets net of deferred tax liabilities	(80)	(43)
– Valuation adjustments	(325)	(180)
– Significant capital investments in unconsolidated financial sector entities	(8,436)	(500)
– Excess AT1 deductions	(9,891)	(14,241)
Total CET1 Capital	73,206	56,739
AT1 Capital		
Total AT1 capital before regulatory deductions	6,981	–
– Perpetual capital instrument	6,981	–
Regulatory deductions to AT1 capital	(6,981)	–
– Significant capital investments in unconsolidated financial sector entities	(16,872)	(14,241)
– Excess AT1 deductions	9,891	14,241
Total AT1 Capital	–	–
Total Tier 1 ("T1") Capital	73,206	56,739
Tier 2 ("T2") Capital		
Total T2 capital before regulatory deductions	17,733	22,518
– Term subordinated debt	5,117	10,872
– Property revaluation reserves[1]	9,803	9,216
– Impairment allowances and regulatory reserve eligible for inclusion in T2 capital	2,813	2,430
Regulatory deductions to T2 capital	(17,187)	(14,241)
– Significant capital investments in unconsolidated financial sector entities	(17,187)	(14,241)
Total T2 Capital	546	8,277
Total Capital	73,752	65,016

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.

The following table shows the pro-forma Basel III end point basis position once all transitional arrangements have been phased out based on the Transition Disclosures Template. It should be noted that the pro-forma Basel III end point basis position takes no account of, for example, any future profits or management actions. In addition, the current regulations or their application may change before full implementation. Given this, the final impact on the Group's capital ratios may differ from the pro-forma position, which is a mechanical application of the current rules to the balance sheet at 31 December 2014; it is not a projection. On this pro-forma basis, the Group's CET1 capital ratio is 10.5%, which is above the Basel III minimum requirement, including the CCB.

Reconciliation of regulatory capital from transitional basis to a pro-forma Basel III end point basis

	2014	2013
CET1 Capital on a transitional basis	**73,206**	56,739
Transitional provisions		
– Significant capital investments in unconsolidated financial sector entities	**(33,744)**	(28,482)
Excess AT1 deductions	**9,891**	14,241
CET1 Capital end point basis	**49,353**	42,498
AT1 Capital on a transitional basis	**–**	–
Transitional provisions		
– Significant capital investments in unconsolidated financial sector entities	**16,872**	14,241
Excess AT1 deductions	**(9,891)**	(14,241)
AT1 Capital end point basis	**6,981**	–
T2 Capital on a transitional basis	**546**	8,277
Grandfathered instruments		
– Term subordinated debt	**(2,790)**	(8,546)
Transitional provisions		
– Significant capital investments in unconsolidated financial sector entities	**16,872**	14,241
T2 Capital end point basis	**14,628**	13,972

Risk-weighted assets by risk type

(unaudited)

	2014	2013
Credit risk		
Standardised approach	**37,402**	28,225
IRB approach	**381,478**	336,852
Market risk	**5,749**	4,293
Operational risk	**45,538**	41,100
Total	**470,167**	410,470

Market risk-weighted assets

(unaudited)

	2014	2013
Internal models approach		
Value at Risk ("VAR")	**1,623**	612
Stressed VAR	**3,442**	3,470
Standardised approach		
Specific interest rate exposures	**684**	211
Equity exposures	**–**	–
Total	**5,749**	4,293

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

(unaudited)

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

	2014	2013
CET1 capital ratio	**15.6%**	13.8%
Tier 1 capital ratio	**15.6%**	13.8%
Total capital ratio	**15.7%**	15.8%

Principal subsidiaries and basis of consolidation

(unaudited)

The basis of consolidation for financial accounting purposes is in accordance with Hong Kong Financial Reporting Standards ("HKFRS"), as described in note 1 to the financial statements.

The basis of consolidation for regulatory purposes is different from that for accounting purposes. 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:

		2014	
in HK$ thousands	Principal activities	**Total assets***	**Total equity***
Hang Seng (Nominee) Ltd	Nominee service	**122**	**100**
Hang Seng Bank (Trustee) Ltd	Trustee service	**4,631**	**3,000**
Hang Seng Futures Ltd	Futures brokerages	**102,593**	**101,642**
Hang Seng Investment Management Ltd	Fund management	**869,533**	**556,779**
Hang Seng Investment Services Ltd	Provision of investment commentaries	**8,686**	**8,686**
Hang Seng Securities Ltd	Stockbroking	**4,461,627**	**1,328,545**
Hang Seng Insurance Co. Ltd	Retirement benefits and life assurance	**103,945,085**	**10,169,632**

* Prepared in accordance with HKFRS

As at 31 December 2014, 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 different 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 Group.

Capital instruments

(unaudited)

The following is a summary of the Group's CET1, AT1 and Tier 2 capital instruments.

	Amount recognised in regulatory capital	
	2014	2013
CET1 capital instruments issued by the Bank		
Ordinary shares:		
1,911,842,736 issued and fully paid ordinary shares	**9,658**	9,559
AT1 capital instruments issued by the Bank		
Perpetual capital instrument (nominal value: US$900m)	**6,981**	–
T2 capital instruments issued by the Bank		
Subordinated loan due 2020 (nominal value: US$775m)	**–**	5,407
Subordinated loan due 2021 (nominal value: US$450m)	**2,790**	3,139
Subordinated loan due 2022 (nominal value: US$300m)	**2,327**	2,326

A description of the main features and the full terms and conditions of the Group's capital instruments can be found in the Regulatory Disclosures section of our website www.hangseng.com.

Additional information

A full reconciliation between the Group's accounting and regulatory balance sheets can be viewed in the Regulatory Disclosures section of our website www.hangseng.com.

Corporate Sustainability

With deep roots in Hong Kong, our success is closely intertwined with the development of our city, and our ability to build close connections and effective dialogue with and among all sectors of our community.

Our corporate sustainability programmes focus on building an inclusive, accepting and vibrant society by providing opportunities for exploration, personal achievement and growth, particularly for young people and socially disadvantaged groups.

By playing a part in creating an aspiring and compassionate population we are helping to ensure our own business will flourish in the years ahead.

Walking the Sustainability Talk

We strive to lead by example, both in managing the sustainability performance of our own operations and through our efforts to encourage others to act as agents of positive social and environmental change.

We were the first local bank in Hong Kong to use the internationally recognised Global Reporting Initiative (GRI) sustainability reporting guidelines and, for our 2011 sustainability report, the first to gain an A+ rating – an achievement we have maintained for all subsequent reports.

For a third consecutive year, we were the only Hong Kong company included in the 'Global 100 Most Sustainable Corporations in the World', compiled by Corporate Knights.

Other recognition of our corporate sustainability efforts includes a Gold Award in the corporate social responsibility category at the 11th China Golden Awards for Excellence in Public Relations, organised by the China International Public Relations Association, for the Hang Seng Bank – Leaders to Leaders Lecture Series that we developed in partnership with the Hong Kong Federation of Youth Groups and the University of Hong Kong.

In 2011, we became the first local Hong Kong bank to be included as a constituent member of the Dow Jones Sustainability Asia Pacific Index. We have been a member of the FTSE4Good Global Index since 2001 and of the Hang Seng Corporate Sustainability Index since 2010.

Since 2005, we have provided over HK$250m in financial support – including around HK$31m in 2014 – for community development initiatives.

“WHAT IF” 要是⋯

INSPIRED.

FINDING THE BEST ANSWERS MEANS KNOWING WHAT QUESTIONS TO ASK. Hang Seng not only brings more than 80 years of experience and knowledge to its core banking business, but also to its wide range of social development programmes, which place particular emphasis on youth development, the environment and staff volunteering. We are proud to be part of a community built on energy, drive and resilience.

Youth Development: Investing in Tomorrow

We reached out to more than 300,000 young people through about 200 Bank-sponsored activities in 2014, giving them the chance to broaden their horizons and learn valuable life lessons through work experience, educational achievement, community service and greater exposure to culture and the arts.

Our programmes aim to improve social mobility and contribute to creating a caring and cohesive society by empowering youngsters with the confidence, skills and enthusiasm to explore their potential and contribute to future growth.

Jointly organised with the Hong Kong Council of Social Service (HKCSS), The Hang Seng – HKCSS Youth Career Exploration Programme nurtures a positive mindset towards career planning in Form 4 students and helps them identify their personal strengths by exposing them to the operations of companies in different industries. About 350 students have gained greater insight into how various career opportunities may align with their personal interests since the programme launched in 2013.

Run in partnership with the Hong Kong Federation of Youth Groups, the Hang Seng Bank – G.P.S. Youth Employment Programme is pioneering the 'gap year' concept in Hong Kong, with a specific focus on low academic achievers. In 2014, about 20 students put their studies on hold for nearly a year to participate in work placements tailored to their interests and with the guidance of social workers. The programme is expected to benefit around 140 students in its first three years of operation.

The Hang Seng Youth Entrepreneurship Scheme offers youth at risk and young ex-offenders the chance to make a fresh start by developing their entrepreneurial skills. Senior Bank executives serve as guest speakers to offer participants the benefit of their practical business experience. The young entrepreneurs are guided through the process of turning their business ideas into credible plans. In 2014-15, about 180 young people are expected to take part in the scheme, which is jointly organised with the Society of Rehabilitation and Crime Prevention, Hong Kong.

Run in partnership with the Hong Kong Family Welfare Society (HKFWS), the Hang Seng – HKFWS Youth Mediation Scheme helps to improve communication, strengthen relationships and foster a positive attitude among students in resolving conflicts with their family members and peers. Over 300 students from 18 primary schools are being trained as 'Peer Mediators' in 2014-15, with assistance from over 20 Hong Kong Institute of Education (HKIEd) students who were trained as 'HKIEd Mediation Ambassadors'. Over 20 Bank volunteer team members were trained as 'Hang Seng Mediation Ambassadors' to assist in a parent-child mediation workshop.

In providing around 360 young people with the opportunity to discuss important regional issues with distinguished community leaders through the award-winning Hang Seng Bank – Leaders to Leaders Lecture Series 2014, we aim to raise social awareness and interest in world affairs.

KEY INITIATIVES

Inspiring new generations for positive social change

Our corporate sustainability activities place high importance on inspiring young people, particularly those from socially disadvantaged groups, to explore their interests, discover new talents, and unlock their potential and passion for making positive contributions to community well-being and the long-term growth of our city. Our active involvement in programmes such as the Hang Seng – HKCSS Youth Career Exploration Programme, the Hang Seng Bank – G.P.S. Youth Employment Programme and the Hang Seng Youth Entrepreneurship Scheme reflects our commitment to improving social mobility and our belief in the high potential of all young people in Hong Kong.

Our long-standing support for the Ming Pao Student Reporter programme and our 20-year involvement in the Hang Seng Bank – Help the Police Fight Youth Crime Competition are helping young people develop the critical analysis skills and sense of civic responsibility that are important elements of a healthy, forward-thinking and inclusive society.

Our support for education includes donating over HK$63m since 1995 under various scholarship schemes, benefiting more than 2,000 students in Hong Kong and mainland China. Every year since 2008, we have awarded a number of Community Scholarships to undergraduate students who have demonstrated their commitment to positive social development by giving over 100 hours in recognised voluntary service to worthy causes in Hong Kong in the previous 12 months.

Promoting Greater Understanding through Cultural Programmes

Our efforts to promote the arts reflect our belief in the power of cultural experiences to spark the imagination, encourage creativity and break down social barriers.

Over 2,000 students from 70 secondary schools gained a greater appreciation for modern Hong Kong history in 2014 through their participation in the Hang Seng – Jao Tsung-I Academy History and Cultural Scheme. The Scheme included a historical photo exhibition that was visited by more than 30,000 people.

To promote greater understanding and compassion across the generations, Hang Seng Student and Community Matinees, organised in cooperation with The Hong Kong Repertory Theatre, gave 1,200 underprivileged students, dementia patients and members of their families the chance to attend an exclusive performance of a play exploring aspects of caring for a loved one suffering from a serious medical condition.

Our sponsorship of Hong Kong Arts Festival and Hong Kong Philharmonic Orchestra student ticket schemes benefited 26,500 students in 2014.

Playing to Promote Good Health and Civic Unity

Our support for sports is aimed at promoting good health and spreading positive messages about the importance of setting goals, good teamwork and fair play.

Established in partnership with the Hong Kong Table Tennis Association in 2001, the Hang Seng Table Tennis Academy plays an instrumental role in identifying and supporting talented young players to hone their sporting skills and go on to achieve sporting glory in local and international table tennis events.

Since 1991, we have provided over HK$38.5m to promote table tennis in Hong Kong, including HK$7.5m to the Academy in 2013-15.

Under the Hang Seng Athlete Incentive Awards Scheme, organised in partnership with the Hong Kong Sports Institute, we gave over HK$11m in cash incentives to medal-winning Hong Kong athletes from the 2014 Asian Games and Asian Para Games, including HK$800,000 to cyclist Lee Wai-sze for her gold medal wins in the Women's Keirin and Sprint events. To date, the Scheme has awarded more than HK$43m to over 450 top local athletes.

KEY INITIATIVES

Athletes excel in international sporting arenas

The success of homegrown sporting talent brings all sectors of the community together by generating civic pride. We recognise and reward top local athletes whose sporting achievements are inspiring young people to work hard in pursuit of their dreams and persevere in the face of challenges. We also help nurture budding sporting talent with the potential to become tomorrow's sporting stars. Hang Seng Table Tennis Academy graduates include Lee Ho-ching and Ng Wing-nam, who both won bronze medals at the 2014 World Team Table Tennis Championships and 2014 Asian Games.

Serving Those Who Support Us

Since 2010, Bank volunteers and their family members have given near 120,000 hours to support charitable events and other worthy causes, including through more than 130 volunteer activities organised by the Bank in 2014.

By engaging in constructive development dialogue with our stakeholders through channels as diverse as staff CSR forums and community-based volunteer activities, we have identified those areas in which our efforts will have the greatest positive impact on sustainable development in Hong Kong.

We held two CSR forums in 2014 for a total of 550 members of staff. Dr Ko Wing-man, Secretary for Food and Health, shared his insights into the satisfaction and fulfillment that comes from participating and contributing in volunteer activities. Mr Andrew Fung, Executive Director and Head of Global Banking and Markets of Hang Seng Bank, and Mr Chua Hoi-wai, Chief Executive of the Hong Kong Council of Social Service, discussed their experiences in planning their careers and taking part in youth work.

Our long-term partnership with The Community Chest of Hong Kong has raised close to HK$67m for 155 local charities over the years, including more than HK$20m through Dress Casual Day – an annual event we have supported since 1994.

Our support for the Hang Seng Bank – Regeneration Society Top Ten Regeneration Warriors Competition, under which 10 'Regeneration Warriors' share their insights and experiences in overcoming significant obstacles to live rewarding lives, helped to promote positive personal values to about 30,000 people in 2014.

We continue to facilitate charitable giving by our customers through our e-Donation service, which was recently extended to our e-Business Banking platform. Over HK$28m has been donated via this service since its establishment in December 2001.

Our contribution to the community relies in large part on the continuing dedication of our people. In taking steps to engage our employees, we aim to ensure they have opportunities to communicate their ideas and concerns, receive the training and resources they need to help us uphold service excellence, and enjoy a healthy work-life balance.

KEY INITIATIVES

Bank volunteers – ambassadors for change

We seek to inspire staff to take Hang Seng's commitment to outstanding service beyond our walls to benefit the wider community. Members of our senior management team lend their knowledge and experience to various youth and social development activities. Our active Bank volunteer team provides colleagues at all levels with opportunities to give back to the society that helps support our business success.

To encourage more of our people to contribute to the community and experience the personal rewards that are gained from greater civic participation, beginning in 2015 Hang Seng permanent staff are able to take up to two working days of volunteer leave per year to engage in charitable initiatives.

To foster good cooperation and communication among colleagues, we organised various social and recreational events in 2014 – including a singing contest and six sporting events under the Hang Seng Cup – through which more than 21,000 members of staff came together with their family and friends in a spirit of friendly competition and healthy fun.

Passing on Green Values

Our well-respected brand, extensive network of outlets and large customer base provide us with many valuable channels and opportunities to communicate positive environmental messages to the community.

Beginning with our own operations, we implement policies and practices that help conserve resources, improve energy efficiency and raise environmental awareness among our staff, business partners and customers.

In 2011, we became the first domestic bank in Hong Kong to achieve ISO14001 certification for its entire network of offices and branches. Our e-Statement and other paperless initiatives are saving over 45 million sheets of paper a year.

We also promote good environmental stewardship through the activities of our Bank volunteer team and by supporting local NGOs and green groups in events and initiatives such as the 'Power Smart' Energy Saving Contest organised by Friends of the Earth (HK), which this year included an energy monitoring equipment lending programme for schools.

RECOGNITION

Constituent Stock of Dow Jones Sustainability Asia Pacific Index

Dow Jones Sustainability Index

Constituent Stock of FTSE4Good Global Index

(for 13th consecutive year)

FTSE Index

Global 100 Most Sustainable Corporations in the World

Corporate Knights

Caring Company

(for 12th consecutive year)

Hong Kong Council of Social Service

Since 2007, we have helped build 3,800 biogas facilities – including 800 facilities in 2014 – in rural areas of Yunnan Province under the Hang Seng Yunnan Biogas Project, organised in partnership with The Conservancy Association. This project is providing a free and stable source of energy to 14,000 rural residents and has cut annual carbon dioxide emissions by about 44,000 tonnes.

As part of our commitment to protecting the world's precious natural resources and working to maintain the fragile balance of ecological systems, we stopped serving shark's fin at Bank functions in 2003 and have since removed endangered reef fish species from our menus. We also provide a WWF (Hong Kong) endorsed sustainable seafood menu at our banquet hall.

Environmental Performance Table

	2014#	2013^	2014 vs 2013 (% change)
Greenhouse gas emissions (kilotonnes CO_2)	**24.71**	24.31	**1.64**
Electricity consumption (GWh)	**35.19**	35.27	**-0.25**
Water consumption (000 m^3)	**68.48**	64.81	**5.67**
IT/electrical waste recycled (tonnes)	**61.50**	58.84	**4.52**

Data coverage: Hang Seng Bank's Hong Kong operations

Key: m^3: cubic metres CO_2: carbon dioxide **GWh**: gigawatt hours

From 1 Oct 2013 to 30 Sep 2014

^ From 1 Oct 2012 to 30 Sep 2013

Corporate Governance and Other Information

Corporate Governance Principles and Practices

Hang Seng Bank Limited (the "Bank") is committed to maintaining and upholding high standards of corporate governance with a view to safeguarding the interests of shareholders, customers, employees and other stakeholders. The Bank has followed the module on "Corporate Governance of Locally Incorporated Authorised Institutions" under the Supervisory Policy Manual ("SPM") issued by the Hong Kong Monetary Authority ("HKMA"). The Bank has also fully complied with all the code provisions and most of the recommended best practices set out in the Corporate Governance Code contained in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("HKEx") (the "Listing Rules"), save that the Risk Committee (all the members of which are Independent Non-executive Directors ("INEDs")), which was established pursuant to HKMA's SPM on corporate governance, is responsible for the oversight of internal control (other than internal control over financial reporting) and risk management systems. If there were no Risk Committee, these matters would be the responsibility of the Audit Committee, as provided under HKEx's Corporate Governance Code. The Bank also constantly reviews and enhances its corporate governance framework to ensure that it is in line with international and local corporate governance best practices.

Board of Directors

The Board has collective responsibilities for promoting the long-term sustainability and success of the Bank by providing entrepreneurial leadership within a framework of prudent and effective controls. In doing so, the Board commits to high standards of integrity and ethics.

According to the Board's terms of reference, specific matters reserved for the Board's consideration and decision include:

- strategic plan and objectives;
- annual operating plans and performance targets;
- annual and interim financial reporting;
- capital plans and management;
- risk appetite statement and profile;
- internal control and risk management governance;
- significant policies and plans;
- significant changes to balance sheet management policies;
- policies, practices and disclosure on corporate governance;
- policies and practices on compliance with legal and regulatory requirements;
- appointment and oversight of senior management;
- corporate values and standards;
- corporate structure;
- effective audit functions;
- transparency in respect of the structure, operation and risk management; and
- acquisitions and disposals above predetermined thresholds.

Chairman and Chief Executive

The roles of the Chairman and Chief Executive of the Bank are separate, with a clear division of responsibilities set out in the Board's terms of reference.

The Chairman of the Board, who is an INED, is responsible for the leadership and effective running of the Board and for ensuring that decisions of the Board are taken on a sound and well-informed basis and in the best interest of the Bank. In addition, as the Chairman of the Board, he is also responsible for ensuring that all Directors are properly briefed on all issues currently on hand and receive adequate, accurate and reliable information in a timely manner. The Chairman possesses the requisite experience, competencies and personal qualities to fulfill these responsibilities.

The Chief Executive, who is an Executive Director, is responsible for implementating the strategy and policy as established by the Board. The Chief Executive is also responsible for the management and day-to-day running of the Bank's business and operations, as well as leading and chairing the Executive Committee.

Board Composition

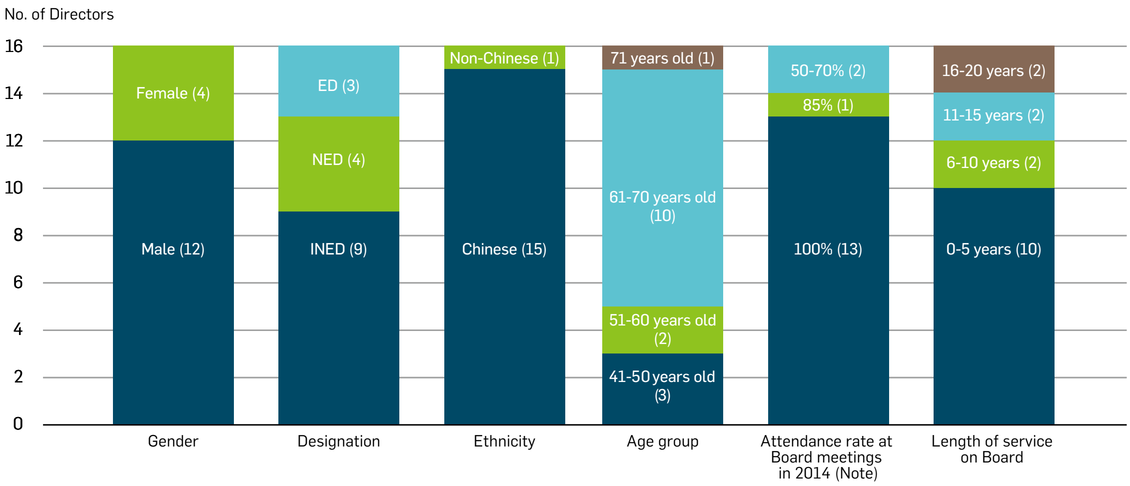
As at the date of this Annual Report, the Board comprises 16 Directors, of whom three are Executive Directors and 13 are Non-executive Directors ("NEDs"). Among the 13 NEDs, nine are INEDs. There is a strong independent element on the Board, to ensure the independence and objectivity of the Board's decision-making process as well as the thoroughness and impartiality of the Board's oversight of the Management.

The Board possesses, both as individual Directors and collectively, appropriate experience, competencies and personal qualities, including professionalism and integrity, to discharge its responsibilities adequately and effectively. In addition, the Board collectively has adequate knowledge and expertise relevant to each of the material business activities that the Bank pursues and the associated risks in order to ensure effective governance and oversight.

Members of the Board, who come from a variety of different backgrounds, have a diverse range of business, banking and professional expertise. Brief biographical particulars of the Directors, together with information relating to the relationship among them, are set out in the section "Biographical Details of Directors" in this Annual Report.

The Bank remains committed to meritocracy in the Boardroom, which requires a diverse and inclusive culture where Directors believe that their views are heard, their concerns are attended to and they serve in an environment where bias, discrimination and harassment on any matter are not tolerated. The Board has adopted a Board Diversity Policy which has been made available on the Bank's website (www.hangseng.com) for better transparency and governance. Board appointments are based on merit and candidates are considered against objective criteria, having due regard for the benefits of diversity on the Board including, but not limited to, gender, age, cultural and educational background, ethnicity, professional experience, skills, knowledge and length of service.

An analysis of the Board's current composition is set out in the following chart:



Note: Ms Anita Y M Fung stepped down as a NED with effect from 31 January 2014. Dr Marvin K T Cheung resigned from the Board with effect from 1 August 2014. Their attendance at Board meetings in 2014 have not been included above. In addition, Mr Kenneth S Y Ng was appointed with effect from 10 March 2014 while Ms Irene Y L Lee and Dr Henry K S Cheng were appointed with effect from 12 and 26 May 2014 respectively.

The Bank has maintained on its website (www.hangseng.com) and on the website of HKEx (www.hkexnews.hk) an updated list of its Directors identifying their roles and functions and whether they are INEDs. INEDs are also identified as such in all corporate communications that disclose the names of the Bank's Directors.

Further, the Bank has received from each of the INEDs an annual confirmation of his/her independence. The independence of the INEDs has been assessed in accordance with the guidelines set out in Rule 3.13 of the Listing Rules. Following such assessment, the Board has affirmed that all the INEDs continue to be independent.

The Bank issues appointment letters to each of the NEDs, setting out the terms and conditions of their appointment, including the time commitment expected of them. Additional time commitment is necessary if the NEDs also serve on committee(s) of the Board.

Board Process

Board meetings shall be held at least six times a year and no less than once every quarter. Additional Board meetings, or meetings of a Board committee established by the Board to consider specific matters, can be convened, when necessary.

Schedule for the regular Board meetings in each year, together with the standing agenda for such meetings, are made available to all Directors before the end of the preceding year. In addition, notice of meetings will be given to all Directors at least 14 days before each regular meeting.

Other than regular meetings, the Chairman also meets with NEDs, including INEDs, without the presence of the Executive Directors, to facilitate an open and frank discussion among the NEDs on issues relating to the Bank.

Meeting agenda for regular meetings are set after consultation with the Chairman and the Chief Executive. All Directors are given an opportunity to include matters in the agenda.

Directors make their best efforts to contribute to the formulation of strategy, policies and decision-making by attending the Board meetings in person or via telephone or video-conferencing facilities.

Minutes of Board meetings with details of the matters discussed by the Board and decisions made, including any concerns or views of the Directors, are kept by the Company Secretary and are open for inspection by Directors.

During 2014, the Board held seven meetings and the important matters discussed at Board meetings included:

- the Bank's financial statements for the year ended 31 December 2013;
- the Bank's interim financial statements for the six months ended 30 June 2014;
- declaration of the Bank's interim dividends for year 2014;
- reports on the Bank's financial and business performance;
- proposals relating to the Bank's investment in Industrial Bank Co., Ltd.;
- strategic plan 2013 – 2015 with quarterly updates;
- risk appetite statement and profile;
- annual operating plan and capital plan;
- internal capital adequacy assessment process;
- results of stress testing analysis;
- significant policies and plans such as Liquidity Management Policy, Policy on Conflicts of Interest, Connected Lending Policy, Contingency Funding Plan, Code for Securities Transactions by Directors and Recovery Plan;
- review of the Bank's large credit exposures and risk concentrations;
- adoption of new Articles of Association;
- review of the Bank's remuneration policy and remuneration system;
- appointment of Directors and senior executives;
- re-election and election of the retiring Directors and terms of appointment of NEDs;
- review of independence of INEDs;
- succession planning for the Board;
- pay review for 2014 and variable pay for 2013;
- review of the fees payable to Directors and Board Committee Chairmen/Members of the Bank and its subsidiaries;
- performance management and succession planning for senior management;
- risk management framework and internal control framework; and
- major regulatory changes affecting the Bank.

In addition to the regular financial and business performance reports submitted to the Board at its regular meetings, the Board also receives financial and business updates with information on the Bank's latest financial performance and material variance from the Bank's annual operating plan during those months where no Board meetings to be held. Directors can therefore have a balanced and understandable assessment of the Bank's performance, position and prospects throughout the year.

The Board reviews and evaluates its work process and effectiveness annually, with a view to identifying areas for improvement and further enhancement. The Board also regularly reviews the time commitment required from NEDs.

All Directors have access to the Executive Directors as and when they consider necessary. They also have access to the Company Secretary who is responsible for ensuring that the Board procedures, and related rules and regulations, are followed.

Under the Articles of Association of the Bank, a Director shall not vote or be counted in the quorum in respect of any contract, arrangement, transaction or other proposal in which he/she or his/her associate(s), is/are materially interested.

The Board has adopted a Policy on Conflicts of Interest. The Policy identifies the relationships, services, activities or transactions in respect of which conflicts of interest may arise and sets out measures for prevention or management of these conflicts. The Policy also contains an objective compliance process for implementing the Policy, which includes notification by a Director of conflicts or potential conflicts, and a review/approval process.

Starting from year 2014, the Board has applied technology designed specifically around the Board to help the Directors manage their time more efficiently in fulfilling their board responsibilities, while staying connected to the Board and other Directors in order to work effectively and securely.

Appointment and Re-election of Directors

The Bank uses a formal, considered and transparent procedure for the appointment of new Directors. Before a prospective Director's name is formally proposed, opinions of the existing Directors (including the INEDs) will be solicited. The proposed appointment will first be reviewed by the Nomination Committee, taking into account the balance of skills, knowledge and experience on the Board. Upon recommendation of the Nomination Committee, the proposed appointment will then be reviewed and, if thought fit, approved by the Board after due deliberation.

In accordance with the requirement under the Banking Ordinance, approval from HKMA will also be obtained.

All new Directors are subject to election by shareholders of the Bank at the next Annual General Meeting ("AGM") after their appointments have become effective. Further, the Bank's Articles of Association provide that all Directors shall be subject to retirement by rotation at least once every three years. Retiring Directors are eligible for re-election at AGMs of the Bank.

According to the policy on the term of appointment of NEDs, term of appointment of each NED is three years except that where a NED has served on the Board for more than nine years, then his/her term of appointment is one year. In renewing the term of appointment of each NED, the Board reviews whether such NED remains qualified for his/her position.

Responsibilities of Directors

All Directors have full and timely access to all relevant information about the Bank so that they can discharge their duties and responsibilities as Directors. In particular, through regular Board meetings and receipt of financial and business updates, all Directors are kept abreast of the conduct, business activities and development, as well as regulatory updates applicable to the Bank.

There are established procedures for Directors to seek independent professional advice on matters relating to the Bank where appropriate. All costs associated with obtaining such advice will be borne by the Bank. In addition, each Director has separate and independent access to the Bank's Management.

The Bank has adopted a Code for Securities Transactions by Directors on terms no less exacting than the required standards set out in the Model Code for Securities Transactions by Directors of Listed Issuers (set out in Appendix 10 to the Listing Rules). Specific enquiries have been made with all Directors who have confirmed that they have complied with the Bank's Code for Securities Transactions by Directors throughout the year 2014.

Directors' interests in securities of the Bank and HSBC Holdings plc ("HSBC") as at 31 December 2014 have been disclosed in the Report of the Directors set out in this Annual Report.

Appropriate Directors' liability insurance cover has also been arranged to indemnify the Directors for liabilities arising out of corporate activities. The coverage and the sum insured under the policy are reviewed annually. Further, the Bank's Articles of Association provide that Directors are entitled to be indemnified out of the Bank's assets against claims from third parties in respect of certain liabilities.

Induction and Training for Directors

Induction programmes on the following key areas are arranged for newly appointed Directors so that they can discharge their responsibilities to the Bank properly and effectively:

- the Bank's business operations in Hong Kong;
- the Bank's business operations and investments on the Mainland;
- the Bank's risk management framework;
- the Bank's governance structure and practices;
- the Bank's control and support functions; and
- directors' duties and responsibilities.

Further, all Directors are provided with briefings and trainings on an on-going basis as necessary to ensure that they have a proper understanding of the Bank's operations and business and are fully aware of their responsibilities under the applicable laws, rules and regulations including, but not limited to, the Banking Ordinance, Listing Rules, Companies Ordinance, Securities and Futures Ordinance and HKMA's SPMs. Such briefings and trainings are provided at the Bank's expense. The Bank also maintains proper records of the trainings provided to and received by its Directors.

During the year, all Directors received briefings or trainings in relation to the following topics:

- Directors' duties
- update on HKMA's anti-money laundering/counter-terrorist financing requirements
- digital banking and emergence of internet finance
- recovery and resolution planning
- capital and liquidity management
- risk appetite statement

To summarise, the Directors received trainings on the following key areas to update and develop their skills and knowledge during the year:

Directors [Note 1]	Training areas		
	Corporate Governance	Regulatory	Business/Management
INEDs			
Dr Raymond K F Ch'ien	√	√	√
Dr John C C Chan	√	√	√
Dr Henry K S Cheng	√	√	√
Ms L Y Chiang	√	√	√
Dr Fred Zuliu Hu	√	√	√
Ms Irene Y L Lee	√	√	√
Dr Eric K C Li	√	√	√
Mr Richard Y S Tang	√	√	√
Mr Michael W K Wu	√	√	√
NEDs			
Ms Sarah C Legg	√	√	√
Dr Vincent H S Lo	√	√	√
Mr Kenneth S Y Ng	√	√	√
Mr Peter T S Wong	√	√	√
Executive Directors			
Ms Rose W M Lee	√	√	√
Mr Andrew H C Fung	√	√	√
Mr Nixon L S Chan	√	√	√

Note 1 Ms Anita Y M Fung stepped down as a NED with effect from 31 January 2014 and Dr Marvin K T Cheung resigned from the Board with effect from 1 August 2014. Accordingly, their training records have not been included above.

Delegation by the Board
Board Committees

The Board has set up five Committees, namely, the Executive Committee, Audit Committee, Risk Committee, Remuneration Committee and Nomination Committee, to assist it in carrying out its responsibilities.

The current composition of the above Board Committees is as follows:

Board

Executive Committee	Audit Committee	Risk Committee	Remuneration Committee	Nomination Committee
Ms Rose W M Lee (Chairman)	Dr Eric K C Li* (Chairman)	Ms Irene Y L Lee* (Chairman)	Dr John C C Chan* (Chairman)	Dr Raymond K F Ch'ien* (Chairman)
Mr Andrew H C Fung	Mr Richard Y S Tang*	Dr Eric K C Li*	Dr Raymond K F Ch'ien*	Ms Rose W M Lee
Mr Nixon L S Chan	Ms Irene Y L Lee*	Dr Fred Zuliu Hu*	Ms L Y Chiang*	Dr John C C Chan*
Mr Andrew W L Leung	Mr Michael W K Wu*			Mr Peter T S Wong#
Mr Christopher H N Ho				Mr Michael W K Wu*
Mr Donald Y S Lam				
Mrs Louise Lam				
Ms Ivy S P Chan				

* INED
# NED

Each of these Committees has specific written terms of reference, which set out in detail their respective authorities and responsibilities. Each Committee reviews its terms of reference and effectiveness annually. The terms of reference of all the Non-executive Board Committees have been made available on the Bank's website (www.hangseng.com). All Committees, except the Executive Committee and Nomination Committee, comprise solely of INEDs. Majority of the Nomination Committee members are INEDs while the Executive Committee comprises the Bank's senior management members.

All Committees adopt the same governance processes as far as possible as the Board and report back to the Board on their decisions or recommendations on a regular basis.

Executive Committee

The Executive Committee usually meets once a month and operates as a general management committee under the direct authority of the Board. It exercises the powers, authorities and discretions as delegated by the Board in so far as they concern the management and day-to-day running of the Bank in accordance with its terms of reference and such other policies and directives as the Board may determine from time to time. The Executive Committee also sub-delegates credit, investment and capital expenditure authorities to its members and senior executives.

To further enhance the Bank's risk management framework and in line with best practices, the Bank has set up a Risk Management Committee ("RMC"), chaired by the Bank's Chief Risk Officer, to centralise the risk management oversight function of the Bank and its subsidiaries. The RMC reports directly to the Executive Committee. Its main functions are to review, analyse, evaluate, recognise and manage various risks of the Bank, including all the eight types of risks stipulated in HKMA's SPMs, namely, credit risk, market risk, liquidity risk, interest rate risk, operational risk, legal and compliance risk, reputation risk and strategic risk. In addition, the RMC also covers business (including insurance) risk, pension risk, security and fraud risk, and sustainability risk, and is responsible for endorsement/approval of all risk management related policies. RMC meetings are usually held monthly. Minutes of RMC meetings are provided to the Executive Committee and the Risk Committee for review.

Audit Committee

The Audit Committee meets at least four times a year with the Bank's executives including, but not limited to, the Chief Executive, Chief Financial Officer, Chief Risk Officer and Head of Audit, and representatives from the Bank's external auditor. The Committee reviews, among other things, the Bank's financial reporting, the nature and scope of audit reviews, and the effectiveness of the systems of internal control and compliance relating to financial reporting. The Audit Committee is also responsible for making recommendations to the Board on the appointment, re-appointment, removal and remuneration of the Bank's external auditor. In addition, the Audit Committee has established a "Policy for the Reporting of Improprieties" to provide a secured and confidential channel through which all staff members may report incidents of improprieties in a secured and confidential manner so that the same will be timely and thoroughly investigated and appropriate actions can be taken promptly.

The Audit Committee reports to the Board following each Audit Committee meeting, drawing the Board's attention to salient points that the Board should be aware of, identifying any matters in respect of which it considers that action or improvement is needed and making relevant recommendations.

During the year, the Audit Committee held four meetings and the major work performed by the Committee was as follows:

- reviewed the Bank's financial statements for the year ended 31 December 2013 and the related documents, and the management letters and audit issues noted by the Bank's external auditor;
- reviewed the Bank's interim financial statements for the six months ended 30 June 2014 and the related documents, and the issues noted by the Bank's external auditor;
- reviewed the Bank's 2014 annual operating plan and capital plan;
- reviewed balance sheet management position;
- reviewed the revised accounting standards and prospective changes to accounting standards, and the impact on the Bank's financial reporting;
- reviewed essential matters or reports relating to financial control and reporting, and discussed the same with the Management;
- reviewed the internal audit reports and discussed the same with the Management and Head of Audit;
- reviewed and adopted the enhanced Internal Audit Standards Manual;
- reviewed the update on internal audit plan for 2014 and reviewed the internal audit plan for 2015;

- reviewed and endorsed the establishment of Quality Assurance and Administration within the Internal Audit function;
- reviewed the adequacies of resources, qualifications and experience of staff of the Bank's Accounting and Financial Reporting function and Internal Audit function, and their training programmes and budgets;
- reviewed the remuneration and engagement letters of the Bank's external auditor, and its independence and objectivity, and the effectiveness of the audit process;
- reviewed the proposed change of external auditor and made recommendations to the Board;
- reviewed the effectiveness of the Policy for the Reporting of Improprieties and the incidents reported through such channel during the year;
- reviewed the Audit Committee's independence and effectiveness in discharging its role and responsibilities and its terms of reference and made recommendation to the Board for any changes; and
- exercised oversight over the audit committees of the Bank's principal subsidiaries.

The Audit Committee meets with the representatives of the Bank's external auditor and Head of Audit without the presence of the Management at least once a year.

Risk Committee

The Risk Committee meets at least four times a year with the Bank's executives including, but not limited to, the Chief Executive, the Chief Financial Officer, Chief Risk Officer, Head of Audit, Head of Regulatory Compliance, Head of Financial Crime Compliance, and representatives from the Bank's external auditor. The Committee is responsible for, among other things, the Bank's high level risk related matters, risk appetite and tolerance, risks associated with proposed strategic acquisitions or disposals, risk management reports from the Management, effectiveness of the Bank's risk management framework and systems of internal control and compliance (other than internal control and compliance regarding financial reporting), and appointment and removal of the Bank's Chief Risk Officer.

The Risk Committee reports to the Board following each Risk Committee meeting, drawing the Board's attention to salient points that the Board should be aware of, identifying any matters in respect of which it considers that action or improvement is needed and making relevant recommendations.

During the year, the Risk Committee held six meetings (including one meeting with HKMA) and the major work performed by the Committee was as follows:

- reviewed routine risk reports submitted by the Management including, but not limited to, the Bank's risk management framework, risk appetite statement and profile, stress testing analysis, risk maps, top and emerging risks, annual plan and reports relating to financial crime compliance, regulatory compliance and internal control;
- reviewed the Bank's Liquidity Management Policy, Contingency Funding Plan and internal capital adequacy assessment process;
- reviewed the report on the alignment of risk and remuneration;
- reviewed the management letters and audit issues noted by the Bank's external auditor insofar as the same related to risk issues/matters;
- reviewed the enhanced Internal Audit Standards Manual and internal audit reports insofar as the same give rise to any risk-related issues;
- reviewed the adequacies of resources, qualifications and experience of staff of the Bank's Risk and Compliance function, and their training programmes and budgets;
- reviewed the incidents reported under the Policy for the Reporting of Improprieties insofar as the same give rise to any risk-related issues;
- reviewed the Risk Committee's independence and effectiveness in discharging its role and responsibilities and its terms of reference and made recommendation to the Board for any changes;
- exercised oversight over the risk committees of the Bank's principal subsidiaries; and
- endorsed the appointment of Risk Committee member and the Chief Risk Officer of the Bank.

The Risk Committee meets with the Bank's Head of Audit and Chief Risk Officer separately without the presence of the Management at least once a year. In addition, the Committee also meets with the representatives of HKMA to maintain a regular dialogue with the regulator and to share HKMA's general views on their supervisory focus.

Remuneration Committee

The Remuneration Committee normally meets twice a year with the Bank's Head of Human Resources. The Committee considers and makes recommendations to the Board on the remuneration policy and structure in order to attract, motivate and retain quality personnel. Pursuant to delegation by the Board, the Committee also determines the remuneration policy, and the specific remuneration packages of all Executive Directors, senior management and key personnel. In addition, it also reviews at least annually and independently of the Management, the adequacy and effectiveness of the Bank's remuneration policy and its implementation, to ensure that the Bank's remuneration policy is consistent with relevant regulatory requirements and promotes effective risk management.

In determining the bank-wide remuneration policy, the Remuneration Committee will take into account the Bank's business objective, people strategy, short-term and long-term performance, business and economic conditions, market practices and risk management needs, in order to ensure the remuneration aligns with business and individual performances, promotes effective risk management, facilitates retention of quality personnel and is competitive in the market. The Committee may invite any Director, executive, consultant or other relevant party to provide advice in this respect. In 2014, the Committee has not requested to seek advice from external consultant on matters relating to remuneration.

The Remuneration Committee reports to the Board following each Committee meeting, drawing the Board's attention to salient points that the Board should be aware of, identifying any matters in respect of which it considers that action or improvement is needed and making relevant recommendations.

During the year, the Remuneration Committee held two meetings and the major work performed by the Committee was as follows:

- reviewed and updated the Bank's remuneration policy to further strengthen the Bank's governance in response to the tightened regulatory requirements;
- reviewed the outcome of the review by the internal audit function of the Bank's remuneration policy and remuneration system, and the adequacy and effectiveness of its implementation;
- reviewed the fees payable to the Bank's Chairman, and the Directors and Board Committee Chairmen/Members of the Bank and its subsidiaries, and recommended the same to the Board for endorsement/approval;
- reviewed the report on the alignment of risk and remuneration;
- determined the remuneration packages of the Executive Directors, senior management and key personnel of the Bank, and the Vice-Chairman and Chief Executive of Hang Seng Bank (China) Limited;
- reviewed the proposed variable pay for 2013 and pay review proposal for 2014, and recommended the same to the Board for approval;
- reviewed the Remuneration Committee's effectiveness in discharging its role and responsibilities and its terms of reference and made recommendation to the Board for any changes; and
- reviewed the proposed establishment of Remuneration Committee of Hang Seng Bank (China) Limited, its composition and the fees payable to the Committee Chairman and members, and recommended the same to the Board for endorsement.

Nomination Committee

The Nomination Committee meets at least twice a year. It leads the process for Board appointments and identifies and nominates for the Board's approval, candidates for appointment to the Board. The Nomination Committee also considers, among other things, the structure, size and composition of the Board, independence of INEDs, term of appointment of and time required from NEDs, and appointment to Board Committees.

The Nomination Committee reports to the Board following each Committee meeting, drawing the Board's attention to salient points that the Board should be aware of, identifying any matters in respect of which it considers that action or improvement is needed and making relevant recommendations.

During the year, the Nomination Committee held two meetings and the major work performed by the Committee was as follows:

- reviewed the structure, size and composition of the Board and Non-executive Board Committees;
- reviewed the succession planning for the Board;
- reviewed the independence of INEDs;
- reviewed the time commitment required from NEDs;
- recommended to the Board for approval the renewal of terms of appointment of NEDs;
- recommended to the Board for endorsement the re-election of the retiring Directors;
- reviewed the revised appointment letter of NEDs;
- recommended to the Board for approval the appointment of INEDs and members of Audit Committee and Risk Committee; and
- reviewed the Nomination Committee's effectiveness in discharging its role and responsibilities and its terms of reference and made recommendation to the Board for any changes.

Attendance Records

The attendance records of Board and Board Committee meetings held in 2014 are as follows:

	Meetings held in 2014						
	AGM	Board	Executive Committee	Audit Committee	Risk Committee	Remuneration Committee	Nomination Committee
Number of Meetings	1	7	12	4	6	2	2
Directors							
Dr Raymond K F Ch'ien* *(Chairman)*	1/1	7/7	–	–	–	2/2	2/2
Ms Rose W M Lee *(Vice-Chairman and Chief Executive)*	1/1	7/7	11/12	–	–	–	2/2
Dr John C C Chan*	1/1	7/7	–	–	–	2/2	2/2
Mr Nixon L S Chan Note 2	1/1	6/6	11/12	–	–	–	–
Dr Henry K S Cheng* Note 3	0/0	3/3	–	–	–	–	–
Ms L Y Chiang*	0/1	7/7	–	–	–	2/2	–
Mr Andrew H C Fung	1/1	6/7	9/12	–	–	–	–
Dr Fred Zuliu Hu*	1/1	4/7	–	–	4/6	–	–
Ms Irene Y L Lee* Note 4	0/0	4/4	–	2/2	4/4	–	–
Ms Sarah C Legg#	1/1	7/7	–	–	–	–	–
Dr Eric K C Li*	1/1	7/7	–	4/4	6/6	–	–
Dr Vincent H S Lo#	0/1	7/7	–	–	–	–	–
Mr Kenneth S Y Ng# Note 5	0/1	5/5	–	–	–	–	–
Mr Richard Y S Tang*	1/1	7/7	–	4/4	–	–	–
Mr Peter T S Wong#	1/1	4/7	–	–	–	–	2/2
Mr Michael W K Wu* Note 6	0/1	7/7	–	1/2	–	–	2/2
Ms Anita Y M Fung# Note 7	0/0	1/1	–	–	–	–	–
Dr Marvin K T Cheung* Note 8	1/1	4/5	–	1/2	3/4	–	–
Senior Executives							
Mr Christopher H N Ho	–	–	9/12	–	–	–	–
Mr Donald Y S Lam	–	–	9/12	–	–	–	–
Mr Andrew W L Leung	–	–	10/12	–	–	–	–
Mrs Louise Lam	–	–	11/12	–	–	–	–
Ms Ivy S P Chan Note 9	–	–	5/6	–	–	–	–
Mr Nai Pan Tang Note 10	–	–	2/5	–	–	–	–
Average Attendance Rate	73%	93%	78%	80%	85%	100%	100%

* INEDs
\# NEDs

Note 2 Mr Nixon L S Chan was appointed as an Executive Director with effect from 31 January 2014.

Note 3 Dr Henry K S Cheng was appointed as an INED with effect from 26 May 2014.

Note 4 Ms Irene Y L Lee was appointed as an INED and a Risk Committee member with effect from 12 May 2014. She was further appointed as Risk Committee Chairman and an Audit Committee member with effect from 1 August 2014.

Note 5 Mr Kenneth S Y Ng was appointed as a NED with effect from 10 March 2014.

Note 6 Mr Michael W K Wu was appointed as an Audit Committee member with effect from 1 August 2014.

Note 7 Ms Anita Y M Fung stepped down from the Board with effect from 31 January 2014.

Note 8 Dr Marvin K T Cheung resigned from the Board with effect from 1 August 2014.

Note 9 Ms Ivy S P Chan was appointed as the Chief Risk Officer and a member of the Executive Committee with effect from 1 July 2014.

Note 10 Mr Nai Pan Tang resigned as the Chief Risk Officer and a member of the Executive Committee with effect from 1 June 2014.

Remuneration of Directors, Senior Management and Key Personnel

The Bank's policy on remuneration is to maintain fair and competitive packages based on business needs and industry practice.

Remuneration of Directors

The level of fees paid to NEDs is determined by reference to factors including Directors' workload and commitments and fees paid by comparable institutions.

As regards Executive Directors, the following factors are considered when determining their remuneration packages :

- business needs;
- general economic situation;
- changes in appropriate markets such as supply/demand fluctuations and changes in competitive conditions;
- individual contributions to results as confirmed in the performance appraisal process; and
- retention consideration and individual potential.

No individual Director will be involved in decisions relating to his/her own remuneration.

The current scales of Director's fees, and additional fees for Chairmen and members of the non-executive Board Committees, namely, Audit Committee, Risk Committee, Remuneration Committee and Nomination Committee, are set out below:

	Current Fees (HK$ '000)		Current Fees (HK$ '000)
Board of Directors		**Risk Committee**	
Chairman	590	Chairman	260
Vice-Chairman Note 11	NIL	Members	160
Other Directors Note 11	450	Members of both Audit Committee and Risk Committee	280
Audit Committee		**Remuneration Committee/ Nomination Committee**	
Chairman	260	Chairman	90
Members	160	Members	60

Note 11 In line with the remuneration policy of HSBC Group, no Director's fee is payable to those Directors who are full time employees of the Bank and its subsidiaries.

Information relating to the remuneration of each Director for the year ended 31 December 2014 is set out in Note 15 to the Bank's 2014 Financial Statements.

Remuneration of Senior Management and Key Personnel

According to the HKMA SPM CG-5 "Guideline on a Sound Remuneration System", Authorised Institutions are required to make disclosures in relation to their remuneration systems as appropriate. The Bank has fully complied with HKMA disclosure requirements set out in Part 3 of the Guideline.

There were 10 employees and 4 employees being classified as Senior Management Note 12 and Key Personnel Note 13 respectively during the year.

Aggregate amount of remuneration[Note 14] of the Senior Management and Key Personnel during the year, split into fixed and variable remuneration, is set out below:

	2014 (14 employees)		2013 (13 employees) (Restated)	
Amount (HK$ '000)	**Non-deferred**	**Deferred**	**Non-deferred**	**Deferred**
Fixed remuneration				
Cash	37,826	–	37,300	–
Shares	3,994	–	–	–
Variable remuneration				
Cash	18,842	4,880	22,033	3,165
Shares	4,987	8,949	2,110	12,014

Note 12 Senior Management refers to those executives who are either:

(a) members of the Executive Committee of the Bank, namely, (i) Executive Directors; (ii) senior executives of the Bank at the rank of Band 1; and if not already covered by the aforesaid, (iii) Heads of the Bank's major business lines, namely, Global Banking and Markets, Retail Banking and Wealth Management, and Commercial Banking; (iv) Chief Risk Officer; (v) Chief Financial Officer; (vi) Chief Operating Officer; and (vii) Head of Human Resources; or

(b) Head(s) of the Bank's principal subsidiary/subsidiaries with offshore operations and with total assets representing more than 5% of the Bank's total assets.

Note 13 Key Personnel refers to those executives other than Senior Management, at the rank of Band 3 or above, who are engaged in trading and dealing activities which involve the assumption of material risk or the taking on of material exposures on behalf of the Bank and its subsidiaries. In 2015, the definition of Key Personnel has been reviewed to include employees classified as "Code Staff" under the UK Prudential Regulatory Authority Remuneration Code.

Note 14 Remuneration refers to all remuneration payable to employees during the year with reference to their tenure as Senior Management and Key Personnel.

Aggregate amount of deferred variable remuneration, split into (a) vested and paid during the year and (b) outstanding and unvested at the end of the year, is set out below:

	2014		2013 (Restated)	
Amount (HK$ '000)	**Awarded for Performance Year 2014**	**Awarded for Prior Performance Years**	**Awarded for Performance Year 2013**	**Awarded for Prior Performance Years**
Vested and paid out during the year				
Cash	–	–	–	–
Shares	–	4,786	–	6,195
Outstanding and unvested at the end of the year				
Cash	4,880	3,165	3,165	–
Shares	8,949	16,951	12,014	13,058

No deferred variable remuneration had been reduced through performance adjustments in 2014 and 2013.

Quantitative information on employees' exposure to implicit adjustments (e.g. fluctuations in the value of shares or performance units) and explicit adjustments (e.g. malus, clawbacks or similar reversals or downward revaluations of awards) of deferred remuneration and retained remuneration is set out below:

(HK$ '000)	2014	2013 (Restated)
Total amount of outstanding deferred remuneration and retained remuneration exposed to ex post explicit/implicit adjustments	33,945	28,237
Total amount of reductions during the year due to:		
- Ex post explicit adjustments	–	–
- Ex post implicit adjustments	+343	+1,066

No Senior Management or Key Personnel has been awarded or paid guaranteed bonus, new sign-on or severance payment during the years of 2014 and 2013.

Other relevant remuneration disclosures are set out in Notes 14, 15 and 58(b) to the Bank's 2014 Financial Statements.

Accountability and Audit

Financial Reporting

The Board aims at making a balanced, clear and comprehensive assessment of the Bank's performance, position and prospects. An annual operating plan is reviewed and approved by the Board on an annual basis. Reports on financial results, business performance and variances against the approved annual operating plan are made available to the Board for regular review and monitoring on a monthly basis.

Strategic planning cycles are generally from three to five years. The Bank's strategic plan 2013-2015 was reviewed and approved by the Board in January 2013. Progress on the implementation of the key initiatives in the strategic plan is reported to and reviewed by the Board and Executive Committee on a quarterly basis.

The annual and interim results of the Bank are announced in a timely manner within the limits of three months and two months respectively after the end of the relevant year or period.

The Directors acknowledge their responsibilities for preparing the accounts of the Bank. As at 31 December 2014, the Directors were not aware of any material uncertainties relating to events or conditions which may cast significant doubt upon the Bank's ability to continue as a going concern. Accordingly, the Bank's Directors have prepared the financial statements of the Bank on a going-concern basis.

The responsibilities of the external auditor with respect to financial reporting are set out in the Independent Auditor's Report attached to the Bank's 2014 Financial Statements.

Internal Controls

System and Procedures

The Board is responsible for internal control of the Bank and its subsidiaries and for reviewing its effectiveness.

The Bank's internal control system comprises a well-established organisational structure and comprehensive policies and standards. Areas of responsibilities for each business and functional unit are clearly defined to ensure effective checks and balances.

Procedures have been designed for safeguarding assets against unauthorised use or disposition; for maintaining proper accounting records; and for ensuring the reliability of financial information used within the business or for publication. The procedures provide reasonable but not absolute assurance against material errors, losses or fraud. Procedures have also been designed to ensure compliance with applicable laws, rules and regulations.

Systems and procedures are in place in the Bank to identify, control and report on the major types of risks the Bank encounters. Business and functional units are responsible for the assessment of individual types of risk arising under their areas of responsibilities, the management of the risks in accordance with risk management procedures and the reporting on risk management. The Bank maintains an effective risk management framework through the setting up of specialised management committees for the oversight and monitoring of major risk areas and the establishment of risk management departments for relevant functions of the Bank. Relevant risk management reports are submitted to Asset and Liability Management Committee, RMC, Executive Committee and Risk Committee, and ultimately to the Board for monitoring the respective types of risk. The Bank's risk management policies and major control limits are approved by the Board or its delegated committees, and are monitored and reviewed regularly according to established policies and procedures.

More detailed discussion on the policies and procedures for management of each of the major types of risk the Bank encounters is set out in the "Risk Management" and "Capital Management" sections of the "Management Discussion and Analysis" in this Annual Report, and Supplementary Notes to the Bank's 2014 Financial Statements.

Annual Assessment

A review of the effectiveness of the Bank's internal control system covering all material controls, including financial, operational, compliance, and risk management controls, is conducted annually. The review at the end of 2014 was conducted with reference to the COSO (The Committee of Sponsoring Organisations of the Treadway Commission) internal control framework, which assesses the Bank's internal control system against the five elements of control environment, risk assessment, control activities, information and communication, and monitoring. The Bank has also conducted an annual review to assess the adequacy of resources, qualifications and experience of staff of the Bank's accounting and financial reporting function, and their training programmes and budget. The approach, findings, analysis and results of these annual reviews have been reported to the Audit Committee, Risk Committee and the Board.

Framework for Disclosure of Inside Information

The Bank has put in place a robust framework for the disclosure of inside information in compliance with the Securities and Futures Ordinance. The framework sets out the procedures and internal controls for the handling and dissemination of inside information in a timely manner so as to allow the shareholders, customers, staff and other stakeholders to apprehend the latest position of the Bank and its subsidiaries. The framework and its effectiveness are subject to review on a regular basis according to established procedures.

Internal Audit

The primary role of the Internal Audit function is to assist the Board and Executive Management in protecting the assets, reputation and sustainability of the Bank. The Internal Audit function provides independent and objective assurance as to whether the design and operational effectiveness of the Bank's framework of risk management, control and governance processes, as designed and represented by the Management, is adequate.

The Bank has adopted a risk management and internal control structure, referred to as the "Three Lines of Defence", to ensure it achieves its commercial aims while meeting regulatory and legal requirements and its responsibilities to shareholders, customers and staff. The Internal Audit function's role as the third line of defence is independent of the first and second lines of defence. The Bank's Head of Audit reports to the Chairman and the Audit Committee.

Results of audit work together with an assessment of the overall risk management and control framework are reported to the Audit Committee and the Risk Committee as appropriate. The Internal Audit function also reviews the Management's action plans in relation to audit findings and verifies the adequacy and effectiveness of the mitigating controls before formally closing the issue.

External Auditor

KPMG is the Bank's external auditor. The Audit Committee is responsible for making recommendations to the Board on the appointment, re-appointment, removal and remuneration of the external auditor. The external auditor's independence and objectivity, and the effectiveness of the audit process are also reviewed and monitored by the Audit Committee on a regular basis.

During 2014, fees paid to the Bank's external auditor for audit services amounted to HK$11.5 million, compared with HK$12 million in 2013. For non-audit services, the fees paid to the Bank's external auditor amounted to HK$9.7 million, compared with HK$7.7 million in 2013. In 2014, the significant non-audit service assignments covered by these fees included the following:

Nature of service	Fees paid (HK$ million)
Other assurance services	9.4
Tax services	0.3
	9.7

Change of Auditor

In 2013, HSBC Holdings plc announced its intention to appoint PricewaterhouseCoopers ("PwC") as its auditor for the year ending 31 December 2015. The aforesaid appointment of PwC will be recommended to shareholders of HSBC Holdings plc for approval at its AGM to be held in 2015.

Both the Audit Committee and the Board of the Bank consider that PwC is an equally professional and qualified audit firm with extensive expertise and experience in the audit of financial institutions as KPMG. As such, appointment of PwC as the Bank's auditor would align the audit arrangements between the Bank and HSBC Holdings plc, the ultimate holding company of the Bank, with a view to enhancing the efficiency and effectiveness of the audit in terms of both cost and audit process which would be in the best interests of the Bank and its shareholders as a whole.

Upon recommendation of the Audit Committee and with endorsement of the Board, the Bank announced on 4 August 2014 its intention to propose to its shareholders to approve the appointment of PwC as the Bank's auditor at the AGM to be held on 7 May 2015.

On 23 February 2015, KPMG tendered its resignation as the Bank's auditor upon its signing of the Bank's financial statements for the year ended 31 December 2014, whereupon the Board, upon the recommendation of the Audit Committee, has appointed PwC to fill the casual vacancy arising from KPMG's resignation as aforesaid, with effect from 23 February 2015. PwC will hold office until the conclusion of the Bank's 2015 AGM.

KPMG has confirmed in writing that there are no matters in relation to its resignation as the Bank's auditor which KPMG needs to bring to the attention of the shareholders. The Bank also confirms that there is no disagreement between KPMG and the Bank, and that there are no other matters in respect of KPMG's resignation that need to be brought to the attention of the shareholders.

Accordingly, the Board proposed to seek the approval of the shareholders by way of an ordinary resolution at the 2015 AGM for the proposed appointment of PwC as the Bank's auditor for the year ending 31 December 2015. The aforesaid appointment shall come into effect upon the passing of such ordinary resolution by the shareholders at the 2015 AGM.

Audit Committee

The Audit Committee assists the Board in meeting its responsibilities for ensuring effective systems of internal control and compliance relating to financial reporting, and in meeting its financial reporting obligations.

Risk Committee

The Risk Committee assists the Board in meeting its responsibilities for ensuring effective systems of risk management, internal control and compliance (other than that relating to financial reporting), and in meeting its risk governance obligations.

Communication with Shareholders

Effective Communication

The Bank attaches great importance to communication with shareholders. To this end, a number of means are used to promote greater understanding and dialogue with the investment community. The Bank holds group meetings with analysts in connection with the Bank's annual and interim results. The results announcements are also broadcast live via webcast. Apart from the above, designated senior executives maintain regular dialogue with institutional investors and analysts to keep them abreast of the Bank's development, subject to compliance with the applicable laws and regulations. Including the two results announcements, around a hundred meetings with analysts and fund managers were held in 2014. In addition, the Bank's Vice-Chairman and Chief Executive, and Chief Financial Officer also made presentations and held group meetings with investors at investor forums.

Further, the Bank's website (www.hangseng.com) offers timely access to the Bank's financial information, announcements/ circulars to shareholders and information on the Bank's corporate governance structure and practices. For efficient communication with shareholders and in the interest of environmental preservation, shareholders are encouraged to browse the Bank's corporate communications on the Bank's website, in the place of receiving printed copies of the same.

The AGM provides a useful forum for shareholders to exchange views with the Board. The Bank's Chairman, Executive Directors, Chairmen of the Board Committees and NEDs are available at the AGM to answer questions from shareholders about the business and performance of the Bank. In addition, the Bank's external auditor is also invited to attend the AGM to answer questions about the conduct of the audit, and the preparation and contents of the auditor's report. Separate resolutions are proposed at general meetings for each substantial issue, including the re-election and election (as the case may be) of individual Directors. An explanation of the detailed procedures of conducting a poll will be provided to shareholders at the AGM, to ensure that shareholders are familiar with such procedures.

The Bank's last AGM was held on Friday, 9 May 2014 at Hang Seng Bank Headquarters, 83 Des Voeux Road Central, Hong Kong. All the resolutions proposed at that meeting were approved by the shareholders by poll voting. Details of the poll results are available under the "Investor Relations" section of the Bank's website at www.hangseng.com.

The next AGM will be held on Thursday, 7 May 2015, the notice of which will be sent to shareholders at least 20 clear business days before the said meeting. Shareholders may refer to the section "Corporate Information and Calendar" in this Annual Report for information on other important dates for shareholders in year 2015.

Calling an Extraordinary General Meeting

Shareholder(s) holding not less than five percent of the total voting rights of all the members having a right to vote may request to call an Extraordinary General Meeting of the Bank.

The requisition (a) must state the general nature of the business to be dealt with at the meeting, (b) must be signed by the requisitionist(s), and (c) may either be deposited at the Bank's registered office at 83 Des Voeux Road Central, Hong Kong in hard copy form or sent by email to egmrequisition@hangseng.com. If the resolution is to be proposed as a special resolution, the requisition should include the text of the resolution and specify the intention to propose the resolution as a special resolution. The requisition may consist of several documents in like form, each signed by one or more requisitionist(s).

The requisition must also state (a) the name(s) of the requisitionist(s), (b) the contact details of the requisitionist(s) and (c) the number of ordinary shares of the Bank held by the requisitionist(s).

The Directors must proceed to convene an Extraordinary General Meeting within 21 days from the date of the receipt of the requisition. Such meeting should be held on a date not more than 28 days after the date on which the notice convening the meeting is given.

If the Directors fail to convene the Extraordinary General Meeting as aforesaid, the requisitionist(s), or any of them representing more than one-half of the total voting rights of all of them, may themselves convene the meeting. Any meeting so convened shall not be held after the expiration of three months from the date of the deposit of the requisition.

A meeting so convened by the requisitionist(s) shall be convened in the same manner, as nearly as possible, as that in which meetings are to be convened by the Directors.

Any reasonable expenses incurred by the requisitionist(s) by reason of the failure of the Directors duly to convene a meeting shall be reimbursed to the requisitionist(s) by the Bank.

Putting Forward Proposals at General Meetings

Shareholders representing at least 2.5 percent of the total voting rights of all the members having a right to vote, or, at least 50 shareholders who have a relevant right to vote, may:

- put forward proposal at general meeting;
- circulate to other shareholders written statement with respect to matter to be dealt with or other business to be dealt with at general meeting.

For further details on the shareholder qualifications, and the procedures and timeline, in connection with the above, shareholders are kindly requested to refer to Sections 580 and 615 of the Companies Ordinance (Cap 622, Laws of Hong Kong).

Further, a shareholder may propose a person other than a retiring Director of the Bank for election as a Director of the Bank at a general meeting. For such purpose, the shareholder must send to the Bank's registered address (for the attention of the Bank's Company Secretary) a written notice which identifies the candidate and includes a notice in writing by that candidate of his/her willingness to be so elected. Such notice must be sent within the seven-day period commencing on the day after the despatch of the notice of the meeting, or such other period as may be determined by the Directors from time to time, and ending no later than seven days prior to the date appointed for such meeting. Procedures for shareholders to propose candidates for election as Directors of the Bank are also available on the website of the Bank (www.hangseng.com).

Putting Enquiries to the Board

Shareholders may send their enquiries requiring the Board's attention to the Bank's Company Secretary at the Bank's registered address. Questions about the procedures for convening or putting forward proposals at an AGM or Extraordinary General Meeting may also be put to the Company Secretary by the same means.

Shareholders Communication Policy

The Bank has established a Shareholders Communication Policy to set out the Bank's processes to provide shareholders and the investment community with ready, equal and timely information on the Bank for them to make informed assessments of the Bank's strategy, operations and financial performance, and to engage actively with the Bank. The Policy is available on the Bank's website (www.hangseng.com).

Material Related Party Transactions and Connected Transactions

Material Related Party Transactions and Contracts of Significance

The Bank's material related party transactions are set out in Note 58 to the 2014 Financial Statements. These transactions include those that the Bank has entered into with its immediate holding company and fellow subsidiary companies in the ordinary course of its interbank activities, including the acceptance and placement of interbank deposits, corresponding banking transactions, off-balance sheet transactions, and the provision of other banking and financial services.

The Bank uses the information technology services of, and shares an automated teller machine network with, The Hongkong and Shanghai Banking Corporation Limited, its immediate holding company. The Bank also shares information technology and certain processing services with fellow subsidiaries on a cost recovery basis. In 2014, the Bank's share of the costs included HK$236 million for system development, HK$303 million for data processing, and HK$180 million for administrative services.

The Bank maintains a staff retirement benefit scheme for which a fellow subsidiary company acts as insurer and administrator. As part of its ordinary course of business with other financial institutions, the Bank also markets Mandatory Provident Fund and life insurance products and distributes retail investment funds for fellow subsidiaries, with a fee income of HK$181 million and HK$48 million respectively in 2014. Hang Seng Investment Management Limited, a wholly owned subsidiary of the Bank, manages, in the ordinary course of its business, a fund administered by a fellow subsidiary, to which management fee rebates were made. The rebate for 2014 amounted to HK$97 million.

These transactions were entered into by the Bank in the ordinary and usual course of business on normal commercial terms, and in relation to those which constituted connected transactions under the Listing Rules, they also complied with applicable requirements under the Listing Rules. The Bank regards its usage of the information technology services of The Hongkong and Shanghai Banking Corporation Limited (amount of information technology services cost incurred for 2014: HK$414 million) as contracts of significance for 2014.

Continuing Connected Transactions

On 21 June 2013, Hang Seng Insurance Company Limited ("HSIC"), a wholly-owned subsidiary of the Bank, entered into the following agreements:

(i) a management services agreement ("Management Services Agreement") with HSBC Life (International) Limited ("INHK") for a term of three years commencing from 22 June 2013, pursuant to which INHK, directly or through one or more of its affiliates, provided certain management services to HSIC.

INHK charged HSIC for the provision of the services on a fully absorbed cost basis plus a mark-up of 5%. These charges were determined following negotiation on an arm's length basis and in accordance with the policy of the HSBC Group, which took into account the transfer pricing guidelines of UK and the Organisation for Economic Co-operation and Development.

(ii) an investment management agreement ("Investment Management Agreement") with HSBC Global Asset Management (Hong Kong) Limited ("AMHK") for a term of three years commencing from 22 June 2013, pursuant to which AMHK acted as investment manager in respect of certain of HSIC's assets held from time to time. AMHK has delegated to HSBC Alternative Investments Limited ("HAIL"), an indirect wholly owned subsidiary of HSBC, the management of part of such assets by way of a bespoke portfolio.

HSIC paid, on a quarterly basis, to AMHK a fee of between 0.05% and 0.35% per annum (previously between 0.15% and 0.75% per annum) of the mean value of the assets under management, with effect from 1 January 2014. HSIC also paid to HAIL a fee of 0.5% per annum (previously between 0.5% and 0.9% per annum) of the aggregate value of assets under management in a bespoke portfolio, with effect from 1 November 2014. On top of the aforesaid, HSIC also paid to HAIL a performance fee of 10% per annum in respect of the amount by which the return of such portfolio exceeded a benchmark return of 8% per annum (previously a benchmark return of 3.5% above 3-month LIBOR per annum), with effect from 1 November 2014. The above fees have been determined on an arm's length basis. Subject to the caps under the Investment Management Agreement not being exceeded, HSIC and AMHK may subsequently agree to vary the above fees.

Details of the terms of and the annual caps under the Management Services Agreement and the Investment Management Agreement for the period from 22 June to 31 December 2013, and for the years ending 31 December 2014 and 2015, and for the period from 1 January to 21 June 2016, were announced by the Bank on 21 June 2013.

The Directors believed that the Management Services Agreement would enable HSIC to run at a reasonably low cost structure by leveraging on the shared infrastructure and expertise of INHK. The resulting cost efficiency has contributed to increased competitiveness of HSIC's manufactured products in the market, which the Directors considered to be essential to the future business growth of HSIC.

The Directors considered that the Investment Management Agreement was based on the normal commercial terms comparable with similar investment management agreements.

INHK and AMHK are both indirect wholly-owned subsidiaries of HSBC, the ultimate controlling shareholder of the Bank and therefore are connected persons of the Bank. Accordingly, all the aforesaid agreements constituted continuing connected transactions of the Bank. The Bank has complied with the disclosure requirements in accordance with Chapter 14A of the Listing Rules.

For the year ended 31 December 2014, the aggregate amount paid under the Management Services Agreement was HK$101 million, whereas the aggregate amount paid under the Investment Management Agreement was HK$39 million, both of which were within the annual caps for the year ended 31 December 2014 of HK$221 million and HK$140 million, respectively.

In respect of all the aforesaid agreements which constituted the Bank's continuing connected transactions, all the INEDs of the Bank have reviewed the said transactions and confirmed that the said transactions have been entered into:

(a) in the ordinary and usual course of business of the Bank and its subsidiaries;

(b) on normal commercial terms or better; and

(c) in accordance with the relevant agreements governing the same on terms that are fair and reasonable and in the interests of the Bank and its shareholders as a whole.

Further, the Bank engaged its external auditor to report on the continuing connected transactions of the Bank and its subsidiaries in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by the Hong Kong Institute of Certified Public Accountants. The Directors confirmed that the external auditor had issued an unqualified letter containing their findings and conclusions in respect of the continuing connected transactions set out in the preceding paragraphs in accordance with Rule 14A.56 of the Listing Rules. A copy of the auditor's letter has been provided by the Bank to HKEx.

Human Resources

The human resources policies of the Bank are designed to attract people of the highest calibre and to motivate them to excel in their careers, as well as uphold the Bank's brand equity and culture of quality service.

Employee Statistics

As at 31 December 2014, the Bank's total headcount was 10,192, representing an increase of 336, or 3.4%, compared with a year earlier. The total headcount comprised 1,847 executives, 4,752 officers and 3,593 clerical and non-clerical staff. The headcount growth in 2014 was mainly in frontline sales to support the Bank's strategic business development.

Employee Remuneration

The Remuneration Committee oversees the Bank's overall reward strategy and ensures all the reward policies are carefully considered in the context of business objective, people strategy, commercial competitiveness and regulatory guidance during their formulation. The Committee may invite any Director, executive, consultant or other relevant party to provide advice in this respect. The fundamental principles, philosophies and processes are documented in the Bank's remuneration policy.

The Bank adopts a Total Reward Approach. In determining the total remuneration for employees, the Bank will make reference to individual's responsibility, capability and risk profile of the job to ensure an appropriate balance between the fixed pay and variable pay.

Fixed pay is determined by taking into account relevant level and composition of pay in the markets in which the Bank operates. Salaries are reviewed in the context of business performance, individual performance and potential, market practice, internal relativities, risk management requirements, competitiveness compared to peers and regulatory requirements.

Bank-wide variable pay budgets are formulated in consideration of the Bank's business performance, people strategy and the risk appetite parameters, including operational risk, credit risk, funding/liquidity risk, risk adjusted return and capital strength. This helps to ensure that the variable pay pool is shaped by risk considerations and the Bank's performance is sustainable in the long-term. The ex ante risk adjustment of remuneration within the Bank is achieved in the way that the Risk Committee of the Bank will advise the Board and/or the Remuneration Committee, as appropriate, on the alignment of risk appetite with performance objectives set in the context of variable incentive and on whether any adjustments for risk need to be applied when considering performance objectives and actual performance. In addition, the overall variable pay funding proposal is refined with reference to the advice of Chief Risk Officer and Chief Financial Officer in respect of the Bank's financial position and performance against its Risk Appetite profile.

Variable pay is determined with respect to individual's performance against respective financial and non-financial goals and measures including sales quality, customer satisfaction, values and behaviours, adherence to risk and compliance and the relevant governance criteria. Under such arrangement, the performance and remuneration of control function staff is assessed according to a performance scorecard specific to the functional role they undertake which is independent of the businesses they oversee.

Variable pay consists of deferred and non-deferred components in the forms of cash and share award. The Bank adopts a progressive deferral mechanism with higher deferral rates and different forms of deferral by reference to (a) the employee's seniority, role, responsibilities and the potential risks that their activities may create for the Bank; and (b) the total amount of variable remuneration exceeding the prescribed thresholds. The deferred award has a vesting period of three to five years and is subject to clawback under certain specific circumstances with respect to the awardee's conduct or the Bank's performance.

The principles of the remuneration policy are applicable to the Bank and its subsidiaries, subject to the local legislative requirements and market practices and are proportionate to the scope and complexity of the local business.

Employee Engagement

The Bank continues to build a best place to work by promoting employee engagement and by driving a diversity and inclusive culture.

The Global People Survey has been conducted in 2013 and follow up actions have been taken as a continuous effort to drive employee engagement, business performance and a values-led high performance culture across the Bank. The results showed that the Bank's employee engagement level is well above the external best-in-class, strategies are well communicated and implemented and the corporate values are well embedded in the Bank's culture. The next Global People Survey will be run in 2015 to collect employee's opinions.

Growth and Development

The Bank is committed to ensuring the competence and ethical behaviour of staff members with due regard to the principles set out in HKMA's SPM CG-6 on "Competence and Ethical Behaviour". The Bank has established policies and procedures for monitoring, developing and maintaining the competence levels and ethical behaviour of staff members. These include clear guidance as set out in various policy manuals, robust performance management system, and training and development solutions provided on a regular and need basis.

In order to fully develop staff competence and potential, the Bank has a comprehensive induction programme that provides new staff with an understanding of the Bank's history, vision, culture, values, risk management and corporate governance. To equip staff members with necessary skills and knowledge to meet future challenges and professional requirements, especially those who are involved in regulated businesses and activities, the Bank offers a wide range of training and development programmes in the areas of sales and relationship management, products, operations, compliance, credit and risk. The Bank also offers Professional Qualifications and Education Award Scheme to support staff members to pursue professional or academic qualifications. On average, our staff members received six days of training in 2014.

The Bank aims to strengthen the leadership pipeline and support the personal growth of staff by providing a broad range of leadership and management development solutions. To ensure sustainability, the Bank has strategy, measures and metrics to plan and manage succession to critical roles, and to facilitate talent feed to the succession pipeline. Line businesses and the Human Resources function are connected to accelerate the development of talents and high potential staff through a mix of on-the-job training, coaching and learning interventions.

In support of the Bank's vision, strategy and values, a series of change leadership programmes have been put in place to enhance capability of managers in leading and guiding their teams towards the Bank's strategic direction. A new programme has been launched this year to further cascade the message to general staff, with the aim of strengthening their proactivity in embracing change that supports a sustainable growth of the Bank. Action learning projects are continued to facilitate collaborative and synergistic efforts to drive and implement new ideas that help to drive the Bank's vision and strategy.

Recruitment and Retention

Vigorous recruitment activities continued throughout 2014 to support the Bank's strategic business development and for replacement of out-going staff, especially for front line sales positions, experienced professionals and specialists.

Young talents are constantly recruited and groomed through well-structured and intensive development programmes. Further, trainee programmes have been provided for jobs in selected functional areas in order to build pipeline for succession. There were also conscious efforts on retention of talents and key staff through review of career advancement opportunities and remuneration package to ensure market competitiveness.

Other Information

Organisational Structure

Under the Bank's current organisational structure, the Bank's businesses and functions are set out as follows:

Businesses	Functions	
Retail Banking and Wealth Management	Audit	Legal
Commercial Banking	Communications	Marketing
Global Banking and Markets	Company Secretarial Services	Risk and Compliance
	Corporate Sustainability	Strategic Planning and Corporate Development
	Financial Control	
	Human Resources	Technology and Services

Business Principles and Values

The Bank has a set of well-founded business principles and corporate values guiding staff to keep the highest standards of integrity as well as to comply with the spirit and letter of all laws and regulations when conducting business. "Courageous Integrity" is the guiding principle whereby every employee has the courage to do the right thing without compromising the ethical standards and integrity, and behaves in a "Dependable, Open and Connected" way in everyday work. The Bank advocates the living of values by all staff, promotes their awareness and commitment, and empowers leaders and managers to drive values behaviour in the workplace.

Code of Conduct

To ensure the Bank operates according to the highest standards of ethical conduct and professional competence, all staff are required to strictly follow the Code of Conduct contained in the Bank's Staff Handbook. With reference to the applicable regulatory guidelines and other industry best practices, the Code sets out ethical standards and values to which all the Bank's staff are required to adhere and covers various legal, regulatory and ethical issues. Topics including but not limited to the prevention of bribery, use of information, insider dealing and personal dealings, personal benefits, outside directorships/employment and equal opportunities policy are covered in the Code.

The Bank uses various communication channels to periodically remind staff of the requirement to adhere to the rules and ethical standards set out in the Code of Conduct.

Avoidance of Conflicts of Interest

The Bank has set standards and established policies and procedures to manage actual or potential conflicts of interest of its staff. Stringent internal structures have been designed to ensure adequate segregation of duties and avoid conflicts of interest. Staff working in sensitive or high-risk areas are required to adhere to job-specific rules and undergo training regarding avoidance of conflicts of interest in carrying out their duties.

Health and Safety

The Bank has a demonstrated commitment to occupational health and safety ("OH&S") in the workplace with employee engagement through committees, forums and working groups in the development of an OH&S Policy and Management System. By successfully implementing the certified BS OHSAS 18001:2007-compliant Safety Management System, the Bank marks its achievement to be the first bank world-wide to conform to this internationally acclaimed best practice aiming at reducing the exposure of the Bank's staff, contractors and customers to OH&S risks associated with its business activities at premises over which it has control.

The Bank provides a range of training and activities to enhance the knowledge of its staff in OH&S, fire safety, manual operation, and office safety. A number of staff have acquired Qualified First Aider status so as to offer prompt assistance to their colleagues and customers in the event of a medical emergency or accident whilst awaiting the arrival of the ambulance. Some Qualified First Aiders have also been trained to operate the Automated External Defibrillators installed in the Bank premises.

The Bank implements a Contingency Plan for Communicable Disease, which sets out the key issues to be addressed and the actions to be taken by various units in response to the occurrence of a serious communicable disease, and the keeping of adequate stock of face masks to cater for the needs of its staff in case of an outbreak of influenza pandemic. Staff have been made aware through the Bank-wide intranet of the importance of personal hygiene and health, and the contingency measures to be adopted, to enable the Bank to continue with its services to the community during an outbreak of a serious communicable disease.

The Bank operates a Staff Recreation Centre at Kowloon Bay with a variety of facilities for health enhancement and leisure activities to foster work life balance among its staff and their family members.

Biographical Details of Directors

* Dr Raymond CH'IEN Kuo Fung GBS, CBE, JP CHAIRMAN AGED 63

JOINED THE BOARD SINCE AUGUST 2007

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
– Chairman of Nomination Committee;
Member of Remuneration Committee

Other major appointments

Justice of the Peace
^ China Resources Power Holdings Company Limited
– Independent Non-executive Director
Economic Development Commission of HKSAR Government
– Non-official Member
Federation of Hong Kong Industries – Honorary President
^ MTR Corporation Limited – Non-executive Chairman
^ Swiss Re Limited – Independent Non-executive Director
The Hongkong and Shanghai Banking Corporation Limited
– Independent Non-executive Director
The Tianjin Municipal Committee of the Chinese People's Political Consultative Conference
– Member of Standing Committee
^ The Wharf (Holdings) Limited
– Independent Non-executive Director
University of Pennsylvania, USA – Trustee

Past major appointments

^ UGL Limited – Non-executive Director (2012-2014) *(Note 1)*
^ Convenience Retail Asia Limited
– Independent Non-executive Director (2001-2014)
Hong Kong Mercantile Exchange Limited
– Independent Non-executive Director (2009-2013)
^ China.com Inc – Chairman (1999-2013)
Ascendas China Commercial Fund Management Limited
– Chairman (2011-2012)
^ CDC Software Corporation – Director (2009-2012)
The Hong Kong/European Union Business Cooperation Committee
– Chairman (2005-2012)
^ CDC Corporation – Chairman (1999-2011)
HSBC Private Equity (Asia) Limited – Chairman (1997-2010)
The APEC Business Advisory Council
– Hong Kong Member (2004-2009)
^ Inchcape plc – Independent Non-executive Director (1997-2009)
^ HSBC Holdings plc
– Independent Non-executive Director (1998-2007)
Independent Commission Against Corruption
– Chairman of Advisory Committee on Corruption (1998-2006)
Executive Council of HKSAR Government – Member (1997-2002)
Executive Council of Hong Kong, then under British Administration
– Member (1992-1997)

Qualification

Doctoral Degree in Economics – University of Pennsylvania, USA

Major awards

Chevalier de l'Ordre du Merite Agricole of France (2008)
Gold Bauhinia Star (1999)
Commander in the Most Excellent Order of the British Empire (1994)

Ms Rose LEE Wai Mun JP VICE-CHAIRMAN AND CHIEF EXECUTIVE AGED 62

JOINED THE BOARD SINCE MARCH 2012

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
– Chairman of Executive Committee;
Member of Nomination Committee
Hang Seng Bank (China) Limited
– Chairman; Member of Executive Committee
Hang Seng Indexes Company Limited
– Chairman of Hang Seng Index Advisory Committee
Hang Seng Insurance Company Limited – Chairman
Chairman of other subsidiaries in Hang Seng Group

Other major appointments

Justice of the Peace
Guangdong's Association for Promotion of Cooperation between Guangdong, Hongkong & Macao
– Vice-Chairman of the Finance Professional Committee
Hang Seng Management College
– Chairman of the Board of Governors
Hang Seng School of Commerce
– Chairman of the Board of Directors
Ho Leung Ho Lee Foundation – Member of Board of Trustees
Hong Kong Trade Development Council
– Member of the Financial Services Advisory Committee
^ HSBC Holdings plc – Group General Manager
^ Hutchison Whampoa Limited
– Independent Non-executive Director
Inaugural Financial Consulting Committee for Authority of Qianhai Shenzhen – Hong Kong Modern Service Industry Cooperation Zone of Shenzhen – Member
^ Swire Pacific Limited – Independent Non-executive Director
The Community Chest of Hong Kong
– Board Member; Second Vice President;
Member of Executive Committee;
Chairman of the Campaign Committee
The Hongkong and Shanghai Banking Corporation Limited
– Director
The Hong Kong Institute of Bankers – Vice President
The Hong Kong University of Science and Technology
– Member of the Court
The University of Hong Kong, New College of Jockey Club Student Village III – Member of the Advisory Committee *(Note 1)*

Past major appointments

City University of Hong Kong
– Member of the Advisory Committee of the Centre for Transportation, Trade and Financial Studies (2012-2013)
Hong Kong Shipowners' Association
– Honorary Treasurer;
Member of the Executive Committee (2009-2013)
Hong Kong General Chamber of Commerce
– Vice-Chairman of the China Committee (2006-2013)
Bank of Shanghai – Director (2006-2012)
Hong Kong Trade Development Council
– Member of the China Trade Advisory Committee (2007-2011)
HKSAR Government Education and Manpower Bureau
– Member of the Continuing Education Fund China Business Focus Group (2002-2009)
The Hong Kong Institute of Bankers
– Member of the China Development Committee (2005-2007)
Hong Kong Monetary Authority
– Member of the PRC Offshore Financing Consultative Committee (1998-2000)
The Hongkong and Shanghai Banking Corporation Limited
– joined Corporate Finance Department of Wardley Limited in 1977, seconded to Area Office China, HSBC in 1979, appointed Deputy Chief Executive, China Business (1994-2002), Managing Director of Hongkong Bank China Services Limited (1985-2004), Head of Corporate Banking, Hong Kong (2002-2004), Head of Corporate and Institutional Banking, Hong Kong (2004-2007), Head of Corporate Banking, Hong Kong and China (2007-2008), Head of Global Banking, China and Hong Kong (2008-2009) and Advisor, China and Hong Kong (2009-2012)

Qualification

Bachelor's Degree in Business Administration
– The University of Hawaii, USA

* Dr John CHAN Cho Chak GBS, JP DIRECTOR AGED 71

JOINED THE BOARD SINCE AUGUST 1995

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
– Chairman of Remuneration Committee;
Member of Nomination Committee

Other major appointments

Justice of the Peace
^ Guangdong Investment Limited
– Independent Non-executive Director
Long Win Bus Company Limited – Non-executive Director
^ RoadShow Holdings Limited
– Chairman and Non-executive Director
^ Swire Properties Limited – Independent Non-executive Director
The Community Chest of Hong Kong
– Board Member; Third Vice President;
Member of Executive Committee;
Chairman of Public Relations Committee
The Hong Kong University of Science and Technology
– Chairman of the Court
The Kowloon Motor Bus Company (1933) Limited
– Non-executive Director
^ Transport International Holdings Limited
– Deputy Chairman and Independent Non-executive Director

Past major appointments

Hong Kong Monetary Authority
– Member of The Exchange Fund Advisory Committee
(2008-2014) *(Note 1)*
Sir Edward Youde Memorial Fund
– Chairman of the Council (2007-2013)
The Community Chest of Hong Kong – Vice Patron (2004-2011)
The Hong Kong Jockey Club – Chairman (2006-2010)
HKSAR Commission on Strategic Development
– Non-Official Member (2005-2009)
^ Hong Kong Exchanges and Clearing Limited
– Independent Non-executive Director (2000-2003)
Hong Kong Civil Service
– Private Secretary to the Governor;
Deputy Secretary (General Duties);
Director of Information Services;
Deputy Chief Secretary;
Secretary for Trade and Industry;
Secretary for Education and Manpower
(1964-1978; 1980-1993)

Qualifications

Degree of Doctor of Social Sciences (honoris causa)
– Lingnan University; The University of Hong Kong;
The Hong Kong University of Science and Technology
Degree of Doctor of Business Administration (honoris causa)
– International Management Centres
Diploma in Management Studies – The University of Hong Kong
Honours Degree in English Literature
– The University of Hong Kong

Major award

Gold Bauhinia Star (1999)

Mr Nixon CHAN Lik Sang EXECUTIVE DIRECTOR AND HEAD OF RETAIL BANKING AND WEALTH MANAGEMENT AGED 62

JOINED THE BOARD SINCE JANUARY 2014

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
– Head of Retail Banking and Wealth Management;
Member of Executive Committee
Hang Seng Bank (Trustee) Limited – Director
Hang Seng Credit Limited – Director
Hang Seng Finance Limited – Director
Hang Seng Futures Limited – Director
Hang Seng Indexes Company Limited
– Member of Hang Seng Index Advisory Committee
Hang Seng Insurance Company Limited – Director
Hang Seng Securities Limited – Director
Hang Seng Security Management Limited – Director
Haseba Investment Company Limited – Director

Other major appointments

Anti-Money Laundering and Counter-Terrorist Financing
(Financial Institutions) Review Tribunal – Member
Employers' Federation of Hong Kong
– Elected Member of General Committee
EPS Company (Hong Kong) Limited – Director
Hang Seng Management College – Governor
Hang Seng School of Commerce – Director
MasterCard Asia/Pacific Advisory Board – Director
Small and Medium Enterprises Committee – Member
TransUnion Limited – Director

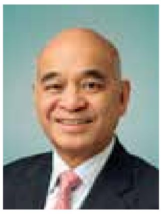
Past major appointments

^ Hang Seng Bank Limited
– Head of Corporate and Commercial Banking (2009-2011)
The Hongkong and Shanghai Banking Corporation Limited
– Senior Executive, Commercial Banking (2005-2009);
Held various senior positions in commercial banking and
personal financial services (1993-2005)

Qualification

Bachelor's Degree in Business Administration
– The University of Hawaii, USA

* Independent Non-executive Directors # Non-executive Directors ^ The securities of these companies are listed on a securities market in Hong Kong or overseas.



* Dr Henry CHENG Kar Shun GBS DIRECTOR AGED 68

JOINED THE BOARD SINCE MAY 2014

Other major appointments

^ Chow Tai Fook Jewellery Group Limited
– Chairman and Executive Director
^ HKR International Limited – Independent Non-executive Director
^ International Entertainment Corporation
– Chairman and Executive Director
^ Lifestyle International Holdings Limited – Non-executive Director
^ New World China Land Limited – Chairman and Managing Director
^ New World Department Store China Limited
– Chairman and Non-executive Director
^ New World Development Company Limited
– Chairman and Executive Director
^ Newton Resources Ltd – Chairman and Non-executive Director
^ NWS Holdings Limited – Chairman and Executive Director
^ SJM Holdings Limited – Non-executive Director
The Better Hong Kong Foundation
– Chairman of the Advisory Council
The Twelfth National Committee of Chinese People's Political Consultative Conference
– Standing Committee Member

Qualifications

Honorary Doctor of Business Administration in Hospitality Management
– The Johnson & Wales University, USA
Honorary Doctor of Laws
– The University of Western Ontario, Canada
Doctor of Social Sciences (honoris causa)
– The University of Hong Kong

Major award

Gold Bauhinia Star (2001)

* Ms CHIANG Lai Yuen JP DIRECTOR AGED 49

JOINED THE BOARD SINCE SEPTEMBER 2010

Other position held within Hang Seng Group

^ Hang Seng Bank Limited
– Member of Remuneration Committee

Other major appointments

Justice of the Peace
^ Chen Hsong Holdings Limited
– Executive Director; Chief Executive Officer
Chen Hsong Investments Limited – Director
China Shenzhen Machinery Association – Vice-President
Federation of Shenzhen Industries – Vice-Chairman
Hospital Authority – Board Member
The Hong Kong University of Science and Technology
– Member of the Court
The Shenzhen Committee of the Chinese People's Political Consultative Conference
– Member of Standing Committee
The Toys Manufacturers' Association of Hong Kong
– Vice-President

Past major appointments

Directorate Salaries and Conditions of Service of HKSAR Government
– Member of Standing Committee (2008-2014)
The Hong Kong University of Science and Technology
– Member of the Council (2006-2012)
The Open University of Hong Kong
– Member of the Council (2006-2012)
Disciplined Services Salaries and Conditions of Service of HKSAR Government
– Member of Standing Committee (retired in December 2010)

Qualification

Bachelor Degree of Arts – Wellesley College, USA

Major award

"Young Industrialist Awards of Hong Kong" by the Federation of Hong Kong Industries (2004)

Mr Andrew FUNG Hau Chung JP EXECUTIVE DIRECTOR AND HEAD OF GLOBAL BANKING AND MARKETS AGED 57

JOINED THE BOARD SINCE OCTOBER 2011

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited – Member of Executive Committee
Hang Seng Bullion Company Limited – Director
Hang Seng Indexes Company Limited
– Member of Hang Seng Index Advisory Committee
Hang Seng Insurance Company Limited – Director
Hang Seng Investment Management Limited
– Director and General Manager
Hang Seng Investment Services Limited – Director
Hang Seng Life Limited – Director
Hang Seng Securities Limited – Executive Director

Other major appointments

Justice of the Peace
Central Policy Unit of HKSAR Government – Associate Member
HKSAR Government Environment Bureau
– Member of Energy Advisory Committee
Hong Kong Institute of Certified Public Accountants
– Lay Member of the Council
Hospital Authority – Board Member
Independent Commission on Remuneration for Members of the Executive Council and the Legislature, and Officials under the Political Appointment System of HKSAR Government
– Member
^ Industrial Bank Co., Ltd.
– Director; Member of Strategic Committee;
Member of Remuneration and Evaluation Committee
Labour Department
– Member of the Protection of Wages on Insolvency Fund Board
Securities and Futures Commission
– Member of Products Advisory Committee
The Community Chest of Hong Kong – Board member
The Hong Kong Mortgage Corporation Limited – Director
The Liaoning Shenyang Committee of the Chinese People's Political Consultative Conference – Member
Treasury Markets Association – Member of the Executive Board

Past major appointments

Business Facilitation Advisory Committee
– Non-official member (2009-2013)
The Federation of Hong Kong Industries
– Member of General Committee (2007-2013)
Central Policy Unit of HKSAR Government
– Pan-Pearl River Delta Panel – Member (2011-2012)
Hong Kong Trade Development Council
– Member of the Financial Services Advisory Committee (2008-2012)
^ Hang Seng Bank Limited
– Executive Director and Head of Treasury and Investment (2011-2012);
General Manager and Head of Treasury and Investment (2009-2011);
General Manager and Head of Investment and Insurance (2008-2009);
Deputy General Manager and Head of Investment and Insurance (2006-2008)
Securities and Futures Commission
– Member of Process Review Panel (2006-2012)
DBS Bank (Hong Kong) Limited
– Managing Director, Advisory Sales, Greater China, Wholesale Banking – Global Financial Markets (2002-2006)
^ Commonwealth Bank of Australia, Hong Kong Branch
– Treasurer and Head of Capital Markets, Asia (1996-2002)
The Hongkong and Shanghai Banking Corporation Limited
– Head of Hong Kong Dollar Markets (1991-1996)

Qualifications

Bachelor of Arts Degree – The University of Hong Kong
Honorary Fellowship – Lingnan University

* Dr HU Zuliu, Fred DIRECTOR AGED 51

JOINED THE BOARD SINCE MAY 2011

Other position held within Hang Seng Group

^ Hang Seng Bank Limited
– Member of Risk Committee

Other major appointments

China Huarong Asset Management Company
– Member of the advisory board
China Medical Board – Trustee
^ Dalian Wanda Commercial Properties Co., Ltd.
– Independent Non-executive Director
^ Hong Kong Exchanges and Clearing Limited
– Independent Non-executive Director *(Note 1)*
National Center for Economic Research at Tsinghua University
– Director and Professor
Primavera Capital Limited – Founder and Chairman
^ SCMP Group Limited – Independent Non-executive Director
^ Shanghai Pudong Development Bank Co., Ltd.
– External Supervisor
The Nature Conservancy China Board – Chairman
Yale-China Association – Trustee

Past major appointments

Securities and Futures Commission
– Member of Advisory Committee (2009-2011)
Goldman Sachs Group Inc.
– Managing Director (2000-2010);
Chairman of Greater China (2008-2010)
HKSAR Commission on Strategic Development
– Member (2007-2009)
^ Shanghai Pudong Development Bank Co., Ltd.
– Independent Director (2002-2008)

Qualifications

Master of Arts and Doctor of Philosophy in Economics
– Harvard University, USA
Master of Science in Engineering Science
– Tsinghua University, PRC

* Independent Non-executive Directors # Non-executive Directors ^ The securities of these companies are listed on a securities market in Hong Kong or overseas.

* Ms Irene LEE Yun Lien DIRECTOR AGED 61

JOINED THE BOARD SINCE MAY 2014

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
– Chairman of Risk Committee; Member of Audit Committee

Other major appointments

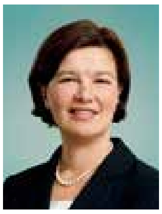
^ Cathay Pacific Airways Limited
– Independent Non-executive Director;
Chairman of Remuneration Committee;
Member of Audit Committee
^ CLP Holdings Limited
– Independent Non-executive Director;
Member of Audit Committee,
Finance & General Committee and Sustainability Committee
^ Hysan Development Company Limited
– Executive Chairman;
Chairman of Nomination Committee and Strategy Committee
^ Noble Group Limited
– Independent Non-executive Director;
Member of Audit Committee, Investment & Capital Markets Committee, Nominating Committee and Risk Committee
The Hongkong and Shanghai Banking Corporation Limited
– Independent Non-executive Director;
Member of Audit Committee

Past major appointments

JP Morgan Australia – Member of Advisory Council (2005-2013)
^ QBE Insurance Group Limited
– Non-executive Director (2002-2013)
^ Keybridge Capital Limited
– Non-executive Chairman (2009-2012);
Executive Chairman (2006-2009)
The Myer Family Company Pty Limited
– Non-executive Director (2009-2011)
ING Bank (Australia) Limited
– Non-executive Director (2005-2011)
Australian Government Takeovers Panel – Member (2001-2010)
Sealcorp Holdings Limited – Chief Executive Officer (1998-1999)
^ Commonwealth Bank of Australia
– Head of Corporate Finance (1993-1998)
Citicorp Investment Bank Limited in New York, London and Sydney
– Executive Director (1977-1987)

Qualifications

Bachelor of Arts Degree – Smith College, USA
Barrister-at-Law in England and Wales
Member – The Honourable Society of Gray's Inn, UK



Ms Sarah Catherine LEGG DIRECTOR AGED 47

JOINED THE BOARD SINCE FEBRUARY 2011

Other major appointments

HSBC Bank (Taiwan) Limited – Director
^ HSBC Holdings plc – Group General Manager
HSBC Securities Investments (Asia) Limited – Director
The Hongkong and Shanghai Banking Corporation Limited
– Chief Financial Officer
The Hong Kong Association of Banks – Acting Chairman;
Chairman of the Basel Implementation Committee
The Hong Kong Society for Rehabilitation – Honorary Treasurer
Director of other subsidiaries in HSBC Group

Past major appointments

HSBC Bank Bahamas Limited – President (2010-2014) *(Note 1)*
HSBC Markets (Bahamas) Limited
– President (2010-2014) *(Note 1)*
HSBC Asia Holdings BV – Director (2011-2013)
The Hongkong and Shanghai Banking Corporation Limited
– Chief Accounting Officer (2006-2010)
^ HSBC Holdings plc
– Senior Manager, Finance Transformation (2003-2006)
HSBC Bank plc
– Head of Product Control, Global Banking and Markets (1999-2003)

Qualifications

Master of Arts – King's College, Cambridge University, UK
Fellow – Chartered Institute of Management Accountants
Fellow – Association of Corporate Treasurers

* Dr Eric LI Ka Cheung GBS, OBE, JP DIRECTOR AGED 61

JOINED THE BOARD SINCE FEBRUARY 2000

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
– Chairman of Audit Committee; Member of Risk Committee

Other major appointments

Justice of the Peace
^ China Resources Enterprise, Limited
– Independent Non-executive Director;
Chairman of Audit Committee
Independent Commission on Remuneration for the Members of the District Councils of HKSAR Government – Chairman
Legal Aid Services Council – Chairman
Li, Tang, Chen & Co, Certified Public Accountants – Senior Partner
Long Win Bus Company Limited
– Independent Non-executive Director
^ RoadShow Holdings Limited
– Independent Non-executive Director;
Chairman of Audit Committee
^ SmarTone Telecommunications Holdings Limited
– Independent Non-executive Director;
Chairman of Audit Committee
^ Sun Hung Kai Properties Limited
– Independent Non-executive Director;
Chairman of Audit Committee
The Hong Kong Institute of Education
– Treasurer of the Council; Chairman of Finance Committee
The Hong Kong Jockey Club
– Steward; Chairman of Audit Committee
The Kowloon Motor Bus Company (1933) Limited
– Independent Non-executive Director;
Chairman of Audit Committee
The Presidium of the Election of Deputies of the Hong Kong Special Administrative Region to the Twelfth National People's Congress – Member
The Twelfth National Committee of the Chinese People's Political Consultative Conference – Member
^ Transport International Holdings Limited
– Independent Non-executive Director;
Chairman of Audit Committee
^ Wong's International (Holdings) Limited
– Independent Non-executive Director;
Chairman of Audit Committee

Past major appointments

^ Bank of Communications Co., Ltd.
– Independent Non-executive Director;
Chairman of Audit Committee (2007-2013)
The Financial Reporting Council
– Convenor of Financial Reporting Review Committee (2007-2013)
HKSAR Commission on Strategic Development
– Member (2007-2012)
Hong Kong Monetary Authority
– Chairman of Process Review Committee (2007-2010)
Meadville Holdings Limited
– Independent Non-executive Director;
Chairman of Remuneration Committee (2007-2010)
The International Federation of Accountants
– Board Member (2004-2006)
The Legislative Council of Hong Kong
– Member (1991-2004);
Chairman of Public Accounts Committee (1995-2004)

Qualifications

BA (Economics) Honours Degree – University of Manchester, UK
Fellow
– Hong Kong Institute of Certified Public Accountants (Practising)
Hon Doctor of Laws – University of Manchester, UK
Hon Doctor of Social Sciences – Hong Kong Baptist University
Hon Fellow – The Chinese University of Hong Kong
Hon Fellow – The Hong Kong Polytechnic University

Major awards

Gold Bauhinia Star (2003)
Officer of the Most Excellent Order of the British Empire (1996)

Dr Vincent LO Hong Sui GBS, JP DIRECTOR AGED 66

JOINED THE BOARD SINCE FEBRUARY 1999

Other major appointments

Justice of the Peace
Airport Authority Hong Kong – Chairman
APEC Business Advisory Council – Hong Kong's Representative
Business and Professionals Federation of Hong Kong
– Honorary Life President
Chongqing Municipal Government – Economic Adviser
Council for the Promotion and Development of Yangtze
– President
^ Great Eagle Holdings Limited – Non-executive Director
Lantau Development Advisory Committee of HKSAR Government
– Non-official Member
Shanghai Tongji University; Shanghai University
– Advisory Professorship
Shui On Group – Chairman
^ Shui On Land Limited – Chairman
^ SOCAM Development Limited – Chairman
The Hong Kong University of Science and Technology
– Honorary Court Chairman
The Twelfth National Committee of the Chinese People's Political Consultative Conference – Member

Past major appointments

^ Shui On Land Limited – Chief Executive Officer (2004-2011)
^ China Telecom Corporation Limited
– Independent Non-executive Director (retired in 2008)
^ New World China Land Limited
– Independent Non-executive Director (retired in 2004)

Qualifications

Doctorate in Business Administration (honoris causa)
– The Hong Kong University of Science and Technology
Doctor of Business (honoris causa)
– The University of New South Wales, Australia

Major awards

Lifetime Achievement Award for Leadership in Property Sector by the 4th World Chinese Economic Forum (2012)
"Ernst & Young Entrepreneur Of The Year 2009" in the China Real Estate Sector (2009)
Ernst & Young China Entrepreneur Of The Year 2009 (2009)
Chevalier des Arts et des Lettres by the French Government (2005)
Director of the Year in the category of Listed Company Executive Directors by The Hong Kong Institute of Directors in 2002 (2002)
Businessman of the Year award in the Hong Kong Business Awards 2001 (2001)
Gold Bauhinia Star (1998)

* Independent Non-executive Directors # Non-executive Directors ^ The securities of these companies are listed on a securities market in Hong Kong or overseas.

Mr Kenneth NG Sing Yip DIRECTOR AGED 64

JOINED THE BOARD SINCE MARCH 2014

Other major appointments

Competition Tribunal Users' Committee of HKSAR Government
– Member
Hong Kong General Chamber of Commerce
– Vice Chairman of Legal Committee
HSBC Bank (China) Company Limited – Non-executive Director
HSBC Bank (Vietnam) Ltd. – Chairman of Board of Supervision
Standing Committee on Company Law Reform – Member
The Hongkong and Shanghai Banking Corporation Limited
– General Counsel, Asia Pacific
The Law Society of Hong Kong – Council Member
The University of Hong Kong
– Member of Asian Institute of International Financial Law Advisory Board of the Faculty of Law

Past major appointments

Board of Review of Inland Revenue Ordinance of HKSAR Government – Member (2008-2014)
^ Ping An Insurance (Group) Company of China, Ltd.
– Non-executive Director (2006-2013)
The Hongkong and Shanghai Banking Corporation Limited
– Deputy Head of Legal and Compliance Department (1993-1998);
Assistant Group Legal Adviser (1987-1993)

Qualifications

Bachelor's Degree and Master's Degree in Laws (L.L.B. and L.L.M.)
– University of London, UK
Bachelor's Degree in Laws (L.L.B.) – Beijing University, PRC

* Mr Richard TANG Yat Sun BBS, JP DIRECTOR AGED 62

JOINED THE BOARD SINCE AUGUST 1995

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited – Member of Audit Committee
Hang Seng Bank (China) Limited – Supervisor

Other major appointments

Justice of the Peace
China Overseas Friendship Association
– Executive Director-General
Customs and Excise Service Children's Education Trust Fund
– Chairman of Investment Advisory Board
Fight Crime Committee – Member
Hong Kong Commercial Broadcasting Company Limited – Director
Hong Kong Institute of Certified Public Accountants
– Member of Investigation Panel A
^ King Fook Holdings Limited – Vice Chairman
^ Miramar Hotel & Investment Company, Limited – Director
Richcom Company Limited – Chairman and Managing Director
Tang Shiu Kin and Ho Tim Charitable Fund – Advisor
The Twelfth National Committee of the Chinese People's Political Consultative Conference – Member
^ Wheelock and Company Limited
– Independent Non-executive Director

Past major appointments

Steering Committee of HKSAR Government Scholarship Fund
– Member (2008-2014)
Customs and Excise Service Children's Education Trust Fund Committee – Chairman (2006-2012)
Hong Kong Institute of Certified Public Accountants
– Member of Disciplinary Panel A (2006-2012)
Correctional Services Children's Education Trust
– Chairman of Investment Advisory Board (2006-2011)

Qualifications

Bachelor of Science Degree in Business Administration
– Menlo College, California, USA
Master's Degree in Business Administration
– University of Santa Clara, California, USA

Major award

Bronze Bauhinia Star (2000)

Notes:

1 New appointments or cessation of appointments since the date of the Bank's 2014 Interim Report.

2 The interests of Directors in shares of the Bank, if any, within the meaning of Part XV of the Securities and Futures Ordinance ("SFO") as at 31 December 2014 are disclosed in the section "Directors' and Alternate Chief Executives' Interests" of the Report of the Directors attached to the Bank's 2014 Annual Report.

3 Some Directors (as disclosed in the section "Biographical Details of Directors" of the Bank's 2014 Annual Report) are also Directors of HSBC Holdings plc ("HSBC") and/or its subsidiaries. HSBC, through its wholly owned subsidiaries, has an interest in the shares of the Bank under the provisions of Divisions 2 and 3 of Part XV of the SFO, the details of which are disclosed in the section "Substantial Interests in Share Capital" of the Report of the Directors attached to the Bank's 2014 Annual Report.

4 Save as disclosed in the section "Biographical Details of Directors" of the Bank's 2014 Annual Report, the Directors (a) have not held any directorships in other publicly listed companies, whether in Hong Kong or overseas, during the last 3 years; (b) do not hold any other positions in the Bank and its subsidiaries; and (c) do not have any other relationships with any Directors, senior management or substantial or controlling shareholders of the Bank, except that Mr Michael W K Wu's spouse is the niece of Dr Vincent H S Lo, a Non-executive Director of the Bank.

5 All Directors (except those Directors who are full time employees of the Bank or its subsidiaries) will receive Directors' fees in the amounts approved from time to time by shareholders at the Annual General Meetings of the Bank. The current amounts of Directors' fees have been determined with reference to market rates, directors' workload and required commitment. A Director will also receive a fee for duties assigned to and services provided by him/her as Chairman or member of various Committees of the Bank. Such fees have been determined with reference to the remuneration policy of the Bank.

Mr Peter WONG Tung Shun JP DIRECTOR AGED 63

JOINED THE BOARD SINCE MAY 2005

Other position held within Hang Seng Group

^ Hang Seng Bank Limited – Member of Nomination Committee

Other major appointments

Justice of the Peace
^ Bank of Communications Co., Ltd. – Non-executive Director
^ Cathay Pacific Airways Limited
– Independent Non-executive Director
Chongqing Mayor's International Economic Advisory Council
– Member
Economic Development Commission of HKSAR Government
– Non-official Member
Hong Kong General Chamber of Commerce
– Member of General Committee
Hong Kong Monetary Authority
– Member of The Exchange Fund Advisory Committee
HSBC Bank (China) Company Limited
– Chairman and Non-executive Director;
Chairman of Nomination Committee;
Member of Remuneration Committee
HSBC Bank Malaysia Berhad
– Chairman and Non-executive Director
^ HSBC Holdings plc
– Group Managing Director;
Member of Group Management Board
International Consultative Conference on the Future Economic Development of Guangdong Province
– Economic Advisor to the Governor of Guangdong Province of the People's Republic of China
The Community Chest of Hong Kong – Board Member
The Eleventh Hubei Provincial Committee of the Chinese People's Political Consultative Conference
– Member; Member of Standing Committee
The Hongkong and Shanghai Banking Corporation Limited
– Deputy Chairman and Chief Executive; Executive Director
The Hong Kong Institute of Bankers – President
The Hong Kong Management Association – Fellow
The Twelfth National Committee of the Chinese People's Political Consultative Conference – Member

Past major appointments

International Advisor to the Mayor of Tianjin (2010-2013)
Greater Pearl River Delta Business Council
– Member (2006-2013)
HSBC Bank (Vietnam) Ltd
– Vice-Chairman and Non-executive Director (2010-2012)
^ Ping An Insurance (Group) Company of China, Ltd.
– Non-executive Director (2006-2012)
Hong Kong Institute for Monetary Research
– Member of the Board of Directors (2010-2011)
HSBC Bank Australia Limited
– Non-executive Director (2010-2011)
^ Hong Kong Exchanges and Clearing Limited
– Member of Risk Management Committee (2010)
Hong Kong Trade Development Council
– Chairman of Financial Services Advisory Committee (2006-2010)
Hong Kong Monetary Authority
– Member of Banking Advisory Committee (2005-2010)
The Hong Kong Association of Banks
– Chairman (2001, 2004, 2006 and 2009)

Qualifications

Bachelor's Degree in Computer Science; MBA in Marketing and Finance; MSc in Computer Science
– Indiana University, USA

* Mr Michael WU Wei Kuo DIRECTOR AGED 44

JOINED THE BOARD SINCE SEPTEMBER 2010

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
– Member of Audit Committee;
Member of Nomination Committee

Other major appointments

Hongkong Caterers Limited
– Executive Director and Company Secretary
^ Hongkong Land Holdings Limited – Non-executive Director
Maxim's Caterers Limited – Chairman and Managing Director
The Community Chest of Hong Kong
– Board Member; Member of Executive Committee
The Hong Kong University of Science and Technology
– Member of the Council
The University of Hong Kong – Member of the Court

Qualification

Bachelor of Science in Applied Mathematics and Economics
– Brown University, USA

Major awards

"Ernst & Young Entrepreneur of The Year 2012 China"
– Category Winner (Services) and Country Winner (Hong Kong/Macau Regions) (2012)
"Executive Award" of the DHL/SCMP Hong Kong Business Awards (2008)

6 No Directors' fees are payable to those Directors who are full time employees of the Bank or its subsidiaries. The salary packages of such Directors have been determined with reference to the remuneration policy of the Bank. Such Directors are also entitled to discretionary bonus.

7 The details of the emoluments of the Directors on a named basis are disclosed in Note 15 of the Bank's Financial Statements as contained in the Bank's 2014 Annual Report.

8 None of the Directors, except Ms Rose W M Lee, Mr Andrew H C Fung and Mr Nixon L S Chan, has signed service contracts with the Bank. The term of appointment of Non-executive Directors (including Independent Non-executive Directors) is three years except that where a Non-executive Director (or an Independent Non-executive Director) has served on the Board for more than nine years, then his/her term of appointment is one year.

9 Biographical details of Directors of the Bank are also available on the website of the Bank at www.hangseng.com.

* Independent Non-executive Directors # Non-executive Directors ^ The securities of these companies are listed on a securities market in Hong Kong or overseas.

Biographical Details of Senior Management

Mr Donald Y S Lam Mr Nixon L S Chan Ms Rose W M Lee Mr Andrew H C Fung Mr Andrew W L Leung

Ms Rose LEE Wai Mun JP VICE-CHAIRMAN AND CHIEF EXECUTIVE
(Biographical details are set out on page 128)

Mr Andrew FUNG Hau Chung JP EXECUTIVE DIRECTOR AND HEAD OF GLOBAL BANKING AND MARKETS
(Biographical details are set out on page 131)

Mr Nixon CHAN Lik Sang EXECUTIVE DIRECTOR AND HEAD OF RETAIL BANKING AND WEALTH MANAGEMENT
(Biographical details are set out on page 129)

Ms Ivy CHAN Shuk Pui CHIEF RISK OFFICER AGED 49

JOINED THE BANK SINCE JULY 2014

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Chief Risk Officer; Member of Executive Committee
Hang Seng Security Management Limited – Director

Past major positions

The Hongkong and Shanghai Banking Corporation Limited
– Chief Risk Officer, HSBC Bank (Taiwan) Limited (2010-2014);
Senior Manager of Credit Risk Management Department (2005-2010);
Senior Relationship Manager of Credit Risk Management Department (2002-2005);
Treasury Credit Risk Manager (1997-2001);
Various positions in HSBC in the areas of Trade Services, Retail Banking, Corporate Banking Relationship Manager, Credit Operations (1988-1997)

Qualification

Professional Diploma in Company Secretaryship and Administration
– The Hong Kong Polytechnic University

Mr Christopher HO Hing Nin CHIEF OPERATING OFFICER AGED 62

JOINED THE BANK SINCE JULY 2009

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Chief Operating Officer; Member of Executive Committee
Hang Seng Real Estate Management Limited – Director
Hang Seng Security Management Limited – Director

Past major positions

Education Bureau of HKSAR Government
– Member of Banking Industry Training Advisory Committee (2010-2014)
Urban Renewal Authority
– Member of Central Oasis Community Advisory Committee (2009-2012)
The Hongkong and Shanghai Banking Corporation Limited
– Head of Service Delivery Asia Pacific (2009);
Held various senior positions in banking operations and personal financial services (1992-2008)

Qualification

MSc in Management Information Systems – Sheffield Hallam University, UK

Mr Donald LAM Yin Shing HEAD OF COMMERCIAL BANKING AGED 51

JOINED THE BANK SINCE MARCH 2003

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Head of Commercial Banking; Member of Executive Committee
Hang Seng Insurance Company Limited – Director

Past major positions

Hang Seng General Insurance (Hong Kong) Company Limited
– Director (2008-2012)
Hang Seng Bank Limited
– Head of Commercial Banking Relationship Management (2005-2006); Deputy Head of Commercial Banking Relationship Management (2004-2005); Department Head, Commercial Banking Relationship Management Department A (2003-2004)
Playmates Holdings Limited
– Executive Director and Chief Financial Officer (2001-2003)
The Hongkong and Shanghai Banking Corporation Limited
– Senior Marketing and Planning Manager (1999-2001); Held various senior positions in Corporate and Commercial Banking (1987-1999)

Qualifications

Associate – The Hong Kong Institute of Bankers
Bachelor of Social Science (1st Class Honor) – The University of Hong Kong
Master of Business Administration – The Chinese University of Hong Kong
Master of Science in e-Commerce – The Chinese University of Hong Kong

Mr Gordon LAM Wai Chung VICE-CHAIRMAN AND CHIEF EXECUTIVE OF HANG SENG BANK (CHINA) LIMITED AGED 55

JOINED THE BANK SINCE OCTOBER 2012

Major positions held within Hang Seng Group

Hang Seng Bank (China) Limited
– Vice-Chairman and Chief Executive; Chairman of Executive Committee

Past major positions

Hang Seng Bank (China) Limited
– First Deputy Chief Executive and Head of Network (2012-2013); Deputy Chief Executive, Head of Business Development, Corporate and Commercial Banking (2012)
HSBC Bank (China) Company Limited
– Managing Director and Head of Global Banking (2007-2011); Chief Credit Officer (2003-2007)
China Banking Regulatory Commission Shanghai Office
– Leader of the Foreign Bank Basel ll Working Committee (2007)
The Hong Kong Association of Banks
– Chairman of Preparatory Committee for Hong Kong Commercial Credit Reference Agency (2003)
The Hongkong and Shanghai Banking Corporation Limited
– Senior Manager, Credit Risk Management, Asia Pacific (1988-2003)
Hong Kong Chamber of Commerce in China
– One of Founding members (1993-1994)

Qualification

Bachelor of Business Administration – The Chinese University of Hong Kong

Mrs Louise LAM HEAD OF HUMAN RESOURCES AGED 58

JOINED THE BANK SINCE AUGUST 2007

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Head of Human Resources; Member of Executive Committee

Past major positions

The Hongkong and Shanghai Banking Corporation Limited
– Head of Human Resources Operations, Asia Pacific (2004-2007); Held various senior positions in Human Resources (1990-2004)
Government of Ontario, Canada
– Senior Consultant, Organisational Development (1987-1990)
Chase Manhattan Bank
– Vice President, Head of Human Resources (1980-1987)

Qualification

Bachelor of Social Sciences in Economics and Management Studies
– The University of Hong Kong

Mr Andrew LEUNG Wing Lok CHIEF FINANCIAL OFFICER AGED 52

JOINED THE BANK IN JULY 1997 (LEFT IN 2006) AND REJOINED IN JULY 2009

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Chief Financial Officer; Member of Executive Committee
Hang Seng Bank (China) Limited – Director
Hang Seng Insurance Company Limited – Director

Past major positions

Hang Seng Bank Limited
– Senior Manager and Deputy Head of China Business (2005-2006); Senior Manager and Deputy Head of Greater China Business (2003-2005); Senior Manager of Corporate Banking (2001-2003); Senior Manager and Deputy Head of Financial Control (1997-2001)

Qualifications

Associate – The Hong Kong Institute of Chartered Secretaries
Associate – The Institute of Chartered Secretaries and Administrators
Bachelor of PRC Law – Peking University, PRC
Bachelor of Social Sciences (Major in Management)
– The University of Hong Kong
Certified Member
– Certified Management Accountants Society of British Columbia, Canada
Fellow – Chartered Association of Certified Accountants
Fellow – Hong Kong Institute of Certified Public Accountants
Master of Science, Data processing – University of Ulster, UK
Master of Science in Electronic Commerce and Internet Computing
– The University of Hong Kong

Note:
Definition of senior management is set out in the “Corporate Governance and Other Information” section in this Annual Report.

Report of the Directors

The Directors have pleasure in presenting their report together with the audited financial statements for the year ended 31 December 2014.

Principal Activities

The Bank and its subsidiaries are engaged in the provision of banking and related financial services.

Profits

The consolidated profit of the Bank and its subsidiaries and associates for the year and the particulars of dividends which have been paid or declared are set out on pages 146 and 180 of this Annual Report respectively.

Major Customers

The Directors believe that the five largest customers of the Bank accounted for less than 30% of the total interest income and other operating income of the Bank for the year.

Subsidiaries

Particulars of the Bank's principal subsidiaries as at 31 December 2014 are set out in note 34 to the financial statements for the year ended 31 December 2014.

Share Capital

Details of share capital of the Bank during the year are set out in note 48 to the financial statements for the year ended 31 December 2014.

Donations

Charitable donations made by the Bank and its subsidiaries during the year amounted to HK$22.9m. For further details of the Bank's corporate social responsibility activities and expenditures, please refer to the section "Corporate Sustainability" of this Annual Report.

Reserves

Profit attributable to shareholders, before dividends, of HK$15,131m (2013: HK$26,678m) has been transferred to reserves. Distributable reserve of the Bank as at 31 December 2014 amounted to HK$35,544m (2013: HK$31,788m). Other movements in reserves are set out in the consolidated statement of changes in equity.

Directors

The Directors of the Bank who were in office as at the end of the year were Dr Raymond K F Ch'ien, Ms Rose W M Lee, Dr John C C Chan, Mr Nixon L S Chan, Dr Henry K S Cheng, Ms L Y Chiang, Mr Andrew H C Fung, Dr Fred Zuliu Hu, Ms Irene Y L Lee, Ms Sarah C Legg, Dr Eric K C Li, Dr Vincent H S Lo, Mr Kenneth S Y Ng, Mr Richard Y S Tang, Mr Peter T S Wong and Mr Michael W K Wu.

Mrs Dorothy K Y P Sit retired and resigned from the Board with effect from 1 January 2014, and Ms Anita Y M Fung stepped down from the Board with effect from 31 January 2014. Dr Marvin K T Cheung resigned from the Board with effect from 1 August 2014. The Board expressed its gratitude to the aforesaid Directors for their wise counsel and contribution during their terms of office.

Mr Nixon L S Chan was appointed as Executive Director with effect from 31 January 2014, and Mr Kenneth S Y Ng was appointed as Non-executive Director with effect from 10 March 2014. Both Mr Chan and Mr Ng were elected as Directors at the Bank's 2014 Annual General Meeting ("AGM") held on 9 May 2014.

Ms Irene Y L Lee and Dr Henry K S Cheng were appointed as Independent Non-executive Directors with effect from 12 May and 26 May 2014 respectively. They will retire under the provisions of the Bank's Articles of Association and, being eligible, offer themselves for election at the Bank's 2015 AGM to be held on 7 May 2015.

The Directors retiring by rotation in accordance with the Bank's Articles of Association are Ms Rose W M Lee, Mr Andrew H C Fung, Dr Fred Zuliu Hu, Mr Richard Y S Tang and Mr Peter T S Wong, who, being eligible, offer themselves for re-election at the Bank's 2015 AGM.

No Director proposed for re-election or election (as the case may be) at the forthcoming AGM has a service contract with the Bank which is not determinable by the Bank within one year without payment of compensation (other than statutory compensation).

The biographical details of the Directors of the Bank are set out in the section "Biographical Details of Directors" of this Annual Report.

Status of Independent Non-executive Directors

The Bank has received from each Independent Non-executive Director an annual confirmation of his/her independence pursuant to Rule 3.13 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") (the "Listing Rules"). The Bank still considers all the Independent Non-executive Directors to be independent.

Directors' and Alternate Chief Executives' Interests

As at 31 December 2014, 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 shares in issue/issued share capital
Number of ordinary shares 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	242,467	1,527	–	100,301[3]	344,295	0.00
Dr John C C Chan	24,605[1]	–	–	–	24,605	0.00
Mr Nixon L S Chan	50,940	–	–	24,353[3]	75,293	0.00
Mr Andrew H C Fung	79,494	–	–	33,311[3]	112,805	0.00
Ms Sarah C Legg	146,380	2,688	–	71,373[3]	220,441	0.00
Dr Eric K C Li	–	47,642	–	–	47,642	0.00
Mr Kenneth S Y Ng	311,772	–	–	49,558[3]	361,330	0.00
Mr Peter T S Wong	1,178,400	20,179	–	1,091,027[3]	2,289,606	0.01
Alternate Chief Executives:						
Mr Christopher H N Ho	107,767	51,447	–	6,450[3]	165,664	0.00
Mr Donald Y S Lam	42,303	–	–	10,189[3]	52,492	0.00
Mr Andrew W L Leung	8,369	–	–	6,760[3]	15,129	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[2]	306,075	0.20

Interests in debentures of associated corporation 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[(2)]	US$7,651,875

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) 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 corporation of the Bank" represented the same interests.

(3) 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	–	100,301	100,301
Mr Nixon L S Chan	–	24,353	24,353
Mr Andrew H C Fung	–	33,311	33,311
Ms Sarah C Legg	–	71,373	71,373
Mr Kenneth S Y Ng	–	49,558	49,558
Mr Peter T S Wong	–	1,091,027	1,091,027
Alternate Chief Executives:			
Mr Christopher H N Ho	–	6,450	6,450
Mr Donald Y S Lam	–	10,189	10,189
Mr Andrew W L Leung	–	6,760	6,760

Options

As at 31 December 2014, 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 31 December 2014	Options exercised/ cancelled during the Director's/ Alternate Chief Executive's term of office in 2014	Exercise price per share	Date granted	Exercisable from	Exercisable until
Directors:						
Mr Nixon L S Chan	–	4,533	£7.2181	30 Apr 2004	30 Apr 2009	29 Apr 2014
Mr Andrew H C Fung	–	4,197[1]	HK$37.8797	29 Apr 2009	1 Aug 2014	31 Jan 2015
Ms Sarah C Legg	–	5,738	£7.2181	30 Apr 2004	30 Apr 2009	30 Apr 2014
	–	4,529[2]	£3.3116	29 Apr 2009	1 Aug 2014	31 Jan 2015
	–					
Alternate Chief Executives:						
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[1]	HK$37.8797	29 Apr 2009	1 Aug 2014	31 Jan 2015
	–					

Notes:

(1) As at the date of exercise, 1 August 2014, the market value per share was HK$82.7500.

(2) As at the date of exercise, 5 November 2014, the market value per share was £6.3340.

Conditional Awards of Shares

As at 31 December 2014, 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 2014	Awards made during the Director's/ Alternate Chief Executive's term of office in 2014	Awards released during the Director's/ Alternate Chief Executive's term of office in 2014	Awards held as at 31 December 2014
Directors:				
Ms Rose W M Lee	35,062	98,372	37,802	100,301(1)
Mr Nixon L S Chan	17,625	13,618	8,058	24,353(1)
Mr Andrew H C Fung	29,668	17,405	15,409	33,311(1)
Ms Sarah C Legg	66,132	52,215	50,384	71,373(1)
Mr Kenneth S Y Ng	73,593(2)	–	26,505	49,558(1)
Mr Peter T S Wong	765,649	398,720	124,750	1,091,027(1)
Alternate Chief Executives:				
Mr Christopher H N Ho	3,913	4,227	2,001	6,450(1)
Mr Donald Y S Lam	8,608	4,973	3,877	10,189(1)
Mr Andrew W L Leung	3,545	4,565	1,672	6,760(1)

Notes:
(1) This included additional shares arising from scrip dividends.
(2) This represented the awards held by Mr Kenneth S Y Ng on 10 March 2014 when he was appointed a Director of the Bank.

All the interests stated above represented long positions. As at 31 December 2014, 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.

Save as disclosed in the preceding paragraphs, neither the Bank nor any of its holding companies or its subsidiaries or fellow subsidiaries was a party to any arrangement to enable the Directors of the Bank to acquire benefits by means of the acquisition of shares in or debentures of the Bank or any other body corporate as at the end of the year or at any time during the year.

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 year ended 31 December 2014.

Directors' Interests in Contracts

No contract of significance, to which the Bank or any of its holding companies or any of its subsidiaries or fellow subsidiaries was a party and in which a Director of the Bank had, directly or indirectly, a material interest, subsisted as at the end of the year or at any time during the year.

Directors' Interests in Competing Businesses

Pursuant to Rule 8.10 of the Listing Rules, as at the date of this report, the following Directors had declared interests in the following entities which compete or are likely to compete, either directly or indirectly, with the businesses of the Bank:

Mr Andrew H C Fung is a Director, a member of Strategic Committee and a member of Remuneration and Evaluation Committee of Industrial Bank Co., Ltd. ("Industrial Bank"), in which the Bank holds a 5.87% stake. Industrial Bank conducts general banking business in mainland China.

Ms Rose W M Lee is a Group General Manager of HSBC Holdings plc and a Director of The Hongkong and Shanghai Banking Corporation Limited.

Ms Sarah C Legg is a Group General Manager of HSBC Holdings plc. She is also the Chief Financial Officer of The Hongkong and Shanghai Banking Corporation Limited and a Director of various HSBC Group subsidiaries.

Mr Kenneth S Y Ng is the General Counsel, Asia Pacific of The Hongkong and Shanghai Banking Corporation Limited and a Director of HSBC Bank (China) Company Limited and certain HSBC Group subsidiaries.

Mr Peter T S Wong is a Group Managing Director and a member of Group Management Board of HSBC Holdings plc. He is also the Deputy Chairman, Chief Executive and Executive Director of The Hongkong and Shanghai Banking Corporation Limited; and Chairman and Non-executive Director of HSBC Bank Malaysia Berhad and HSBC Bank (China) Company Limited, which are wholly-owned subsidiaries of The Hongkong and Shanghai Banking Corporation Limited. He is a Non-executive Director of Bank of Communications Co., Ltd., which conducts general banking business.

HSBC Holdings plc, through its subsidiaries and associated undertakings, including The Hongkong and Shanghai Banking Corporation Limited, the immediate holding company of the Bank, is engaged in providing a comprehensive range of banking, insurance and related financial services.

The entities in which the Directors have declared interests are managed by separate Boards of Directors and management, which are accountable to their respective shareholders.

Further, Industrial Bank has an Audit and Related Party Transaction Control Committee which is responsible for considering all matters concerning audit as well as connected party transactions to be entered into by Industrial Bank as required by the laws of mainland China. The majority of members of Industrial Bank's Audit and Related Party Transaction Control Committee are independent Directors.

The Board of the Bank includes nine Independent Non-executive Directors whose views carry significant weight in the Board's decisions. The Audit Committee and Risk Committee of the Bank, which consist of four and three Independent Non-executive Directors respectively, meet regularly to assist the Board of Directors in reviewing the financial performance, internal control and compliance systems of the Bank and its subsidiaries. The Bank is, therefore, capable of carrying on its businesses in the best interests of all shareholders and has put in place adequate mechanisms to ensure that the Directors discharge their duties vis-a-vis all shareholders, including in respect of the Bank's dealings with the businesses in which Directors have declared interests.

Directors' Emoluments

The emoluments of the Directors of the Bank (including Executive Directors and Independent Non-executive Directors) on a named basis are set out in note 15 to the financial statements for the year ended 31 December 2014.

Indemnity Provision

Details of the Bank's permitted indemnity provision are set out in the "Corporate Governance and Other Information" section in this Annual Report.

Substantial Interests in Share Capital

The register maintained by the Bank pursuant to the SFO recorded that, as at 31 December 2014, 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 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 interests of The Hongkong and Shanghai Banking Corporation Limited 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, representing 62.14% of the Bank's share capital.

All the interests stated above represented long positions. As at 31 December 2014, 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 year.

Public Float

As at the date of this report, the Bank has maintained the prescribed public float under the Listing Rules, based on the information that is publicly available to the Bank and within the knowledge of the Directors of the Bank.

Code on Corporate Governance Practices

Details of the Bank's corporate governance practices are set out in the "Corporate Governance and Other Information" section in this Annual Report.

Auditor

The financial statements for the year ended 31 December 2014 were audited by KPMG who resigned as auditor of the Bank upon signing of the Auditor's Report of the financial statements on 23 February 2015.

PricewaterhouseCoopers was appointed as auditor of the Bank with effect from 23 February 2015 to fill the vacancy following the resignation of KPMG and to hold office until the conclusion of the Bank's 2015 AGM.

A resolution for appointing PricewaterhouseCoopers as auditor of the Bank to hold office until conclusion of the next AGM will be proposed for consideration and approval by the Bank's shareholders at the 2015 AGM.

On behalf of the Board

Raymond Ch'ien
Chairman
Hong Kong, 23 February 2015

2014 Financial Statements

Consolidated Income Statement

for the year ended 31 December 2014
(Expressed in millions of Hong Kong dollars)

	note	2014	2013
Interest income	4	**26,270**	23,825
Interest expense	4	**(6,399)**	(5,221)
Net interest income		**19,871**	18,604
Fee income		**7,712**	7,329
Fee expense		**(1,463)**	(1,442)
Net fee income	5	**6,249**	5,887
Net trading income	6	**1,944**	2,045
Net income from financial instruments designated at fair value	7	**1,201**	345
Dividend income	8	**1,210**	1,014
Net insurance premium income	9	**10,779**	10,005
Other operating income	10	**1,695**	1,936
Total operating income		**42,949**	39,836
Net insurance claims and benefits paid and movement in liabilities to policyholders	11	**(12,742)**	(11,774)
Net operating income before loan impairment charges		**30,207**	28,062
Loan impairment charges	12	**(1,144)**	(536)
Net operating income		**29,063**	27,526
Employee compensation and benefits		**(4,616)**	(4,432)
General and administrative expenses		**(4,055)**	(3,796)
Depreciation of premises, plant and equipment		**(831)**	(762)
Amortisation of intangible assets		**(111)**	(113)
Operating expenses	13	**(9,613)**	(9,103)
Impairment loss on intangible assets		**–**	(13)
Operating profit		**19,450**	18,410
Gains less losses from financial investments and fixed assets	17	**(2,159)**	179
Gain on reclassification of Industrial Bank		**–**	8,454
Loss on reclassification of Yantai Bank		**–**	(297)
Net surplus on property revaluation	18	**521**	1,188
Share of profits from associates		**237**	562
Profit before tax		**18,049**	28,496
Tax expense	19	**(2,918)**	(1,818)
Profit for the year		**15,131**	26,678
Profit attributable to shareholders		**15,131**	26,678
(Figures in HK$) Earnings per share	21	**7.91**	13.95

The notes on pages 152 to 269 form part of these financial statements.

Consolidated Statement of Comprehensive Income

for the year ended 31 December 2014
(Expressed in millions of Hong Kong dollars)

	2014	2013
Profit for the year	**15,131**	26,678
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	**319**	(913)
– on equity shares	**16,744**	(2,638)
– fair value changes transferred to income statement:		
– on hedged items	**32**	689
– on disposal	**(34)**	(1)
– on impairment	**2,188**	–
– share of changes in equity of associates:		
– fair value changes	**–**	(1)
– fair value changes transferred to income statement on reclassification of Industrial Bank and Yantai Bank	**–**	111
– deferred taxes	**(96)**	57
– exchange difference and other	**(523)**	851
Cash flow hedging reserve:		
– fair value changes taken to equity	**318**	432
– fair value changes transferred to income statement	**(339)**	(445)
– deferred taxes	**4**	2
Exchange differences on translation of:		
– financial statements of overseas branches, subsidiaries and associates	**(155)**	438
– cumulative foreign exchange reserve transferred to income statement on reclassification of Industrial Bank and Yantai Bank	**–**	(2,150)
– other	**–**	2
Others	**–**	30
Items that will not be reclassified subsequently to the income statement:		
Premises:		
– unrealised surplus on revaluation of premises	**1,457**	2,103
– deferred taxes	**(244)**	(337)
– exchange difference	**(2)**	3
Defined benefit plans:		
– actuarial gains on defined benefit plans	**164**	778
– deferred taxes	**(27)**	(128)
Share-based payments	**(2)**	(3)
Other comprehensive income for the year, net of tax	**19,804**	(1,120)
Total comprehensive income for the year	**34,935**	25,558
Total comprehensive income for the year attributable to shareholders	**34,935**	25,558

Consolidated Balance Sheet

at 31 December 2014
(Expressed in millions of Hong Kong dollars)

	note	2014	2013
ASSETS			
Cash and sight balances at central banks	26	**11,311**	22,717
Placings with and advances to banks	27	**145,731**	141,940
Trading assets	28	**41,823**	31,996
Financial assets designated at fair value	29	**11,112**	6,987
Derivative financial instruments	30	**7,421**	6,646
Reverse repurchase agreements – non-trading		**1,296**	–
Loans and advances to customers	31	**658,431**	586,240
Financial investments	32	**318,032**	282,845
Interest in associates	35	**2,218**	2,062
Investment properties	36	**11,732**	10,918
Premises, plant and equipment	37	**21,898**	21,000
Intangible assets	38	**9,053**	7,974
Other assets	39	**23,932**	22,405
Total assets		**1,263,990**	1,143,730
LIABILITIES AND EQUITY			
Liabilities			
Current, savings and other deposit accounts	40	**896,521**	824,996
Deposits from banks		**9,095**	11,826
Trading liabilities	41	**72,587**	62,117
Financial liabilities designated at fair value	42	**3,489**	489
Derivative financial instruments	30	**6,462**	5,246
Certificates of deposit and other debt securities in issue	43	**12,402**	8,601
Other liabilities	44	**21,304**	20,467
Liabilities to customers under insurance contracts	45	**92,442**	85,844
Current tax liabilities	46	**374**	692
Deferred tax liabilities	46	**4,304**	3,850
Subordinated liabilities	47	**5,817**	11,824
Total liabilities		**1,124,797**	1,035,952
Equity			
Share capital	48	**9,658**	9,559
Retained profits		**83,667**	78,679
Other equity instruments	49	**6,981**	–
Other reserves		**34,490**	15,334
Proposed dividends	22	**4,397**	4,206
Shareholders' funds		**139,193**	107,778
Total equity and liabilities		**1,263,990**	1,143,730

Rose W M Lee *Vice-Chairman and Chief Executive*

John C C Chan *Director*

Eric K C Li *Director*

Andrew W L Leung *Chief Financial Officer*

The notes on pages 152 to 269 form part of these financial statements.

Balance Sheet

at 31 December 2014
(Expressed in millions of Hong Kong dollars)

	note	2014	2013
ASSETS			
Cash and sight balances at central banks	26	**9,246**	20,405
Placings with and advances to banks	27	**111,656**	106,392
Trading assets	28	**38,160**	30,477
Financial assets designated at fair value	29	**–**	–
Derivative financial instruments	30	**7,039**	5,837
Reverse repurchase agreements – non-trading		**1,296**	–
Loans and advances to customers	31	**588,131**	519,135
Amounts due from subsidiaries		**28,195**	23,553
Financial investments	32	**222,878**	195,524
Investments in subsidiaries	34	**17,902**	17,918
Interest in associates	35	**–**	–
Investment properties	36	**6,973**	6,878
Premises, plant and equipment	37	**16,578**	15,414
Intangible assets	38	**376**	381
Other assets	39	**14,695**	14,807
Total assets		**1,063,125**	956,721
LIABILITIES AND EQUITY			
Liabilities			
Current, savings and other deposit accounts	40	**850,324**	774,462
Deposits from banks		**4,140**	10,012
Trading liabilities	41	**34,373**	29,914
Financial liabilities designated at fair value	42	**2,994**	–
Derivative financial instruments	30	**6,224**	4,486
Certificates of deposit and other debt securities in issue	43	**11,156**	8,601
Amounts due to subsidiaries		**15,490**	14,326
Other liabilities	44	**17,021**	15,802
Current tax liabilities	46	**283**	662
Deferred tax liabilities	46	**2,143**	1,985
Subordinated liabilities	47	**5,817**	11,824
Total liabilities		**949,965**	872,074
Equity			
Share capital	48	**9,658**	9,559
Retained profits	50	**62,762**	60,267
Other equity instruments	49	**6,981**	–
Other reserves	50	**29,362**	10,615
Proposed dividends	22	**4,397**	4,206
Shareholders' funds		**113,160**	84,647
Total equity and liabilities		**1,063,125**	956,721

Rose W M Lee *Vice-Chairman and Chief Executive*

John C C Chan *Director*

Eric K C Li *Director*

Andrew W L Leung *Chief Financial Officer*

The notes on pages 152 to 269 form part of these financial statements.

Consolidated Statement of Changes in Equity

for the year ended 31 December 2014
(Expressed in millions of Hong Kong dollars)

	2014	2013
Share capital		
At beginning of the year	9,559	9,559
Transfer from capital redemption reserve	99	–
	9,658	9,559
Retained profits (including proposed dividends)		
At beginning of the year	82,885	63,507
Dividends to shareholders		
– dividends approved in respect of the previous year	(4,206)	(3,824)
– dividends declared in respect of the current year	(6,309)	(6,309)
Transfer	428	2,184
Total comprehensive income for the year	15,266	27,327
	88,064	82,885
Other equity instruments		
At beginning of the year	–	–
Other equity instruments issued	6,981	–
	6,981	–
Other reserves		
Premises revaluation reserve		
At beginning of the year	14,904	13,790
Transfer	(428)	(655)
Total comprehensive income for the year	1,211	1,769
	15,687	14,904
Available-for-sale investment reserve		
At beginning of the year	(1,618)	227
Total comprehensive income for the year	18,630	(1,845)
	17,012	(1,618)
Cash flow hedging reserve		
At beginning of the year	6	17
Total comprehensive income for the year	(17)	(11)
	(11)	6
Foreign exchange reserve		
At beginning of the year	1,295	3,071
Transfer	–	(64)
Total comprehensive income for the year	(155)	(1,712)
	1,140	1,295
Other reserves		
At beginning of the year	747	2,152
Cost of share-based payment arrangements	14	30
Transfer	–	(1,465)
Transfer of capital redemption reserve	(99)	–
Total comprehensive income for the year	–	30
	662	747
Total equity		
At beginning of the year	107,778	92,323
Dividends to shareholders	(10,515)	(10,133)
Other equity instruments issued	6,981	–
Cost of share-based payment arrangements	14	30
Total comprehensive income for the year	34,935	25,558
	139,193	107,778

Consolidated Cash Flow Statement

for the year ended 31 December 2014
(Expressed in millions of Hong Kong dollars)

	note	2014	2013
Net cash inflow from operating activities	51(a)	**2,219**	23,102
Cash flows from investing activities			
Purchase of available-for-sale investments		**(53,942)**	(43,174)
Purchase of held-to-maturity debt securities		**(1,855)**	(1,563)
Proceeds from sale or redemption of available-for-sale investments		**51,726**	33,488
Proceeds from redemption of held-to-maturity debt securities		**645**	84
Net cash inflow from the sales of loan portfolio		**610**	663
Purchase of properties, plant and equipment and intangible assets		**(682)**	(3,589)
Proceeds from sale of properties, plant and equipment and assets held for sale		**–**	911
Interest received from available-for-sale investments		**2,128**	1,525
Dividends received from available-for-sale investments		**1,209**	1,013
Net cash outflow from investing activities		**(161)**	(10,642)
Cash flows from financing activities			
Dividends paid		**(10,515)**	(10,133)
Interest paid for subordinated liabilities		**(302)**	(311)
Repayment of subordinated liabilities		**(6,008)**	–
Proceeds from issuance of other equity instruments		**6,981**	–
Net cash outflow from financing activities		**(9,844)**	(10,444)
(Decrease)/increase in cash and cash equivalents		**(7,786)**	2,016
Cash and cash equivalents at 1 January		**115,779**	115,947
Effect of foreign exchange rate changes		**(2,643)**	(2,184)
Cash and cash equivalents at 31 December	51(b)	**105,350**	115,779

The notes on pages 152 to 269 form part of these financial statements.

1. Basis of preparation

(a) Compliance with Hong Kong Financial Reporting Standards

The consolidated financial statements comprise the financial statements of Hang Seng Bank Limited ("the Bank") and its subsidiaries ("the Group") made up to 31 December 2014. These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRS"), the provisions of the Hong Kong Companies Ordinance and accounting principles generally accepted in Hong Kong. HKFRS comprises Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKAS"), and interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). In addition, these financial statements comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. A summary of the principal accounting policies adopted by the Group is set out in note 3.

Standards adopted during the year ended 31 December 2014

On 1 January 2014, the Group adopted the following significant new standards and amendments to HKFRS. The impact of these new standards and amendments are as follow:

– Amendments to HKAS 32 "Offsetting Financial Assets and Financial Liabilities" clarified that rights of set-off must not only be legally enforceable in the normal course of business, but must also be enforceable in the event of default and the event of bankruptcy or insolvency of all of the counterparties to the contract. The amendments also clarify the rights of set-off must not be contingent on a future event. Gross settlement mechanisms with specific features would meet the net settlement criterion. The Group has applied the amendments retrospectively without material impact.

– HK (IFRIC) Interpretation 21 "Levies" provides guidance on when a liability to pay a levy imposed by a government should be recognised. It defines what "Levies" are and clarifies that the obligating event that gives rise to such liability is the activity that triggers the payment of the levy as identified by the legislation. The Group has applied the amendments retrospectively without material impact.

– Amendments to HKAS 39 "Financial Instruments: Recognition and Measurement – Novation of Derivatives and Continuation of Hedge Accounting" provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. The amendments have been applied retrospectively.

– "Investment Entities" – Amendments to HKFRS 10, HKFRS 12 and HKAS 27 define the term 'investment entity' and provide supporting guidance for measurement of investments in the form of controlling interests in another entity at fair value through profit or loss in accordance with HKFRS 9 'Financial Instruments' (or HKAS 39 "Financial Instruments: Recognition and Measurement") instead of consolidating them. They also specify disclosure requirements for investments entities. The Group has applied the amendments retrospectively without material impact.

– The Amendments to HKAS 36 "Impairment of Assets: Recoverable Amounts Disclosures for Non-Financial Assets" requires disclosures for an individual asset or a cash-generating unit if an impairment loss has been recognised or reversed during the period. Recoverable amounts of such assets are required to be disclosed. And if the recoverable amount is based on fair value less costs of disposal, its "fair value hierarchy", description of valuation technique and key assumptions have to be disclosed where applicable. On the other hand, it removes the requirement to disclose recoverable amounts for cash-generating unit containing goodwill or intangible assets with indefinite useful lives when they have not had impairment or reversal of impairment. The amendments have insignificant impact to the Group.

– Amendments to HKAS 19 "Defined Benefit Plan: Employee Contributions" clarifies that contributions from employees or third parties contributions under the defined benefits scheme are independent of the number of years of service, an entity is permitted to recognise such contributions as a reduction in the service cost in the period in which the service is rendered, instead of allocating the contributions to the periods of services. The Group has applied the amendments retrospectively without any impact.

– The New Hong Kong Companies Ordinance (Cap. 622) ("NCO") came into effect on 3 March 2014. On this effective date, the concept of par (nominal) value no longer exists. Consequently, the concepts of "share premium", "capital redemption reserve" and "authorised share capital" are also abolished. Any amount received for issuing equity shares of a company should be recorded as part of "share capital". The effect of the transition is to subsume share premium account and capital redemption reserve balances into share capital as set out in section 37 of Schedule 11 to the NCO. These changes do not have an impact on the number of shares in issue or the relative entitlement of any of the members.

1. Basis of preparation continued

(b) Presentation of information

The following have been included in the audited sections of the "Management Discussion and Analysis" ("MD&A"):

- Disclosure under HKFRS 4 "Insurance Contracts" and HKFRS 7 "Financial Instruments: Disclosures" concerning the nature and extent of risks relating to insurance contracts and financial instruments on pages 38 to 40.

- Capital disclosures under HKAS 1 "Presentation of Financial Statements" on pages 95 to 101.

In accordance with the Group's policy to provide disclosures that help stakeholders understand the Group's performance, financial position and changes thereto, the information provided in the Notes to the Financial Statements and the Risk disclosures in the MD&A goes beyond the minimum levels required by accounting standards, statutory and regulatory requirements. In particular, the Group provides additional disclosures recommended by the Enhanced Disclosure Task Force ("EDTF") report "Enhancing the Risk Disclosures of Banks" issued in October 2012. The report aims to help financial institutions identify areas in which users had highlighted a need for better and more transparent information about banks' risks, and how these risks relate to performance measurement and reporting.

(c) Consolidation

The Group controls and consequently consolidates an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Group is considered to have power over an entity when it has existing rights that give it the current ability to direct the relevant activities of the entity. For the Group to have power over an entity, it must have the practical ability to exercise those rights. In situations where potential voting rights exist, these are taken into account if the Group has the practical ability to exercise those rights.

Where voting rights are not relevant in deciding whether the Group has power over an entity, the assessment of control is based on all facts and circumstances. The Group may have power over an entity even though it holds less than a majority of the voting rights, if it holds additional rights arising through other contractual arrangements or substantive potential voting rights which give it power.

When assessing whether to consolidate investment funds, the Group reviews all facts and circumstances to determine whether the Group, as fund manager, is acting as agent or principal, the Group may be deemed to be a principal, and hence controls and consolidates the funds, when it acts as fund manager and cannot be removed without cause, has variable returns through significant unit holdings and/or a guarantee, and is able to influence the returns of the funds by exercising its power.

Changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are treated as transactions between equity holders and are reported in equity.

Entities that are controlled by the Group are consolidated from the date the Group gains controls until the date the Group loses control of the entities.

The Group performs a reassessment of the consolidation status quarterly and whenever there is a change in the facts and circumstances relevant to determining the control of entities.

All intra-group transactions are eliminated on consolidation.

The consolidated financial statements also include the attributable share of the results and reserves of associates based on the financial statements prepared at dates not earlier than three months prior to 31 December 2014.

(d) Future Accounting Developments

The HKICPA has issued a number of amendments and new standards which are not yet effective for the year ended 31 December 2014 and which have not been adopted in the financial statements. Key changes are summarised as follows:

- In July 2014, the HKICPA issued HKFRS 15 "Revenue from Contracts with Customers". The standard is effective for annual periods beginning on or after 1 January 2017 with early adoption permitted. HKFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied. The standard should be applied retrospectively, with certain practical expedients available. The Group is currently assessing the impact of this standard but it is not practicable to quantify the effect as at the date of the publication of these financial statements.

1. Basis of preparation continued

(d) Future Accounting Developments continued

- In September 2014, the HKICPA issued the final HKFRS 9 "Financial Instruments", which is the comprehensive standard to replace HKAS 39 "Financial Instruments: Recognition and Measurement", and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

  The classification and measurement of financial assets will depend on the entity's business model for their management and their contractual cash flow characteristics and result in financial assets being classified and measured at amortised cost, fair value through other comprehensive income ("FVOCI") or fair value through profit or loss. The classification of financial liabilities is essentially unchanged, except that, for certain liabilities measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in OCI.

  The impairment requirements apply to financial assets measured at amortised cost and FVOCI, lease receivables, certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of commitments and guarantees) is required for expected credit losses ("ECL") resulting from default events that are possible within the next 12 months ("12 month ECL"). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ("lifetime ECL").

  The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the probability of default occurring over the remaining life of the financial instrument, rather than by considering an increase in ECL.

  As a result of the final HKFRS 9, the recognition and measurement of impairment is intended to be more forward-looking than under HKAS 39.

  The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link between it and risk management strategy and permitting the former to be applied to a greater variety of hedging instruments and risks.

  The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. Hedge accounting is generally applied prospectively from that date.

  The mandatory application date for the standard as a whole is 1 January 2018, but it is possible to apply the revised presentation for certain liabilities measured at fair value at an earlier date. The Group intends to revise the presentation of fair value gains and losses relating to the entity's own credit risk on certain liabilities. If this presentation was applied at 31 December 2014, the effect would be to increase or decrease profit before tax with the opposite effect on other comprehensive income based on the change in fair value attributable to changes in the Group's credit risk for the year, with no effect on net assets.

  The Group is currently assessing the impact that the rest of HKFRS 9 will have on the financial statements through a groupwide project which has been in place since 2012, but due to the complexity of the classification and measurement, impairment, and hedge accounting requirements and their inter-relationships, it is not possible to quantify the potential effect at this stage.

- Additionally, in accordance with the New Hong Kong Companies Ordinance (Cap. 622) ("NCO"), a new "business review report" has to be included in the Directors' Report in annual report which is an analytical and forward looking review of the company or group. The change is to be implemented by companies for financial year end on or after 3 March 2015.

  The Group includes a MD&A in its annual report for the Group's performance during the financial year and the material factors driving its results and financial position. The Group has to review and assess if the current MD&A has included sufficient information to meet the new requirement for its 2015 annual report.

2. Critical accounting estimates and judgements in applying accounting policies

The results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of the consolidated financial statements. The principal accounting policies are described in Note 3 to the financial statements.

The accounting policies that are deemed critical to our results and financial position, in terms of the materiality of the items to which the policies are applied and the high degree of judgement involved, including the use of assumptions and estimation, are discussed below.

(i) Loan Impairment charges

Application of the Group's methodology for assessing loan impairment, as set out in note 3(d), involves considerable judgement and estimation.

For individually significant loans, judgement is required in determining whether there are indications that an impairment loss may already have been incurred and then estimating the amount and timing of expected cash flows, which form the basis of the impairment loss calculation.

For collectively assessed loans, judgement is involved in selecting and applying the criteria for grouping together loans with similar credit characteristics, as well as the statistical and other models used to estimate the losses incurred for each group of loans in the reporting period. The benchmarking of loss rates, the assessment of the extent to which historical losses are representative of current conditions and the ongoing refinement of modelling methodologies provide a means of identifying changes that may be required, but the process is inherently an estimation.

(ii) Valuation of financial instruments

The best evidence of fair value is a quoted price in an actively traded principal market. In the event that the market for a financial instrument is not active, and the valuation technique uses only observable market data, the reliability of the fair value measurement is high. However, when valuation techniques include one or more significant unobservable inputs, they rely to a greater extent on management judgement and the fair value derived becomes less reliable. In absence of observable valuation inputs, due to lack of or a reduced volume of similar transactions, management judgement is required to assess the price at which an arm's length transaction would occur under normal business conditions, in which case management may rely on historical prices for that particular financial instrument or on recent prices for similar instruments.

The main assumptions and estimates which management consider when applying a model with valuation techniques are:

- the likelihood and expected timing of future cash flows on the instrument; judgement may be required to assess the counterparty's ability to service the instrument in accordance with its contractual terms;
- selecting appropriate discount rate for the instrument; judgement is required to assess what a market participant would regard as the appropriate spread of the rate for an instrument over the appropriate risk-free rate; and
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivatives.

When applying a model with observable inputs, estimates are made to reflect uncertainties in fair values resulting from a lack of market data inputs, for example, as a result of illiquidity in the market. For these instruments, the fair value measurement is less reliable. Inputs into valuations based on observable data are inherently uncertain because there is little or no current market data available from which to determine the level at which an arm's length transaction would occur under normal business conditions. However, in most cases there is some market data available on which to base a determination of fair value, for example historical data, and the fair values of most financial instruments are based on some market observable inputs even when observable inputs are significant.

The Group's accounting policy for valuation of financial instruments is included in note 3(h) and is discussed further within note 59 "Fair value of financial instruments".

(iii) Liabilities under investment contracts

Estimating the liabilities for long-term investment contracts where the Group has guaranteed a minimum return involves the use of statistical techniques. The selection of these techniques and the assumptions used about future interest rates and rates of return on equities, as well as behavioural and other future events, has a significant impact on the amount recognised as a liability.

(iv) Impairment of available-for-sale financial assets

Judgement is required in determining whether or not a decline in fair value of an available-for-sale financial investment below its original cost is of such a nature as to constitute impairment, and thus whether an impairment loss needs to be recognised under HKAS 39 "Financial Instruments: Recognition and Measurement" ("HKAS 39").

2. Critical accounting estimates and judgements in applying accounting policies continued

(v) Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity investments if the Group has the intention and ability to hold them until maturity. In evaluating whether the requirements to classify a financial asset as held-to-maturity are met, management makes significant judgements. Failure in correctly assessing the Group's intention and ability to hold specific investments until maturity may result in reclassification of the whole portfolio as available-for-sale.

(vi) Insurance contracts

Classification

HKFRS 4 "Insurance Contracts" ("HKFRS 4") requires the Group to determine whether an insurance contract that transfers both insurance risk and financial risk is classified as an insurance contract, or as a financial instrument under HKAS 39, or whether the insurance and non-insurance elements of the contract should be accounted for separately. This process involves judgement and estimation of the amounts of different types of risks that are transferred or assumed under a contract. The estimation of such risks often involves the use of assumptions about future events and is thus subject to a degree of uncertainty.

Present value of in-force long-term insurance business ("PVIF")

The value of PVIF, which is recorded as an intangible asset, depends upon assumptions regarding future events. These are described in more detail in note 38(a). The assumptions are reassessed at each reporting date and changes in the estimates which affect the value of PVIF are reflected in the income statement.

Insurance liabilities

The estimation of insurance liabilities involves selecting statistical models and making assumptions about future events which need to be frequently calibrated against experience and forecasts. The sensitivity of insurance liabilities to potential changes in key assumptions is set out in the MD&A.

(vii) Income taxes

Determining income tax provisions involves judgement on the future tax treatment of certain transactions. The Group carefully evaluates tax implications of transactions and tax provisions are set up accordingly. The tax treatment of such transactions is reconsidered periodically to take into account all changes in tax legislations.

3. Principal accounting policies

(a) Interest income and expense

Interest income and expense for all financial instruments are recognised in "Interest income" and "Interest expense" respectively in the income statement using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but excluding future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

For impaired loans, the accrual of interest income based on the original terms of the loan is discounted to arrive at the net present value of impaired loans. Subsequent increase of such net present value of impaired loans due to the passage of time is recognised as interest income.

(b) Non-interest income

(i) Fee income

Fee income is earned from a diverse range of services provided to customers and accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as an arrangement for the acquisition of shares or other securities);
- income earned from the provision of services is recognised as revenue when the services are provided (for example, asset management, portfolio and other management advisory and service fees); and
- income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and reported in "Interest income" (see note 3(a)).

3. Principal accounting policies continued

(b) Non-interest income continued

(ii) Net trading income

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading and dividend income from equities held for trading. Gains or losses arising from changes in fair value of derivatives are recognised in “Net trading income” to the extent as described in the accounting policy set out in note 3(j). Gains and losses on foreign exchange trading and other transactions are also reported as “Net trading income” except for those gains and losses on translation of foreign currencies recognised in other comprehensive income and accumulated separately in equity in the foreign exchange reserve in accordance with the accounting policy set out in note 3(w).

(iii) Net income/(expense) from financial instruments designated at fair value

Net income/(expense) from financial instruments designated at fair value comprises all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value and dividends arising on those financial instruments and the changes in fair value of the derivatives managed in conjunction with the financial assets and liabilities designated at fair value.

(iv) Dividend income

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders have approved the dividend for unlisted equity securities.

(v) Rental income from operating lease

Rental income received under an operating lease is recognised in “Other operating income” in equal instalments over the accounting periods covered by the lease term. Lease incentives granted are recognised in the income statement as an integral part of the aggregate net lease payments receivable. Contingent rentals receivable are recognised as income in the accounting period in which they are earned.

(c) Loans and advances to customers and placing with and advances to banks

Loans and advances to customers and placing with and advances to banks include loans and advances originated or acquired by the Group, which have not been classified either as held for trading or designated at fair value. Loans and advances are recognised when cash is advanced to borrowers and are derecognised when they are repaid, sold or written off, or substantially all the risks and rewards of ownership transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest rate method, less impairment allowances.

(d) Impairment on loans and advances

Losses for impaired loans and advances are promptly recognised when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances are assessed either for significant loans individually or for loan portfolios with similar credit risk characteristics collectively.

(i) Individually assessed loans and advances

For all loans that are considered individually significant, the Group assesses on a case-by-case basis at each reporting date whether there is any objective evidence that a loan is impaired. The criteria used by the Group to determine that there is such objective evidence include:

- known cash flow difficulties experienced by the borrower;
- past due contractual payments of either principal or interest being past due for more than 90 days;
- the probability that the borrower will enter bankruptcy or other financial restructuring;
- a concession granted to the borrower for economic or legal reasons relating to the borrower’s financial difficulty that results in the forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and
- a significant downgrading in credit rating by an external rating agency.

3. Principal accounting policies continued

(d) Impairment on loans and advances continued

For those loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

– the Group's aggregate exposure to the borrower;

– the viability of the borrower's business model and capability to trade successfully out of financial difficulties and generate cash flow to service their debt obligations;

– the amount and timing of expected receipts and recoveries;

– the likely dividend available on liquidation or bankruptcy;

– the extent of other creditors' commitments ranking ahead of, or pari passu with, the Group and the likelihood of other creditors continuing to support the borrower;

– the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;

– the realisable value of collateral (or other credit mitigants) and likelihood of successful repossession;

– the likely deduction of any costs involved in recovery of amounts outstanding;

– the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and

– where available, the secondary market price for the debt.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at its original effective interest rate and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

(ii) Collectively assessed loans and advances

Impairment allowances are calculated on a collective basis:

– to cover losses which have been incurred but have not yet been identified as loans subject to individual assessment; and

– for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective impairment. This reflects impairment losses that the Group has incurred as a result of events occurring before the reporting date, which the Group is not able to identify on an individual loan basis, and that can be reliably estimated. These losses will only be individually identified in the future. As soon as information becomes available which identifies losses on individual loans within the Group, those loans are removed from the Group and assessed on an individual basis for impairment. The collective impairment allowance is determined after taking into account:

– historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);

– the estimated period between a loss occurring and that loss being identified and evidenced by the establishment of an appropriate allowance against the loss on an individual loan; and

– management's judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses at the reporting date is likely to be greater or less than that suggested by historical experience.

Homogeneous groups of loans and advances

Portfolios of small homogeneous groups of loans are collectively assessed using roll rate or historical loss rate methodologies.

3. Principal accounting policies continued

(d) Impairment on loans and advances continued

(iii) Write-off of loans and advances

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of collateral. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write off may be earlier.

(iv) Reversals of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognised in the income statement.

(v) Repossessed assets

Non-financial assets acquired in exchange for loans in order to achieve an orderly realisation are reported under "Assets held for sale" if the carrying amounts of the assets are recovered principally through sale, the assets are available for sale in their present condition and the sale is highly probable. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan, net of impairment allowance amounts, at the date of exchange. No depreciation is provided in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recorded as an impairment loss and included in the income statement. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative impairment loss, is recognised in the income statement.

Financial assets acquired in exchange for loans are classified and reported in accordance with the relevant accounting policies.

(vi) Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as new loans for measurement purposes once the minimum number of payments required under the new arrangements has been received. A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument. These renegotiated loans are segregated from other parts of the loan portfolio for the purposes of collective impairment assessment, to reflect their risk profile. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired. The carrying amounts that have been classified as renegotiated loans retain this classification until maturity or derecognition.

(e) Trading assets and trading liabilities

Financial instruments and short positions thereof which have been acquired or incurred principally for the purpose of selling or repurchasing in the near term, or are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking, are classified as held-for-trading. Trading liabilities also include customer deposits and certificates of deposit with embedded options or other derivatives and the market risk of which is managed in the trading book. Trading assets and liabilities are recognised initially at fair value with transaction costs taken to the income statement, and are subsequently remeasured at fair value. All subsequent gains and losses from changes in the fair value of these assets and liabilities are recognised in the income statement within "Net trading income" as they arise. Upon disposal or repurchase, the difference between the net sale proceeds or the net payment and the carrying value is included in the income statement.

3. Principal accounting policies continued

(f) Financial instruments designated at fair value

A financial instrument is classified in this category if it meets any one of the criteria set out below, and is so designated irrevocably by management on initial recognition. The Group may designate financial instruments at fair value upon inception when the designation:

- eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial instruments or recognising the gains and losses on them on different bases.
- applies to a group of financial assets, financial liabilities or both that is managed and its performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and where information about that group of financial instruments is provided internally on that basis to key management personnel. Under this criterion, certain liabilities under investment contracts and financial assets held to meet liabilities under insurance and investment contracts are the main classes of financial instruments so designated.
- relates to financial instruments containing one or more embedded derivatives, and which would otherwise be required to be accounted for separately.

Designated financial assets and financial liabilities are recognised at fair value when the Group enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequent changes in fair values are recognised in the income statement within "Net income from financial instruments designated at fair value".

(g) Financial Investments

Financial instruments intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale or held-to-maturity.

(i) Available-for-sale financial assets

Available-for-sale financial assets are initially measured at fair value. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income and accumulated separately in equity in the "Available-for-sale investment reserve". When available-for-sale financial assets are sold, cumulative gains or losses which are previously recognised in other comprehensive income shall be reclassified from equity to the income statement as "Gains less losses from financial investments and fixed assets".

(ii) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has the positive intention and ability to hold until maturity. Held-to-maturity investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest rate method, less any impairment allowances.

(h) Valuation of financial instruments

All financial instruments are recognised initially at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price, (that is the fair value of the consideration given or received). However, sometime the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Group recognises a trading gain or loss on day 1, being the difference between the transaction price and the fair value. When significant unobservable parameters are used the entire day 1 gain or loss is deferred and is recognised in the income statement over the life of the transaction until the transaction matures, is closed out, the valuation inputs become observable, or when the Group enters into an offsetting transaction.

The fair value of financial instruments is generally measured on an individual basis. However, in cases where the Group manages a group of financial assets and liabilities according to its net market or credit risk exposure, the Group measures the fair value of the group of financial instruments on a net basis but presents the underlying financial assets and liabilities separately in the financial statements, unless they satisfy the HKFRS offsetting criteria as described in note 59.

3. Principal accounting policies continued

(i) Sale and repurchase agreements

Where securities are sold subject to commitment to repurchase them at a pre-determined price ("repo"), they remain on the balance sheet and a liability is recorded in respect of the consideration received in "Repurchase agreements-non-trading". Conversely, securities purchased under analogous commitments to resell ("reverse repos") are not recognised on the balance sheet and the consideration paid is recorded in "Reverse repurchase agreements-non-trading". The difference between the sale and repurchase price is treated as interest income and recognised over the life of the agreement.

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. The transfer of securities to counterparties under these agreements is not normally reflected on the balance sheet. Cash collateral advanced or received is recorded as an asset or a liability respectively.

(j) Derivative financial instruments and hedge accounting

Derivative financial instruments are recognised initially, and are subsequently remeasured, at fair value. Fair values of derivatives are obtained from quoted market prices or by using valuation techniques.

Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract; their contractual terms would otherwise meet the definition of a stand-alone derivative; and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with changes therein recognised in the income statement.

Derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis. Derivative assets and liabilities arising from different transactions are only offset for accounting purposes if the offsetting criteria are met.

The method of recognising fair value gains or losses depends on whether the derivative is held for trading, or is designated as a hedging instrument, and if the latter, the nature of the risk being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement.

The Group designates certain derivatives as either (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ("fair value hedge"); (ii) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ("cash flow hedge").

Hedge accounting

At the inception of a hedging relationship, the Group documents the relationship between the hedging instruments and the hedged items, its risk management objective and its strategy for undertaking the hedge. The Group requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments, are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items.

(i) Fair value hedge

Changes in the fair value of derivatives that are designated and qualified as fair value hedging instruments are recorded in the income statement within "Net trading income", along with changes in the fair value of the hedged assets, liabilities or group thereof that are attributable to the hedged risk.

If the hedging relationship no longer meets the criteria for hedge accounting, the hedge accounting is discontinued. The cumulative adjustment to the carrying amount of a hedged item is amortised to the income statement based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised.

3. Principal accounting policies continued

(j) Derivative financial instruments and hedge accounting continued

(ii) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualified as cash flow hedges is recognised in other comprehensive income and accumulated separately in equity. Any gain or loss in fair value relating to an ineffective portion is recognised immediately in the income statement within "Net trading income".

The accumulated gains and losses recognised in other comprehensive income are recycled to the income statement in the periods in which the hedged item will affect profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss at that time remains in equity until the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in other comprehensive income is immediately reclassified to the income statement.

(iii) Hedge effectiveness testing

To qualify for hedge accounting, the Group requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness), and demonstrate actual effectiveness (retrospective effectiveness) on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed and the method adopted by the Group to assess hedge effectiveness depends on its risk management strategy.

For fair value hedge relationships, the Group utilises the cumulative dollar offset method or regression as effectiveness testing methodology. For cash flow hedge relationships, the Group utilises the change in variable cash flow method, capacity test or the cumulative dollar offset method using the hypothetical derivative approach.

For prospective effectiveness, the hedging instrument is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For retrospective effectiveness, the change in fair value or cash flows must offset each other in the range of 80 per cent to 125 per cent. Hedge ineffectiveness is recognised in the income statement in "Net trading income".

(iv) Derivatives that do not qualify for hedge accounting

Non-qualifying hedges are economic hedges entered into as part of documented interest rate management strategies for which hedge accounting is not applied. Changes in fair value of non-qualifying hedges do not alter the cash flows expected as part of the documented management strategies for both the non-qualifying hedge instruments and the related assets and liabilities. All gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in the income statement.

(k) Derecognition of financial assets and liabilities

Financial assets are derecognised when the rights to receive cash flows from the assets have expired; or where the Group has transferred its contractual rights to receive the cash flows of the financial assets and has transferred substantially all the risks and rewards of ownership; or where both control and substantially all the risks and rewards are not retained. Financial liabilities are derecognised when they are extinguished, i.e. when the obligation is discharged or cancelled or expires.

(l) Offsetting financial assets and financial liabilities

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognised amount and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(m) Application of trade date accounting

Except for loans and advances and deposits, all financial assets, liabilities and instruments are accounted for on trade date basis.

(n) Subsidiaries and associates

The Group classifies investments in entities which it controls as subsidiaries. The Group classifies investments in entities over which it has significant influence, and that are not subsidiaries, as associates.

For the purpose of determining this classification, control is considered when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns by exercising its power over the entity.

3. Principal accounting policies continued

(n) Subsidiaries and associates continued

Investment in associates is recognised using the equity method. Under this method, such investments are initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in the Group's share of net assets.

Profits on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the respective associates. Losses are also eliminated to the extent of the Group's interest in the associates unless the transaction provides evidence of an impairment of the asset transferred.

The Group's investments in subsidiaries and associates are stated at cost less any impairment losses. An impairment loss recognised in prior periods shall be reversed through the income statement if, and only if, there has been a change in the estimates used to determine the recoverable amount of the investment since the last impairment loss was recognised.

In order to determine whether an impairment test under HKAS 36 "Impairment of Assets" is required in respect of an interest in an associate, it is necessary to consider the indicators in HKAS 39 "Financial Instruments: Recognition and Measurement". Where the review of the indicators suggests that the interest in an associate may be impaired, the impairment testing requirements of HKAS 36 are applied.

The Group's policy for impairment testing on goodwill arising on acquisition of subsidiaries is included under note 3(o). In the case of an interest in an associate, the entire carrying amount in the consolidated balance sheet is compared to its recoverable amount. If the recoverable amount is less than its carrying amount, an impairment loss is recognised in the Group's consolidated financial statements.

(o) Goodwill and intangible assets

(i) Goodwill

Goodwill arises on business combinations, including the acquisition of subsidiaries or associates when the cost of acquisition exceeds the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities acquired and is reported in the consolidated balance sheet. If the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of an acquired business is greater than the cost of acquisition, the excess is recognised immediately in the income statement. Goodwill on acquisitions of associates is included in "Interest in associates" and is not tested separately for impairment.

Goodwill is allocated to cash-generating units ("CGUs") for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. Impairment testing is performed at least annually, and whenever there is an indication that the CGU may be impaired, by comparing the recoverable amount of a CGU with the carrying value of its net assets, including attributable goodwill. The recoverable amount of an asset is the higher of, its fair value less cost to sell, and its value in use. Value in use is the present value of the expected future cash flows from a CGU. If the recoverable amount of the CGU is less than the carrying value, an impairment loss is charged to the income statement. Any write-off in excess of the carrying value of goodwill is limited to the fair value of the individual assets and liabilities of the CGU. Goodwill is stated at cost less any accumulated impairment losses, if any.

At the date of disposal of a business, attributable goodwill is included in the Group's share of net assets in the calculation of the gain or loss on disposal.

(ii) Intangible assets

Intangible assets include the present value of in-force long-term insurance business ("PVIF"), acquired software licences and capitalised development costs of computer software programmes.

- The PVIF is stated at a valuation determined annually by using the methodology as described in note 3(z).
- Computer software acquired is stated at cost less amortisation and impairment allowances. Amortisation of computer software is charged to the income statement over its estimated useful life. Costs incurred in the development phase of a project to produce application software for internal use are capitalised and amortised over the software's estimated useful life, usually five years.

Intangible assets that have an indefinite estimated useful life, or are not yet ready for use, are tested for impairment annually. Intangible assets that have a finite estimated useful life, except for the PVIF, are stated at cost less amortisation and accumulated impairment losses and are amortised over their estimated useful lives. Estimated useful life is the lower of legal duration and expected economic life. Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

3. Principal accounting policies continued

(p) Investment properties

Investment properties are land and/or buildings which are owned or held under a leasehold interest to earn rental income and/or for capital appreciation. Investment properties are stated at fair value with changes in fair value being recognised in the income statement. Fair values are determined by independent professional valuers, primarily on the basis of capitalisation of net incomes with due allowance for outgoings and reversionary income potential. Property interests which are held under operating leases to earn rentals, or for capital appreciation or, both, are classified and accounted for as investment property on a property-by-property basis. Such property interests are accounted for as if they were held under finance leases (see note 3(r)) and measured at fair value.

(q) Premises, plant and equipment

(i) Land and buildings

The following land and buildings held for own use are stated in the balance sheet at their revalued amount, being their fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses:

- leasehold land and buildings where the fair value of the land cannot be reliably separated from the value of the building at inception of the lease and the premises are not clearly held under an operating lease; and
- leasehold land and buildings where the value of the land can be reliably separated from the value of the building at inception of the lease and the term of the lease is not less than 50 years.

Revaluations are performed by professionally qualified valuers, on a market basis, with sufficient regularity to ensure that the net carrying amount does not differ materially from the fair value at the reporting date. Surpluses arising on revaluation are credited firstly to the income statement to the extent of any deficits arising on revaluation previously charged to the income statement in respect of the same land and buildings, and are thereafter taken to other comprehensive income and are accumulated separately in the “Premises revaluation reserve”. Deficits arising on revaluation, are firstly set off against any previous revaluation surpluses included in the “Premises revaluation reserve” in respect of the same land and buildings, and are thereafter recognised in the income statement.

Depreciation is calculated to write off the valuation of the land and buildings over their estimated useful lives as follows:

- freehold land is not depreciated;
- leasehold land is depreciated over the unexpired terms of the leases; and
- buildings and improvements thereto are depreciated at the greater of 2 per cent per annum on the straight-line basis or over the unexpired terms of the leases or over the remaining estimated useful lives of the buildings.

On revaluation of the land and buildings, depreciation accumulated during the year will be eliminated. Depreciation charged on revaluation surplus of the land and buildings is transferred from “Premises revaluation reserve” to “Retained profits”.

On disposal of the land and buildings, the profit and loss is calculated as the difference between the net sales proceeds and the net carrying amount and recognised in the income statement. Surpluses relating to the land and buildings disposed of included in the “Premises revaluation reserve” are transferred as movements in reserves to “Retained profits”.

(ii) Other plant and equipment

Furniture, plant and equipment, are stated at cost less depreciation calculated on the straight-line basis to write off the assets over their estimated useful lives, which are generally between 3 and 10 years. On disposal, the profit and loss is calculated as the difference between the net sales proceeds and the net carrying amount.

Plant and equipment are subject to review for impairment if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

(iii) Interest in leasehold land held for own use under operating lease

The Government of Hong Kong owns all the land in Hong Kong and permits its use under leasehold arrangements. Similar arrangements exist in mainland China. At inception of the lease, where the cost of land is known or can be reliably determined and the term of the lease is less than 50 years, the Group records its interest in leasehold land and land use rights separately as operating leases.

Where the cost of land is known or can be reliably determined and the term of the lease is not less than 50 years, the Group records its interest in leasehold land and land use rights as land and buildings held for own use.

Where the cost of the land is unknown or cannot be reliably determined, and the leasehold land and land use rights are not clearly held under an operating lease, they are accounted for as land and buildings held for own use.

3. Principal accounting policies continued

(r) Finance and operating leases

Leases which transfer substantially all the risks and rewards of ownership to the lessees, other than legal title, are classified as finance leases. Leases which do not transfer substantially all the risks and rewards of ownership to the lessees are classified as operating leases, with the exceptions of land and building held under a leasehold interest as set out in notes 3(p) & 3(q).

(i) Finance leases

Where the Group is a lessor under finance leases, an amount representing the net investment in the lease is included in the balance sheet as loans and advances to customers. Hire purchase contracts having the characteristics of a finance lease are accounted for in the same manner as finance leases. Impairment allowances are accounted for in accordance with the accounting policies set out in note 3(d).

Where the Group acquires the use of assets under finance leases, the amount representing the fair value of the leased asset, or, if lower, the present value of the minimum payments of such assets is included in fixed assets and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. Depreciation is provided at rates which write off the cost or valuation of the assets over the term of the relevant lease or, where it is likely the Group will obtain ownership of the asset, the life of the asset, as set out in note 3(q). Impairment allowances are accounted for in accordance with the accounting policy as set out in note 3(s). Finance charges implicit in the lease payments are charged to the income statement over the period of the leases so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period. Contingent rentals are written off as an expense of the accounting period in which they are incurred.

(ii) Operating leases

Where the Group leases out assets as lessors under operating leases, the assets are included in the balance sheet according to their nature and, where applicable. Where the Group is the lessee, the leased assets are not recognised on the balance sheet. Rental revenue arising from operating lease is recognised on a straight-line basis in accordance with the Group's revenue recognition policies as set out in note 3(b)(v).

(s) Impairment of assets

The carrying amount of the Group's assets are reviewed at each reporting date to determine whether there is objective evidence of impairment. If any such evidence exists, the carrying amount is reduced to the estimated recoverable amount by means of a charge to the income statement.

The accounting policies on impairment losses on loans and receivables and goodwill are set out in notes 3(d) and 3(o) respectively.

(i) Held-to-maturity investments

For held-to-maturity investments, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets) on an individual basis.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement. The reversal of impairment is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

(ii) Available-for-sale financial assets

At each reporting date, an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset or group of assets. Impairment losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the income statement, is reclassified from equity to the income statement.

The impairment methodologies for available-for-sale financial assets are set out in more detail below.

Impairment losses on available-for-sale debt securities are recognised within "Loan impairment charges and other credit risk provisions" in the income statement and impairment losses on available-for-sale equity securities are recognised within "Gains less losses from financial investments and fixed assets" in the income statement.

3. Principal accounting policies continued

(s) Impairment of assets continued

Available-for-sale debt security

When assessing available-for-sale debt securities for objective evidence of impairment at the reporting date, the Group considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. These events may include a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial reorganisation, or the disappearance of an active market for the debt security because of financial difficulties relating to the issuer. These types of specific event and other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment of a debt security.

For an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in the income statement if, and only if there is objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income and accumulated separately in equity. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement to the extent of the increase in fair value.

Available-for-sale equity securities

Objective evidence of impairment for available-for sale equity securities may include specific information about the issuer as detailed above, but may also include information about significant changes in technology, markets, economics or the law that provides evidence that the cost of the equity securities may not be recovered. A significant or prolonged decline in the fair value of the asset below its cost is also objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the period in which the fair value of the asset has been below its original cost at initial recognition.

For an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and recognised in other comprehensive income and accumulated separately in equity. Impairment losses recognised on the equity security are not reversed through the income statement. Subsequent recovery in the fair value of the available-for-sale equity security is recognised in the other comprehensive income and the past impairment loss recognised in the income statement is not reversed.

(iii) Other assets

Internal and external sources of information are reviewed at each reporting date to identify indications that the following types of assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased:

- premises and equipment (other than properties carried at revalued amounts);
- pre-paid interests in leasehold land classified as "Interest in leasehold land held for own use under operating lease";
- investments in subsidiaries and associates; and
- intangible assets.

If any such indication exists, the asset's recoverable amount is estimated and impairment losses recognised.

Calculation of recoverable amount

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the assets. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

Recognition of impairment losses

An impairment loss is recognised in the income statement whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

3. Principal accounting policies continued

(s) Impairment of assets continued

Reversals of impairment losses

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognised.

(t) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the income statement except to the extent that they relate to items recognised in other comprehensive income or directly in equity, in which case the relevant amounts of tax are recognised in other comprehensive income or directly in equity, respectively.

Current tax is the expected tax payable on the taxable profits for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities are settled on an individual taxable entity basis.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purpose and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available, against which deductible temporary differences can be utilised.

Deferred tax is calculated using the tax rates that are expected to apply in the periods in which the assets will be realised or the liabilities settled. Deferred tax assets and liabilities are not discounted. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when a legal right to offset exists in the entity.

The carrying amount of deferred tax assets/liabilities is reviewed at each reporting date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised.

(u) Employee benefits

(i) Salaries, annual bonuses, paid annual leave, leave passage and the cost to the Group of non-monetary benefits are accrued in the year in which the associated services are rendered by the employees. Provision is made in respect of paid leave entitlement accumulated during the year, which can be carried forward into future periods for compensated absence or payment in lieu if the employee leaves employment.

(ii) The Group provides retirement benefits for staff members and operates defined benefit and defined contribution schemes and participates in mandatory provident fund schemes in accordance with the relevant laws and regulations.

Payments to defined contribution plans and state-managed retirement benefit plans, where the Group's obligations under the plans are equivalent to a defined contribution plan, are charged as an expense as they incur.

The costs recognised for funding defined benefit plans are determined using the projected unit credit method, with annual actuarial valuations performed on each plan. The net charge to the income statement mainly comprises the service cost and the net interest on the net defined benefit liability and is presented in operating expenses. Service cost comprises current service cost, past service cost, and gain or loss on settlement.

The net defined benefit asset or liability recognised in the balance sheet represents the difference between the fair value of plan assets and the present value of the defined benefit obligations adjusted for unrecognised past service costs. In the case of a defined benefit asset, it is limited to unrecognised past service costs plus the present value of available refunds and reductions in future contributions to the plan.

(v) Share-based payments

The cost of share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted, and recognised as an expense on a straight-line basis over the vesting period, with a corresponding credit to the "Other reserves". The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, is expensed immediately.

3. Principal accounting policies continued

(v) Share-based payments continued

Fair value is determined by using market prices or appropriate valuation models, taking into account the terms and conditions upon which the equity instruments were granted. Market performance conditions are taken into account when estimating the fair value of equity instruments at the date of grant, so that an award is treated as vesting irrespective of whether the market performance condition is satisfied, provided all other conditions are satisfied.

Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

Where an award has been modified, as a minimum, the expense of the original award continues to be recognised as if it had not been modified. Where the effect of a modification is to increase the fair value of an award or increase the number of equity instruments, the incremental fair value of the award or incremental fair value of the extra equity instruments is recognised in addition to the expense of the original grant, measured at the date of modification, over the modified vesting period.

A cancellation that occurs during the vesting period is treated as an acceleration of vesting, and recognised immediately for the amount that would otherwise have been recognised for services over the remaining vesting period.

(w) Translation of foreign currencies

Foreign currency transactions during the year are translated at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rates ruling at the reporting date. Any resulting exchange differences are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

The results of branches, subsidiaries and associates not reporting in Hong Kong dollars are translated into Hong Kong dollars at the average rates of exchange for the reporting period. Exchange differences arising from the re-translation of opening foreign currency net investments and the related cost of hedging, if any, and exchange differences arising from re-translation of the result for the year from the average rate to the exchange rate ruling at the year-end, are recognised in other comprehensive income and accumulated separately in equity in the foreign exchange reserve.

Exchange differences on a monetary item that is part of a net investment in a foreign operation are recognised in the income statement of separate subsidiary's financial statements. In the consolidated financial statements, these exchange differences are recognised in other comprehensive income and accumulated separately in equity in the foreign exchange reserve. On disposal of a foreign operation, exchange differences relating thereto previously recognised in reserves are recognised in the income statement.

(x) Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation arising from past events and a reliable estimate can be made as to the amount of the obligation. Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or nonoccurrence, of one or more uncertain future events not wholly within the control of the Group; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

(y) Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of the loans or debt instruments.

Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). Financial guarantees are included within other liabilities.

3. Principal accounting policies continued

(z) Insurance contracts

Through its insurance subsidiaries, the Group issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which the Group accepts significant insurance risk from another party, by agreeing to compensate that party on the occurrence of a specified uncertain future event, is classified as an insurance contract. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant.

A contract issued by the Group that transfers financial risk, without significant insurance risk, is classified as an investment contract, and is accounted for as a financial instrument. The financial assets held by the Group for the purpose of meeting liabilities under insurance and investment contracts are classified and accounted for based on their classifications as set out in notes 3(c) to 3(j).

Insurance contracts are accounted for as follows:

Net earned insurance premiums

Premiums for life insurance are accounted for when receivable, except in unit-linked business where premiums are accounted for when liabilities are recognised.

Reinsurance premiums, netted by the reinsurers' share of provision for unearned premiums, are accounted for in the same accounting year as the premiums for the direct insurance to which they relate.

Claims and reinsurance recoveries

Gross insurance claims for life insurance reflect the total cost of all claims arising during the year, including policyholder cash dividend payment upon policy anniversary and payments of maturities, surrenders and death claims. The technical reserves for non-linked liabilities (long-term business provision) are calculated based on actuarial principles. The technical reserves for linked liabilities are at least the element of any surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices. Reinsurance recoveries are accounted for in the same period as the related claims.

Deferred acquisition costs

The deferred acquisition costs related to insurance contract, such as initial commission, are amortised over the period in which the related revenues are earned.

Present value of in-force long-term insurance business

A value is placed on insurance contracts that are classified as long-term insurance business and in force at the reporting date and such value is recognised as an asset. This asset represents the present value of the shareholders' interest in the profits expected to emerge from those contracts.

The present value of the in-force long-term insurance business, referred to as PVIF, is determined by discounting future earnings expected to emerge from business currently in force, using appropriate assumptions in assessing factors such as future mortality and morbidity, lapse rates, levels of expenses and a risk discount rate that reflects the risk premium attributable to the respective long-term insurance business. The valuation has also included explicit risk margins for non-economic risks in the projection assumptions, and explicit allowances for financial options and guarantees using stochastic methods. Risk discount rates are set on an active basis with reference to market risk free yields and incorporate the explicit margins and allowances for certain risks and uncertainties in place of implicit adjustments. Movements in the PVIF are included in other operating income on a pre-tax basis. The PVIF is reported under "Intangible assets" in the balance sheet.

Liabilities under insurance contracts

Liabilities under non-linked life insurance contracts are calculated by each life insurance operation based on local actuarial principles. Some insurance contracts may contain discretionary participation features whereby the policyholder is entitled to additional payments whose amount and/or timing is at the discretion of the issuer. The discretionary element of these contracts is included in "Liabilities to customers under insurance contracts".

Liabilities under unit-linked life insurance contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

A liability adequacy test is carried out on insurance liabilities to ensure that the carrying amount of the liabilities is sufficient in the light of current estimates of future cash flows. When performing the liability adequacy test, all expected cash flows are discounted and compared with the carrying value of the liability. When a shortfall is identified it is charged immediately to the income statement.

3. Principal accounting policies continued

(aa) Investment contracts

Customer liabilities under linked investment contracts are measured at fair value and reported under "Financial liabilities designated at fair value". The linked financial assets are measured at fair value and the movements in fair value are recognised in the income statement in "Net income from financial instruments designated at fair value". Deposits receivable and amounts withdrawn are accounted for as increases or decreases in the liability recorded in respect of investment contracts.

Investment management fee receivables are recognised in the income statement over the period of the provision of the investment management services, in "Net fee income".

(ab) Dividends

Dividends proposed or declared after the reporting date, are disclosed as a separate component of shareholders' equity.

(ac) Debt securities in issue and subordinated liabilities

Financial liabilities are recognised when the Group enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.

Debt securities in issue and subordinated liabilities are measured at amortised cost using the effective interest rate method, and are reported under "Debt securities in issue" or "Subordinated liabilities", except for those issued for trading or designated at fair value, which are carried at fair value and reported under the "Trading liabilities" and "Financial liabilities designated at fair value" in the balance sheet.

(ad) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of change in value. Such investments comprise cash and balances with banks maturing within one month, treasury bills and certificates of deposit with less than three months' maturity from the date of acquisition and items in the course of collection from or in transmission to other banks.

(ae) Operating segments

The Group's operating segments are determined to be customer group segment because the chief operating decision maker uses customer group information in order to make decisions about allocating resources and assessing performance.

(af) Assets held for sale

Non-current assets held for sale and disposal groups (including both assets and liabilities of the disposal groups) are classified as held for sale when their carrying amounts will be recovered principally through sale, they are available for sale in their present condition and their sale is highly probable. Non-current assets held for sale and disposal groups are measured at the lower of their carrying amount and fair value less costs to sell, except for deferred tax assets, financial assets, investment properties, insurance contracts and assets arising from employee benefits, which are measured in accordance with the accounting policies described above.

Immediately before the initial classification as held for sale, the carrying amounts of the asset (or assets and liabilities in the disposal group) are measured in accordance with applicable HKFRSs. On subsequent remeasurement of a disposal group, the carrying amounts of the assets and liabilities that are not within the scope of the measurement requirements of HKFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" are measured in accordance with applicable HKFRSs before the fair value less costs to sell of the disposal group is determined.

Income earned and expenses incurred on assets and liabilities of disposal groups held for sale continue to be recognised in the appropriate line items in the income statement until the transaction is complete.

3. Principal accounting policies continued

(ag) Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are members of the same group. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities which are under the significant influence of related parties of the Group and post employment benefit scheme. Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group and its holding companies, directly or indirectly, including any directors (whether executive or otherwise) and Executive Committee members of the Group and its holding companies.

4. Interest income/interest expense

(a) Interest income

	2014	2013
Interest income arising from:		
– financial assets that are not at fair value through profit and loss	**26,037**	23,613
– trading assets	**230**	153
– financial assets designated at fair value	**3**	59
	26,270	23,825
of which:		
– interest income from listed investments*	**2,207**	1,824
– interest income from unlisted investments*	**3,104**	3,047
– interest income from impaired financial assets	**12**	13

(b) Interest expense

	2014	2013
Interest expense arising from:		
– financial liabilities that are not at fair value through profit and loss	**4,149**	3,371
– trading liabilities	**2,244**	1,850
– financial liabilities designated at fair value	**6**	–
	6,399	5,221
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	**302**	311

* During 2014, certain stock exchanges have been regarded as recognised stock exchanges, causing more financial investments to be classified as listed. Comparative figures have been restated to conform with current year's presentation.

5. Net fee income

	2014	2013
– securities broking and related services	**1,355**	1,241
– retail investment funds	**1,681**	1,548
– insurance	**466**	441
– account services	**392**	354
– remittances	**404**	348
– cards	**2,196**	2,142
– credit facilities	**403**	370
– trade services	**521**	585
– other	**294**	300
Fee income	**7,712**	7,329
Fee expense	**(1,463)**	(1,442)
	6,249	5,887
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	**2,368**	2,304
– fee income	**3,549**	3,448
– fee expense	**(1,181)**	(1,144)
Net fee income on trust and other fiduciary activities where the Group holds or invests on behalf of its customers	**708**	674
– fee income	**857**	844
– fee expense	**(149)**	(170)

6. Net trading income

	2014	2013
Dealing profits/(losses)	**1,953**	2,052
– foreign exchange	**1,824**	1,964
– interest rate derivatives	**1**	64
– debt securities	**65**	(35)
– equities and other trading	**63**	59
Net loss from hedging activities	**(9)**	(7)
– fair value hedge		
– net loss on hedged items attributable to the hedged risk	**(32)**	(689)
– net gain on hedging instruments	**22**	680
– cash flow hedges		
– net hedging gain	**1**	2
	1,944	2,045

7. Net income from financial instruments designated at fair value

	2014	2013
Net income on assets designated at fair value which back insurance and investment contracts	**1,204**	345
Net change in fair value of other financial instruments designated at fair value	**(3)**	–
	1,201	345
of which dividend income from:		
– listed investments	**210**	81
– unlisted investments	**2**	1
	212	82

8. Dividend income

	2014	2013
Dividend income:		
– listed investments	**1,194**	999
– unlisted investments	**16**	15
	1,210	1,014

9. Net insurance premium income

	Non-linked insurance	Linked insurance	Total
2014			
Gross insurance premium income	**12,202**	**5**	**12,207**
Reinsurers' share of gross insurance premium income	**(1,428)**	**–**	**(1,428)**
Net insurance premium income	**10,774**	**5**	**10,779**
2013			
Gross insurance premium income	11,102	7	11,109
Reinsurers' share of gross insurance premium income	(1,104)	–	(1,104)
Net insurance premium income	9,998	7	10,005

10. Other operating income

	2014	2013
Rental income from investment properties	**395**	293
Movement in present value of in-force long-term insurance business	**1,065**	1,195
Others	**235**	448
	1,695	1,936

11. Net insurance claims and benefits paid and movement in liabilities to policyholders

	Non-linked insurance	Linked insurance	Total
2014			
Claims, benefits and surrenders paid	**7,721**	**10**	**7,731**
Movement in provisions	**6,435**	**(3)**	**6,432**
Gross claims and benefits paid and movement in liabilities to policyholders	**14,156**	**7**	**14,163**
Reinsurers' share of claims, benefits and surrenders paid	**(31)**	**–**	**(31)**
Reinsurers' share of movement in provisions	**(1,390)**	**–**	**(1,390)**
Reinsurers' share of claims and benefits paid and movement in liabilities to policyholders	**(1,421)**	**–**	**(1,421)**
Net insurance claims and benefits paid and movement in liabilities to policyholders	**12,735**	**7**	**12,742**
2013			
Claims, benefits and surrenders paid	8,803	12	8,815
Movement in provisions	4,040	(3)	4,037
Gross claims and benefits paid and movement in liabilities to policyholders	12,843	9	12,852
Reinsurers' share of claims, benefits and surrenders paid	(42)	–	(42)
Reinsurers' share of movement in provisions	(1,036)	–	(1,036)
Reinsurers' share of claims and benefits paid and movement in liabilities to policyholders	(1,078)	–	(1,078)
Net insurance claims and benefits paid and movement in liabilities to policyholders	11,765	9	11,774

12. Loan impairment charges

	Group 2014	Group 2013	Bank 2014	Bank 2013
Net charge for impairment of loans and advances to customers (note 31(b)):				
Individually assessed impairment allowances:				
– new allowances	**(699)**	(191)	**(123)**	(122)
– releases	**131**	91	**42**	47
– recoveries	**36**	16	**32**	9
	(532)	(84)	**(49)**	(66)
Net charge for collectively assessed impairment allowances	**(612)**	(452)	**(621)**	(476)
Loan impairment charges	**(1,144)**	(536)	**(670)**	(542)

There was no impairment charge (2013: Nil) provided for available-for-sale debt securities, held-to-maturity debt securities and placings with and advances to banks by the Group and the Bank.

13. Operating expenses

	2014	2013
Employee compensation and benefits:		
– salaries and other costs*	**4,155**	3,991
– retirement benefit costs		
– defined benefit scheme (note 56(a))	**297**	310
– defined contribution scheme (note 56(b))	**164**	131
	4,616	4,432
General and administrative expenses:		
– rental expenses	**682**	645
– other premises and equipment	**1,112**	1,098
– marketing and advertising expenses	**829**	713
– other operating expenses	**1,432**	1,340
	4,055	3,796
Depreciation of premises, plant and equipment (note 37(a))	**831**	762
Amortisation of intangible assets (note 38(c))	**111**	113
	9,613	9,103
*of which:		
share-based payments (note 57(e))	**43**	49
Cost efficiency ratio	**31.8%**	32.4%

Included in operating expenses are minimum lease payments under operating leases of HK$705 million (2013: HK$674 million).

14. The emoluments of the five highest paid individuals

(a) The aggregate emoluments

	2014	2013
Salaries, allowances and benefits in kind	**24**	21
Retirement scheme contributions	**2**	1
Variable bonuses	**23**	26
	49	48

(b) The numbers of the five highest paid individuals whose emoluments fell within the following bands were:

	2014 Number of Individuals	2013 Number of Individuals
HK$		
5,000,001 – 5,500,000	**–**	1
5,500,001 – 6,000,000	**1**	–
6,000,001 – 6,500,000	**1**	–
7,000,001 – 7,500,000	**–**	1
8,000,001 – 8,500,000	**2**	1
8,500,001 – 9,000,000	**–**	1
19,000,001 – 19,500,000	**–**	1
20,500,001 – 21,000,000	**1**	–
	5	5

The emoluments of the five highest paid individuals set out above include the emoluments of three (2013: three) Executive Directors. There are no Non-executive Director included in the table above (2013: Nil). Their respective directors' emoluments are included in note 15.

15. Directors' emoluments

The emoluments of the Directors of the Bank calculated in accordance with section 78 of Schedule 11 to the new Hong Kong Companies Ordinance (Cap. 622), with reference to section 161 of the predecessor Hong Kong Companies Ordinance (Cap. 32) were:

				Variable bonus[5]					
				Cash[6]		Shares[6]			
	Fees '000	Salaries, allowances and benefits in kind '000	Pension and Pension contribution[4] '000	Deferred '000	Non-deferred '000	Deferred '000	Non-deferred '000	Total 2014 '000	Total 2013 '000
Executive Directors									
Ms Rose W M Lee [1]	–	**9,897**	**364**	**2,800**	**1,867**	**3,838**	**1,867**	**20,633**	19,433
Mrs Dorothy K Y P Sit [1] (Resigned on 1 Jan 2014)	–	–	–	–	–	–	–	–	8,580
Mr Andrew H C Fung [1]	–	**3,951**	**277**	**796**	**1,194**	**796**	**1,194**	**8,208**	7,666
Mr Nixon L S Chan [1] (Appointed on 31 Jan 2014)	–	**3,650**	**16**	**808**	**1,212**	**808**	**1,212**	**7,706**	–
Non-Executive Directors									
Dr Raymond K F Ch'ien [3]	**740**	–	–	–	–	–	–	**740**	740
Dr John C C Chan [3]	**600**	–	–	–	–	–	–	**600**	600
Dr Marvin K T Cheung [3] (Resigned on 1 Aug 2014)	**507**	–	–	–	–	–	–	**507**	870
Ms L Y Chiang [3]	**510**	–	–	–	–	–	–	**510**	490
Ms Anita Y M Fung [2] (Resigned on 31 Jan 2014)	**37**	–	–	–	–	–	–	**37**	450
Mr Kenneth S Y Ng [2] (Appointed on 10 Mar 2014)	**366**	–	–	–	–	–	–	**366**	–
Dr Fred Zuliu Hu [3]	**610**	–	–	–	–	–	–	**610**	610
Dr Henry K S Cheng [3] (Appointed on 26 May 2014)	**300**	–	–	–	–	–	–	**300**	–
Ms Irene Y L Lee [3] (Appointed on 12 May 2014)	**515**	–	–	–	–	–	–	**515**	–
Mr Jenkin Hui [3] (Resigned on 16 May 2013)	–	–	–	–	–	–	–	–	238
Ms Sarah C Legg [2]	**450**	–	–	–	–	–	–	**450**	450
Dr Eric K C Li [3]	**870**	–	–	–	–	–	–	**870**	870
Dr Vincent H S Lo	**450**	–	–	–	–	–	–	**450**	450
Mr Richard Y S Tang [3]	**835**	–	–	–	–	–	–	**835**	801
Mr Peter T S Wong [2]	**510**	–	–	–	–	–	–	**510**	510
Mr Michael W K Wu [3]	**577**	–	–	–	–	–	–	**577**	490
Past Directors	–	–	**2,308**	–	–	–	–	**2,308**	2,292
	7,877	**17,498**	**2,965**	**4,404**	**4,273**	**5,442**	**4,273**	**46,732**	45,540
2013	7,569	14,337	2,913	3,165	7,184	8,262	2,110		

Notes:

(1) In line with the HSBC Group's remuneration policy, no Director's fees were paid to those Directors who were full time employees of the Bank or its subsidiaries.

(2) Fees receivable as a Director of Hang Seng Bank Limited were surrendered to The Hongkong and Shanghai Banking Corporation Limited in accordance with the HSBC Group's internal policy.

(3) Independent Non-Executive Director.

(4) The aggregate amount of pensions received by the past Directors of the Bank under the relevant pension schemes amounted to HK$2.3m in 2014. The Bank made contributions during 2014 into the pension schemes of which the Bank's past Directors are among their members. The contributions serve to maintain the funding positions of these schemes in respect of liabilities to all scheme members, including but not limited to the past Directors. The amount of contribution attributable to any specific scheme member is not determinable.

(5) The amount of variable bonus comprises the cash and the estimated purchase cost of the award of HSBC Holdings Restricted Share which is measured according to the Group's accounting policies for share-based payment as set out in note 3(v). The bonus comprises the deferred and non-deferred variable pay, details of which are also set out in the section of "remuneration of director, senior management and key personnel" under "Corporate Governance and Other Information". The details are also set out in note 58.

(6) For 2013, the cash bonus on deferred basis and shares bonus on non-deferred basis portion was payable to Ms Rose Lee.

16. Auditors' remuneration

	Group		Bank	
	2014	2013	**2014**	2013
Statutory audit services	**12**	12	**7**	8
Non-statutory audit services and others	**9**	8	**9**	6
	21	20	**16**	14

17. Gains less losses from financial investments and fixed assets

	2014	2013
Net gains from disposal of available-for-sale equity securities		
– reclassified from reserve	**32**	–
– net gains arising in the year	**1**	–
	33	–
Net gains from disposal of available-for-sale debt securities		
– reclassified from reserve	**2**	(3)
– net (losses)/gains arising in the year	**(1)**	4
	1	1
Gains less losses on disposal of assets held for sale	**–**	177
Gains less losses on disposal of loans and advances	**3**	5
Gains less losses on disposal of fixed assets	**(8)**	(4)
Impairment of investment in Industrial Bank	**(2,103)**	–
Impairment of investment in Yantai Bank	**(85)**	–
	(2,159)	179

There were no impairment losses or gains less losses on disposal of held-to-maturity debt securities and financial liabilities measured at amortised cost for 2014 and 2013.

18. Net surplus on property revaluation

	2014	2013
Surplus of revaluation on investment properties	**521**	1,058
Surplus of revaluation on assets held for sale	**–**	133
Reversal of revaluation deficit on premises (note 37(a))	**–**	(3)
	521	1,188

19. Tax expense

(a) Taxation in the consolidated income statement represents:

	2014	2013
Current tax – provision for Hong Kong profits tax		
Tax for the year	**2,808**	2,534
Adjustment in respect of prior years	**(100)**	(14)
	2,708	2,520
Current tax – taxation outside Hong Kong		
Tax for the year	**151**	213
Adjustment in respect of prior years	**13**	7
	164	220
Deferred tax (note 46(b))		
Origination and reversal of temporary differences	**46**	(922)
Total tax expense	**2,918**	1,818

The current tax provision is based on the estimated assessable profit for 2014, 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 (2013: 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.

(b) Reconciliation between taxation charge and accounting profit at applicable tax rates:

	2014	2013
Profit before tax	**18,049**	28,496
Notional tax on profit before tax, calculated at Hong Kong tax rate of 16.5% (2013: 16.5%)	**2,978**	4,702
Tax effect of:		
– different tax rates in other countries/areas	**4**	(75)
– non-taxable income and non-deductible expenses	**(62)**	(1,835)
– share of results of associates	**(39)**	(93)
– others	**37**	(881)
Actual charge for taxation	**2,918**	1,818

20. Profit attributable to shareholders

Of the profit attributable to shareholders, HK$12,432 million (2013: HK$38,730 million) has been dealt with in the financial statements of the Bank.

Reconciliation of the above amount to the Bank's profit for the year:

	2014	2013
Amount of consolidated profit attributable to shareholders dealt with in the Bank's financial statements	**12,432**	38,730
Dividends declared during the year by subsidiaries from retained profits	**283**	2,861
The Bank's profit for the year	**12,715**	41,591

21. Earnings per share

The calculation of earnings per share for 2014 is based on earnings of HK$15,131 million (2013: HK$26,678 million) and on the weighted average number of ordinary shares in issue of 1,911,842,736 shares (unchanged from 2013).

22. Dividends per share

(a) Dividends attributable to the year:

	2014		2013	
	per share HK$	HK$ million	per share HK$	HK$ million
First interim	**1.10**	**2,103**	1.10	2,103
Second interim	**1.10**	**2,103**	1.10	2,103
Third interim	**1.10**	**2,103**	1.10	2,103
Fourth interim	**2.30**	**4,397**	2.20	4,206
	5.60	**10,706**	5.50	10,515

The fourth interim dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date.

(b) Dividends attributable to the previous year, approved and paid during the year:

	2014	2013
Fourth interim dividend in respect of the previous year, approved and paid during the year, of HK$2.20 per share (2013: HK$2.00 per share)	**4,206**	3,824

23. 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. In 2014, there was a change in the reportable segments information reported internally to the Group's most senior executive management for the purposes of resources allocation and performance assessment. To align with the internal reporting information, the Group has presented the following five reportable segments. Corresponding amounts have been restated to ensure information is provided on a basis consistent with the revised segment information. 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;
- **Commercial Banking** activities offer a comprehensive suite of products and services to corporate, commercial and SME customers – including corporate lending, trade and receivable finance, payments and cash management, treasury and foreign exchange, general insurance, key-person insurance, investment services and corporate wealth management;
- **Global Banking and Markets** provides tailored financial solutions to major corporate and institutional clients. Undertaking a long-term relationships management approach, its services include general banking, corporate lending, interest rates, foreign exchange, money markets, structured products and derivatives, etc. Global Banking and Markets also manages the funding and liquidity positions of the Bank and other market risk positions arising from banking activities; and
- **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.

23. Segmental analysis continued

(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 the 'Other' segment. When these premises are utilised by Global Businesses, notional rent will be charged to the relevant business segments based on market rates.

	Hong Kong and other businesses							
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Other	Total	Mainland China business	Inter-segment elimination	Total
2014								
Net interest income/(expense)	10,036	4,894	3,378	(197)	18,111	1,760	–	19,871
Net fee income	4,147	1,568	253	149	6,117	132	–	6,249
Net trading income/(loss)	174	414	1,148	(1)	1,735	209	–	1,944
Net income/(expense) from financial instruments designated at fair value	1,205	(1)	1	(4)	1,201	–	–	1,201
Dividend income	1	–	–	1,209	1,210	–	–	1,210
Net insurance premium income	10,671	108	–	–	10,779	–	–	10,779
Other operating income	1,268	64	1	425	1,758	8	(71)	1,695
Total operating income	27,502	7,047	4,781	1,581	40,911	2,109	(71)	42,949
Net insurance claims and benefits paid and movement in liabilities to policyholders	(12,655)	(87)	–	–	(12,742)	–	–	(12,742)
Net operating income before loan impairment charges	14,847	6,960	4,781	1,581	28,169	2,109	(71)	30,207
Loan impairment charges	(531)	(128)	(5)	–	(664)	(480)	–	(1,144)
Net operating income	14,316	6,832	4,776	1,581	27,505	1,629	(71)	29,063
Operating expenses*	(5,545)	(1,754)	(595)	(277)	(8,171)	(1,513)	71	(9,613)
Operating profit	8,771	5,078	4,181	1,304	19,334	116	–	19,450
Gains less losses from financial investments and fixed assets	–	–	4	(2,161)	(2,157)	(2)	–	(2,159)
Net surplus on property revaluation	–	–	–	521	521	–	–	521
Share of profits/(loss) from associates	246	1	–	–	247	(10)	–	237
Profit/(loss) before tax	9,017	5,079	4,185	(336)	17,945	104	–	18,049
Share of profit/(loss) before tax	50.0%	28.1%	23.2%	(1.9%)	99.4%	0.6%	–	100.0%
Share of profit/(loss) before tax as a percentage of Hong Kong and other businesses	50.2%	28.3%	23.3%	(1.8%)	100.0%			
Operating profit excluding loan impairment charges	9,302	5,206	4,186	1,304	19,998	596	–	20,594
**Depreciation/amortisation included in operating expenses*	(46)	(28)	(5)	(767)	(846)	(96)	–	(942)
Total assets	339,219	253,833	462,197	114,123	1,169,372	127,948	(33,330)	1,263,990
Total liabilities	685,299	198,685	126,781	21,905	1,032,670	117,726	(25,599)	1,124,797
Interest in associates	2,186	12	–	–	2,198	20	–	2,218
Non-current assets acquired during the year	248	16	8	333	605	77	–	682

23. Segmental analysis continued

(a) Segmental result continued

	Hong Kong and other businesses							
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Other	Total	Mainland China business	Inter-segment elimination	Total
2013 (restated)								
Net interest income/(expense)	9,959	4,171	3,236	(221)	17,145	1,459	–	18,604
Net fee income	3,849	1,565	231	144	5,789	98	–	5,887
Net trading income/(loss)	300	506	1,122	(14)	1,914	131	–	2,045
Net income/(expense) from financial instruments designated at fair value	350	(4)	(1)	–	345	–	–	345
Dividend income	–	7	–	1,007	1,014	–	–	1,014
Net insurance premium income	9,925	80	–	–	10,005	–	–	10,005
Other operating income	1,612	39	1	334	1,986	7	(57)	1,936
Total operating income	25,995	6,364	4,589	1,250	38,198	1,695	(57)	39,836
Net insurance claims and benefits paid and movement in liabilities to policyholders	(11,702)	(72)	–	–	(11,774)	–	–	(11,774)
Net operating income before loan impairment charges	14,293	6,292	4,589	1,250	26,424	1,695	(57)	28,062
Loan impairment charges	(482)	(38)	(8)	–	(528)	(8)	–	(536)
Net operating income	13,811	6,254	4,581	1,250	25,896	1,687	(57)	27,526
Operating expenses*	(5,315)	(1,621)	(515)	(230)	(7,681)	(1,479)	57	(9,103)
Impairment loss on intangible assets	(11)	(2)	–	–	(13)	–	–	(13)
Operating profit	8,485	4,631	4,066	1,020	18,202	208	–	18,410
Gains less losses from financial investments and fixed assets	(1)	1	4	176	180	(1)	–	179
Gain on reclassification of Industrial Bank	–	–	–	–	–	8,454	–	8,454
Loss on reclassification of Yantai Bank	–	–	–	–	–	(297)	–	(297)
Net surplus on property revaluation	–	–	–	1,188	1,188	–	–	1,188
Share of profits from associates	455	2	–	–	457	105	–	562
Profit before tax	8,939	4,634	4,070	2,384	20,027	8,469	–	28,496
Share of profit before tax	31.4%	16.3%	14.3%	8.3%	70.3%	29.7%	–	100.0%
Share of profit before tax as a percentage of Hong Kong and other businesses	44.6%	23.2%	20.3%	11.9%	100.0%			
Operating profit excluding loan impairment charges	8,967	4,669	4,074	1,020	18,730	216	–	18,946
**Depreciation/amortisation included in operating expenses*	(49)	(28)	(5)	(695)	(777)	(98)	–	(875)
Total assets	309,758	211,747	426,288	104,027	1,051,820	118,476	(26,566)	1,143,730
Total liabilities	650,309	173,675	105,484	16,924	946,392	108,495	(18,935)	1,035,952
Interest in associates	2,022	10	–	–	2,032	30	–	2,062
Non-current assets acquired during the year	1,734	26	1	3,359	5,120	108	–	5,228

23. 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.

	2014	2013
Total operating income		
– Hong Kong	**40,698**	37,458
– Mainland	**2,109**	1,695
– Others	**213**	758
– Inter-segment elimination	**(71)**	(75)
	42,949	39,836
Profit before tax		
– Hong Kong	**17,814**	19,343
– Mainland	**104**	8,469
– Others	**131**	684
	18,049	28,496
Total assets		
– Hong Kong	**1,165,918**	1,048,106
– Mainland	**127,948**	118,476
– Others	**14,636**	12,887
– Inter-segment elimination	**(44,512)**	(35,739)
	1,263,990	1,143,730
Total liabilities		
– Hong Kong	**1,029,796**	943,141
– Mainland	**117,726**	108,495
– Others	**14,170**	12,404
– Inter-segment elimination	**(36,895)**	(28,088)
	1,124,797	1,035,952
Equity		
– Hong Kong	**136,122**	104,965
– Mainland	**10,222**	9,981
– Others	**466**	483
– Inter-segment elimination	**(7,617)**	(7,651)
	139,193	107,778
of which:		
Share capital		
– Hong Kong	**9,658**	9,559
– Mainland	**8,700**	8,847
– Others	**12**	30
– Inter-segment elimination	**(8,712)**	(8,877)
	9,658	9,559

23. Segmental analysis continued

(b) Geographic Information continued

	2014	2013
Interest in associates		
– Hong Kong	**2,198**	2,032
– Mainland	**20**	30
– Others	**–**	–
	2,218	2,062
Non-current assets*		
– Hong Kong	**41,571**	38,786
– Mainland	**1,108**	1,105
– Others	**4**	1
	42,683	39,892
Contingent liabilities and commitments		
– Hong Kong	**292,781**	269,197
– Mainland	**41,691**	34,129
– Others	**4,491**	3,152
	338,963	306,478

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

24. 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".

	Group								
	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
2014									
Assets									
Cash and sight balances at central banks	11,311	–	–	–	–	–	–	–	11,311
Placings with and advances to banks	21,413	67,164	50,532	4,510	–	2,112	–	–	145,731
Trading assets	–	–	–	–	–	–	41,823	–	41,823
Financial assets designated at fair value	–	–	–	–	15	60	–	11,037	11,112
Derivative financial instruments	–	–	–	353	179	1	6,888	–	7,421
Reverse repurchase agreements – non-trading	–	1,296	–	–	–	–	–	–	1,296
Loans and advances to customers	13,250	49,544	53,498	139,508	218,166	184,465	–	–	658,431
Financial investments:									
– available-for-sale investments	–	23,144	65,865	70,648	39,999	5,856	–	44,284	249,796
– held-to-maturity debt securities	–	87	382	3,433	27,440	36,894	–	–	68,236
Interest in associates	–	–	–	–	–	–	–	2,218	2,218
Investment properties	–	–	–	–	–	–	–	11,732	11,732
Premises, plant and equipment	–	–	–	–	–	–	–	21,898	21,898
Intangible assets	–	–	–	–	–	–	–	9,053	9,053
Other assets	8,414	5,825	3,921	2,287	2,774	138	–	573	23,932
	54,388	147,060	174,198	220,739	288,573	229,526	48,711	100,795	1,263,990
Liabilities									
Current, savings and other deposit accounts	630,301	124,457	94,150	44,590	3,023	–	–	–	896,521
Deposits from banks	3,797	3,171	–	2,127	–	–	–	–	9,095
Trading liabilities	–	–	–	–	–	–	72,587	–	72,587
Financial liabilities designated at fair value	2	–	–	–	2,994	493	–	–	3,489
Derivative financial instruments	–	2	20	67	351	108	5,914	–	6,462
Certificates of deposit and other debt securities in issue:									
– certificates of deposit in issue	–	–	–	7,156	4,000	–	–	–	11,156
– other debt securities in issue	–	–	–	–	1,246	–	–	–	1,246
Other liabilities	6,707	5,606	4,090	2,237	127	46	–	2,491	21,304
Liabilities to customers under insurance contracts	–	–	–	–	–	–	–	92,442	92,442
Current tax liabilities	–	–	–	374	–	–	–	–	374
Deferred tax liabilities	–	–	–	–	–	–	–	4,304	4,304
Subordinated liabilities	–	–	–	–	–	5,817	–	–	5,817
	640,807	133,236	98,260	56,551	11,741	6,464	78,501	99,237	1,124,797
of which:									
Certificates of deposit included in:									
– trading assets	–	–	–	–	–	–	–	–	–
– financial assets designated at fair value	–	–	–	–	–	–	–	–	–
– available-for-sale investments	–	113	1,644	4,762	–	–	–	–	6,519
– held-to-maturity debt securities	–	–	–	537	2,831	2,202	–	–	5,570
	–	113	1,644	5,299	2,831	2,202	–	–	12,089
Debt securities included in:									
– trading assets	–	–	–	–	–	–	37,727	–	37,727
– financial assets designated at fair value	–	–	–	–	15	60	–	–	75
– available-for-sale investments	–	23,031	64,221	65,886	39,999	5,856	–	235	199,228
– held-to-maturity debt securities	–	87	382	2,896	24,609	34,692	–	–	62,666
	–	23,118	64,603	68,782	64,623	40,608	37,727	235	299,696
Certificates of deposit in issue included in:									
– trading liabilities	–	–	–	–	–	–	–	–	–
– financial liabilities designated at fair value	–	–	–	–	2,994	–	–	–	2,994
– issue at amortised cost	–	–	–	7,156	4,000	–	–	–	11,156
	–	–	–	7,156	6,994	–	–	–	14,150

24. Analysis of assets and liabilities by remaining maturity continued

	Group								
	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
2013									
Assets									
Cash and sight balances at central banks	22,717	–	–	–	–	–	–	–	22,717
Placings with and advances to banks	13,222	62,104	58,380	6,206	–	2,028	–	–	141,940
Trading assets	–	–	–	–	–	–	31,996	–	31,996
Financial assets designated at fair value	–	–	5	38	482	287	–	6,175	6,987
Derivative financial instruments	–	–	177	210	372	17	5,870	–	6,646
Reverse repurchase agreements – non-trading	–	–	–	–	–	–	–	–	–
Loans and advances to customers	10,528	46,148	49,992	117,086	193,905	168,581	–	–	586,240
Financial investments:									
– available-for-sale investments	–	34,571	50,614	54,039	41,766	2,041	–	28,309	211,340
– held-to-maturity debt securities	–	668	2,075	6,204	25,130	37,428	–	–	71,505
Interest in associates	–	–	–	–	–	–	–	2,062	2,062
Investment properties	–	–	–	–	–	–	–	10,918	10,918
Premises, plant and equipment	–	–	–	–	–	–	–	21,000	21,000
Intangible assets	–	–	–	–	–	–	–	7,974	7,974
Other assets	8,691	5,624	3,808	2,275	1,439	130	–	438	22,405
	55,158	149,115	165,051	186,058	263,094	210,512	37,866	76,876	1,143,730
Liabilities									
Current, savings and other deposit accounts	601,180	113,464	71,154	36,116	3,081	1	–	–	824,996
Deposits from banks	3,868	7,570	388	–	–	–	–	–	11,826
Trading liabilities	–	–	–	–	–	–	62,117	–	62,117
Financial liabilities designated at fair value	2	–	–	–	–	487	–	–	489
Derivative financial instruments	–	15	6	216	362	122	4,525	–	5,246
Certificates of deposit and other debt securities in issue:									
– certificates of deposit in issue	–	–	–	3,949	4,652	–	–	–	8,601
Other liabilities	5,977	5,240	3,917	2,391	167	71	–	2,704	20,467
Liabilities to customers under insurance contracts	–	–	–	–	–	–	–	85,844	85,844
Current tax liabilities	–	–	–	692	–	–	–	–	692
Deferred tax liabilities	–	–	–	–	–	–	–	3,850	3,850
Subordinated liabilities	–	–	–	–	–	11,824	–	–	11,824
	611,027	126,289	75,465	43,364	8,262	12,505	66,642	92,398	1,035,952
of which:									
Certificates of deposit included in:									
– trading assets	–	–	–	–	–	–	–	–	–
– financial assets designated at fair value	–	–	–	–	–	–	–	–	–
– available-for-sale investments	–	692	848	2,716	209	–	–	17	4,482
– held-to-maturity debt securities	–	–	–	110	2,637	2,500	–	–	5,247
	–	692	848	2,826	2,846	2,500	–	17	9,729
Debt securities included in:									
– trading assets	–	–	–	–	–	–	23,807	–	23,807
– financial assets designated at fair value	–	–	5	38	482	287	–	–	812
– available-for-sale investments	–	33,879	49,766	51,323	41,557	2,041	–	296	178,862
– held-to-maturity debt securities	–	668	2,075	6,094	22,493	34,928	–	–	66,258
	–	34,547	51,846	57,455	64,532	37,256	23,807	296	269,739
Certificates of deposit in issue included in:									
– trading liabilities	–	–	–	–	–	–	–	–	–
– financial liabilities designated at fair value	–	–	–	–	–	–	–	–	–
– issue at amortised cost	–	–	–	3,949	4,652	–	–	–	8,601
	–	–	–	3,949	4,652	–	–	–	8,601

24. Analysis of assets and liabilities by remaining maturity continued

	Bank								
	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
2014									
Assets									
Cash and sight balances at central banks	9,246	–	–	–	–	–	–	–	9,246
Placings with and advances to banks	12,442	49,174	46,985	3,055	–	–	–	–	111,656
Trading assets	–	–	–	–	–	–	38,160	–	38,160
Derivative financial instruments	–	–	–	353	179	1	6,506	–	7,039
Reverse repurchase agreements – non-trading	–	1,296	–	–	–	–	–	–	1,296
Loans and advances to customers	12,051	44,091	44,396	121,150	197,482	168,961	–	–	588,131
Amounts due from subsidiaries	3,279	5,081	4,923	8,109	6,436	367	–	–	28,195
Financial investments:									
– available-for-sale investments	–	22,768	65,741	57,895	30,810	1,646	–	44,018	222,878
Investments in subsidiaries	–	–	–	–	–	–	–	17,902	17,902
Interest in associates	–	–	–	–	–	–	–	–	–
Investment properties	–	–	–	–	–	–	–	6,973	6,973
Premises, plant and equipment	–	–	–	–	–	–	–	16,578	16,578
Intangible assets	–	–	–	–	–	–	–	376	376
Other assets	8,303	3,660	2,103	464	–	123	–	42	14,695
	45,321	126,070	164,148	191,026	234,907	171,098	44,666	85,889	1,063,125
Liabilities									
Current, savings and other deposit accounts	612,229	120,483	87,136	30,419	57	–	–	–	850,324
Deposits from banks	3,713	427	–	–	–	–	–	–	4,140
Trading liabilities	–	–	–	–	–	–	34,373	–	34,373
Financial liabilities designated at fair value	–	–	–	–	2,994	–	–	–	2,994
Derivative financial instruments	–	2	20	67	351	108	5,676	–	6,224
Certificates of deposit and other debt securities in issue:									
– certificates of deposit in issue	–	–	–	7,156	4,000	–	–	–	11,156
Amounts due to subsidiaries	10,219	5,257	14	–	–	–	–	–	15,490
Other liabilities	6,545	4,529	2,636	830	53	46	–	2,382	17,021
Current tax liabilities	–	–	–	283	–	–	–	–	283
Deferred tax liabilities	–	–	–	–	–	–	–	2,143	2,143
Subordinated liabilities	–	–	–	–	–	5,817	–	–	5,817
	632,706	130,698	89,806	38,755	7,455	5,971	40,049	4,525	949,965
of which:									
Certificates of deposit included in:									
– trading assets	–	–	–	–	–	–	–	–	–
– financial assets designated at fair value	–	–	–	–	–	–	–	–	–
– available-for-sale investments	–	112	1,520	4,148	–	–	–	–	5,780
	–	112	1,520	4,148	–	–	–	–	5,780
Debt securities included in:									
– trading assets	–	–	–	–	–	–	34,064	–	34,064
– financial assets designated at fair value	–	–	–	–	–	–	–	–	–
– available-for-sale investments	–	22,656	64,221	53,747	30,810	1,646	–	236	173,316
	–	22,656	64,221	53,747	30,810	1,646	34,064	236	207,380
Certificates of deposit in issue included in:									
– trading liabilities	–	–	–	–	–	–	–	–	–
– financial liabilities designated at fair value	–	–	–	–	2,994	–	–	–	2,994
– issue at amortised cost	–	–	–	7,156	4,000	–	–	–	11,156
	–	–	–	7,156	6,994	–	–	–	14,150

24. Analysis of assets and liabilities by remaining maturity continued

	Bank								
	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
2013									
Assets									
Cash and sight balances at central banks	20,405	–	–	–	–	–	–	–	20,405
Placings with and advances to banks	9,604	38,286	54,853	3,649	–	–	–	–	106,392
Trading assets	–	–	–	–	–	–	30,477	–	30,477
Derivative financial instruments	–	–	177	210	372	17	5,061	–	5,837
Reverse repurchase agreements – non-trading	–	–	–	–	–	–	–	–	–
Loans and advances to customers	10,564	41,779	40,611	98,951	172,619	154,611	–	–	519,135
Amounts due from subsidiaries	726	1,884	5,973	7,096	7,530	344	–	–	23,553
Financial investments:									
– available-for-sale investments	–	34,444	49,156	49,108	32,749	2,041	–	28,026	195,524
Investments in subsidiaries	–	–	–	–	–	–	–	17,918	17,918
Interest in associates	–	–	–	–	–	–	–	–	–
Investment properties	–	–	–	–	–	–	–	6,878	6,878
Premises, plant and equipment	–	–	–	–	–	–	–	15,414	15,414
Intangible assets	–	–	–	–	–	–	–	381	381
Other assets	8,582	3,367	1,943	754	1	120	–	40	14,807
	49,881	119,760	152,713	159,768	213,271	157,133	35,538	68,657	956,721
Liabilities									
Current, savings and other deposit accounts	585,612	106,649	61,120	21,022	59	–	–	–	774,462
Deposits from banks	3,868	6,144	–	–	–	–	–	–	10,012
Trading liabilities	–	–	–	–	–	–	29,914	–	29,914
Derivative financial instruments	–	15	6	216	362	122	3,765	–	4,486
Certificates of deposit and other debt securities in issue:									
– certificates of deposit in issue	–	–	–	3,949	4,652	–	–	–	8,601
Amounts due to subsidiaries	3,400	10,914	12	–	–	–	–	–	14,326
Other liabilities	5,891	3,756	2,164	1,230	100	71	–	2,590	15,802
Current tax liabilities	–	–	–	662	–	–	–	–	662
Deferred tax liabilities	–	–	–	–	–	–	–	1,985	1,985
Subordinated liabilities	–	–	–	–	–	11,824	–	–	11,824
	598,771	127,478	63,302	27,079	5,173	12,017	33,679	4,575	872,074
of which:									
Certificates of deposit included in:									
– trading assets	–	–	–	–	–	–	–	–	–
– financial assets designated at fair value	–	–	–	–	–	–	–	–	–
– available-for-sale investments	–	692	848	2,716	209	–	–	18	4,483
– held-to-maturity debt securities	–	–	–	–	–	–	–	–	–
	–	692	848	2,716	209	–	–	18	4,483
Debt securities included in:									
– trading assets	–	–	–	–	–	–	22,288	–	22,288
– financial assets designated at fair value	–	–	–	–	–	–	–	–	–
– available-for-sale investments	–	33,752	48,308	46,392	32,540	2,041	–	296	163,329
– held-to-maturity debt securities	–	–	–	–	–	–	–	–	–
	–	33,752	48,308	46,392	32,540	2,041	22,288	296	185,617
Certificates of deposit in issue included in:									
– trading liabilities	–	–	–	–	–	–	–	–	–
– financial liabilities designated at fair value	–	–	–	–	–	–	–	–	–
– issue at amortised cost	–	–	–	3,949	4,652	–	–	–	8,601
	–	–	–	3,949	4,652	–	–	–	8,601

25. Accounting classifications

The tables below set out the Group's classification of financial assets and liabilities:

	Group						
	Trading	Designated at fair value	Available-for-sale/ hedging	Held-to-maturity	Loans and receivables	Other amortised cost	Total
2014							
Cash and sight balances at central banks	–	–	–	–	–	11,311	11,311
Placings with and advances to banks	–	–	–	–	145,731	–	145,731
Derivative financial instruments	6,888	–	533	–	–	–	7,421
Reverse repurchase agreements – non-trading	–	–	–	–	1,296	–	1,296
Loans and advances to customers	–	–	–	–	658,431	–	658,431
Investment securities	37,767	11,112	249,796	68,236	–	–	366,911
Acceptances and endorsements	–	–	–	–	–	5,715	5,715
Other financial assets	4,056	–	–	–	–	11,504	15,560
Total financial assets	48,711	11,112	250,329	68,236	805,458	28,530	1,212,376
Non-financial assets							51,614
Total assets							1,263,990
Current, savings and other deposit accounts	40,380	–	–	–	–	896,521	936,901
Deposits from banks	–	–	–	–	–	9,095	9,095
Derivative financial instruments	5,913	1	548	–	–	–	6,462
Certificates of deposit and other debt securities in issue	4,223	2,994	–	–	–	12,402	19,619
Other financial liabilities	27,984	–	–	–	–	12,991	40,975
Subordinated liabilities	–	–	–	–	–	5,817	5,817
Liabilities to customers under investment contracts	–	495	–	–	–	–	495
Acceptances and endorsements	–	–	–	–	–	5,715	5,715
Total financial liabilities	78,500	3,490	548	–	–	942,541	1,025,079
Non-financial liabilities							99,718
Total liabilities							1,124,797

25. Accounting classifications continued

	Group						
	Trading	Designated at fair value	Available-for-sale/ hedging	Held-to-maturity	Loans and receivables	Other amortised cost	Total
2013							
Cash and sight balances at central banks	–	–	–	–	–	22,717	22,717
Placings with and advances to banks	–	–	–	–	141,940	–	141,940
Derivative financial instruments	5,870	–	776	–	–	–	6,646
Reverse repurchase agreements – non-trading	–	–	–	–	–	–	–
Loans and advances to customers	–	–	–	–	586,240	–	586,240
Investment securities	23,835	6,987	211,340	71,505	–	–	313,667
Acceptances and endorsements	–	–	–	–	–	6,351	6,351
Other financial assets	8,161	–	–	–	–	10,131	18,292
Total financial assets	37,866	6,987	212,116	71,505	728,180	39,199	1,095,853
Non-financial assets							47,877
Total assets							1,143,730
Current, savings and other deposit accounts	34,489	–	–	–	–	824,996	859,485
Deposits from banks	–	–	–	–	–	11,826	11,826
Derivative financial instruments	4,525	–	721	–	–	–	5,246
Certificates of deposit and other debt securities in issue	1,615	–	–	–	–	8,601	10,216
Other financial liabilities	26,013	–	–	–	–	11,320	37,333
Subordinated liabilities	–	–	–	–	–	11,824	11,824
Liabilities to customers under investment contracts	–	489	–	–	–	–	489
Acceptances and endorsements	–	–	–	–	–	6,351	6,351
Total financial liabilities	66,642	489	721	–	–	874,918	942,770
Non-financial liabilities							93,182
Total liabilities							1,035,952

25. Accounting classifications continued

	Bank						
	Trading	Designated at fair value	Available-for-sale/ hedging	Held-to-maturity	Loans and receivables	Other amortised cost	Total
2014							
Cash and sight balances at central banks	–	–	–	–	–	9,246	9,246
Placings with and advances to banks	–	–	–	–	111,656	–	111,656
Derivative financial instruments	6,506	–	533	–	–	–	7,039
Reverse repurchase agreements – non-trading	–	–	–	–	1,296	–	1,296
Loans and advances to customers	–	–	–	–	588,131	–	588,131
Investment securities	34,104	–	222,878	–	–	–	256,982
Amounts due from subsidiaries	–	–	–	–	–	28,195	28,195
Acceptances and endorsements	–	–	–	–	–	3,029	3,029
Other financial assets	4,056	–	–	–	–	7,841	11,897
Total financial assets	44,666	–	223,411	–	701,083	48,311	1,017,471
Non-financial assets							45,654
Total assets							1,063,125
Current, savings and other deposit accounts	2,166	–	–	–	–	850,324	852,490
Deposits from banks	–	–	–	–	–	4,140	4,140
Derivative financial instruments	5,675	1	548	–	–	–	6,224
Certificates of deposit and other debt securities in issue	4,223	2,994	–	–	–	11,156	18,373
Amounts due to subsidiaries	–	–	–	–	–	15,490	15,490
Other financial liabilities	27,984	–	–	–	–	11,568	39,552
Subordinated liabilities	–	–	–	–	–	5,817	5,817
Acceptances and endorsements	–	–	–	–	–	3,029	3,029
Total financial liabilities	40,048	2,995	548	–	–	901,524	945,115
Non-financial liabilities							4,850
Total liabilities							949,965

25. Accounting classifications continued

	Bank						
	Trading	Designated at fair value	Available-for-sale/ hedging	Held-to-maturity	Loans and receivables	Other amortised cost	Total
2013							
Cash and sight balances at central banks	–	–	–	–	–	20,405	20,405
Placings with and advances to banks	–	–	–	–	106,392	–	106,392
Derivative financial instruments	5,061	–	776	–	–	–	5,837
Reverse repurchase agreements – non-trading	–	–	–	–	–	–	–
Loans and advances to customers	–	–	–	–	519,135	–	519,135
Investment securities	22,316	–	195,524	–	–	–	217,840
Amounts due from subsidiaries	–	–	–	–	–	23,553	23,553
Acceptances and endorsements	–	–	–	–	–	3,254	3,254
Other financial assets	8,161	–	–	–	–	7,226	15,387
Total financial assets	35,538	–	196,300	–	625,527	54,438	911,803
Non-financial assets							44,918
Total assets							956,721
Current, savings and other deposit accounts	2,286	–	–	–	–	774,462	776,748
Deposits from banks	–	–	–	–	–	10,012	10,012
Derivative financial instruments	3,765	–	721	–	–	–	4,486
Certificates of deposit and other debt securities in issue	1,615	–	–	–	–	8,601	10,216
Amounts due to subsidiaries	–	–	–	–	–	14,326	14,326
Other financial liabilities	26,013	–	–	–	–	9,930	35,943
Subordinated liabilities	–	–	–	–	–	11,824	11,824
Acceptances and endorsements	–	–	–	–	–	3,254	3,254
Total financial liabilities	33,679	–	721	–	–	832,409	866,809
Non-financial liabilities							5,265
Total liabilities							872,074

26. Cash and sight balances at central banks

	Group		**Bank**	
	2014	2013	**2014**	2013
Cash in hand	**5,016**	6,005	**4,787**	5,742
Sight balances at central banks	**6,295**	16,712	**4,459**	14,663
	11,311	22,717	**9,246**	20,405

27. Placings with and advances to banks

	Group		Bank	
	2014	2013	**2014**	2013
Balances with banks	**15,972**	10,577	**12,434**	9,604
Placings with and advances to banks maturing within one month	**72,605**	64,749	**49,182**	38,286
Placings with and advances to banks maturing after one month but less than one year	**55,042**	64,586	**50,040**	58,502
Placings with and advances to banks maturing after one year	**2,112**	2,028	**–**	–
	145,731	141,940	**111,656**	106,392
of which:				
Placings with and advances to central banks	**13,566**	13,914	**50**	44

There were no overdue advances, impaired advances and rescheduled advances to banks at 31 December 2014 by the Group and the Bank (2013: Nil).

28. Trading assets

	Group		Bank	
	2014	2013	**2014**	2013
Treasury bills	**24,228**	18,336	**24,228**	18,336
Other debt securities	**13,499**	5,471	**9,836**	3,952
Debt securities	**37,727**	23,807	**34,064**	22,288
Investment funds	**40**	28	**40**	28
Total trading securities	**37,767**	23,835	**34,104**	22,316
Other*	**4,056**	8,161	**4,056**	8,161
Total trading assets	**41,823**	31,996	**38,160**	30,477
Debt securities:				
– listed in Hong Kong	**9,829**	3,783	**9,829**	3,783
– listed outside Hong Kong**	**424**	700	**7**	700
	10,253	4,483	**9,836**	4,483
– unlisted**	**27,474**	19,324	**24,228**	17,805
	37,727	23,807	**34,064**	22,288
Investment funds:				
– listed in Hong Kong	**40**	28	**40**	28
Total trading securities	**37,767**	23,835	**34,104**	22,316
Debt securities:				
Issued by public bodies:				
– central governments and central banks	**34,481**	22,650	**34,064**	22,119
	34,481	22,650	**34,064**	22,119
Issued by other bodies:				
– banks	**598**	853	**–**	169
– corporate entities	**2,648**	304	**–**	–
	3,246	1,157	**–**	169
	37,727	23,807	**34,064**	22,288
Investment funds:				
Issued by corporate entities	**40**	28	**40**	28
Total trading securities	**37,767**	23,835	**34,104**	22,316

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

** During 2014, certain stock exchanges have been regarded as recognised stock exchanges, causing more financial investments to be classified as listed. Comparative figures have been restated to conform with current year's presentation.

29. Financial assets designated at fair value

	Group		Bank	
	2014	2013	**2014**	2013
Other debt securities	**75**	812	**–**	–
Debt securities	**75**	812	**–**	–
Equity shares	**6,799**	3,639	**–**	–
Investment funds	**4,238**	2,536	**–**	–
	11,112	6,987	**–**	–
Debt securities:				
– listed in Hong Kong	**20**	103	**–**	–
– listed outside Hong Kong	**55**	489	**–**	–
	75	592	**–**	–
– unlisted	**–**	220	**–**	–
	75	812	**–**	–
Equity shares:				
– listed in Hong Kong	**1,958**	2,072	**–**	–
– listed outside Hong Kong*	**4,735**	1,539	**–**	–
	6,693	3,611	**–**	–
– unlisted*	**106**	28	**–**	–
	6,799	3,639	**–**	–
Investment funds:				
– listed in Hong Kong	**1,504**	32	**–**	–
– listed outside Hong Kong	**332**	314	**–**	–
	1,836	346	**–**	–
– unlisted	**2,402**	2,190	**–**	–
	4,238	2,536	**–**	–
	11,112	6,987	**–**	–
Debt securities:				
Issued by public bodies:				
– central governments and central banks	**–**	358	**–**	–
– other public sector entities	**1**	44	**–**	–
	1	402	**–**	–
Issued by other bodies:				
– banks	**14**	208	**–**	–
– corporate entities	**60**	202	**–**	–
	74	410	**–**	–
	75	812	**–**	–
Equity shares:				
Issued by banks	**1,069**	634	**–**	–
Issued by public sector entities	**9**	12	**–**	–
Issued by corporate entities	**5,721**	2,993	**–**	–
	6,799	3,639	**–**	–
Investment funds:				
Issued by corporate entities	**4,238**	2,536	**–**	–
	4,238	2,536	**–**	–
	11,112	6,987	**–**	–

* During 2014, certain stock exchanges have been regarded as recognised stock exchanges, causing more financial investments to be classified as listed. Comparative figures have been restated to conform with current year's presentation.

30. Derivative financial instruments

Derivatives are financial contracts whose values and characteristics are derived from underlying assets, exchange and interest rates, and indices. Derivative instruments are subject to both credit risk and market risk. The credit risk relating to a derivative contract is principally the replacement cost of the contract when it has a positive mark-to-market value and the estimated potential future change in value over the residual maturity of the contract. The nominal value of the contracts does not represent the amount of the Group's exposure to credit risk. All activities relating to derivatives are subject to the same credit approval and monitoring standards used to control credit risk for other transactions. Market risk from derivative positions is controlled individually and in combination with on-balance sheet market risk positions within the Group's market risk limits regime as described in Management Discussion and Analysis.

The Group transacts derivatives for three primary purposes: to create risk management solutions for clients, for proprietary trading purposes, and to manage and hedge its own risks. For accounting purposes, derivative financial instruments are held for trading, or financial instruments designated at fair value, or designated as either fair value hedge or cash flow hedge. The Group primarily traded over-the-counter derivatives and also participated in exchange traded derivatives.

Trading derivatives

Most of the Group's trading derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities in derivatives are entered into principally for the purpose of generating profits from short-term fluctuations in price or margin. Positions may be traded actively or be held over a period of time to benefit from expected changes in currency rates, interest rates, equity prices or other market parameters.

Derivatives classified as held for trading include non-qualifying hedging derivatives and ineffective hedging derivatives. Non-qualifying hedging derivatives are entered into for risk management purposes but do not meet the criteria for hedge accounting. These include derivatives managed in conjunction with financial instruments designated at fair value. Ineffective hedging derivatives were previously designated as hedges, but no longer meet the criteria for hedge accounting.

Hedging instruments

The Group uses derivatives (principally interest rate swaps) for hedging purposes in the management of its own asset and liability portfolios and structural positions. This enables the Group to optimise the cost of managing the balance sheet, and to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities.

(a) Fair value hedge

The Group's fair value hedge principally consists of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates.

30. Derivative financial instruments continued

(b) Cash flow hedge

The Group is exposed to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio for financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedge of forecast transactions.

Gains and losses are initially recognised in equity, in the cash flow hedging reserve, and are transferred to the income statement when the forecast cash flows affect the income statement. During the year ended 31 December 2014, the amount of cash flow hedging reserve transferred to the income statement consist of HK$42 million (2013: HK$46 million) in net interest income and HK$297 million (2013: HK$399 million) in net trading income.

There was insignificant ineffectiveness recognised in the Group's income statement arising from cash flow hedge during the years of 2014 and 2013. During the years of 2014 and 2013, there were forecast transactions for which hedge accounting had previously been used but which were no longer expected to occur. In 2014, there was no gain recognised due to termination of such forecast transactions (2013: HK$3 million)

The schedules of forecast principal balances on which the expected interest cash flows associated with derivatives that are cash flow hedge were as follows:

	Group		
	Three months or less	Over three months but within one year	Over one year but within five years
At 31 December 2014			
Cash inflows from assets	**18,691**	**21,109**	**10,345**
Cash outflows from liabilities	**–**	**–**	**–**
Net cash inflows	**18,691**	**21,109**	**10,345**
At 31 December 2013			
Cash inflows from assets	4,633	5,759	4,816
Cash outflows from liabilities	–	–	–
Net cash inflows	4,633	5,759	4,816

30. Derivative financial instruments continued

(c) The following table shows the nominal contract amounts and marked-to-market value of assets and liabilities by each class of derivatives.

	Group					
	2014			2013		
	Contract amounts	Derivative assets	Derivative liabilities	Contract amounts	Derivative assets	Derivative liabilities
Derivatives held for trading						
Exchange rate contracts:						
– spot and forward foreign exchange	**638,980**	**3,588**	**2,727**	590,846	4,066	2,849
– currency swaps	**30,014**	**192**	**238**	1,742	4	10
– currency options purchased	**99,703**	**2,098**	**–**	104,145	183	–
– currency options written	**98,597**	**–**	**2,079**	105,366	–	160
	867,294	**5,878**	**5,044**	802,099	4,253	3,019
Interest rate contracts:						
– interest rate swaps	**184,283**	**758**	**639**	193,275	1,553	1,348
– interest rate options written	**5,084**	**–**	**–**	–	–	–
– other interest rate contracts	**2,130**	**2**	**1**	78	–	–
	191,497	**760**	**640**	193,353	1,553	1,348
Equity and other contracts:						
– equity swaps	**2,223**	**5**	**74**	2,883	16	109
– equity options purchased	**8,011**	**227**	**–**	3,161	44	–
– equity options written	**5,370**	**–**	**154**	2,979	–	42
– spot and forward contracts and others	**824**	**18**	**1**	965	4	7
	16,428	**250**	**229**	9,988	64	158
Total derivatives held for trading	**1,075,219**	**6,888**	**5,913**	1,005,440	5,870	4,525
Derivatives managed in conjunction with financial assets designated at fair value						
Interest rate contracts:						
– interest rate swaps	**3,000**	**–**	**1**	–	–	–
Cash flow hedge derivatives						
Exchange rate contracts:						
– currency swaps	**4,332**	**491**	**10**	3,463	667	6
Interest rate contracts:						
– interest rate swaps	**17,078**	**12**	**8**	3,100	5	2
	21,410	**503**	**18**	6,563	672	8
Fair value hedge derivatives						
Interest rate contracts:						
– interest rate swaps	**24,075**	**30**	**530**	29,149	104	713
Total derivatives	**1,123,704**	**7,421**	**6,462**	1,041,152	6,646	5,246

30. Derivative financial instruments continued

	Bank					
	2014			2013		
	Contract amounts	**Derivative assets**	**Derivative liabilities**	Contract amounts	Derivative assets	Derivative liabilities
Derivatives held for trading						
Exchange rate contracts:						
– spot and forward foreign exchange	**571,565**	**3,390**	**2,379**	526,467	3,725	2,411
– currency swaps	**28,113**	**203**	**187**	505	3	–
– currency options purchased	**99,823**	**2,098**	**–**	104,223	183	–
– currency options written	**98,834**	**–**	**2,303**	105,515	–	305
	798,335	**5,691**	**4,869**	736,710	3,911	2,716
Interest rate contracts:						
– interest rate swaps	**149,488**	**637**	**574**	153,489	998	874
– interest rate options written	**5,084**	**–**	**–**	–	–	–
– other interest rate contracts	**2,130**	**2**	**1**	78	–	–
	156,702	**639**	**575**	153,567	998	874
Equity and other contracts:						
– equity swaps	**2,609**	**6**	**77**	4,638	98	124
– equity options purchased	**5,438**	**152**	**–**	3,161	44	–
– equity options written	**5,440**	**–**	**153**	3,162	–	44
– spot and forward contracts and others	**824**	**18**	**1**	1,300	10	7
	14,311	**176**	**231**	12,261	152	175
Total derivatives held for trading	**969,348**	**6,506**	**5,675**	902,538	5,061	3,765
Derivatives managed in conjunction with financial assets designated at fair value						
Interest rate contracts:						
– interest rate swaps	**3,000**	**–**	**1**	–	–	–
Cash flow hedge derivatives						
Exchange rate contracts:						
– currency swaps	**4,332**	**491**	**10**	3,463	667	6
Interest rate contracts:						
– interest rate swaps	**17,078**	**12**	**8**	3,100	5	2
	21,410	**503**	**18**	6,563	672	8
Fair value hedge derivatives						
Interest rate contracts:						
– interest rate swaps	**24,075**	**30**	**530**	29,149	104	713
Total derivatives	**1,017,833**	**7,039**	**6,224**	938,250	5,837	4,486

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

30. Derivative financial instruments continued

(d) Contract amounts, credit equivalent amounts and risk-weighted amounts

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

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

The credit equivalent amounts after taking into account of recognised netting are calculated for the purposes of deriving the risk-weighted amounts. These are assessed in accordance with the Banking (Capital) Rules ("the Capital Rules") and depend on the status of the counterparty and maturity characteristics of the instrument.

Where a legally enforceable bilateral netting is arranged with counterparty, the Group has the right to offset the gross amount of positive marked-to-market assets with any negative marked-to-market liabilities with the same customer. These offsets are recognised by the Hong Kong Monetary Authority in the calculation of risk assets for the capital adequacy ratio.

The Group uses the approaches approved by the Hong Kong Monetary Authority to calculate the capital adequacy ratio in accordance with the Capital Rules. The risk-weighted assets at 31 December 2014 and 2013 were calculated based on the advanced internal ratings-based approach.

	Group			Bank		
	Contract amounts	Credit equivalent amounts	Risk-weighted amounts	Contract amounts	Credit equivalent amounts	Risk-weighted amounts
2014						
Exchange rate contracts:						
– spot and forward foreign exchange	556,036	4,353	1,525	495,677	3,543	1,185
– currency swaps	32,426	1,164	242	32,426	1,164	242
– currency options purchased	99,709	5,541	5,231	99,820	5,540	5,159
	688,171	11,058	6,998	627,923	10,247	6,586
Interest rate contracts:						
– interest rate swaps	228,436	1,280	405	193,640	1,103	264
– other interest rate contracts	2,130	1	–	2,130	1	–
	230,566	1,281	405	195,770	1,104	264
Equity and other contracts:						
– equity swaps	2,223	139	23	2,609	164	26
– equity options purchased	5,438	484	371	5,438	484	371
	7,661	623	394	8,047	648	397

The total fair value of the derivatives at 31 December 2014 was HK$4,490 million (31 December 2013: HK$3,093 million) after taking into account the effect of valid bilateral netting agreement amounting to HK$2,390 million (31 December 2013: HK$3,103 million).

30. Derivative financial instruments continued

(d) Contract amounts, credit equivalent amounts and risk-weighted amounts continued

	Group			Bank		
	Contract amounts	Credit equivalent amounts	Risk-weighted amounts	Contract amounts	Credit equivalent amounts	Risk-weighted amounts
2013						
Exchange rate contracts:						
– spot and forward foreign exchange	537,659	4,414	1,133	480,068	3,397	731
– currency swaps	3,991	742	86	3,968	741	86
– currency options purchased	104,218	2,909	2,484	104,293	2,911	2,484
– other exchange rate contracts	14	–	–	14	–	–
	645,882	8,065	3,703	588,343	7,049	3,301
Interest rate contracts:						
– interest rate swaps	225,524	2,021	626	185,738	1,373	278
– other interest rate contracts	78	–	–	78	–	–
	225,602	2,021	626	185,816	1,373	278
Equity and other contracts:						
– equity swaps	2,883	190	24	4,639	380	46
– equity options purchased	3,161	233	164	3,161	233	164
	6,044	423	188	7,800	613	210

31. Loans and advances to customers

(a) Loans and advances to customers

	Group		Bank	
	2014	2013	**2014**	2013
Gross loans and advances to customers	**660,269**	587,688	**589,365**	520,279
Less:				
Loan impairment allowances				
– Individually assessed	**(999)**	(709)	**(514)**	(534)
– collectively assessed	**(839)**	(739)	**(720)**	(610)
	658,431	586,240	**588,131**	519,135

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

	Group		Bank	
	2014	2013	**2014**	2013
	%	%	**%**	%
Loan impairment allowances:				
– individually assessed	**0.15**	0.12	**0.09**	0.10
– collectively assessed	**0.13**	0.13	**0.12**	0.12
Total loan impairment allowances	**0.28**	0.25	**0.21**	0.22

31. Loans and advances to customers continued

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

	Group		
	Individually assessed	Collectively assessed	Total
2014			
At 1 January	**709**	**739**	**1,448**
Amounts written off	**(266)**	**(563)**	**(829)**
Recoveries of loans and advances written off in previous years	**36**	**56**	**92**
New impairment allowances charged to income statement (note 12)	**699**	**668**	**1,367**
Impairment allowances released to income statement (note 12)	**(167)**	**(56)**	**(223)**
Unwinding of discount of loan impairment allowances recognised as "interest income"	**(8)**	**(4)**	**(12)**
Exchange difference	**(4)**	**(1)**	**(5)**
At 31 December	**999**	**839**	**1,838**
2013			
At 1 January	681	728	1,409
Amounts written off	(69)	(494)	(563)
Recoveries of loans and advances written off in previous years	16	52	68
New impairment allowances charged to income statement (note 12)	191	562	753
Impairment allowances released to income statement (note 12)	(107)	(110)	(217)
Unwinding of discount of loan impairment allowances recognised as "interest income"	(5)	(4)	(9)
Exchange difference	2	5	7
At 31 December	709	739	1,448

	Bank		
	Individually assessed	Collectively assessed	Total
2014			
At 1 January	**534**	**610**	**1,144**
Amounts written off	**(96)**	**(563)**	**(659)**
Recoveries of loans and advances written off in previous years	**32**	**56**	**88**
New impairment allowances charged to income statement (note 12)	**123**	**677**	**800**
Impairment allowances released to income statement (note 12)	**(74)**	**(56)**	**(130)**
Unwinding of discount of loan impairment allowances recognised as "interest income"	**(5)**	**(4)**	**(9)**
At 31 December	**514**	**720**	**1,234**
2013			
At 1 January	503	580	1,083
Amounts written off	(40)	(494)	(534)
Recoveries of loans and advances written off in previous years	9	52	61
New impairment allowances charged to income statement (note 12)	122	562	684
Impairment allowances released to income statement (note 12)	(56)	(86)	(142)
Unwinding of discount of loan impairment allowances recognised as "interest income"	(4)	(4)	(8)
At 31 December	534	610	1,144

31. Loans and advances to customers continued

(c) Impaired loans and advances to customers and allowances

	Group		Bank	
	2014	2013	**2014**	2013
Gross impaired loans and advances	**2,115**	1,311	**1,280**	1,097
Individually assessed allowances	**(999)**	(709)	**(514)**	(534)
Net impaired loans and advances	**1,116**	602	**766**	563
Individually assessed allowances as a percentage of gross impaired loans and advances	**47.2%**	54.1%	**40.2%**	48.7%
Gross impaired loans and advances as a percentage of gross loans and advances to customers	**0.32%**	0.22%	**0.22%**	0.21%

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.

	Group		Bank	
	2014	2013	**2014**	2013
Gross individually assessed impaired loans and advances	**1,963**	1,157	**1,128**	943
Individually assessed allowances	**(999)**	(709)	**(514)**	(534)
	964	448	**614**	409
Gross individually assessed impaired loans and advances as a percentage of gross loans and advances to customers	**0.30%**	0.20%	**0.19%**	0.18%
Amount of collateral which has been taken into account in respect of individually assessed impaired loans and advances to customers	**637**	516	**554**	365

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.

31. 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:

	Group		Bank	
		%		%
2014				
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	**449**	**0.1**	**250**	**–**
– more than six months but not more than one year	**98**	**–**	**88**	**–**
– more than one year	**558**	**0.1**	**533**	**0.1**
	1,105	**0.2**	**871**	**0.1**
of which:				
– individually impaired allowances	**(622)**		**(440)**	
– covered portion of overdue loans and advances	**377**		**330**	
– uncovered portion of overdue loans and advances	**728**		**541**	
– current market value of collateral held against the covered portion of overdue loans and advances	**1,043**		**949**	
2013				
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	121	–	101	–
– more than six months but not more than one year	73	–	47	–
– more than one year	637	0.1	516	0.1
	831	0.1	664	0.1
of which:				
– individually impaired allowances	(583)		(454)	
– covered portion of overdue loans and advances	298		168	
– uncovered portion of overdue loans and advances	533		496	
– current market value of collateral held against the covered portion of overdue loans and advances	599		421	

Collateral held with respect to overdue loans and advances is mainly residential properties and commercial properties. The current market value of residential properties and commercial properties were HK$558 million and HK$66 million respectively (2013: HK$384 million and HK$164 million respectively).

Loans and advances with a specific repayment date are classified as overdue when the principal or interest is overdue and remains unpaid at period-end. Loans and advances repayable by regular instalments are treated as overdue when an instalment payment is overdue and remains unpaid at 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.

31. 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:

	Group		Bank	
		%		%
2014	**90**	**–**	**89**	**–**
2013	123	–	121	–

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 31(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.

	Group				
	Gross loans and advances	Individually impaired loans and advances	Overdue loans and advances	Individually assessed allowances	Collectively assessed allowances
At 31 December 2014					
Hong Kong	**543,757**	**1,124**	**842**	**506**	**692**
Rest of Asia-Pacific	**109,520**	**837**	**263**	**493**	**138**
Others	**6,992**	**2**	**–**	**–**	**9**
	660,269	**1,963**	**1,105**	**999**	**839**
At 31 December 2013					
Hong Kong	480,545	924	642	527	589
Rest of Asia-Pacific	99,987	233	189	182	140
Others	7,156	–	–	–	10
	587,688	1,157	831	709	739

	Bank				
	Gross loans and advances	Individually impaired loans and advances	Overdue loans and advances	Individually assessed allowances	Collectively assessed allowances
At 31 December 2014					
Hong Kong	**528,301**	**1,106**	**837**	**505**	**674**
Rest of Asia-Pacific	**57,657**	**22**	**34**	**9**	**44**
Others	**3,407**	**–**	**–**	**–**	**2**
	589,365	**1,128**	**871**	**514**	**720**
At 31 December 2013					
Hong Kong	464,740	911	639	527	569
Rest of Asia-Pacific	52,021	32	25	7	38
Others	3,518	–	–	–	3
	520,279	943	664	534	610

31. 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 Hong Kong Monetary Authority is as follows:

	Group			
	2014		2013	
		% of gross advances covered by collateral		% of gross advances covered by collateral
Gross loans and advances to customers for use in Hong Kong				
Industrial, commercial and financial sectors				
– property development	**41,676**	**38.6**	30,529	47.2
– property investment	**112,589**	**94.6**	100,912	90.6
– financial concerns	**5,499**	**45.8**	2,773	46.4
– stockbrokers	**531**	**24.7**	304	46.2
– wholesale and retail trade	**27,550**	**47.0**	21,912	46.5
– manufacturing	**21,501**	**52.5**	17,372	37.6
– transport and transport equipment	**7,530**	**72.9**	6,289	67.8
– recreational activities	**125**	**7.6**	160	15.5
– information technology	**2,935**	**34.2**	1,870	43.4
– other	**34,279**	**64.1**	35,664	53.4
	254,215	**70.0**	217,785	68.0
Individuals				
– loans and advances for the purchase of flats under the Government Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	**15,710**	**100.0**	14,452	100.0
– loans and advances for the purchase of other residential properties	**143,541**	**100.0**	131,305	100.0
– credit card loans and advances	**24,175**	**–**	21,419	–
– other	**17,039**	**39.7**	14,431	41.6
	200,465	**82.8**	181,607	83.6
Total gross loans and advances for use in Hong Kong	**454,680**	**75.7**	399,392	75.1
Trade finance	**41,537**	**26.5**	52,117	19.6
Gross loans and advances for use outside Hong Kong	**164,052**	**21.4**	136,179	29.4
Gross loans and advances to customers	**660,269**	**59.1**	587,688	59.6

31. Loans and advances to customers continued

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

	Bank			
	2014		2013	
		% of gross advances covered by collateral		% of gross advances covered by collateral
Gross loans and advances to customers for use in Hong Kong				
Industrial, commercial and financial sectors				
– property development	**41,676**	**38.6**	30,529	47.2
– property investment	**112,204**	**94.8**	100,507	90.8
– financial concerns	**5,499**	**45.8**	2,773	46.4
– stockbrokers	**531**	**24.7**	304	46.2
– wholesale and retail trade	**27,550**	**47.0**	21,912	46.5
– manufacturing	**21,501**	**52.5**	17,372	37.6
– transport and transport equipment	**7,314**	**72.1**	5,968	66.3
– recreational activities	**125**	**7.6**	160	15.5
– information technology	**2,935**	**34.2**	1,870	43.4
– other	**33,407**	**65.7**	35,544	53.6
	252,742	**70.3**	216,939	68.1
Individuals				
– loans and advances for the purchase of flats under the Government Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	**12,043**	**100.0**	9,737	100.0
– loans and advances for the purchase of other residential properties	**143,047**	**100.0**	130,615	100.0
– credit card loans and advances	**24,175**	**–**	21,419	–
– other	**17,039**	**39.7**	14,429	41.6
	196,304	**82.5**	176,200	83.1
Total gross loans and advances for use in Hong Kong	**449,046**	**75.6**	393,139	74.8
Trade finance	**41,537**	**26.5**	52,117	19.6
Gross loans and advances for use outside Hong Kong	**98,782**	**6.8**	75,023	13.9
Gross loans and advances to customers	**589,365**	**60.6**	520,279	60.5

31. Loans and advances to customers continued

(h) Net investments in finance leases

Loans and advances to customers include net investments in equipment leased to customers under finance leases and hire purchase contracts having the characteristics of finance leases. The contracts usually run for an initial period of 5 to 25 years, with an option for acquiring by the lessee the leased asset at nominal value at the end of the lease period. The total minimum lease payments receivable and their present value at the year-end are as follows:

	Group		Bank	
	2014	2013	**2014**	2013
Finance leases	**–**	–	**–**	–
Hire purchase contracts	**5,315**	4,194	**5,098**	3,872
	5,315	4,194	**5,098**	3,872

	Group		
	Present value of minimum lease payments receivable	**Interest income relating to future periods**	**Total minimum lease payments receivable**
2014			
Amounts receivable:			
– within one year	**300**	**71**	**371**
– after one year but within five years	**1,107**	**239**	**1,346**
– after five years	**3,908**	**428**	**4,336**
	5,315	**738**	**6,053**
Loans impairment allowances	**–**		
Net investments in finance leases and hire purchase contracts	**5,315**		
2013			
Amounts receivable:			
– within one year	303	57	360
– after one year but within five years	988	187	1,175
– after five years	2,903	288	3,191
	4,194	532	4,726
Loans impairment allowances	–		
Net investments in finance leases and hire purchase contracts	4,194		

31. Loans and advances to customers continued

(h) Net investments in finance leases continued

	Bank		
	Present value of minimum lease payments receivable	Interest income relating to future periods	Total minimum lease payments receivable
2014			
Amounts receivable:			
– within one year	**277**	**67**	**344**
– after one year but within five years	**1,014**	**227**	**1,241**
– after five years	**3,807**	**423**	**4,230**
	5,098	**717**	**5,815**
Loans impairment allowances	**–**		
Net investments in finance leases and hire purchase contracts	**5,098**		
2013			
Amounts receivable:			
– within one year	273	51	324
– after one year but within five years	867	167	1,034
– after five years	2,732	277	3,009
	3,872	495	4,367
Loans impairment allowances	–		
Net investments in finance leases and hire purchase contracts	3,872		

32. Financial investments

	Group		Bank	
	2014	2013	**2014**	2013
Financial investments:				
– which may be repledged or resold by counterparties	**506**	96	**506**	96
– which may not be repledged or resold or are not subject to repledge or resale by counterparties	**317,526**	282,749	**222,372**	195,428
	318,032	282,845	**222,878**	195,524
Held-to-maturity debt securities at amortised cost	**68,236**	71,505	**–**	–
Available-for-sale at fair value:				
– debt securities	**205,747**	183,344	**179,096**	167,812
– equity shares	**44,039**	27,948	**43,782**	27,712
– investment funds	**10**	48	**–**	–
	318,032	282,845	**222,878**	195,524
Treasury bills	**107,503**	91,811	**107,503**	91,811
Certificates of deposit	**12,089**	9,729	**5,780**	4,483
Other debt securities	**154,391**	153,309	**65,813**	71,518
Debt securities	**273,983**	254,849	**179,096**	167,812
Equity shares	**44,039**	27,948	**43,782**	27,712
Investment funds	**10**	48	**–**	–
	318,032	282,845	**222,878**	195,524

There were no overdue debt securities at 31 December 2014 (31 December 2013: Nil) for the Group and the Bank. The Group did not hold any asset-backed securities, mortgage-backed securities and collateralised debt obligations.

(a) Held-to-maturity debt securities

	Group		Bank	
	2014	2013	**2014**	2013
Listed in Hong Kong	**1,704**	1,447	**–**	–
Listed outside Hong Kong	**12,303**	14,749	**–**	–
	14,007	16,196	**–**	–
Unlisted	**54,229**	55,309	**–**	–
	68,236	71,505	**–**	–
Issued by public bodies:				
– central governments and central banks	**543**	1,168	**–**	–
– other public sector entities	**10,143**	11,129	**–**	–
	10,686	12,297	**–**	–
Issued by other bodies:				
– banks	**29,321**	32,252	**–**	–
– corporate entities	**28,229**	26,956	**–**	–
	57,550	59,208	**–**	–
	68,236	71,505	**–**	–
Fair value of held-to-maturity debt securities:				
– listed	**14,805**	16,419	**–**	–
– unlisted	**56,024**	55,595	**–**	–
	70,829	72,014	**–**	–

There were no held-to-maturity debt securities determined to be impaired at 31 December 2014 for the Group and the Bank (31 December 2013: Nil).

32. Financial investments continued

(b) Available-for-sale debt securities

	Group		Bank	
	2014	2013	**2014**	2013
Listed in Hong Kong	**10,870**	10,262	**10,255**	10,262
Listed outside Hong Kong*	**54,483**	53,029	**33,532**	40,311
	65,353	63,291	**43,787**	50,573
Unlisted*	**140,394**	120,053	**135,309**	117,239
	205,747	183,344	**179,096**	167,812
Issued by public bodies:				
– central governments and central banks	**156,336**	126,431	**137,359**	112,587
– other public sector entities	**9,493**	16,551	**8,706**	16,551
	165,829	142,982	**146,065**	129,138
Issued by other bodies:				
– banks	**34,361**	36,937	**30,477**	35,249
– corporate entities	**5,557**	3,425	**2,554**	3,425
	39,918	40,362	**33,031**	38,674
	205,747	183,344	**179,096**	167,812

* During 2014, certain stock exchanges have been regarded as recognised stock exchanges, causing more financial investments to be classified as listed. Comparative figures have been restated to conform with current year's presentation.

At 31 December 2014 and 2013, there were no available-for-sale debt securities determined to be impaired on the basis that there was objective evidence of impairment in the value of the debt securities for the Group and the Bank.

(c) Available-for-sale equity shares

	Group		Bank	
	2014	2013	**2014**	2013
Listed in Hong Kong	**69**	67	**–**	–
Listed outside Hong Kong	**42,736**	26,897	**42,736**	26,897
	42,805	26,964	**42,736**	26,897
Unlisted	**1,234**	984	**1,046**	815
	44,039	27,948	**43,782**	27,712
Issued by banks	**43,556**	27,510	**43,556**	27,510
Issued by corporate entities	**483**	438	**226**	202
	44,039	27,948	**43,782**	27,712

During 2014, certain of the Group's and the Bank's available-for-sale equity shares were individually determined to be impaired on the basis that there was a "significant" or "prolonged" decline in the fair value of an equity investment. Impairment losses on these investments were recognised in the income statement in accordance with the accounting policy set out in Note 3(s). During the year of 2013, there were no available-for-sale equity shares determined to be impaired.

32. Financial investments continued

(d) Available-for-sale investment funds

	Group		Bank	
	2014	2013	**2014**	2013
Unlisted	**10**	48	**–**	–
Issued by corporate entities	**10**	48	**–**	–

There were no available-for-sale investment funds determined to be impaired during the years of 2014 and 2013 for the Group and the Bank.

33. Transfers of financial assets not qualifying for derecognition

The Group enters into transactions in the normal course of business by which it transfers recognised financial assets directly to third parties or to special purpose entities. These transfers may give rise to full or partial derecognition of the financial assets concerned.

- Full derecognition occurs when the Group transfers its contractual right to receive cash flows from the financial assets, or retains the right but assumes an obligation to pass on the cash flows from the asset, and transfers substantially all the risks and rewards of ownership. The risks include credit, interest rate, currency, prepayment and other price risks.
- Partial derecognition occurs when the Group sells or otherwise transfers financial assets in such a way that some but not substantially all of the risks and rewards of ownership are transferred but control is retained. These financial assets are recognised in the balance sheet to the extent of the Group's continuing involvement.

The majority of transferred financial assets that do not qualify for derecognition are securities lent under securities lending agreements. The following table analyses the carrying amount of financial assets transferred to third parties that did not qualify for derecognition during 2014 and 2013.

Financial assets and associated financial liabilities not qualifying for full derecognition

	Group and Bank			
	2014			
	Carrying amount of transferred assets	**Carrying amount of associated liabilities**	**Fair value of associated liabilities**	**Net position**
Transaction not qualifying for full derecognition:				
Securities lending agreements	**506**	**–**	**–**	**506**
	2013			
	Carrying amount of transferred assets	Carrying amount of associated liabilities	Fair value of associated liabilities	Net position
Transaction not qualifying for full derecognition:				
Securities lending agreements	96	–	–	96

There were no outstanding transferred financial assets in which the Group and the Bank has a continuing involvement, that were derecognised in their entirety at 31 December 2014 (31 December 2013: Nil).

34. Investments in subsidiaries

	Bank	
	2014	2013
Unlisted shares, at cost	**17,902**	17,918

The principal subsidiaries of the Bank are:

Name of company	Place of incorporation	Principal activities	Issued equity capital
Hang Seng Bank (China) Limited	People's Republic of China	Banking	RMB6,817,500,000
Hang Seng Finance Limited	Hong Kong SAR	Lending	HK$1,000,000,000
Hang Seng Credit Limited	Hong Kong SAR	Lending	HK$200,000,000
Hang Seng Bank (Trustee) Limited	Hong Kong SAR	Trustee service	HK$3,000,000
Hang Seng (Nominee) Limited	Hong Kong SAR	Nominee service	HK$100,000
Hang Seng Life Limited	Hong Kong SAR	Retirement benefits and life assurance	HK$970,000,000
Hang Seng Insurance Company Limited	Hong Kong SAR	Retirement benefits and life assurance	HK$6,426,184,570
Hang Seng Asset Management Pte Ltd	Singapore	Fund management	SG$2,000,000
Hang Seng Investment Management Limited	Hong Kong SAR	Fund management	HK$10,000,000
Haseba Investment Company Limited	Hong Kong SAR	Investment holding	HK$6,000
Hang Seng Securities Limited	Hong Kong SAR	Stockbroking	HK$26,000,000
Yan Nin Development Company Limited	Hong Kong SAR	Investment holding	HK$100,000
Hang Seng Indexes Company Limited	Hong Kong SAR	Compilation and dissemination of the Hang Seng share index	HK$10,000
Hang Seng Real Estate Management Limited	Hong Kong SAR	Property management	HK$10,000
High Time Investments Limited	Hong Kong SAR	Investment holding	HK$2,250,010,000

All the above companies are wholly-owned subsidiaries and unlisted. All subsidiaries are held directly by the Bank except for Hang Seng Life Limited and Hang Seng Indexes Company Limited. The principal places of operation are the same as the places of incorporation.

Some principal subsidiaries are regulated banking and insurance entities and as such, are required to maintain certain minimum levels of capital and liquid assets to support their operations. The effect of these regulatory requirements is to limit the extent to which the subsidiaries may transfer funds to the Bank in the form of repayment of certain shareholder loans or cash dividends.

35. Interest in associates

	Group		Bank	
	2014	2013	**2014**	2013
Share of net assets	**2,218**	2,062	**–**	–

The associates are:

Name of company	Place of incorporation and operation	Principal activity	Group's interest in equity capital	Issued equity capital
Unlisted				
Barrowgate Limited	Hong Kong SAR	Property investment	24.64%	HK$10,000
GZHS Research Co., Ltd.	People's Republic of China	Conduct market/ securities analysis and publish research reports	33.00%	RMB44,680,000

The interest in Barrowgate Limited and GZHS Research Co., Ltd. ("GZHS") are owned by the subsidiaries of the Bank.

All of the above associates are accounted for using the equity method in the consolidated financial statements as at 31 December 2014 and 2013.

For the year ended 31 December 2014, the financial results of GZHS was included in the financial statements based on financial statements drawn up to 30 September 2014, but taking into account any changes in the subsequent period from 1 October 2014 to 31 December 2014 that would materially affect the results. The Group has taken advantage of the provision contained in HKAS 28 (2011) "Investments in Associates and Joint Ventures" whereby it is permitted to include the attributable share of associates' results based on accounts drawn up to a non-coterminous period end where the difference must be no greater than three months.

	Assets	Liabilities	Equity	Revenue	Expenses	Revenue Less Expenses
2014						
100 per cent	**10,243**	**1,291**	**8,952**	**1,212**	**238**	**974**
The Group's effective interest	**2,538**	**320**	**2,218**	**302**	**65**	**237**
2013						
100 per cent	9,562	1,223	8,339	3,618	1,228	2,390
The Group's effective interest	2,365	303	2,062	819	257	562

At 31 December 2014, the investment in GZHS was tested for impairment by estimating the recoverable amount of the investment based on "value in use". An impairment loss of HK$11 million was recognised since the carrying amount exceeded the recoverable amount (2013: Nil).

36. Investment properties

The Group's investment properties were revalued by DTZ Debenham Tie Leung Limited, an independent professional valuer, at 30 November 2014, and were updated for any material changes in the valuation as at 31 December 2014. The valuations were carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of valuations of investment properties were market value which is consistent with the definition of fair value under HKFRS 13 "Fair Value Measurement" and take into account the highest and best use of the property from the perspective of market participants.

(a) Movement of investment properties

	Group		Bank	
	2014	2013	**2014**	2013
At 1 January	**10,918**	4,860	**6,878**	2,988
Additions	**–**	4,867	**–**	3,228
Surplus on revaluation credited to income statement	**556**	1,338	**373**	809
Transfer from/(to) premises (note 37(a))	**258**	(147)	**(278)**	(147)
At 31 December	**11,732**	10,918	**6,973**	6,878
Representing:				
– measure at valuation	**11,732**	10,918	**6,973**	6,878

(b) Terms of lease

	Group		Bank	
	2014	2013	**2014**	2013
Leaseholds				
Held in Hong Kong:				
– long leases (over 50 years unexpired)	**1,670**	1,593	**685**	653
– medium leases (10 to 50 years unexpired)	**10,062**	9,325	**6,288**	6,225
	11,732	10,918	**6,973**	6,878

(c) The Group leases out investment properties under operating leases. The leases typically run for an initial period of 2 to 3 years, and may contain an option to renew the lease after that date at which time all terms are renegotiated. None of the leases includes contingent rentals.

	Group		Bank	
	2014	2013	**2014**	2013
Direct operating expenses arising from investment properties	**26**	26	**17**	18
Direct operating expenses from investment properties that generated rental income	**22**	25	**14**	17

The Group's total future minimum lease payments receivable under non-cancellable operating leases are as follows:

	Group		Bank	
	2014	2013	**2014**	2013
Less than one year	**379**	282	**156**	175
Over one year but within five years	**132**	183	**81**	110
Over five years	**–**	1	**–**	–
	511	466	**237**	285

37. Premises, plant and equipment

The Group's premises were revalued by DTZ Debenham Tie Leung Limited, an independent professional valuer, at 30 November 2014, and were updated for any material changes in the valuation as at 31 December 2014. The valuations were carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of valuations of premises were market value which is consistent with the definition of fair value under HKFRS 13 "Fair Value Measurement" and take into account the highest and best use of the property from the perspective of market participants.

(a) Movement of premises, plant and equipment

	Group		
	Premises	Plant and equipment	Total
2014			
Cost or valuation:			
At 1 January	20,496	3,856	24,352
Additions	–	556	556
Disposals	–	(238)	(238)
Elimination of accumulated depreciation on revalued premises	(607)	–	(607)
Surplus on revaluation:			
– credited to premises revaluation reserve	1,457	–	1,457
– debited to income statement (note 18)	–	–	–
Transfer to investment properties (note 36(a))	(258)	–	(258)
Exchange adjustments and other	(15)	(11)	(26)
At 31 December	21,073	4,163	25,236
Accumulated depreciation:			
At 1 January	–	(3,352)	(3,352)
Exchange adjustments	–	8	8
Charge for the year (note 13)	(607)	(224)	(831)
Written off on disposal	–	230	230
Elimination of accumulated depreciation on revalued premises	607	–	607
At 31 December	–	(3,338)	(3,338)
Net book value at 31 December	21,073	825	21,898
Representing:			
– measure at cost	–	825	825
– measure at valuation	21,073	–	21,073
	21,073	825	21,898

37. Premises, plant and equipment continued

(a) Movement of premises, plant and equipment continued

	Group		
	Premises	Plant and equipment	Total
2013			
Cost or valuation:			
At 1 January	18,748	3,751	22,499
Additions	34	203	237
Disposals	–	(117)	(117)
Elimination of accumulated depreciation on revalued premises	(556)	–	(556)
Surplus on revaluation:			
– credited to premises revaluation reserve	2,103	–	2,103
– debited to income statement (note 18)	(3)	–	(3)
Transfer from investment properties (note 36(a))	147	–	147
Exchange adjustments and other	23	19	42
At 31 December	20,496	3,856	24,352
Accumulated depreciation:			
At 1 January	–	(3,237)	(3,237)
Exchange adjustments	–	(15)	(15)
Charge for the year (note 13)	(556)	(206)	(762)
Written off on disposal	–	106	106
Elimination of accumulated depreciation on revalued premises	556	–	556
At 31 December	–	(3,352)	(3,352)
Net book value at 31 December	20,496	504	21,000
Representing:			
– measure at cost	–	504	504
– measure at valuation	20,496	–	20,496
	20,496	504	21,000

37. Premises, plant and equipment continued

(a) Movement of premises, plant and equipment continued

	Bank		
	Premises	Plant and equipment	Total
2014			
Cost or valuation:			
At 1 January	15,088	3,205	18,293
Additions	–	488	488
Disposals	–	(191)	(191)
Elimination of accumulated depreciation on revalued premises	(465)	–	(465)
Surplus on revaluation:			
– credited to premises revaluation reserve	1,036	–	1,036
Transfer from investment properties (note 36(a))	278	–	278
At 31 December	15,937	3,502	19,439
Accumulated depreciation:			
At 1 January	–	(2,879)	(2,879)
Charge for the year	(465)	(167)	(632)
Written off on disposal	–	185	185
Elimination of accumulated depreciation on revalued premises	465	–	465
At 31 December	–	(2,861)	(2,861)
Net book value at 31 December	15,937	641	16,578
Representing:			
– measure at cost	–	641	641
– measure at valuation	15,937	–	15,937
	15,937	641	16,578

37. Premises, plant and equipment continued

(a) Movement of premises, plant and equipment continued

	Bank		
	Premises	Plant and equipment	Total
2013			
Cost or valuation:			
At 1 January	13,810	3,150	16,960
Additions	–	152	152
Disposals	–	(97)	(97)
Elimination of accumulated depreciation on revalued premises	(421)	–	(421)
Surplus on revaluation:			
– credited to premises revaluation reserve	1,558	–	1,558
– debited to income statement	(3)	–	(3)
Transfer from investment properties (note 36(a))	147	–	147
Other	(3)	–	(3)
At 31 December	15,088	3,205	18,293
Accumulated depreciation:			
At 1 January	–	(2,825)	(2,825)
Charge for the year	(421)	(148)	(569)
Written off on disposal	–	94	94
Elimination of accumulated depreciation on revalued premises	421	–	421
At 31 December	–	(2,879)	(2,879)
Net book value at 31 December	15,088	326	15,414
Representing:			
– measure at cost	–	326	326
– measure at valuation	15,088	–	15,088
	15,088	326	15,414

(b) Terms of lease

The net book value of premises comprises:

	Group		Bank	
	2014	2013	**2014**	2013
Leaseholds				
Held in Hong Kong:				
– long leases (over 50 years unexpired)	**2,451**	2,367	**1,919**	1,836
– medium leases (10 to 50 years unexpired)	**17,749**	17,252	**14,016**	13,250
Held outside Hong Kong:				
– long leases (over 50 years unexpired)	**–**	10	**–**	–
– medium leases (10 to 50 years unexpired)	**873**	867	**2**	2
	21,073	20,496	**15,937**	15,088

37. Premises, plant and equipment continued

(c) The carrying amount of all premises which have been stated in the balance sheet would have been as follows had they been stated at cost less accumulated depreciation:

	Group		Bank	
	2014	2013	**2014**	2013
Cost less accumulated depreciation at 31 December	**3,127**	2,998	**1,643**	1,408

(d) Fair value measurement of properties

(i) Fair value hierarchy

The following table presents the fair value of the Group's properties measured at the end of the reporting period on a recurring basis, categorised into the three-level fair value hierarchy as defined in HKFRS 13 "Fair value measurement". The level into which a fair value measurement is classified is determined with reference to the observability and significance of the inputs used in the valuation technique as follows:

Level 1: Fair value measured using unadjusted quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2: Fair value measured using observable inputs and not using significant unobservable inputs. Unobservable inputs are inputs for which market data are not available.

Level 3: Fair value measured using significant unobservable inputs.

	Group			
	Fair value	**Quoted market price Level 1**	**Using observable inputs Level 2**	**With significant unobservable inputs Level 3**
Recurring fair value measurement				
2014				
Investment properties	**11,732**	**–**	**–**	**11,732**
Properties held for own use				
– held in Hong Kong	**20,200**	**–**	**–**	**20,200**
– held outside Hong Kong	**873**	**–**	**–**	**873**
2013				
Investment properties	10,918	–	–	10,918
Properties held for own use				
– held in Hong Kong	19,619	–	–	19,619
– held outside Hong Kong	877	–	–	877

37. Premises, plant and equipment continued

(d) Fair value measurement of properties continued

(i) Fair value hierarchy continued

	Bank			
	Fair value	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3
Recurring fair value measurement				
2014				
Investment properties	**6,973**	**–**	**–**	**6,973**
Properties held for own use				
– held in Hong Kong	**15,935**	**–**	**–**	**15,935**
– held outside Hong Kong	**2**	**–**	**–**	**2**
2013				
Investment properties	6,878	–	–	6,878
Properties held for own use				
– held in Hong Kong	15,086	–	–	15,086
– held outside Hong Kong	2	–	–	2

During the year ended 31 December 2014, there were no transfers between Level 1 and Level 2, or transfers into or out of Level 3. Transfers between levels of the fair value hierarchy are deemed to occur at the end of the reporting period.

The Group's investment properties were revalued by DTZ Debenham Tie Leung Limited, an independent professional valuer, at 30 November 2014, and were updated for any material changes in the valuation as at 31 December 2014. The valuations were carried out by qualified persons who are members of the Hong Kong Institute of Surveyors in accordance with the HKIS Valuation Standards published by the Hong Kong Institute of Surveyors.

The fair value of investment properties is determined using Investment Approach on the basis of capitalisation of net incomes with due allowance for outgoings and reversionary income potential.

The fair values of the majorities of properties owned and occupied by the Group in Hong Kong and the PRC are determined using Direct Comparison Approach assuming sale with immediate vacant possession and by making reference to comparable sales evidence.

For properties with development potentials, their values are on redevelopment basis and reported upon the assessment on the basis that each of these properties will be developed to its full potential and completed to a good standard. The fair values are determined using Direct Comparison Approach by making reference to comparable sales transactions as available in the relevant market and have also taken into account the development costs that will be expended to complete the development.

37. Premises, plant and equipment continued

(d) Fair value measurement of properties continued

(i) Fair value hierarchy continued

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy

The following table provides a reconciliation of the movement between opening and closing balances of Level 3 properties, measured at fair value using a valuation technique with significant unobservable inputs:

	Group		
	Investment properties	**Properties held for own use in Hong Kong**	**Properties held for own use outside Hong Kong**
At 1 January 2014	**10,918**	**19,619**	**877**
Depreciation for the year	**–**	**(576)**	**(31)**
Surplus on revaluation:			
– credited to premises revaluation reserve	**–**	**1,415**	**42**
– credited to income statement	**556**	**–**	**–**
Transfer	**258**	**(258)**	**–**
Exchange adjustments and other	**–**	**–**	**(15)**
At 31 December 2014	**11,732**	**20,200**	**873**
Unrealised gains or losses recognised in profit or loss relating to those assets held at the end of the reporting period			
– other operating income	**35**	**–**	**–**
– net surplus on property revaluation	**521**	**–**	**–**
– depreciation of premises, plant and equipment	**–**	**(576)**	**(31)**

	Investment properties	Properties held for own use in Hong Kong	Properties held for own use outside Hong Kong
At 1 January 2013	4,860	17,941	807
Additions	4,867	–	34
Depreciation for the year	–	(528)	(28)
Surplus on revaluation:			
– credited to premises revaluation reserve	–	2,065	38
– credited/(debited) to income statement	1,338	(3)	–
Transfer	(147)	147	–
Exchange adjustments and other	–	(3)	26
At 31 December 2013	10,918	19,619	877
Unrealised gains or losses recognised in profit or loss relating to those assets held at the end of the reporting period			
– other operating income	280	–	–
– net surplus on property revaluation	1,058	(3)	–
– depreciation of premises, plant and equipment	–	(528)	(28)

37. Premises, plant and equipment continued

(d) Fair value measurement of properties continued

(i) Fair value hierarchy continued

	Bank		
	Investment properties	**Properties held for own use in Hong Kong**	**Properties held for own use outside Hong Kong**
At 1 January 2014	**6,878**	**15,086**	**2**
Additions	**–**	**–**	**–**
Depreciation for the year	**–**	**(465)**	**–**
Surplus on revaluation:			
– credited to premises revaluation reserve	**–**	**1,036**	**–**
– credited to income statement	**373**	**–**	**–**
Transfer	**(278)**	**278**	**–**
At 31 December 2014	**6,973**	**15,935**	**2**
Unrealised gains or losses recognised in profit or loss relating to those assets held at the end of the reporting period			
– other operating income	**–**	**–**	**–**
– net surplus on property revaluation	**373**	**–**	**–**
– depreciation of premises, plant and equipment	**–**	**(465)**	**–**

	Investment properties	Properties held for own use in Hong Kong	Properties held for own use outside Hong Kong
At 1 January 2013	2,988	13,808	2
Additions	3,228	–	–
Depreciation for the year	–	(421)	–
Surplus on revaluation:			
– credited to premises revaluation reserve	–	1,558	–
– credited/(debited) to income statement	809	(3)	–
Transfer	(147)	147	–
Exchange adjustments and other	–	(3)	–
At 31 December 2013	6,878	15,086	2
Unrealised gains or losses recognised in profit or loss relating to those assets held at the end of the reporting period			
– other operating income	–	–	–
– net surplus on property revaluation	809	(3)	–
– depreciation of premises, plant and equipment	–	(421)	–

37. Premises, plant and equipment continued

(d) Fair value measurement of properties continued

(ii) Information about significant unobservable inputs in Level 3 valuations

At 31 December 2014

	Valuation technique(s)	**Unobservable input(s)**	**Range**
Investment properties	Investment approach	Market yields (reversionary yield)	2.9 % to 5.2 %
		Market rental	HK$17 to HK$1,020 per square foot
Premises held for own use	Direct comparison approach	Premium (discount) on characteristic of the properties	–20% to 20%

At 31 December 2013

	Valuation technique(s)	Unobservable input(s)	Range
Investment properties	Investment approach	Market yields (reversionary yield)	3.0% to 5.6%
		Market rental	HK$15 to HK$1,014 per square foot
Premises held for own use	Direct comparison approach	Premium (discount) on characteristic of the properties	–20% to 20%

The fair value of investment properties is determined using investment approach on the basis of capitalisation of net incomes with due allowance of outgoings and reversionary income potential. The fair value measurement is positively correlated to the market rental but inversely correlated to the market yields.

The fair value of premises held for own use are determined using direct comparison approach to value these properties in their respective existing states and uses on the market basis assuming sale with immediate vacant possession and by making reference to comparable sales evidence. The valuations take into account the characteristic of the properties which included the location, size, shape, view, floor level, year of completion and other factors collectively. Higher premium for properties with higher characteristic will result in a higher fair value measurement.

38. Intangible assets

	Group		Bank	
	2014	2013	**2014**	2013
Present value of in-force long-term insurance business	**8,263**	7,198	**–**	–
Internally developed software	**372**	378	**372**	378
Acquired software	**89**	69	**4**	3
Goodwill	**329**	329	**–**	–
	9,053	7,974	**376**	381

(a) Movement of present value of in-force long-term insurance business ("PVIF")

	Group	
	2014	2013
At 1 January	**7,198**	6,003
Addition from current year new business	**1,410**	1,436
Movement from in-force business	**(345)**	(241)
At 31 December	**8,263**	7,198

The key assumptions used in the computation of PVIF are as follows:

	2014	2013
Risk discount rate	**5.9%**	6.2%
Expenses inflation	**3.0%**	3.0%
Average lapse rate:		
– 1st year	**2.8%**	2.7%
– 2nd year onwards	**0.5%**	0.5%

The sensitivity of PVIF valuation to changes in individual assumptions at the balance sheet dates is shown in the Management Discussion and Analysis.

38. Intangible assets continued

(b) Goodwill

	Group		Bank	
	2014	2013	**2014**	2013
At 1 January and at 31 December	**329**	329	**–**	–

Goodwill arising from acquisition of the remaining 50 per cent of Hang Seng Life Limited from HSBC Insurance (Asia-Pacific) Holdings Limited amounted to HK$329 million is allocated to cash-generating units of Life Insurance – Hang Seng Insurance Company Limited ("HSIC") for the purpose of impairment testing.

During 2014, there was no impairment of goodwill (2013: Nil). Impairment testing in respect of goodwill is performed annually by comparing the recoverable amount of cash generating unit based on appraisal value with the carrying amount of its net assets, including attributable goodwill.

The appraisal value comprises HSIC's net assets (other than value of business acquired and goodwill) as at 31 December 2014, the PVIF and the expected value of future business. The PVIF is determined by discounting future earnings expected from the current business, taking into account factors such as future mortality, lapse rates, levels of expenses and risk discount rate. The above details are shown in note 38(a) and the Management Discussion and Analysis.

(c) Movement of internally developed application software and acquired software

	Group		Bank	
	2014	2013	**2014**	2013
Cost:				
At 1 January	**1,178**	1,090	**1,068**	1,014
Additions	**126**	124	**90**	91
Disposals	**(5)**	(25)	**(4)**	(24)
Written off	**–**	(13)	**–**	(13)
Exchange and others	**(1)**	2	**–**	–
At 31 December	**1,298**	1,178	**1,154**	1,068
Accumulated amortisation:				
At 1 January	**(731)**	(639)	**(687)**	(608)
Charge for the year (note 13)	**(111)**	(113)	**(95)**	(99)
Written off on disposal	**5**	22	**4**	20
Exchange and others	**–**	(1)	**–**	–
At 31 December	**(837)**	(731)	**(778)**	(687)
Net book value at 31 December	**461**	447	**376**	381

During 2014, there was no impairment on internally developed application software and acquired software (2013: HK$13 million).

39. Other assets

	Group		Bank	
	2014	2013	**2014**	2013
Items in the course of collection from other banks	**5,182**	4,743	**5,182**	4,742
Bullion	**3,681**	4,184	**3,681**	4,184
Prepayments and accrued income	**3,820**	3,519	**1,687**	1,539
Acceptances and endorsements	**5,715**	6,351	**3,029**	3,254
Other accounts	**5,534**	3,608	**1,116**	1,088
	23,932	22,405	**14,695**	14,807

Other accounts include “Assets held for sale” of HK$6 million for the Group (2013: HK$9 million) and HK$3 million for the Bank (2013: HK$8 million). It also includes “Retirement benefit assets” of HK$42 million (2013: HK$40 million) for the Group and the Bank (2013: HK$40 million for the Group and the Bank).

There was no accumulated loss recognised directly in equity relating to assets held for sale for 2014 and 2013.

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

40. Current, savings and other deposit accounts

	Group		Bank	
	2014	2013	**2014**	2013
Current, savings and other deposit accounts:				
– as stated in balance sheet	**896,521**	824,996	**850,324**	774,462
– structured deposits reported as trading liabilities (note 41)	**40,380**	34,489	**2,166**	2,286
	936,901	859,485	**852,490**	776,748
By type:				
– demand and current accounts	**76,807**	74,664	**76,803**	74,662
– savings accounts	**550,765**	526,403	**533,190**	509,393
– time and other deposits	**309,329**	258,418	**242,497**	192,693
	936,901	859,485	**852,490**	776,748

41. Trading liabilities

	Group		Bank	
	2014	2013	**2014**	2013
Other structured debt securities in issue (note 43)	**4,223**	1,615	**4,223**	1,615
Structured deposits (note 40)	**40,380**	34,489	**2,166**	2,286
Short positions in securities and others	**27,984**	26,013	**27,984**	26,013
	72,587	62,117	**34,373**	29,914

42. Financial liabilities designated at fair value

	Group		Bank	
	2014	2013	**2014**	2013
Certificate of deposit in issue (note 43)	**2,994**	–	**2,994**	–
Liabilities to customers under investment contracts	**495**	489	**–**	–
	3,489	489	**2,994**	–

43. Certificates of deposit and other debt securities in issue

	Group		Bank	
	2014	2013	**2014**	2013
Certificates of deposit and other debt securities in issue:				
– as stated in balance sheet	**12,402**	8,601	**11,156**	8,601
– certificates of deposit issued designated at fair value (note 42)	**2,994**	–	**2,994**	–
– other structured debt securities in issue reported as trading liabilities (note 41)	**4,223**	1,615	**4,223**	1,615
	19,619	10,216	**18,373**	10,216
By type:				
– certificates of deposit in issue	**14,150**	8,601	**14,150**	8,601
– other debt securities in issue	**5,469**	1,615	**4,223**	1,615
	19,619	10,216	**18,373**	10,216

44. Other liabilities

	Group		Bank	
	2014	2013	**2014**	2013
Items in the course of transmission to other banks	**7,508**	6,987	**7,508**	6,986
Accruals	**3,859**	3,330	**2,531**	2,192
Acceptances and endorsements	**5,715**	6,351	**3,029**	3,254
Retirement benefit liabilities	**1,615**	1,772	**1,615**	1,772
Other	**2,607**	2,027	**2,338**	1,598
	21,304	20,467	**17,021**	15,802

45. Liabilities under insurance contracts

	Group		
	Gross	**Reinsurers' share**	**Net**
2014			
Non-linked insurance contracts			
At 1 January	**85,756**	**(1,446)**	**84,310**
Benefits paid	**(7,721)**	**31**	**(7,690)**
Increase in liabilities to policyholders	**14,156**	**(1,421)**	**12,735**
Exchange and other movements	**165**	**60**	**225**
At 31 December	**92,356**	**(2,776)**	**89,580**
Linked insurance contracts			
At 1 January	**88**	**–**	**88**
Benefits paid	**(10)**	**–**	**(10)**
Increase in liabilities to policyholders	**7**	**–**	**7**
Exchange and other movements	**1**	**–**	**1**
At 31 December	**86**	**–**	**86**
	92,442	**(2,776)**	**89,666**

	Gross	Reinsurers' share	Net
2013			
Non-linked insurance contracts			
At 1 January	81,579	(414)	81,165
Benefits paid	(8,803)	42	(8,761)
Increase in liabilities to policyholders	12,843	(1,078)	11,765
Exchange and other movements	137	4	141
At 31 December	85,756	(1,446)	84,310
Linked insurance contracts			
At 1 January	91	–	91
Benefits paid	(12)	–	(12)
Increase in liabilities to policyholders	9	–	9
Exchange and other movements	–	–	–
At 31 December	88	–	88
	85,844	(1,446)	84,398

46. Current tax and deferred tax

(a) Current tax and deferred tax are represented in the balance sheet:

	Group		Bank	
	2014	2013	**2014**	2013
Included in "Other assets":				
Current taxation recoverable	**5**	82	**–**	–
Deferred tax assets	**80**	43	**–**	–
	85	125	**–**	–
Current tax liabilities:				
Provision for Hong Kong profits tax	**358**	675	**267**	650
Provision for taxation outside Hong Kong	**16**	17	**16**	12
	374	692	**283**	662
Deferred tax liabilities	**4,304**	3,850	**2,143**	1,985
	4,678	4,542	**2,426**	2,647

(b) Deferred tax assets and liabilities recognised

The major components of deferred tax (assets)/liabilities recognised in the balance sheet and the movements during the year are as follows:

	Group						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Loan impairment allowances	Fair value adjustments for available-for-sale financial assets	Cash flow hedge	Other	Total
2014							
At 1 January	**103**	**3,007**	**(82)**	**(48)**	**1**	**826**	**3,807**
Exchange adjustment	**–**	**–**	**1**	**–**	**–**	**1**	**2**
Charged/(credited) to income statement (note 19(a))	**76**	**(79)**	**(39)**	**–**	**–**	**88**	**46**
Charged/(credited) to reserves	**–**	**243**	**–**	**102**	**(3)**	**27**	**369**
At 31 December	**179**	**3,171**	**(120)**	**54**	**(2)**	**942**	**4,224**
2013							
At 1 January	79	2,702	(87)	9	3	1,617	4,323
Exchange adjustment	–	–	–	–	–	–	–
Charged/(credited) to income statement (note 19(a))	24	(32)	5	–	–	(919)	(922)
Charged/(credited) to reserves	–	337	–	(57)	(2)	128	406
At 31 December	103	3,007	(82)	(48)	1	826	3,807

46. Current tax and deferred tax continued

(b) Deferred tax assets and liabilities recognised continued

	Bank						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Loan impairment allowances	Fair value adjustments for available-for-sale financial assets	Cash flow hedge	Other	Total
2014							
At 1 January	**92**	**2,303**	**(71)**	**(6)**	**1**	**(334)**	**1,985**
Charged/(credited) to income statement	**39**	**(69)**	**(13)**	**–**	**–**	**(7)**	**(50)**
Charged/(credited) to reserves	**–**	**171**	**–**	**13**	**(3)**	**27**	**208**
At 31 December	**131**	**2,405**	**(84)**	**7**	**(2)**	**(314)**	**2,143**
2013							
At 1 January	74	2,135	(76)	5	3	(454)	1,687
Charged/(credited) to income statement	18	(64)	5	–	–	(8)	(49)
Charged/(credited) to reserves	–	232	–	(11)	(2)	128	347
At 31 December	92	2,303	(71)	(6)	1	(334)	1,985

(c) Deferred tax assets not recognised

At the balance sheet date, the Group has not recognised deferred tax assets in respect of tax losses amounting to HK$30 million (2013: HK$34 million) which are considered unlikely to be utilised. The unrecoginsed deferred tax assets of HK$30 million (2013: HK$34 million) have no expiry date.

(d) Deferred tax liabilities not recognised

There were no deferred tax liabilities not recognised as at 31 December 2014 (31 December 2013: Nil).

47. Subordinated liabilities

		Group		Bank	
Nominal value	Description	**2014**	2013	**2014**	2013
Amount owed to HSBC Group undertakings					
US$775 million	Floating rate subordinated loan due December 2020[1]	**–**	6,009	**–**	6,009
US$450 million	Floating rate subordinated loan due July 2021[2]	**3,490**	3,489	**3,490**	3,489
US$300 million	Floating rate subordinated loan due July 2022[3]	**2,327**	2,326	**2,327**	2,326
		5,817	11,824	**5,817**	11,824
Representing:					
– measured at amortised cost		**5,817**	11,824	**5,817**	11,824

1 The Bank exercised its option to redeem the subordinated loan at par of US$775 million.
2 Interest rate at three-month US dollar LIBOR plus 2.05 per cent per annum, payable quarterly, to the maturity date.
3 Interest rate at three-month US dollar LIBOR plus 4.06 per cent per annum, payable quarterly, to the maturity date.

The outstanding subordinated loan serve to help the Bank maintain a balanced capital structure and support business growth.

The Group has not had any defaults of principal, interest or other breaches with respect to its debt securities during the years 2014 and 2013.

48. Share capital

	Group and Bank			
	2014		2013	
	No. of shares	**HK$**	No. of shares	HK$
Authorised[1]				
Ordinary shares of $5 each[2]	**–**	**–**	2,200,000,000	11,000
Ordinary shares, issued and fully paid				
At 1 January	**1,911,842,736**	**9,559**	1,911,842,736	9,559
Transfer from capital redemption reserve[3]	**–**	**99**	–	–
At 31 December	**1,911,842,736**	**9,658**	1,911,842,736	9,559

1 Under the New Hong Kong Companies Ordinance (Cap. 622) which came into effect on 3 March 2014, the concept of authorised share capital no longer exists.

2 The Bank's shares no longer have a par or nominal value with effect from 3 March 2014.

3 As part of the transition to the no-par value regime, the amount of HK$99 million standing to the credit of the capital redemption reserve on 3 March 2014 have become part of the Bank's share capital.

49. Other equity instruments

		Group		Bank	
Nominal value	Description	**2014**	2013	**2014**	2013
US$900 million	Floating rate perpetual capital instrument callable from December 2019[1]	**6,981**	–	**6,981**	–

1 Interest rate at one-year US dollar LIBOR plus 3.84 per cent.

During 2014, the Bank issued new capital instruments that are included in the Group's capital base as Basel III compliant additional tier 1 capital under the Banking (Capital) Rules. The net proceeds of the issuances will be used to support further business expansion and for other purposes as deemeed appropriate by the Board, and to further strengthen the capital base.

The additional tier 1 capital instruments are perpetual and subordinated, and the coupon payments may be cancelled at the sole discretion of the Bank. The capital instruments will be written down at the point of non-viability on the occurrence of a trigger event as defined in the Banking (Capital) Rules. They rank higher than ordinary shares in the event of a winding-up.

50. Reserves

The reconciliation between the opening and closing balances of each component of the Group's consolidated equity is set out in the consolidated statement of changes in equity.

The Bank and its banking subsidiaries operate under regulatory jurisdictions which require the maintenance of minimum capital adequacy ratios and which could therefore potentially restrict the amount of realised profits which can be distributed to shareholders.

Regulatory reserve

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" from retained profits. Movements in the reserve are made directly through retained earnings. As at 31 December 2014, the effect of this requirement is to restrict the amount of reserves which can be distributed by the Group and the Bank to shareholders by HK$6,229 million (2013: HK$5,440 million) and HK$5,642 million (2013: HK$4,904 million) respectively.

Retained profits

Retained profits are the cumulative net earnings of the Group that have not been paid out as dividends, but retained to be reinvested in the business.

50. Reserves continued

Other equity instruments

In December 2014, the Bank issued a perpetual capital loan of US$900 million and repaid a subordinated loan of US$775 million to enhance capital efficiency.

Premises revaluation reserve

The premises revaluation reserve represents the difference between the fair value of the premises and its original depreciated cost.

There is no premises revaluation reserve related to premises classified as assets held for sale, included in “Other assets” in the consolidated balance sheet at 31 December 2014 (31 December 2013: Nil).

Cash flow hedging reserve

The cash flow hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions.

Available-for-sale investment reserve

The available-for-sale investment reserve includes the cumulative net change in the fair value of available-for-sale investments other than impairments which have been recognised in the income statement.

Capital redemption reserve

Capital redemption reserve has been included in share capital under the Hong Kong New Companies Ordinance (Cap. 622) which became effective on 3 March 2014.

Other reserves

Other reserves comprise foreign exchange reserve and share-based payment reserve. The foreign exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations. The share-based payment reserve is used to record the corresponding amount of share options granted by ultimate holding company to the Group’s employees and other cost of share-based payment arrangement.

50. Reserves continued

Details of the changes in the Bank's individual components of equity between the beginning and the end of the year are set out below:

	Bank	
	2014	2013
Retained profits (including proposed dividends)	**67,159**	64,473
Other equity instruments	**6,981**	–
Premises revaluation reserve	**12,168**	11,654
Cash flow hedging reserve	**(11)**	6
Available-for-sale investment reserve:		
– on debt securities	**33**	(30)
– on equity securities	**16,490**	(1,776)
Capital redemption reserve	**–**	99
Other reserves	**682**	662
Total reserves (including proposed dividends)	**103,502**	75,088
Retained profits (including proposed dividends)		
At beginning of the year	**64,473**	31,888
Dividends to shareholders:		
– dividends approved in respect of the previous year	**(4,206)**	(3,824)
– dividends declared in respect of the current year	**(6,309)**	(6,309)
Transfer	**351**	474
Total comprehensive income for the year	**12,850**	42,244
	67,159	64,473
Other equity instruments		
At beginning of the year	**–**	–
Other equity instrument issued	**6,981**	–
	6,981	–
Premises revaluation reserve		
At beginning of the year	**11,654**	10,802
Transfer	**(351)**	(474)
Total comprehensive income for the year	**865**	1,326
	12,168	11,654
Cash flow hedging reserve		
At beginning of the year	**6**	17
Total comprehensive income for the year	**(17)**	(11)
	(11)	6
Available-for-sale investment reserve		
At beginning of the year	**(1,806)**	95
Total comprehensive income for the year	**18,329**	(1,901)
	16,523	(1,806)
Capital redemption reserve		
At beginning of the year	**99**	99
Transfer to share capital	**(99)**	–
Total comprehensive income for the year	**–**	–
	–	99
Other reserve		
At beginning of the year	**662**	631
Costs of share-based payment arrangements	**14**	30
Total comprehensive income for the year	**6**	1
	682	662
Total reserves (including proposed dividends)	**103,502**	75,088

50. Reserves continued

At 31 December 2014, the aggregate amount of reserves available for distribution to equity shareholders of the Bank as calculated under the provision of Part 6 of the new Hong Kong Companies Ordinance (Cap. 622), with reference to section 79B of the predecessor Hong Kong Companies Ordinance (Cap. 32) amounted to HK$35,544 million (2013: HK$31,788 million). After considering regulatory capital requirement and business development needs, an amount of HK$4,397 million has been declared as the proposed fourth interim dividends in respect of the financial year ended 31 December 2014 (2013: HK$4,206 million). The difference between the aggregate distributable reserves of HK$35,544 million and the Bank's retained profit of HK$67,159 million as reported above mainly represents the exclusion of unrealised revaluation gain on investment properties, the regulatory reserve of the Bank and the accounting gain upon derecognition of Industrial Bank as an associate in January 2013.

51. Reconciliation of cash flow statement

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

	2014	2013
Operating profit	**19,450**	18,410
Net interest income	**(19,871)**	(18,604)
Dividend income	**(1,210)**	(1,014)
Loan impairment charges	**1,144**	536
Impairment loss of intangible assets	**–**	13
Depreciation	**831**	762
Amortisation of intangible assets	**111**	113
Amortisation of available-for-sale investments	**9**	67
Amortisation of held-to-maturity debt securities	**–**	1
Loans and advances written off net of recoveries	**(737)**	(495)
Movement in present value of in-force long-term insurance business	**(1,065)**	(1,195)
Interest received	**24,432**	22,760
Interest paid	**(6,548)**	(4,999)
Operating profit before changes in working capital	**16,546**	16,355
Change in treasury bills and certificates of deposit with original maturity more than three months	**(26,402)**	5,631
Change in placings with and advances to banks maturing after one month	**9,544**	(3,271)
Change in trading assets	**(11,000)**	4,705
Change in financial assets designated at fair value	**–**	–
Change in derivative financial instruments	**441**	(339)
Change in reverse repurchase agreements – non-trading	**(1,296)**	–
Change in loans and advances to customers	**(72,569)**	(50,676)
Change in other assets	**(5,079)**	(1,846)
Change in financial liabilities designated at fair value	**2,975**	–
Change in current, savings and other deposit accounts	**71,542**	55,832
Change in deposits from banks	**(2,815)**	(8,019)
Change in trading liabilities	**10,470**	2,264
Change in certificates of deposit and other debt securities in issue	**3,801**	(2,690)
Change in other liabilities	**5,393**	3,020
Elimination of exchange differences and other non-cash items	**3,779**	4,832
Cash generated from operating activities	**5,330**	25,798
Taxation paid	**(3,111)**	(2,696)
Net cash inflow from operating activities	**2,219**	23,102

51. Reconciliation of cash flow statement continued

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

	2014	2013
Cash and sight balances at central banks	**11,311**	22,717
Balances with banks	**15,972**	10,577
Items in the course of collection from other banks	**5,182**	4,743
Placings with and advances to banks maturing within one month	**67,553**	62,043
Treasury bills	**12,840**	22,686
Certificates of deposit	**–**	–
Less: items in the course of transmission to other banks	**(7,508)**	(6,987)
	105,350	115,779

The balances of cash and cash equivalents included cash and sight balances at central banks, balances with banks and placings with and advances to banks maturing within one month that are subject to exchange control and regulatory restrictions, amounting to HK$20,277 million at 31 December 2014 (31 December 2013: HK$24,795 million).

52. Contingent liabilities and commitments

(a) Off-balance sheet contingent liabilities and commitments

The table below gives the nominal contract amounts and risk-weighted amounts of contingent liabilities, commitments and derivative transactions. The information is consistent with that in the “Capital Adequacy Ratio” return submitted to the Hong Kong Monetary Authority (“HKMA”) by the Group. The return is prepared on a consolidated basis as specified by the HKMA under the requirement of section 3C(1) of the Banking (Capital) Rules.

For accounting purposes, acceptances and endorsements are recognised on the balance sheet in “Other assets” and “Other Liabilities” in accordance with HKAS 39 “Financial Instruments: Recognition and Measurement”. 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 for the Group and the Bank were HK$5,715 million (2013: HK$6,351 million) and HK$3,029 million (2013: HK$3,254 million) respectively.

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

The risk-weighted assets at balance sheet dates were calculated based on the advanced internal ratings-based approach.

	Group		**Bank**	
	2014	2013	**2014**	2013
Direct credit substitutes	**4,541**	8,977	**4,300**	5,185
Transaction-related contingencies	**2,474**	1,821	**2,168**	1,765
Trade-related contingencies	**13,355**	14,922	**9,814**	10,922
Forward asset purchases	**85**	43	**85**	43
Commitments that are unconditionally cancellable without prior notice	**280,000**	243,895	**254,781**	216,902
Commitments which have an original maturity of not more than one year	**4,286**	3,723	**19,486**	8,898
Commitments which have an original maturity of more than one year	**26,029**	24,620	**23,484**	22,570
Contract amounts	**330,770**	298,001	**314,118**	266,285
Risk-weighted amounts	**31,464**	30,818	**27,182**	24,519

(b) Contingencies

There is no material litigation expected to result in a significant adverse effect on the financial position of the Group and the Bank, either collectively or individually. Management believes that adequate provisions have been made in respect of such litigation.

53. Assets pledged as security for liabilities and collateral accepted as security for assets

	Group		Bank	
	2014	2013	**2014**	2013
Assets pledged to secure liabilities				
Financial assets[1] pledged to secure liabilities	**30,084**	24,879	**30,084**	24,879
Liabilities secured by financial assets	**29,789**	24,689	**29,789**	24,689
Collateral accepted as security for assets				
Fair value of the collateral permitted to sell or repledge in the absence of default[2]	**1,296**	–	**1,296**	–
Fair value of collateral actually sold or repledged	**–**	–	**–**	–

1 Financial assets comprise trading assets and financial investments.

2 These transactions are conducted under terms that are usual and customary to standard securities borrowing and reverse repurchase agreements. The Group is obliged to return equivalent securities.

54. Capital commitments

	Group		Bank	
	2014	2013	**2014**	2013
Expenditure authorised and contracted for	**1,176**	414	**580**	393
Expenditure authorised but not contracted for	**–**	–	**–**	–

55. Lease commitments

The Group leases certain properties and equipment under operating leases. The leases typically run for an initial period of one to five years and may include an option to renew the lease when all terms are renegotiated. None of these leases includes contingent rentals.

The total future minimum lease payments payable under non-cancellable operating leases are as follows:

	Group		Bank	
	2014	2013	**2014**	2013
Within one year	**632**	613	**442**	468
Between one and five years	**545**	645	**295**	485
Over five years	**59**	59	**15**	14
	1,236	1,317	**752**	967

56. Employee retirement benefits

(a) Defined benefit schemes

(i) Total defined benefit recognised in the income statement

Included within "Employee compensation and benefits" are components of expense related to the Group's defined benefit schemes, as follows:

	Group and Bank	
	2014	2013
Defined benefit schemes		
– Current service cost	**261**	294
– Net interest expense on the net defined benefit liability/asset	**34**	14
– Administrative costs and taxes paid by scheme	**2**	2
Total expense (note 13)	**297**	310

(ii) Cumulative actuarial gains/(losses) recognised in other comprehensive income in respect of defined benefit schemes

	Group and Bank	
	2014	2013
At 1 January	**(2,025)**	(2,803)
Actuarial gains recognised in other comprehensive income	**164**	778
At 31 December	**(1,861)**	(2,025)

The Group operates three defined benefit schemes, the Hang Seng Bank Limited Defined Benefit Scheme ("HSBDBS"), which is the principal scheme which covers about 29 per cent of the Group's employees, and two other schemes, the Hang Seng Bank Limited Pension Scheme ("HSBPS") and the Hang Seng Bank Limited Non-contributory Terminal Benefits Scheme ("HSBNTBS"). HSBDBS was closed to new entrants with effect from 1 April 1999, and HSBPS and HSBNTBS were closed to new entrants with effect from 31 December 1986. Since the defined benefit section of the HSBDBS is a final salary lump sum scheme, its exposure to longevity risk and interest rate risk is limited.

These schemes are registered under Occupational Retirement Schemes Ordinance (Cap. 426 of the law of Hong Kong) ("the Ordinance"). These schemes are administered by trustees, the majority of which are independent, with their assets held separately from those of the Group. The trustees are required by the Trust Deed to act in the best interest of the scheme participants and are responsible for setting investment policies of the schemes.

HSBDBS is predominantly a funded scheme with assets which is held under insurance policy separate from the Group. HSBDBS is reviewed at least on a triennial basis in accordance with local regulations. The actuarial assumptions used to calculate the defined benefit obligations of HSBDBS vary according to the economic conditions.

HSBDBS mainly invests in bonds and equities and each investment manager has been assigned an investment mandate with the targeted asset allocation. The ranges of target asset allocations for the portfolio are as follows: Bonds (0 – 50%), Equity (0 – 50%) and cash (0 – 100%).

56. Employee retirement benefits continued

(a) Defined benefit schemes continued

(iii) Movements in the scheme assets and present value of the defined benefit obligations

Net asset/(liability) under defined benefit schemes

	Group and Bank		
	Fair value of scheme assets	Present value of defined benefit obligations	Net defined benefit liability
At 1 January 2014	4,660	(6,392)	(1,732)
Current service cost	–	(261)	(261)
Net interest income/(cost) on the net defined benefit liability	99	(133)	(34)
Remeasurement effects recognised in other comprehensive income	1	163	164
– Actuarial gains from changes in financial assumptions	–	36	36
– Actuarial gains from experience	1	127	128
Contributions by the Group	292	–	292
Benefits paid	(468)	468	–
Administrative costs and taxes paid by scheme	(2)	–	(2)
At 31 December 2014	4,582	(6,155)	(1,573)
Retirement benefit liabilities recognised in balance sheet (included in "Other liabilities")	4,360	(5,975)	(1,615)
Retirement benefit assets recognised in balance sheet (included in "Other accounts" of "Other assets")	222	(180)	42
Present value of defined benefit obligation relating to:			
– Actives			5,978
– Pensioners			177

56. Employee retirement benefits continued

(a) Defined benefit schemes continued

(iii) Movements in the scheme assets and present value of the defined benefit obligations continued

Net asset/(liability) under defined benefit schemes continued

	Group and Bank		
	Fair value of scheme assets	Present value of defined benefit obligations	Net defined benefit liability
At 1 January 2013	4,613	(7,030)	(2,417)
Current service cost	–	(294)	(294)
Net interest income/(cost) on the net defined benefit liability	28	(42)	(14)
Remeasurement effects recognised in other comprehensive income	165	613	778
– Actuarial gains from changes in financial assumptions	–	604	604
– Actuarial gains from experience	165	9	174
Contributions by the Group	217	–	217
Benefits paid	(361)	361	–
Administrative costs and taxes paid by scheme	(2)	–	(2)
At 31 December 2013	4,660	(6,392)	(1,732)
Retirement benefit liabilities recognised in balance sheet (included in "Other liabilities")	4,431	(6,203)	(1,772)
Retirement benefit assets recognised in balance sheet (included in "Other accounts" of "Other assets")	229	(189)	40
Present value of defined benefit obligation relating to:			
– Actives			6,205
– Pensioners			187

The Group and the Bank expect to make HK$296 million of contributions to defined benefit pension schemes during 2015.

(iv) Benefits expected to be paid

Benefits expected to be paid from the HSBDBS, HSBPS and HSBNTBS to retirees over each of the next five years, and in aggregate for the five years thereafter, are as follows:

	2015	2016	2017	2018	2019	2020-2024
HSBDBS	364	409	457	469	547	2,594
HSBPS/HSBNTBS	14	14	13	13	12	51

The duration of the principal scheme HSBDBS is 8 years (2013: 9 years) under the disclosure assumptions adopted.

56. Employee retirement benefits continued

(a) Defined benefit schemes continued

(v) Fair value of scheme assets by asset classes

	Group and Bank		
	Value	Quoted market price in active market	Of which held by the Group
2014			
Fair value of scheme assets			
– Equities	**2,324**	**2,324**	**–**
– Bonds	**2,165**	**2,165**	**–**
– Other*	**93**	**93**	**56**
	4,582	**4,582**	**56**
2013			
Fair value of scheme assets			
– Equities	2,056	2,056	–
– Bonds	2,069	2,069	–
– Other*	535	535	38
	4,660	4,660	38

* Other mainly consists of cash and deposits.

(vi) The Principal Scheme's actuarial financial assumptions

These schemes are funded defined benefit schemes and are administered by trustees with assets held separately from those of the Group. The latest annual actuarial valuations at 31 December 2014 were performed by Quinnie Chung, fellow of the Society of Actuaries of the United States of America, of Mercer (Hong Kong) Limited, using the Attained Age Method.

The Ordinance requires that registered retirement benefit schemes shall at all time be fully funded to meet its aggregate vested liability (i.e. on a wind-up basis) in accordance with the recommendations contained in an actuarial certificate supplied under the Ordinance. Any shortfall must be made up within the specified time under the Ordinance. Any deficits to meet the aggregate past service liability (i.e. on an on-going basis) can however be eliminated over a period of time in accordance with the funding recommendations of an actuary.

On an on-going basis, the value of the principal scheme assets of HSBDBS represented 97 per cent (2013: 94 per cent) of the benefits accrued to scheme members, after allowing for expected future increases in salaries, and the resulting deficit amounted to HK$130 million (deficit in 2013: HK$283 million). On a wind-up basis, the actuarial value of the HSBDBS assets represented 103 per cent (2013: 101 per cent) of the members' vested benefits, based on salaries at that date, and the resulting surplus amounted to HK$157 million (surplus in 2013: HK$37 million).

The determinations for actuarial funding valuation purposes are based on different methods and assumptions from those used for financial reporting purposes, and as a result should neither be compared nor related to other determinations included in these financial statements.

56. Employee retirement benefits continued

(a) Defined benefit schemes continued

(vi) The Principal Scheme's actuarial financial assumptions continued

The present value of the principal scheme's obligation was a final lump sum salary of HK$5,975 million (2013: HK$6,203 million). The principal actuarial assumptions used to calculate the Group's obligations for the HSBDBS for each year, and used as the basis for measuring the expenses in relation to the scheme, were as follows:

Principal actuarial assumptions for the principal scheme

	Group and Bank HSBDBS %
2014	
Discount rate	**1.75**
Expected rate of salary increases	**4.50**
of which:	
– 2015	**4.50**
– thereafter	**4.50**
2013	
Discount rate	2.15
Expected rate of salary increases	5.00
of which:	
– 2014	5.50
– thereafter	5.00

The Group determines the discount rates to be applied to its obligations in consultation with the schemes' actuaries, on the basis of current average yields of high quality (AA rated or equivalent) debt instruments, with maturities consistent with those of the defined benefit obligations. Where there is not a deep market in corporate bonds, government bond yields have been used, and this is the case for HSBDBS. The yield curve has been extrapolated where the term of the liabilities is longer than the duration of available bonds and the discount rate used then takes into account the term of the liabilities and the shape of the yield curve.

56. Employee retirement benefits continued

(a) Defined benefit schemes continued

(vii) Actuarial assumption sensitivities

The discount rate and rate of pay increase are sensitive to changes in market conditions arising during the reporting year. The following table shows the effect of changes in these on the HSBDBS:

The effect of changes in key assumptions:

	HSBDBS	
	2014	2013
Discount rate		
– change in retirement benefit obligation at year end from a 25bps increase	**(122)**	(133)
– change in retirement benefit obligation at year end from a 25bps decrease	**126**	138
– change in 2015/2014 retirement benefit cost from a 25bps increase	**(4)**	(5)
– change in 2015/2014 retirement benefit cost from a 25bps decrease	**3**	5
Rate of pay increase		
– change in retirement benefit obligation at year end from a 25bps increase	**123**	134
– change in retirement benefit obligation at year end from a 25bps decrease	**(119)**	(130)
– change in 2015/2014 retirement benefit cost from a 25bps increase	**8**	9
– change in 2015/2014 retirement benefit cost from a 25bps decrease	**(7)**	(8)

(b) Defined contribution schemes

The principal defined contribution scheme for Group employees joining on or after 1 April 1999 is the HSBC Group Hong Kong Local Staff Defined Contribution Scheme. The Group also operates two other defined contribution schemes, the Hang Seng Bank Provident Fund Scheme which was closed to new entrants since 31 December 1986 and the Hang Seng Insurance Company Limited Employees' Provident Fund. The Bank and relevant Group entities also participated in mandatory provident fund schemes ("MPF schemes") registered under the Hong Kong Mandatory Provident Fund Ordinance, which are also defined contribution schemes.

Contributions made in accordance with the relevant scheme rules to these defined contribution schemes (including MPF schemes) are charged to the income statement as below:

	2014	2013
Amounts charged to the income statement (note 13)	**164**	131

Under the schemes, the Group's contributions are reduced by contributions forfeited by those employees who leave the schemes prior to the contributions vesting fully. The forfeited contributions utilised during the year or available at the year-end to reduce future contributions is HK$2 million (2013: HK$1 million).

57. Share-based payments

The Group participated in various share compensation plans as listed in the following tables that are operated by the HSBC Group for acquiring of HSBC Holdings plc shares. These are to be settled by the delivery of shares of HSBC Holdings plc.

Share Awards and Option Plans

Award	Policy	Purpose
Restricted Share Awards (including Group Performance Share Plan)	– Vesting of awards generally subject to continued employment with the Group – Vesting often staggered over three years – Certain shares subject to a retention requirement post-vesting – Awards generally not subject to performance conditions – Awards granted from 2010 onwards are subject to clawback provision prior to vesting	– Rewards employee performance, potential and retention of key employees – To defer variable pay – To aid recruitment
Savings-related share award plan ("HSBC International Employee Share Purchase Plan")	– A new broad-based employee plan which was offered to eligible employees in Hong Kong in September 2013 – Eligible employees make contributions up to the local equivalent of £250 per month which are applied in the purchase of shares on a quarterly basis. For every three shares purchased, the employee is granted a matching award by the HSBC Group of one share – The matching award vests subject to continued employment with the Group and retention of the purchased shares in the plan until the third anniversary of the start of the relevant plan year	– To align the interests of all employees with the creation of shareholder value
Savings-Related Share Option Plan	– Eligible employees save up to £250 per month (or its equivalent in Hong Kong dollars), with the option to use the savings to acquire shares – Exercisable within three months following the first anniversary of the commencement of a one-year savings contract or within six months following either the third or fifth anniversaries of the commencement of three-year or five-year contracts, respectively – The exercise price is set at a 20% (2013: 20%) discount to the market value immediately preceding the date of invitation	– To align the interests of all employees with the creation of shareholder value
Group Share Option Plan	– Vesting of awards based on achievement of certain corporate performance condition targets – Exercisable between third and tenth anniversaries of the date of grant – Plan ceased in 2004	– Long-term incentive plan between 2000 and 2004 during which certain employees were awarded share options

57. Share-based payments continued

(a) Savings-Related Share Option Plan

The number of options, weighted average exercise price, and the weighted average remaining contractual life for options outstanding at the balance sheet date, are as follows:

Option scheme with exercise price set in Hong Kong dollars

	2014		2013	
	Weighted average exercise price HK$	**Number ('000)**	Weighted average exercise price HK$	Number ('000)
Outstanding at 1 January	**42.82**	**5,548**	46.01	7,443
Exercised in the year	**38.36**	**(4,084)**	54.21	(1,845)
Less: Cancellation/Lapsed in the year	**42.82**	**(101)**	46.01	(50)
Outstanding at 31 December	**55.49**	**1,363**	42.82	5,548
Exercisable at 31 December	**–**	**–**	–	–

The weighted average share price at the date of exercise for share options exercised during the year was HK$82.95 (2013: HK$85.03).

The options outstanding at the year end of 2014 had an exercise price in the range of HK$37.88 to HK$63.99 (2013: HK$37.88 to HK$63.99), and a weighted average remaining contractual life of 1.23 years (2013: 1.39 years).

No share option was granted during 2014 and 2013.

(b) Group Share Option Plan

The number of options, weighted average exercise price, and the weighted average remaining contractual life for options outstanding at the balance sheet date, are as follows:

	2014		2013	
	Weighted average exercise price £	**Number ('000)**	Weighted average exercise price £	Number ('000)
Outstanding at 1 January	**7.22**	**794**	6.88	1,144
Exercised in the year	**7.22**	**(1)**	6.15	(155)
Lapsed in the year	**7.22**	**(793)**	6.88	(195)
Outstanding at 31 December		**–**	7.22	794
Exercisable at 31 December		**–**	7.22	794

The weighted average share price at the date of exercise for share options exercised during the year was £7.22 (2013: £7.11).

There were no options outstanding at the year end of 2014. The options outstanding at the year end of 2013 had an exercise price of £7.22, and a weighted average remaining contractual life of 0.33 years.

No share option was granted during 2014 and 2013.

57. Share-based payments continued

(c) Restricted Share Awards

	2014 Number ('000)	2013 Number ('000)
Outstanding at 1 January	**323**	334
Additions during the year	**288**	175
Less: Released/lapsed in the year	**(254)**	(186)
Outstanding at 31 December	**357**	323

The closing price of the HSBC Holdings plc share at 31 December 2014 was £6.09 (2013: £6.62).

The weighted average remaining vesting period as at 31 December 2014 was 0.94 years (2013: 1.25 years).

(d) Calculation of fair value

The recognition of compensation cost of share option is based on the fair value of the options on grant date. The calculation of the fair value of HSBC share option is centrally managed by HSBC Holdings plc. Fair values of share options, measured at the date of grant of the options are calculated using a binomial lattice model methodology that is based on the underlying assumptions of the Black-Scholes model. Expected dividends are incorporated into the valuation model for share options and awards where applicable. The expected life of options depends on the behaviour of option holders, which is incorporated into the option model consistent with historic observable data. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used.

(e) Income statement charge

	2014	2013
Restricted share awards	**25**	14
Savings-related share awards and option plans	**18**	35
Income statement charge (note 13)	**43**	49
Equity-settled share-based payments	**43**	49
Cash-settled share-based payments	**–**	–
	43	49

The above charge was computed from the fair values of the share-based payment transaction when contracted, that arose under employee share awards made in accordance with HSBC's reward structures.

58. Material related-party transactions

(a) Immediate holding company and its subsidiaries, fellow subsidiary companies, subsidiaries and associates

In 2014, the Group entered into transactions with its immediate holding company, its subsidiaries and fellow subsidiary companies in the ordinary course of its interbank activities mainly including lending activities, acceptance and placement of interbank deposits, correspondent banking transactions, off-balance sheet transactions and the provision of other banking and financial services. The activities were on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

The Group used the IT service of, and shared an automated teller machine network with, its immediate holding company. The Group also shared certain IT projects with and used certain processing services of fellow subsidiaries on a cost recovery basis. The Group maintained a staff retirement benefit scheme for which a fellow subsidiary company acts as insurer and administrator. A fellow subsidiary company was appointed as fund manager to manage the Group's life insurance investment portfolios. The Bank acted as agent for the marketing of Mandatory Provident Fund products and the distribution of retail investment funds for two fellow subsidiary companies.

There was an arrangement whereby a fellow subsidiary provided certain management services to Hang Seng Insurance Company Limited. The fees on these transactions are determined on an arm's length basis.

58. Material related-party transactions continued

(a) Immediate holding company and its subsidiaries, fellow subsidiary companies, subsidiaries and associates continued

During the year, the Bank issued perpetual capital instrument of HK$6,981 million to its immediate holding company reported under "Other equity instruments".

The aggregate amount of income and expenses arising from these transactions during the year, the balances of amounts due to and from the relevant related parties, and the total contract sum of off-balance sheet transactions at the year-end are as follows:

	Group					
	Immediate holding company and its subsidiaries		Fellow subsidiaries		Associates	
	2014	2013	**2014**	2013	**2014**	2013
Interest income	**69**	106	**2**	–	**190**	119
Interest expense	**(350)**	(375)	**–**	–	**(3)**	(3)
Other operating income	**125**	117	**(16)**	–	**–**	–
Operating expenses*	**(689)**	(738)	**(636)**	(550)	**(37)**	(29)
Amounts due from:						
Placings with and advances to banks	**24,353**	17,291	**5,218**	458	**4,398**	5,597
Financial assets designated at fair value	**–**	–	**–**	–	**–**	–
Derivative financial instruments	**408**	503	**35**	104	**–**	–
Reverse repurchase agreements – non-trading	**1,296**	–	**–**	–	**–**	–
Loans and advances to customers	**300**	–	**–**	–	**233**	233
Financial investments	**–**	–	**–**	–	**–**	–
Other assets	**27**	23	**–**	–	**7**	7
	26,384	17,817	**5,253**	562	**4,638**	5,837
Amounts due to:						
Current, savings and other deposit accounts	**1,440**	1,042	**–**	–	**166**	112
Deposits from banks	**3,789**	1,051	**22**	66	**250**	166
Derivative financial instruments	**617**	802	**1,607**	54	**–**	–
Certificates of deposit and other debt securities in issue	**6,493**	–	**–**	–	**–**	–
Subordinated liabilities	**5,817**	11,824	**–**	–	**–**	–
Other liabilities	**296**	370	**83**	90	**–**	–
	18,452	15,089	**1,712**	210	**416**	278
Derivative contracts:						
Contract amount	**96,322**	85,784	**75,982**	73,713	**–**	–

* 2014 operating expenses included payment of HK$81 million (2013: HK$88 million) of software costs which were capitalised as intangible assets in the balance sheet of the Group.

58. Material related-party transactions continued

(a) Immediate holding company and its subsidiaries, fellow subsidiary companies, subsidiaries and associates continued

	Bank							
	Immediate holding company and its subsidiaries		Fellow subsidiaries		Subsidiaries		Associates	
	2014	2013	**2014**	2013	**2014**	2013	**2014**	2013
Amounts due from:								
Placings with and advances to banks	**23,674**	17,129	**2,711**	206	**–**	–	**3,850**	4,690
Financial assets designated at fair value	**–**	–	**–**	–	**–**	–	**–**	–
Derivative financial instruments	**337**	437	**35**	104	**201**	153	**–**	–
Reverse repurchase agreements – non-trading	**1,296**	–	**–**	–	**–**	–	**–**	–
Loans and advances to customers	**300**	–	**–**	–	**–**	–	**–**	–
Amounts due from subsidiaries	**–**	–	**–**	–	**28,195**	23,553	**–**	–
Financial investments	**–**	–	**–**	–	**–**	–	**–**	–
Other assets	**24**	18	**–**	–	**–**	–	**7**	7
	25,631	17,584	**2,746**	310	**28,396**	23,706	**3,857**	4,697
Amounts due to:								
Current, savings and other deposit accounts	**1,438**	1,039	**–**	–	**–**	–	**163**	102
Deposits from banks	**192**	409	**23**	66	**–**	–	**250**	166
Derivative financial instruments	**513**	629	**1,606**	53	**241**	175	**–**	–
Certificates of deposit and other debt securities in issue	**6,493**	–	**–**	–	**–**	–	**–**	–
Subordinated liabilities	**5,817**	11,824	**–**	–	**–**	–	**–**	–
Amounts due to subsidiaries	**–**	–	**–**	–	**15,490**	14,326	**–**	–
Other liabilities	**228**	247	**74**	78	**–**	–	**–**	–
	14,681	14,148	**1,703**	197	**15,731**	14,501	**413**	268
Derivative contracts:								
Contract amount	**76,258**	69,949	**75,982**	73,713	**20,502**	19,179	**–**	–
Guarantees:								
Guarantees issued	**–**	–	**–**	–	**453**	464	**–**	–
Guarantees received	**–**	–	**–**	–	**–**	–	**–**	–
Committed facilities:								
Committed facilities from	**–**	–	**–**	–	**–**	–	**–**	–
Committed facilities to	**–**	–	**–**	–	**15,488**	5,481	**–**	–

58. Material related-party transactions continued

(b) Key management personnel remuneration

Remuneration for key management personnel, including amounts paid to the Bank's directors as disclosed in note 15 and highest paid employees as disclosed in note 14, is as follows:

	Group		Bank	
	2014	2013	**2014**	2013
Salaries, allowances and benefits in kind	**40**	39	**40**	39
Retirement scheme contributions	**4**	4	**4**	4
Variable bonuses	**30**	33	**28**	33
	74	76	**72**	76

(c) Material transactions with key management personnel

During the year, the Group provided credit facilities to and accepted deposits from key management personnel of the Bank and its holding companies, their close family members and companies controlled or significantly influenced by them. The credit facilities extended and deposit taken were provided in the ordinary course of business and on substantially the same terms as for comparable transactions with persons of a similar standing or, where applicable, with other employees.

Material transactions conducted with key management personnel of the Bank and its holding companies and parties related to them are as follows:

	Group		Bank	
	2014	2013	**2014**	2013
For the year				
Interest income	**399**	287	**399**	287
Interest expense	**16**	7	**16**	7
Fees and commission income	**17**	13	**17**	13
Maximum aggregate amount of loans and advances	**16,098**	10,082	**15,171**	9,075
At the year-end				
Loans and advances	**13,136**	9,112	**12,319**	8,185
Deposits	**5,895**	3,586	**4,982**	3,091
Guarantees issued	**65**	27	**65**	27
Undrawn commitments	**1,443**	845	**1,432**	845

The Group adheres to section 83 of the Hong Kong Banking Ordinance regarding lending to related parties; this includes unsecured lending to key management personnel, their relatives and companies that may be directly or indirectly influenced or controlled by such individuals.

No impairment losses have been recorded against balances outstanding during the year with key management personnel, and there are no specific impairment allowances on balances with key management personnel at the year-end.

58. Material related-party transactions continued

(d) Loans to officers

Loans to officers of the Bank disclosed pursuant to section 78 of Schedule 11 to the new Hong Kong Companies Ordinance (Cap. 622) with reference to section 161B of the predecessor Hong Kong Companies Ordinance (Cap. 32) are as follows:

	Group		Bank	
	2014	2013	**2014**	2013
Aggregate amount of relevant transactions outstanding at 31 December	**245**	18	**245**	18
Maximum aggregate amount of relevant transactions during the year	**272**	22	**272**	22

(e) Associates

Information relating to associates and transactions with associates can be found in notes 35 and 58(a).

The Group maintains a shareholders' loan to an associate. The shareholders' loan is unsecured, interest free and with no fixed term of repayment. The balance at 31 December 2014 was HK$233 million (2013: HK$233 million).

(f) Ultimate holding company

The Group participates in various share option and share plans operated by HSBC Holdings plc whereby share options or shares of HSBC Holdings plc are granted to employees of the Group. As disclosed in note 57, the Group recognises an expense in respect of these share options and share awards. The cost borne by the ultimate holding company in respect of these share options and share awards is treated as a capital contribution and is recorded under "Other reserves". The balance of this reserve as at 31 December 2014 amounted to HK$662 million comprising HK$664 million relating to share option schemes and negative reserve amounted to HK$2 million relating to share award schemes (2013: HK$648 million comprising HK$653 million relating to share option schemes and negative reserve amounted to HK$5 million relating to share award schemes).

(g) Employee retirement benefits

At 31 December 2014, defined benefit scheme assets amounted to HK$1,855 million (2013: HK$1,873 million) was under management by the Bank's subsidiary company and the related fee paid was HK$6 million (2013: HK$6 million).

59. Fair value of financial instruments

(a) Fair value of financial instruments carried at fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following tables set out the financial instruments carried at fair value.

	Group					
	Valuation techniques					
	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3	Third party total	Amounts with HSBC entities*	Total
Recurring fair value measurements						
2014						
Assets						
Trading assets	**34,094**	**7,729**	**–**	**41,823**	**–**	**41,823**
Financial assets designated at fair value	**8,817**	**1,594**	**701**	**11,112**	**–**	**11,112**
Derivative financial instruments	**492**	**6,455**	**32**	**6,979**	**442**	**7,421**
Available-for-sale financial investments	**161,459**	**87,103**	**1,234**	**249,796**	**–**	**249,796**
Liabilities						
Trading liabilities	**27,791**	**44,707**	**89**	**72,587**	**–**	**72,587**
Financial liabilities designated at fair value	**–**	**3,489**	**–**	**3,489**	**–**	**3,489**
Derivative financial instruments	**117**	**4,121**	**1**	**4,239**	**2,223**	**6,462**
2013						
Assets						
Trading assets	22,146	9,850	–	31,996	–	31,996
Financial assets designated at fair value	4,531	1,956	500	6,987	–	6,987
Derivative financial instruments	414	5,622	3	6,039	607	6,646
Available-for-sale financial investments	125,701	84,655	984	211,340	–	211,340
Liabilities						
Trading liabilities	24,475	37,534	108	62,117	–	62,117
Financial liabilities designated at fair value	–	489	–	489	–	489
Derivative financial instruments	48	4,342	–	4,390	856	5,246

59. Fair value of financial instruments continued

(a) Fair value of financial instruments carried at fair value continued

	Bank					
	Valuation techniques					
	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3	Third party total	Amounts with HSBC entities*	Total
Recurring fair value measurements						
2014						
Assets						
Trading assets	**34,094**	**4,066**	**–**	**38,160**	**–**	**38,160**
Financial assets designated at fair value	**–**	**–**	**–**	**–**	**–**	**–**
Derivative financial instruments	**405**	**6,030**	**32**	**6,467**	**572**	**7,039**
Available-for-sale financial investments	**161,389**	**60,443**	**1,046**	**222,878**	**–**	**222,878**
Liabilities						
Trading liabilities	**27,791**	**6,511**	**71**	**34,373**	**–**	**34,373**
Financial liabilities designated at fair value	**–**	**2,994**	**–**	**2,994**	**–**	**2,994**
Derivative financial instruments	**108**	**3,753**	**1**	**3,862**	**2,362**	**6,224**
2013						
Assets						
Trading assets	22,146	8,331	–	30,477	–	30,477
Financial assets designated at fair value	–	–	–	–	–	–
Derivative financial instruments	413	4,727	3	5,143	694	5,837
Available-for-sale financial investments	125,634	69,075	815	195,524	–	195,524
Liabilities						
Trading liabilities	24,475	5,352	87	29,914	–	29,914
Financial liabilities designated at fair value	–	–	–	–	–	–
Derivative financial instruments	42	3,587	–	3,629	857	4,486

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

59. Fair value of financial instruments continued

(a) Fair value of financial instruments carried at fair value continued

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

There were no material transfers between Level 1 and Level 2 during the year.

Control framework

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.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the Group will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors that are considered in this regard are, inter alia:

– the extent to which prices may be expected to represent genuine traded or tradeable prices;

– the degree of similarity between financial instruments;

– the degree of consistency between different sources;

– the process followed by the pricing provider to derive the data;

– the elapsed time between the date to which the market data relates and the balance sheet date; and

– the manner in which the data was sourced.

For fair values determined using a valuation model, the control framework may include, as applicable, development or validation by independent support functions of (i) the logic within valuation models; (ii) the inputs to those models; (iii) any adjustments required outside the valuation models; and (iv) where possible, model outputs. Valuation models are subject to a process of due diligence and calibration before becoming operational and are calibrated against external market data on an ongoing basis.

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 compliance with all relevant accounting standards.

Determination of 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. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. Where a financial instrument has a quoted price in an active market and it is part of a portfolio, the fair value of the portfolio is calculated as the product of the number of units and quoted price. In the event that the market for a financial instrument is not active, a valuation technique is used.

59. Fair value of financial instruments continued

(a) Fair value of financial instruments carried at fair value continued

The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. In inactive markets, obtaining assurance that the transaction price provides evidence of fair value or determining the adjustments to transaction prices that are necessary to measure the fair value of the instrument requires additional work during the valuation process.

Valuation techniques incorporate assumptions about factors that other market participants would use in their valuations. A range of valuation techniques is employed, dependent upon the instrument type and available market data. Most valuation techniques are based upon discounted cash flow analysis, in which expected future cash flows are calculated and discounted to present value using a discounting curve. Prior to consideration of credit risk, the expected future cash flows may be known, as would be the case for the fixed leg of an interest rate swap, or may be uncertain and require projection, as would be the case for the floating leg of an interest rate swap. Projection utilises market forward curves, if available. In option models, the probability of different potential future outcomes must be considered. In addition, the value of some products are dependent upon more than one market factor, and in these cases it will typically be necessary to consider how movements in one market factor may impact the other market factors. The model inputs necessary to perform such calculations include interest rate yield curves, exchange rates, volatilities, correlations, prepayment and default rates.

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 unobservable, and for them the measurement of fair value is more judgemental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's inception profit ("day 1 gain or loss") or greater than 5% of the instrument's carrying value is driven by unobservable inputs. "Unobservable" in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no market data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used). All fair value adjustments are included within the levelling determination.

The types of financial instruments carried at fair values are as follows:

– 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 long-dated equity volatilities and correlations between equity prices, between equity prices and interest rates and between interest rates and foreign exchange rates.

– 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.

59. Fair value of financial instruments continued

(a) Fair value of financial instruments carried at fair value continued

Fair value adjustments

Fair value adjustments are adopted when the Group considers that there are additional factors that would be considered by a market participant that are not incorporated within the valuation model. The Group classifies fair value adjustments as either "risk-related" or "model-related". The majority of these adjustments relate to Global Markets.

Movements in the level of fair value adjustments do not necessarily result in the recognition of profits or losses within the income statement. For example, as models are enhanced, fair value adjustments may no longer be required. Similarly, fair value adjustments will decrease when the related positions are unwound, but this may not result in profit or loss.

The major fair value adjustment categories being regularly reviewed by the Group are as follow:

Risk-related adjustments

– Bid-offer

HKFRS 13 requires use of the price within the bid-offer spread that is most representative of fair value. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the extent to which bid-offer cost would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the position.

– Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, there exists a range of possible values that the financial instrument or market parameter may assume and an adjustment may be necessary to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model.

– Credit valuation adjustment

The credit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the counterparty may default and that the Group may not receive the full market value of the transactions.

– Debit valuation adjustment

The debit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the Group may default, and that the Group may not pay full market value of the transactions.

Model-related adjustments

– Model limitation

Models used for portfolio valuation purposes may be based upon a simplifying set of assumptions that do not capture all material market characteristics. Additionally, markets evolve, and models that were adequate in the past may require development to capture all material market characteristics in current market conditions. In these circumstances, model limitation adjustments are adopted. As model development progresses, model limitations are addressed within the valuation models and a model limitation adjustment is no longer needed.

– Inception profit (Day 1 P&L reserves)

Inception profit adjustments are adopted where the fair value estimated by a valuation model is based on one or more significant unobservable inputs.

59. Fair value of financial instruments continued

(a) Fair value of financial instruments carried at fair value continued

Valuation of uncollateralised derivatives

The Group values both collateralised and uncollateralised derivatives by discounting expected future cash flows at a benchmark interest rate, typically LIBOR or its equivalent. This approach has historically been adopted across the industry, and has therefore been an appropriate basis for fair value. The Group and other industry participants are currently considering whether it appropriately reflects the manner in which the derivatives are funded, which may occur at rates other than interbank offer rates. In the second half of 2014, the Group has adopted a "funding fair value adjustment" to reflect the funding of uncollateralised derivatives exposure at rates other than interbank offer rates. As at 31 December 2014, the funding fair value adjustment was insignificant. This is an area in which a full industry consensus has not yet emerged. The Group will continue to monitor industry evolution and refine the calculation methodology as necessary.

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

	Group						
	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
2014							
Private equity	**1,234**	**–**	**701**	**–**	**–**	**–**	**–**
Structured notes	**–**	**–**	**–**	**–**	**89**	**–**	**–**
Derivatives	**–**	**–**	**–**	**32**	**–**	**–**	**1**
	1,234	**–**	**701**	**32**	**89**	**–**	**1**
2013							
Private equity	984	–	500	–	–	–	–
Structured notes	–	–	–	–	108	–	–
Derivatives	–	–	–	3	–	–	–
	984	–	500	3	108	–	–

	Bank						
	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
2014							
Private equity	**1,046**	**–**	**–**	**–**	**–**	**–**	**–**
Structured notes	**–**	**–**	**–**	**–**	**71**	**–**	**–**
Derivatives	**–**	**–**	**–**	**32**	**–**	**–**	**1**
	1,046	**–**	**–**	**32**	**71**	**–**	**1**
2013							
Private equity	815	–	–	–	–	–	–
Structured notes	–	–	–	–	87	–	–
Derivatives	–	–	–	3	–	–	–
	815	–	–	3	87	–	–

59. Fair value of financial instruments continued

(a) Fair value of financial instruments carried at fair value continued

Movement in Level 3 financial instruments

	Group						
	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 2014	**984**	–	**500**	**3**	**108**	–	–
Total gains or losses recognised in profit or loss							
– trading income	–	–	–	**37**	–	–	**2**
– net income from other financial instruments designated at fair value	–	–	**110**	–	–	–	–
– gains less losses from financial investments	–	–	–	–	–	–	–
Total gains or losses recognised in other comprehensive income							
– fair value gains	**250**	–	–	–	–	–	–
– exchange differences	–	–	–	–	–	–	–
Purchases	–	–	**264**	–	–	–	–
Issues/deposit taking	–	–	–	–	**89**	–	–
Sales	–	–	**(2)**	–	–	–	–
Settlements	–	–	**(257)**	–	**(87)**	–	–
Transfers out	–	–	–	**(9)**	**(21)**	–	**(1)**
Transfers in	–	–	**86**	**1**	–	–	–
At 31 December 2014	**1,234**	–	**701**	**32**	**89**	–	**1**
Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of the reporting period							
– trading income	–	–	–	**38**	–	–	**(5)**
– net income from other financial instruments designated at fair value	–	–	**115**	–	–	–	–

59. Fair value of financial instruments continued

(a) Fair value of financial instruments carried at fair value continued

Movement in Level 3 financial instruments continued

	Group						
	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 or loss							
– trading income	–	–	–	(81)	–	–	–
– net income from other financial instruments designated at fair value	–	–	27	–	–	–	–
– gains less losses from financial investments	–	–	–	–	–	–	–
Total gains or losses recognised in other comprehensive income							
– fair value gains	148	–	–	–	–	–	–
– exchange differences	–	–	–	–	–	–	–
Purchases	–	–	92	–	–	–	–
Issues/deposit taking	–	–	–	–	87	–	–
Sales	–	–	(10)	–	–	–	–
Settlements	–	–	(37)	(60)	(114)	–	–
Transfers out	–	–	(54)	(17)	–	–	–
Transfers in	612	–	4	–	–	–	–
At 31 December 2013	984	–	500	3	108	–	–
Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of the reporting period							
– trading income	–	–	–	3	–	–	–
– net income from other financial instruments designated at fair value	–	–	25	–	–	–	–

59. Fair value of financial instruments continued

(a) Fair value of financial instruments carried at fair value continued

Movement in Level 3 financial instruments continued

	Bank						
	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 2014	815	–	–	3	87	–	–
Total gains or losses recognised in profit or loss							
– trading income	–	–	–	37	–	–	2
– net income from other financial instruments designated at fair value	–	–	–	–	–	–	–
– gains less losses from financial investments	–	–	–	–	–	–	–
Total gains or losses recognised in other comprehensive income							
– fair value gains	231	–	–	–	–	–	–
– exchange differences	–	–	–	–	–	–	–
Purchases	–	–	–	–	–	–	–
Issues/deposit taking	–	–	–	–	71	–	–
Sales	–	–	–	–	–	–	–
Settlements	–	–	–	–	(87)	–	–
Transfers out	–	–	–	(9)	–	–	(1)
Transfers in	–	–	–	1	–	–	–
At 31 December 2014	1,046	–	–	32	71	–	1
Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of the reporting period							
– trading income	–	–	–	38	–	–	(5)
– net income from other financial instruments designated at fair value	–	–	–	–	–	–	–

59. Fair value of financial instruments continued

(a) Fair value of financial instruments carried at fair value continued

Movement in Level 3 financial instruments continued

	Bank						
	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	100	–	–	–	117	–	–
Total gains or losses recognised in profit or loss							
– trading income	–	–	–	3	–	–	–
– net income from other financial instruments designated at fair value	–	–	–	–	–	–	–
– gains less losses from financial investments	–	–	–	–	–	–	–
Total gains or losses recognised in other comprehensive income							
– fair value gains	103	–	–	–	–	–	–
– exchange differences	–	–	–	–	–	–	–
Purchases	–	–	–	–	–	–	–
Issues/deposit taking	–	–	–	–	87	–	–
Sales	–	–	–	–	–	–	–
Settlements	–	–	–	–	(117)	–	–
Transfers out	–	–	–	–	–	–	–
Transfers in	612	–	–	–	–	–	–
At 31 December 2013	815	–	–	3	87	–	–
Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of the reporting period							
– trading income	–	–	–	3	–	–	–
– net income from other financial instruments designated at fair value	–	–	–	–	–	–	–

59. Fair value of financial instruments continued

(a) Fair value of financial instruments carried at fair value continued

Movement in Level 3 financial instruments continued

The transfer out of Level 3 held for trading liabilities reflects change in observability of correlation between equity and equity index during the period. In respect of financial assets designated at fair value, the transfer into Level 3 was due to change in portfolio mix of private equity investments.

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

As discussed above, the fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions which 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:

Sensitivity of fair values to reasonably possible alternative assumptions

	Group			
	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes	Unfavourable changes	Favourable changes	Unfavourable changes
2014				
Private equity	**70**	**(70)**	**127**	**(127)**
Structured notes	**–**	**–**	**–**	**–**
Derivatives	**–**	**–**	**–**	**–**
	70	**(70)**	**127**	**(127)**
2013				
Private equity	50	(50)	91	(91)
Structured notes	–	–	–	–
Derivatives	–	–	–	–
	50	(50)	91	(91)

	Bank			
	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes	Unfavourable changes	Favourable changes	Unfavourable changes
2014				
Private equity	**–**	**–**	**108**	**(108)**
Structured notes	**–**	**–**	**–**	**–**
Derivatives	**–**	**–**	**–**	**–**
	–	**–**	**108**	**(108)**
2013				
Private equity	–	–	74	(74)
Structured notes	–	–	–	–
Derivatives	–	–	–	–
	–	–	74	(74)

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.

59. Fair value of financial instruments continued

(a) Fair value of financial instruments carried at fair value continued

Quantitative information about significant unobservable inputs in Level 3 valuations

	Group			
	Fair value at 31 December 2014	Valuation technique(s)	Unobservable input(s)	Range
Assets				
Private equity	**1,935**	Net asset value	N/A	N/A
		Market-comparable approach	Earnings Multiple	22 – 37
			P/B ratios	1.11 – 1.59
			Liquidity Discount	10% – 30%
Derivatives	**30**	Option model	Equity Volatility	17.77% – 36.97%
			FX Volatility	3.61% – 10.49%
	2	Discounted cash flow model	IR Curve	1.33% – 5.37%
Liabilities				
Structured notes	**89**	Option model	FX Volatility	8.95% – 15.56%
			Equity and Equity Index Correlation	0.585 – 0.710
Derivatives	**1**	Option model	FX Volatility	6.25% – 10.49%

	Bank			
	Fair value at 31 December 2014	Valuation technique(s)	Unobservable input(s)	Range
Assets				
Private equity	**1,046**	Net asset value	N/A	N/A
		Market-comparable approach	Earnings Multiple	22 – 37
			P/B ratios	1.11 – 1.59
			Liquidity Discount	10% – 30%
Derivatives	**30**	Option model	Equity Volatility	17.77% – 36.97%
			FX Volatility	3.61% – 10.49%
	2	Discounted cash flow model	IR Curve	1.33% – 5.37%
Liabilities				
Structured notes	**71**	Option model	FX Volatility	8.95% – 15.56%
Derivatives	**1**	Option model	FX Volatility	6.25% – 10.49%

59. Fair value of financial instruments continued

(a) Fair value of financial instruments carried at fair value continued

Quantitative information about significant unobservable inputs in Level 3 valuations continued

	Group			
	Fair value at 31 December 2013	Valuation technique(s)	Unobservable input(s)	Range
Assets				
Private equity	1,484	Net asset value	N/A	N/A
		Market-comparable approach	Earning Multiple	20 – 33
			P/B ratios	0.78 – 1.43
			Liquidity Discount	10% – 30%
Derivatives	3	Option model	Equity Volatility	7.21% – 72.54%
			FX Volatility	1.85% – 7.68%
Liabilities				
Structured notes	108	Option model	FX Volatility	6.15% – 11.65%
			Equity and Equity Index Correlation	0.508 – 0.588

	Bank			
	Fair value at 31 December 2013	Valuation technique(s)	Unobservable input(s)	Range
Assets				
Private equity	815	Net asset value	N/A	N/A
		Market-comparable approach	Earning Multiple	20 – 33
			P/B ratios	0.78 – 1.43
			Liquidity Discount	10% – 30%
Derivatives	3	Option model	Equity Volatility	7.21% – 72.54%
			FX Volatility	1.85% – 7.68%
Liabilities				
Structured notes	87	Option model	FX Volatility	6.15% – 11.65%

Key unobservable inputs to Level 3 financial instruments

The table above lists the key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 31 December 2014. A further description of the categories of key unobservable inputs is given below.

Private equity

The Group's private equity includes investment funds and unlisted equity shares, which are classified as designated at fair value through profit or loss or available-for-sale and are not traded in active markets. In the absence of an active market, the investment's fair value is estimated on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors, as well as by reference to market valuations for similar entities quoted in an active market, or the price at which similar companies have changed ownership.

Investment funds are valued using their net asset value. Higher net asset value results in higher fair value, and vice versa. Given the bespoke nature of the analysis, it is not practical to quote a range of key observable inputs.

For unlisted available-for-sale equity shares, the fair values are determined with reference to multiples of comparable listed companies, such as price/earning or price/book ratios of comparables, adjusted for a liquidity discount to reflect the fact that the shares are not actively traded. An increase in the ratio in isolation will result in favourable movement in the fair values, while an increase in liquidity discount in isolation will result in unfavourable movement.

59. Fair value of financial instruments continued

(a) Fair value of financial instruments carried at fair value continued

Key unobservable inputs to Level 3 financial instruments continued

Volatility

Volatility is a measure of the anticipated future variability of a market price. Volatility tends to increase in stressed market conditions, and decrease in calmer market conditions. Volatility is an important input in the pricing of options. In general, the higher the volatility, the more expensive the option will be. This reflects both the higher probability of an increased return from the option, and the potentially higher costs that the Group may incur in hedging the risks associated with the option. If option prices become more expensive, this will increase the value of the Group's long option positions (i.e. the positions in which the Group has purchased options), while the Group's short option positions (i.e. the positions in which the Group has sold options) will suffer losses.

Volatility varies by underlying reference market price, and by strike and maturity of the option. Volatility also varies over time. As a result, it is difficult to make general statements regarding volatility levels.

Certain volatilities, typically those of a longer-dated nature, are unobservable. The unobservable volatility is then estimated from observable data.

The range of unobservable volatilities quoted in the table reflects the wide variation in volatility inputs by reference to market price. For any single unobservable volatility, the uncertainty in the volatility determination is significantly less than the range quoted above.

Correlation

Correlation is a measure of the inter-relationship between two market prices. Correlation is a number between minus one and one. A positive correlation implies that the two market prices tend to move in the same direction, with a correlation of one implying that they always move in the same direction. A negative correlation implies that the two market prices tend to move in opposite directions, with a correlation of minus one implying that the two market prices always move in opposite directions.

Correlation is used to value more complex instruments where the payout is dependent upon more than one market price. Correlation may be unobservable. Unobservable correlations may be estimated based upon a range of evidence, including consensus pricing services, the Group's trade prices, proxy correlations and examination of historical price relationships.

The range of unobservable correlations quoted in the table reflects the wide variation in correlation inputs by market price pair. For any single unobservable correlation, the uncertainty in the correlation determination is likely to be less than the range quoted above.

59. Fair value of financial instruments continued

(b) Fair value of financial instruments not carried at fair value

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

	Group				
	Carrying amount	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3	Fair value
2014					
Financial Assets					
Placings with and advances to banks	**145,731**	**–**	**145,798**	**–**	**145,798**
Loans and advances to customers	**658,431**	**–**	**2,854**	**652,786**	**655,640**
Held-to-maturity debt securities	**68,236**	**495**	**70,334**	**–**	**70,829**
Financial Liabilities					
Current, savings and other deposit accounts	**896,521**	**–**	**896,578**	**–**	**896,578**
Deposits from banks	**9,095**	**–**	**9,095**	**–**	**9,095**
Certificates of deposit and other debt securities in issue	**12,402**	**–**	**12,484**	**–**	**12,484**
Subordinated liabilities	**5,817**	**–**	**6,939**	**–**	**6,939**
2013					
Financial Assets					
Placings with and advances to banks	141,940	–	141,907	–	141,907
Loans and advances to customers	586,240	–	1,400	581,493	582,893
Held-to-maturity debt securities	71,505	427	71,546	41	72,014
Financial Liabilities					
Current, savings and other deposit accounts	824,996	–	825,093	–	825,093
Deposits from banks	11,826	–	11,826	–	11,826
Certificates of deposit and other debt securities in issue	8,601	–	8,601	–	8,601
Subordinated liabilities	11,824	–	13,799	–	13,799

59. Fair value of financial instruments continued

(b) Fair value of financial instruments not carried at fair value continued

	Bank				
	Carrying amount	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3	Fair value
2014					
Financial Assets					
Placings with and advances to banks	**111,656**	**–**	**111,656**	**–**	**111,656**
Loans and advances to customers	**588,131**	**–**	**1,985**	**583,577**	**585,562**
Financial Liabilities					
Current, savings and other deposit accounts	**850,324**	**–**	**850,413**	**–**	**850,413**
Deposits from banks	**4,140**	**–**	**4,140**	**–**	**4,140**
Certificates of deposit and other debt securities in issue	**11,156**	**–**	**11,238**	**–**	**11,238**
Subordinated liabilities	**5,817**	**–**	**6,939**	**–**	**6,939**
2013					
Financial Assets					
Placings with and advances to banks	106,392	–	106,392	–	106,392
Loans and advances to customers	519,135	–	1,281	514,507	515,788
Financial Liabilities					
Current, savings and other deposit accounts	774,462	–	774,560	–	774,560
Deposits from banks	10,012	–	10,012	–	10,012
Certificates of deposit and other debt securities in issue	8,601	–	8,601	–	8,601
Subordinated liabilities	11,824	–	13,799	–	13,799

The calculation of fair values of financial instruments that are not carried at fair value is described below.

The calculation of fair value incorporates the Group's estimate of the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. 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.

(i) Loans and advances to banks and customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using valuation models that incorporate a range of input assumptions. These assumptions may include value estimates from third party brokers which reflect over-the-counter trading activity; forward looking discounted cash flow models using assumptions which the Group believes are consistent with those which would be used by market participants in valuing such loans; and trading inputs from other market participants which includes observed primary and secondary trades.

Loans are grouped, as far as possible, into homogeneous groups and stratified by loans with similar characteristics to improve the accuracy of estimated valuation outputs. The stratification of a loan book considers all material factors, including vintage, origination period, estimates of future interest rates, prepayment speeds, delinquency rates, loan-to-value ratios, the quality of collateral, default probability, and internal credit risk ratings.

Valuation techniques are calibrated on a regular basis and tested for validity using prices from observable current market transactions in the same instrument, without modification or repackaging, or are based on any available observable market data.

The fair value of a loan reflects both loan impairments at the balance sheet date and estimates of market participants' expectations of credit losses over the life of the loans, and the fair value impact of repricing between origination and the balance sheet date. For impaired loans, fair value is estimated by discounting the future cash flows over the time period they are expected to be recovered.

59. Fair value of financial instruments continued

(b) Fair value of financial instruments not carried at fair value continued

(ii) Financial investments

The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that take into consideration the prices and future earnings streams of equivalent quoted securities.

(iii) Deposits by banks and customer accounts

For the purpose of estimating fair value, deposits by banks and customer accounts are grouped by remaining contractual maturity. Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is assumed to be the amount payable on demand at the balance sheet date.

(iv) Debt securities in issue and subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments.

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. In many cases, it would not be possible to realise immediately the estimated fair values given the size of the portfolios measured. Accordingly, these fair values do not represent the value of these financial instruments to the Group as a going concern.

The following table lists financial instruments for which their carrying amounts are reasonable approximations of their fair values because, for example, they are short-term in nature or reprice to current market rates frequently:

Assets

Cash and sight balances at central banks
Items in the course of collection from other banks
Reverse repurchase agreements – non-trading
Acceptances and Endorsements
Short-term receivables within “Other assets”
Accrued income

Liabilities

Items in the course of transmission to other banks
Acceptances and Endorsements
Short-term payables within “Other liabilities”
Accruals

60. The New Hong Kong Companies Ordinance (Cap. 622)

The New Hong Kong Companies Ordinance (“NCO”) (Cap. 622) came into effect on 3 March 2014. On this effective date, the concept of par (nominal) value no longer exist. Consequently, the concepts of “share premium”, “capital redemption reserve” and “authorised share capital” are also abolished. Any amount received for issuing equity shares of a company should be recorded as part of “share capital”. The effect of the transition is to subsume share premium account and capital redemption reserve balances into share capital as set out in section 37 of Schedule 11 to the NCO (Cap. 622). Prior to 3 March 2014, the application of the share premium account and the capital redemption reserve was governed by sections 48B and 49H respectively of the predecessor Hong Kong Companies Ordinance (Cap. 32).

As at 31 December 2013, 1,911,842,736 ordinary shares of the Bank, with par value of $5 each, were authorised for issue. Under the NCO (Cap. 622), as part of the transition to the no-par value regime, the amount of HK$99 million standing to the credit of the capital redemption reserve on 3 March 2014 have become part of the Bank’s share capital, under the NCO (Cap. 622).

These changes do not have an impact on the number of shares in issue or the relative entitlement of any of the members.

61. Changes in presentation

From 1 January 2014, non-trading reverse repurchase agreements and repurchase agreements are presented as separate lines in the balance sheet to align disclosure with market practice and provide more meaningful information in relation to loans and advances. Previously, non-trading reverse repurchase agreements were included within "Placings with and advances to banks" and "Loans and advances to customers" and non-trading repurchase agreements were included within "Deposits from banks" and "Current, savings and other deposit accounts".

The Group has also changed the balance sheet line item, "Cash and balances with banks" to "Cash and sight balances at central banks". "Balances with banks", is now included within "Placings with and advances to banks".

Comparative figures have been presented accordingly and the affected lines are shown below. There are no other effects of this change in presentation.

	As disclosed	Adjustments	As restated
31 December 2013 consolidated balance sheet items			
Assets			
Cash and balances with banks/ Cash and sight balances at central banks	**33,294**	**(10,577)**	**22,717**
Placings with and advances to banks	**131,363**	**10,577**	**141,940**

62. Comparative figures

Certain comparative figures have been adjusted to conform with current year's presentation.

63. 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.

64. The appointment of PricewaterhouseCoopers ("PwC") as the Bank's auditor

In 2013, HSBC Holdings plc announced its intention to appoint PwC as its auditor for the year ending 31 December 2015. The aforesaid appointment of PwC will be recommended to shareholders of HSBC Holdings plc for approval at its annual general meeting ("AGM") to be held in 2015.

Both the Audit Committee and the Board of the Bank consider that PwC is an equally professional and qualified audit firm with extensive expertise and experience in the audit of financial institutions as KPMG. As such, appointment of PwC as the Bank's auditor would align the audit arrangements between the Bank and HSBC Holdings plc, the ultimate holding company of the Bank, with a view to enhancing the efficiency and effectiveness of the audit in terms of both cost and audit process which would be in the best interests of the Bank and its shareholders as a whole.

Upon recommendation of the Audit Committee and with endorsement of the Board, the Bank announced on 4 August 2014 its intention to propose to its shareholders to approve the appointment of PwC as the Bank's auditor at the AGM to be held on 7 May 2015.

On 23 February 2015, KPMG tendered its resignation as the Bank's auditor upon its signing of the Bank's financial statements for the year ended 31 December 2014, whereupon the Board, upon the recommendation of the Audit Committee, has appointed PwC to fill the casual vacancy arising from KPMG's resignation as aforesaid, with effect from 23 February 2015. PwC will hold office until the Bank's 2015 AGM.

KPMG has confirmed in writing that there are no matters in relation to its resignation as the Bank's auditor which KPMG needs to bring to the attention of the shareholders. The Bank also confirms that there is no disagreement between KPMG and the Bank, and that there are no other matters in respect of KPMG's resignation that need to be brought to the attention of the shareholders.

Accordingly, the Board proposed to seek the approval of the shareholders by way of an ordinary resolution at the 2015 AGM for the proposed appointment of PwC as the Bank's auditor for the year ending 31 December 2015. The aforesaid appointment shall come into effect upon the passing of such ordinary resolution by the shareholders at the 2015 AGM.

65. Accounting treatment for Industrial Bank Co., Ltd. ("Industrial Bank") and Yantai Bank Co., Ltd ("Yantai Bank")

Industrial Bank

The Group recorded an accounting gain of HK$9,517 million (the accounting gain included the deemed disposal profit on the reclassification of HK$8,454 million and the release of deferred tax of HK$1,063 million) on the reclassification of Industrial Bank as a financial investment following its issue of additional share capital to third parties in 2013.

At 30 September 2014, the fair value of the Bank's investment in Industrial Bank was HK$26.7 billion, which was below the deemed cost of HK$28.8 billion (the fair value on reclassification from associate to available-for-sale equity investment in January 2013). Following an impairment assessment, the Bank has recognised an impairment loss of HK$2.1 billion. In subsequent periods, any further declines in fair value below HK$26.7 billion will be reflected in the Bank's income statement for the relevant period as additional impairment losses, whereas any increases in fair value will be reflected in the Bank's available-for-sale investment reserves. Subsequent to the impairment provided in September 2014, there was an increase in the fair value of the Bank's investment in Industrial Bank, resulting in the increase in unrealised revaluation gain at 31 December 2014.

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 2014 with last year. For the sake of comparison, we have prepared the following key financial results and performance metrics by excluding the accounting gain in 2013 and the impairment loss on Industrial Bank in 2014.

	As reported			Excluding Industrial Bank impairment loss and reclassification		
	Year ended 31 December			Year ended 31 December		
	2014	2013	Change	**2014**	2013	Change
Attributable profit	**15,131**	26,678	(43.3%)	**17,234**	17,161	0.4%
Profit before tax	**18,049**	28,496	(36.7%)	**20,152**	20,042	0.5%
Return on average shareholders' funds (%)	**13.4**	25.4	(12.0pp)	**16.3**	17.6	(1.3pp)
Return on average total assets (%)	**1.3**	2.4	(1.1pp)	**1.4**	1.5	(0.1pp)
Earnings per share (HK$)	**7.91**	13.95	(43.3%)	**9.01**	8.98	0.3%

Yantai Bank

The Group recorded an accounting loss of HK$297 million on the reclassification of Yantai Bank as a financial investment following a private placement of additional share capital to a third party in the second half of 2013. Since then, the fair value of the Bank's investment in Yantai Bank had been below the carrying amount for a prolonged period and a HK$85 million impairment loss on the Bank's investment on Yantai Bank was recognised in September 2014 following an impairment assessment according to the accounting policies of the Group. The Group will continue to perform impairment review of its investment in Yantai Bank at each balance sheet date in accordance with the Group's accounting policy. In subsequent periods, any further decline in fair value will be reflected in the Bank's income statement for the relevant period as additional impairment losses, whereas any increases in fair value will be reflected in the Banks' available-for-sale investment reserves.

66. Non-adjusting post balance sheet event

On 10 February 2015, the Group entered into a placing agreement with Goldman Sachs Gao Hua Securities Company Limited to sell 5% (up to 952,616,838 ordinary shares ("Shares") of its shareholding of the ordinary shares of Industrial Bank Co., Ltd. ("Industrial Bank"), at a price of RMB13.36 per share. The disposal price represents a discount of approximately 7% to the closing price of Industrial Bank's ordinary shares listed on the Shanghai Stock Exchange on the date of entry into the placing agreement. The transaction was completed on 13 February 2015. Upon completion of the transaction, the Group's remaining shareholding in Industrial Bank represented approximately 5.87% of the ordinary shares of Industrial Bank. Please refer to the Group's announcement on 10 February 2015 for further details on the transaction.

The Group's investment in Industrial Bank was accounted for as available-for-sale financial investment in the financial statements of the Group. The fair value of the investment in Industrial Bank as at 31 December 2014 was HK$42,736 million, with HK$16,001 million accumulated unrealised gains recorded in other comprehensive income.

It is estimated that the net gain on the transaction will be approximately HK$2.8 billion, representing the difference between the consideration and the carrying value of the Shares as at 31 December 2014 in the Bank and Group's financial statements, together with the reclassification of the related cumulative foreign exchange and revaluation reserve less any tax effect and expenses on the transaction. The net gain will be recognised in the income statements of the Bank and the Group for the year ending 31 December 2015. The transaction is estimated to increase the Group's Common Equity Tier 1 ("CET1"), Tier 1 and Total capital ratios by 1.0 percentage point ("pp"), 1.3pp and 3.5pp respectively based on the Group's published financial statements for the year ended 31 December 2014. As at 31 December 2014, the Group's CET1 and Tier 1 capital ratios were both 15.6% and the Total capital ratio was 15.7%. The transaction is estimated to increase the Group's Basel III end point basis proforma CET1 ratio by 3.8pp.

67. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 23 February 2015.

Independent Auditor's Report

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

We have audited the consolidated financial statements of Hang Seng Bank Limited ("the Bank") and its subsidiaries (together "the Group") set out on pages 146 to 269, which comprise the consolidated and the Bank balance sheets as at 31 December 2014, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the consolidated financial statements

The directors of the Bank are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. This report is made solely to you, as a body, in accordance with section 80 of Schedule 11 to the new Hong Kong Companies Ordinance (Cap. 622), and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Bank and of the Group as at 31 December 2014 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

KPMG
Certified Public Accountants

8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

23 February 2015

Supplementary Notes to the Financial Statements (unaudited)

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

These notes set out on pages 271 to 292 are supplementary to and should be read in conjunction with the consolidated financial statements set out on pages 146 to 269. The consolidated financial statements and these supplementary notes taken together comply with the Banking (Disclosure) Rules (the "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 excludes 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 Management Discussion and Analysis.

(b) The accounting policies applied in preparing these supplementary notes are the same as those applied in preparing the consolidated financial statements for the year ended 31 December 2014 as set out in note 3 to the financial statements.

2. Credit risk capital requirements

The table below shows the capital requirements for credit risk for each class and subclass of exposures as specified in the Capital Rules.

	2014	2013
Subject to internal ratings-based approach		
Sovereign exposures	**1,097**	1,279
Bank exposures	**2,680**	2,510
Corporate exposures	**19,498**	17,403
Residential mortgages to individuals and property-holding shell companies	**1,135**	772
Qualifying revolving retail exposures	**1,660**	1,258
Small business retail exposures	**13**	14
Other retail exposures to individuals	**417**	359
Other exposures	**1,894**	1,784
Securitisation exposures	**–**	–
Equity exposures	**1,892**	1,381
Credit valuation adjustment	**232**	178
Total capital requirements for credit risk under internal ratings-based approach	**30,518**	26,938
Subject to standardised (credit risk) approach		
On-balance sheet		
Sovereign exposures	**–**	–
Public sector entity exposures	**71**	137
Multilateral development bank exposures	**–**	–
Bank exposures	**9**	10
Securities firm exposures	**–**	–
Corporate exposures	**1,530**	986
Collective investment scheme exposures	**–**	–
Cash items	**–**	–
Regulatory retail exposures	**268**	101
Residential mortgage loans	**701**	798
Other exposures which are not past due exposures	**150**	127
Past due exposures	**14**	24
Total capital requirements for on-balance sheet exposures	**2,743**	2,183
Off-balance sheet		
Direct credit substitutes	**147**	30
Transaction-related contingencies	**1**	1
Trade-related contingencies	**2**	3
Forward asset purchases	**7**	3
Partly paid-up shares and securities	**–**	–
Forward forward deposits placed	**–**	–
Unconditionally cancellable commitments	**–**	–
Other commitments	**55**	30
Exchange rate contracts	**7**	2
Interest rate contracts	**1**	3
Equity contracts	**28**	12
OTC derivative transactions and credit derivative contracts subject to valid bilateral netting agreements	**1**	1
Other off-balance exposures which are not elsewhere specified	**–**	–
Total capital requirements for off-balance sheet exposures	**249**	85
Total capital requirements for credit risk under standardised (credit risk) approach	**2,992**	2,268
Total capital requirements for credit risk	**33,510**	29,206

The capital requirement is made by multiplying the Group's risk-weighted amount derived from the relevant calculation approach by 8 per cent. It does not reflect the Group's actual regulatory capital.

3. Credit risk under the internal ratings-based approach

(a) The internal rating system

(i) Nature of exposures within each internal ratings-based ("IRB") class

The Group adopted advanced IRB approach for the majority of its business with effect from 1 January 2009. The following exposures are subject to IRB approach:

– Corporate exposures include exposures to global large corporates, local large corporates, middle market corporates and small and medium-sized enterprises, non-bank financial institutions and specialised lending.

– Sovereign exposures include exposures to central governments, government agencies, central monetary institutions and relevant international organisations.

– Bank exposures include exposures to banks and regulated securities firms.

– Retail exposures include residential mortgages, qualifying revolving retail exposures, small business retail exposures and other retail exposures to individuals.

– Other exposures mainly include notes and coins, premises, plant and equipment and other assets.

(ii) Risk rating systems and control mechanisms

The Group's exposure to credit risk arises from a wide range of customers and product types. To measure and manage the risk in these exposures, both to distinct customer types or product categories, the Group employs diverse risk rating systems and methodologies: judgmental, analytical, and hybrids of the two.

A fundamental principle of the Group's policy and approach is that analytical risk rating systems and scorecards are decision tools facilitating management, serving ultimately judgemental decisions for which individual approvers are accountable. In case of automated decision making process, accountability rests with those responsible for the parameters built into those processes/systems and the controls surrounding their use. For individually assessed customers, the credit process provides for at least annual review of the facility granted. Review may be more frequent, as required by circumstances.

The Group adopts a set of standards that govern the process through which risk rating systems are developed, judged fit for purpose, approved and implemented, the conditions under which analytical risk model outcomes can be overridden by approvers; and the process of model performance monitoring and reporting. The framework emphasises on an effective dialogue between business line and risk management, suitable independence of decision takers and a good understanding and robust challenge of senior management.

Analytical risk rating systems are not static and are subject to review and modification in light of the changing environment and the availability or quality of data. Processes are established to capture the relevant data for continuous model improvement.

3. Credit risk under the internal ratings-based approach continued

(a) The internal rating system continued

(iii) Application of IRB parameters

The Group-wide credit risk rating framework incorporates probability of default ("PD", representing the likelihood of a default event in a one-year horizon) of an obligor and loss severity expressed in terms of exposures at default ("EAD", an estimate of exposures at time of default) and loss given default ("LGD", the estimates of loss that the Group may incur in the event of default expressed as a percentage of EAD). These measures are used to calculate expected loss and capital requirements. They are also used in conjunction with other inputs to form rating assessments for the purpose of credit approval and for risk management decisions.

For sovereign, bank and corporate exposures, PD models are developed based on historical loss data, combining financial statistics and expert inputs on various aspects such as industry environment, financial trend and quality assessment on the companies. PD model for sovereign exposures incorporates both quantitative and qualitative data on economic, political, financial and social conditions. For corporate, bank and sovereign exposures, obligor PD is estimated using a Customer Risk Rating ("CRR") of 23 grades, of which 21 are non-default ratings representing varying degrees of strength of financial condition, and two are default ratings. Credit score generated by a model and/or a scorecard for individual obligor, mapped to the corresponding Customer Risk Rating, is recommended to and reviewed by credit approver taking into account all relevant information (including external rating and market data where available) for risk rating determination. The approved CRR is mapped to a PD value range of which the "mid-point" is used in regulatory capital calculation. PD models are developed where the risk profile of corporate borrower is specific to a country or a region.

LGD and EAD estimation for wholesale business is subject to Group framework of basic principles. EAD is estimated to a 12-month horizon and broadly represents the current exposure plus an estimate for future draw down on undrawn facilities and the crystallization of contingent exposures after default. LGD focuses on the facility and collateral structure which takes into account the priority/seniority of the facility, the type and value of the collateral and past experience on the type of counterparty, which is expressed as a percentage of EAD.

The Group uses supervisory slotting criteria approach in rating its regulatory specialised lending exposure. Under this approach, rating will be assigned based on the borrower and transaction characteristics.

For retail business including residential mortgage exposures, qualifying revolving retail exposures, small business retail exposures and other retail exposures to individuals, a wide range of application and behavioural models used in the management of retail portfolios has been supplemented to develop the credit models for measuring PD, EAD and LGD under the IRB approach. The PD models typically incorporate the characteristics of the products and the borrower's account behaviour.

EAD models are developed for retail revolving exposures to predict additional drawdown at the time of default, plus current outstanding balance. For non-revolving retail exposures such as residential mortgage, EAD is mainly estimated based on current outstanding balance.

LGD models for retail exposures are developed based on the Group's internal loss and default experience including recovery values for different types of collaterals for secured retail exposures such as residential mortgage; for unsecured retail exposures such as qualifying revolving retail exposures, LGD models are developed based on past recovery experiences, account behaviours and repayment ability.

For management information and reporting purposes, retail portfolios are segmented into 10 Expected Loss ("EL") bands facilitating comparability across retail customer segment and product types. EL band is derived through a combination of PD and LGD.

(iv) Model Governance

Model governance is under the general oversight of HSBC Group or Regional Model Oversight Committee ("Group MOC"). Local Model Oversight Committee ("Local MOC") is established for Wholesale Credit and Market Risk ("WCMR") and Retail Banking and Wealth Management ("RBWM") respectively in the Bank with comparable terms of reference as Regional MOC. Local MOCs meet bi-monthly and report to Risk Management Committee. They are chaired by the Risk function, and its membership is drawn from Risk, Finance and Global Businesses.

Compliance with the Group standards for development, validation and implementation of credit risk models are subject to review by Independent Model Review Team and Internal Audit. Internal Audit also conducts regular reviews of the risk rating model application by business groups.

3. Credit risk under the internal ratings-based approach continued

(a) The internal rating system continued

(v) Use of internal ratings

While internal estimates derived from applying the IRB approach are employed in the calculation of risk-weighted exposure amounts for the purpose of determining regulatory capital requirements, they are also used in a multitude of contexts within risk management and business processes. Such uses continue to develop and become embedded as experience grows and the repository of quality data improves. They include:

- credit approval: authorities, including those for specific counterparty types and transactions, are delegated to officers and executives in the Group's credit risk function and business division involving lending activities using a risk-based approach, tiered relative to obligor customer risk rating;
- credit risk analytical tools: IRB measures are valuable tools deployed in the assessment of customer and portfolio risk; migration of customer risk rating is one of the important indicators in credit monitoring process;
- pricing: customer relationship managers apply a risk adjusted return on capital methodology in risk-weighted assets and profitability calculators;
- portfolio management: regular reports to respective Portfolio Oversight Committees of wholesale credit risk and retail credit risk, and Risk Management Committee containing analyses of risk exposures employing IRB risk metrics, e.g. portfolio distribution by internal-credit grade; return on risk weighted asset;
- economic capital: IRB risk measures are essential components of the credit risk economic capital model, which are evaluated in the capital adequacy assessment process of the Group;
- stress testing: IRB risk measures are stressed to understand the sensitivities of the Group's capital management plan under adverse economic environment; and
- risk appetite: IRB risk capital and risk estimates are elements of the risk appetite and internal risk control measures of the Group.

(vi) Credit risk mitigation

The Group's approach when granting credit facilities is on the basis of capacity to repay, rather than primarily rely on credit risk mitigation. Depending on a customer's standing and the type of product, facilities may be provided on unsecured basis. Nevertheless, mitigation of credit risk is an important aspect of effective management and takes in many forms.

The Group's general policy is to promote the use of credit risk mitigation, justified by commercial prudence and good practice as well as capital efficiency. Policies covering the acceptability, structuring, control and valuation with regard to different types of collateral security are established to ensure that they are supported by evidence and continue to fulfil their intended purpose.

The main types of recognised collateral taken by the Group are those as stated in section 80 of the Capital Rules, including (but not limited to) cash on deposit, gold bullion, equities listed in a main index and/or a recognised exchange, collective investment schemes, various recognised debt securities, residential, industrial and commercial property, etc.

The Group's policy provides that netting is only to be applied where it has the legal right to do so. Consistent with the Capital Rules, only bilateral netting arrangements are included for capital adequacy credit risk mitigation calculation.

In terms of the application within IRB approach, credit risk mitigants are considered in two broad categories: first, those which reduce the intrinsic probability of default of an obligor and therefore operate as adjustments to PD estimation, and second, those which affect estimated recoverability of obligations and require adjustment of LGD. The first includes, for example, full parental or group company guarantees; the second, collateral security of various kinds such as cash, equity, properties, fixed assets such as motor vehicles, plant and machinery, stock and debtors, bank and sovereign guarantees, etc.

3. Credit risk under the internal ratings-based approach continued

(b) Exposures subject to supervisory estimates

The following table indicates the exposure classes and the respective exposure amounts that are subject to supervisory estimates as at 31 December:

	2014	2013
IRB Exposure Class		
Sovereign exposures	–	–
Bank exposures	–	–
Corporate exposures	17,684	26,101
Total EAD	17,684	26,101

(c) Exposures by IRB calculation approach

The table below shows the Group's exposures:

	Advanced IRB approach	Supervisory slotting criteria approach	Retail IRB approach	Specific risk-weight approach	Total exposures
2014					
Sovereign exposures	190,619	–	–	–	190,619
Bank exposures	167,420	–	–	–	167,420
Corporate exposures	418,052	17,684	–	–	435,736
Retail exposures:					
– Residential mortgages to individuals and property-holding shell companies	–	–	167,240	–	167,240
– Qualifying revolving retail exposures	–	–	82,079	–	82,079
– Small business retail exposures	–	–	5,200	–	5,200
– Other retail exposures to individuals	–	–	10,993	–	10,993
Equity exposures	–	–	–	8,672	8,672
Other exposures	–	–	–	48,738	48,738
	776,091	17,684	265,512	57,410	1,116,697
2013					
Sovereign exposures	157,251	–	–	–	157,251
Bank exposures	172,618	–	–	–	172,618
Corporate exposures	356,502	26,101	–	–	382,603
Retail exposures					
– Residential mortgages to individuals and property-holding shell companies	–	–	155,100	–	155,100
– Qualifying revolving retail exposures	–	–	79,793	–	79,793
– Small business retail exposures	–	–	5,356	–	5,356
– Other retail exposures to individuals	–	–	9,920	–	9,920
Equity exposures	–	–	–	6,262	6,262
Other exposures	–	–	–	45,335	45,335
	686,371	26,101	250,169	51,597	1,014,238

3. Credit risk under the internal ratings-based approach continued

(d) Exposures by credit risk mitigation used

The table below shows the Group's exposures (after the effect of any on-balance sheet or off-balance sheet recognised netting) which are covered by recognised guarantees after the application of haircuts required under the Capital Rules. These exposures exclude derivative contracts.

	2014	2013
Portfolio		
Sovereign exposures	–	–
Bank exposures	4,601	4,278
Corporate exposures	153,295	155,841
Retail exposures	17,185	15,789
	175,081	175,908

For the class of sovereign exposures, there were no exposures covered by recognised guarantees.

(e) Risk assessment for exposures under IRB approach

The tables below detail the total EAD of sovereign, bank and corporate exposures by exposure-weighted average risk-weight, exposure-weighted average PD and exposure-weighted average LGD for each obligor grade as at 31 December.

(i) Sovereign, bank and corporate (other than specialised lending) exposures – analysis by obligor grade

The exposures at default disclosed below in respect of sovereign, bank and corporate exposures have taken into account the effect of recognised collateral and recognised guarantees.

	2014			
	Exposure-weighted average PD %	Exposure-weighted average LGD %	Exposure-weighted average risk-weight %	Exposure at default
Sovereign exposure				
Minimal default risk	0.02	21.43	3.50	138,721
Low default risk	0.07	45.00	17.08	51,898
				190,619
Bank exposure				
Minimal default risk	0.04	33.69	10.30	67,617
Low default risk	0.08	45.97	22.85	89,356
Satisfactory default risk	0.36	45.34	56.24	10,127
Fair default risk	1.20	45.28	86.42	136
Moderate default risk	4.15	45.00	157.37	125
Significant default risk	7.57	51.68	183.54	59
High default risk	–	–	–	–
				167,420
Corporate exposure (other than specialised lending)				
Minimal default risk	0.04	42.00	14.75	12,868
Low default risk	0.10	42.36	28.80	97,323
Satisfactory default risk	0.41	39.86	53.63	187,023
Fair default risk	1.25	39.05	80.25	88,963
Moderate default risk	2.95	37.23	101.25	28,711
Significant default risk	6.24	23.35	84.72	814
High default risk	11.10	24.42	112.03	246
Special management	19.00	40.29	214.38	82
Default	100.00	45.61	–	2,022
				418,052

3. Credit risk under the internal ratings-based approach continued

(e) Risk assessment for exposures under IRB approach continued

(i) Sovereign, bank and corporate (other than specialised lending) exposures – analysis by obligor grade continued

	2013			
	Exposure-weighted average PD %	Exposure-weighted average LGD %	Exposure-weighted average risk-weight %	Exposure at default
Sovereign exposure				
Minimal default risk	0.02	45.00	5.94	91,301
Low default risk	0.07	45.00	16.02	65,950
				157,251
Bank exposure				
Minimal default risk	0.04	25.04	7.56	50,814
Low default risk	0.08	35.55	17.45	96,289
Satisfactory default risk	0.30	34.23	39.98	23,969
Fair default risk	0.98	34.93	66.36	1,409
Moderate default risk	2.98	42.46	130.52	72
Significant default risk	7.42	52.79	190.39	64
High default risk	10.00	81.82	338.97	1
				172,618
Corporate exposure (other than specialised lending)				
Minimal default risk	0.04	41.34	13.21	16,663
Low default risk	0.11	43.42	28.29	100,620
Satisfactory default risk	0.41	41.51	54.85	137,813
Fair default risk	1.25	41.55	86.81	63,640
Moderate default risk	2.99	37.11	103.31	34,958
Significant default risk	6.93	37.51	141.29	1,590
High default risk	11.56	25.44	125.00	100
Special management	19.00	59.00	363.35	2
Default	100.00	50.46	–	1,116
				356,502

(ii) Corporate exposures (specialised lending) – analysis by supervisory rating grade

	2014		2013	
	Exposure-weighted average risk-weight %	**Exposure at default**	Exposure-weighted average risk-weight %	Exposure at default
Obligor Grade				
Strong	**63.48**	**15,196**	64.97	23,783
Good	**87.73**	**2,311**	88.83	2,222
Satisfactory	**121.90**	**177**	121.90	96
Weak	**–**	**–**	–	–
		17,684		26,101

3. Credit risk under the internal ratings-based approach continued

(e) Risk assessment for exposures under IRB approach continued

(iii) Retail exposures – analysis by credit quality

The table below shows a breakdown of exposures (the EAD of on-balance sheet exposures and off-balance sheet exposures) on a pool basis by credit quality classification:

	Residential mortgages	Qualifying revolving retail exposures	Small business retail exposures	Other retail exposures	Total exposures
2014					
Strong	**166,608**	**68,617**	**5,200**	**7,959**	**248,384**
Medium	**513**	**13,004**	**–**	**2,900**	**16,417**
Sub-standard	**–**	**407**	**–**	**111**	**518**
Impaired	**119**	**51**	**–**	**23**	**193**
	167,240	**82,079**	**5,200**	**10,993**	**265,512**
2013					
Strong	154,534	68,938	5,101	7,265	235,838
Medium	456	10,554	167	2,555	13,732
Sub-standard	–	292	–	80	372
Impaired	110	9	88	20	227
	155,100	79,793	5,356	9,920	250,169

(iv) Undrawn commitments

The table below shows the amount of undrawn commitments and exposure-weighted average EAD for sovereign, bank and corporate exposures as at 31 December:

	2014		2013	
	Undrawn commitments	Exposure-weighted average EAD	Undrawn commitments	Exposure-weighted average EAD
Sovereign exposures	**–**	**–**	–	–
Bank exposures	**348**	**108**	288	123
Corporate exposures	**133,554**	**38,867**	127,793	34,625
	133,902	**38,975**	128,081	34,748

3. Credit risk under the internal ratings-based approach continued

(f) Analysis of actual loss and estimates

The table below shows the actual losses which represent the net charges (including write-offs and impairment loss allowances) made during the year.

	2014	2013
Exposure Class		
Sovereign	**–**	–
Bank	**–**	–
Corporate	**585**	55
Residential mortgage	**(5)**	(20)
Qualifying revolving retail	**510**	456
Other retail	**139**	108
	1,229	599

The actual losses in 2014 increased mainly due to downgrade of certain customers.

The table below shows the expected loss which is the estimated future loss over a one-year time horizon for different exposure classes under IRB approach.

	31 December 2013	31 December 2012
Exposure Class		
Sovereign	29	11
Bank	64	71
Corporate	1,691	1,672
Residential mortgage	76	78
Qualifying revolving retail	525	476
Other retail	173	172
	2,558	2,480

It should be noted that actual loss and expected loss are measured and calculated using different methodologies which may not be directly comparable. The limitation arises mainly from the fundamental differences in the definition of “loss” under expected loss calculation which is derived based on regulatory rules and actual loss includes write-offs and impairment loss allowances.

3. Credit risk under the internal ratings-based approach continued

(f) Analysis of actual loss and estimates continued

The tables below set out the comparison of the predicted risk estimates of the Group's credit risk models against actual outcomes of the wholesale and retail exposures.

(i) Wholesale exposures

Risk estimates as at 31 December 2013 against actual outcome for the year 2014

	PD		LGD		EAD	
	Actual %	Estimated %	Actual %	Estimated %	Actual %	Estimated %
Sovereign exposure	**–**	**0.06**	**–**	**45.00**	**–**	**100.00**
Bank exposure	**–**	**0.33**	**–**	**31.58**	**–**	**98.15**
Corporate exposure	**0.57**	**1.17**	**44.21**	**42.88**	**79.92**	**79.08**

Risk estimates as at 31 December 2012 against actual outcome for the year 2013

	PD		LGD		EAD	
	Actual %	Estimated %	Actual %	Estimated %	Actual %	Estimated %
Sovereign exposure	–	0.07	–	16.45	–	100.00
Bank exposure	–	0.36	–	30.38	–	98.79
Corporate exposure	0.28	1.31	29.72	44.62	69.74	79.28

The actual PD rate is measured using the number of obligor defaulted during the reporting period whereas the estimated PD rate is the long run average default rate estimated at the beginning of the reporting period. The PD estimated by internal model is calibrated to the Group's long run default experience. Hence, actual default rate in a particular year ("point-in-time") will typically differ from the estimated PD which is the "through the cycle" estimates as economies move above or below cyclical norms.

The estimated LGD is the exposure weighted average LGD for the portfolio, adjusted by a downturn factor, as of the beginning of the reporting period whereas the actual LGD is computed using the resolved default cases accumulated in 2014 which covers cases defaulted in or before 2014. No default and loss has been observed for Bank and Sovereign exposures during the reporting period.

The estimated EAD% represents the ratio of total model estimated exposure values to total limits for the portfolio at the beginning of the reporting period. The actual EAD% compares the realised EAD of the resolved default cases accumulated in 2014 which covers cases defaulted in or before 2014 to the limits 1 year prior to default.

3. Credit risk under the internal ratings-based approach continued

(f) Analysis of actual loss and estimates continued

(ii) Retail exposures

Risk estimates as at 31 December 2013 against actual outcome for the year 2014

	PD		LGD		EAD	
	Actual %	Estimated %	Actual %	Estimated %	Actual %	Estimated %
Residential mortgages to individuals and property-holding shell companies	**0.13**	**0.49**	**0.58**	**10.45**	**92.57**	**100.00**
Qualifying revolving retail exposures	**0.42**	**0.54**	**84.79**	**93.27**	**82.08**	**90.33**
Small business retail exposures	**0.05**	**0.58**	**0.02**	**32.70**	**96.58**	**100.00**
Other retail exposures to individuals	**2.31**	**2.60**	**68.25**	**84.52**	**80.41**	**98.14**

Risk estimates as at 31 December 2012 against actual outcome for the year 2013

	PD		LGD		EAD	
	Actual %	Estimated %	Actual %	Estimated %	Actual %	Estimated %
Residential mortgages to individuals and property-holding shell companies	0.11	0.50	0.68	10.89	94.43	100.00
Qualifying revolving retail exposures	0.36	0.53	86.38	93.94	85.75	93.34
Small business retail exposures	0.32	0.61	1.31	10.07	93.77	100.00
Other retail exposures to individuals	2.28	2.57	60.53	76.18	78.58	98.24

The actual and estimated PD rate are measured in the same ways as wholesale exposure.

The actual LGD for the retail exposures takes into account the 24-months recovery period and represents the realised LGD for cases defaulted during 2012 which were recovered within 24 months after default. The estimated LGD is the exposure weighted average LGD for the defaulted cases estimated prior to default.

The estimated EAD% represents the ratio of total model estimated EAD to total limits for cases defaulted during 2014 whereas the actual EAD% compares the exposure values of the cases defaulted in 2014 at the time of default against the maximum limit 1 year prior to default.

4. Credit risk under the standardised (credit risk) approach

(a) Ratings from External Credit Assessment Institutions ("ECAIs")

The Group uses the following ECAIs to calculate its capital adequacy requirements under the standardised (credit risk) approach prescribed in the Capital Rules:

- Fitch Ratings
- Moody's Investors Service
- Standard & Poor's Ratings Services

Where exposures have been rated by the above-mentioned ECAIs, they are categorised under the following class of exposures:

- Sovereign exposures
- Public sector entity exposures
- Multilateral development bank exposures
- Bank exposures
- Securities firm exposures
- Corporate exposures
- Collective investment scheme exposures

The process used to map ECAIs issuer ratings or ECAIs issue specific ratings in the Group's banking book is consistent with those prescribed in the Capital Rules.

(b) Credit risk mitigation

As stated in sections 98 and 99 of the Capital Rules, certain guarantees and credit derivative contracts are recognised for credit risk mitigation purposes. The main types of guarantees are from sovereigns, corporate and banks. With corporate guarantees, in order for it to be recognised as a credit risk mitigants, it must have a credit rating of A- or better by Standard & Poor's Ratings Services, Fitch Ratings or a credit rating of A3 or better by Moody's Investors Service.

4. Credit risk under the standardised (credit risk) approach continued

(c) Credit risk exposures under the standardised (credit risk) approach

Class of exposures	Total exposures*	Exposures after recognised credit risk mitigation		Risk-weighted amounts		Total risk-weighted amounts	Total exposures covered by recognised collateral	Total exposures covered by recognised guarantees or recognised credit derivative contracts
		Rated	Unrated	Rated	Unrated			
2014								
On-balance sheet								
Sovereign	–	935	289	–	–	–	–	–
Public sector entity	9,984	8,690	360	738	150	888	–	935
Multilateral development bank	–	–	–	–	–	–	–	–
Bank	13	–	230	–	113	113	–	–
Securities firm	–	–	–	–	–	–	–	–
Corporate	21,523	–	19,214	–	19,214	19,214	1,806	503
Collective investment scheme	–	–	–	–	–	–	–	–
Cash items	–	–	–	–	–	–	–	–
Regulatory retail	5,204	–	4,492	–	3,369	3,369	709	3
Residential mortgage loan	18,225	–	18,194	–	8,794	8,794	30	1
Other exposures which are not past due exposures	4,310	–	1,887	–	1,887	1,887	2,423	–
Past due exposures	130	–	130	–	178	178	23	3
	59,389	9,625	44,796	738	33,705	34,443	4,991	1,445
Off-balance sheet								
Off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts	3,029	–	2,926	–	2,653	2,653	103	3
OTC derivative contracts	476	–	476	–	461	461	–	–
Credit derivative contracts	–	–	–	–	–	–	–	–
Other off-balance sheet exposures not elsewhere specified	–	–	–	–	–	–	–	–
	3,505	–	3,402	–	3,114	3,114	103	3
Total	62,894	9,625	48,198	738	36,819	37,557	5,094	1,448
Exposures deducted from capital base	–							

* Principal amount or credit equivalent amount, as applicable, net of specific provisions.

4. Credit risk under the standardised (credit risk) approach continued

(c) Credit risk exposures under the standardised (credit risk) approach continued

Class of exposures	Total exposures*	Exposures after recognised credit risk mitigation		Risk-weighted amounts		Total risk-weighted amounts	Total exposures covered by recognised collateral	Total exposures covered by recognised guarantees or recognised credit derivative contracts
		Rated	Unrated	Rated	Unrated			
2013								
On-balance sheet								
Sovereign	–	–	572	–	–	–	–	–
Public sector entity	14,239	13,168	1,073	1,494	215	1,709	–	–
Multilateral development bank	24,870	24,870	–	–	–	–	–	–
Bank	5	–	250	–	124	124	–	–
Securities firm	–	–	–	–	–	–	–	–
Corporate	14,118	1	12,321	1	12,321	12,322	989	808
Collective investment scheme	–	–	–	–	–	–	–	–
Cash items	–	–	–	–	–	–	–	–
Regulatory retail	2,293	–	1,680	–	1,260	1,260	602	11
Residential mortgage loan	17,836	–	17,802	–	9,976	9,976	32	1
Other exposures which are not past due exposures	3,890	–	1,584	–	1,584	1,584	2,307	–
Past due exposures	212	–	212	–	300	300	26	–
	77,463	38,039	35,494	1,495	25,780	27,275	3,956	820
Off-balance sheet								
Off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts	1,833	–	1,074	–	836	836	759	19
OTC derivative contracts	237	–	237	–	226	226	–	–
Credit derivative contracts	–	–	–	–	–	–	–	–
Other off-balance sheet exposures not elsewhere specified	–	–	–	–	–	–	–	–
	2,070	–	1,311	–	1,062	1,062	759	19
Total	79,533	38,039	36,805	1,495	26,842	28,337	4,715	839
Exposures deducted from capital base	–							

* Principal amount or credit equivalent amount, as applicable, net of specific provisions.

5. Counterparty credit risk-related exposures

(a) In respect of counterparty credit risk exposures which arises from derivative contracts and securities financing transactions (referred as "relevant transaction") hereunder, credit limit to counterparty credit risk arising from the relevant transaction is assigned, monitored and reported in accordance with the Group risk methodology. The credit limit established takes into account the gross contract amount and the future potential exposure measured on the basis of 95 percentile potential worst case loss estimates for the product involved. This method of calculating credit limit applies to all counterparties.

Credit equivalent amount and risk-weighted amount of relevant transaction is determined following the regulatory capital requirements. Risk-weighted amount is calculated in accordance with the counterparty risk weighting as per internal ratings-based approach/standardised (credit risk) approach under the Capital Rules.

The policy for secured collateral on derivatives is guided by the Group's internal Best Practice Guidelines ensuring the due-diligence necessary to fully understand the effectiveness of netting and collateralisation by jurisdiction, counterparty, product and agreement type is fully assessed and that the due-diligence standards are high and consistently applied. The Group's policies for establishing provisions are discussed in note 3(d) to the financial statements – Impairment on loans and advances.

Under the terms of our current collateral obligations under derivative contracts, we estimate based on the positions as at 31 December 2014 that the Bank would not be required to post additional collateral in the event of one or two notch downgrade in the Bank's credit ratings (2013: nil).

Wrong-way risk is an aggravated form of concentration risk and arises when there is a strong correlation between the counterparty's PD and the mark-to-market value of the underlying transaction. The Group uses a range of procedures to monitor and control wrong-way risk, including requiring front offices to obtain prior approval before undertaking wrong way risk transactions outside pre-agreed guidelines.

(b) Counterparty credit risk exposures

The following tables show the counterparty credit risk exposures under the internal-ratings based approach and standardised (credit risk) approach.

(i) Counterparty credit risk exposures under the internal-ratings based approach

	2014		2013	
	Derivative contracts	**Securities financing transactions**	Derivative contracts	Securities financing transactions
Gross total positive fair value	**6,684**	**–**	6,110	–
Credit equivalent amount/Net credit exposures*	**12,486**	**9**	10,307	–
Value of recognised collateral by type:				
Debt securities	**–**	**1,298**	–	–
Others	**238**	**–**	22	–
	238	**1,298**	22	–
Credit equivalent amount or net credit exposures net of recognised collateral**	**12,486**	**9**	10,307	–
Risk-weighted amount	**7,336**	**–**	4,294	–
Notional amount of recognised credit derivative contracts which provide credit protection	**–**	**–**	–	–

* For repo-style transactions, the recognised collateral is netted against EAD.
** For over-the-counter ("OTC") derivative contracts, the recognised collateral is reflected in LGD.

5. Counterparty credit risk-related exposures continued

(b) Counterparty credit risk exposures continued

(ii) Counterparty credit risk exposures under the standardised (credit risk) approach

There were no outstanding securities financing transactions at 31 December 2014 (2013: Nil).

	2014	2013
Derivative contracts:		
Gross total positive fair value	**196**	86
Credit equivalent amount	**476**	237
Value of recognised collateral by type:		
Debt securities	**–**	–
Others	**–**	–
	–	–
Credit equivalent amount or net credit exposures net of recognised collateral held	**476**	237
Risk-weighted amount	**461**	226
Notional amount of recognised credit derivative contracts which provide credit protection	**–**	–

(c) Major classes of exposures by counterparty type

(i) Major classes of exposures under the internal ratings-based approach by counterparty type

	2014			2013		
	Contract amount	Credit equivalent amount	Risk-weighted amount	Contract amount	Credit equivalent amount	Risk-weighted amount
Sovereign	**–**	**–**	**–**	–	–	–
Public sector entities	**–**	**–**	**–**	–	–	–
Banks	**790,954**	**6,170**	**1,540**	734,118	6,700	1,221
Corporates	**128,317**	**6,316**	**5,796**	136,740	3,607	3,073
	919,271	**12,486**	**7,336**	870,858	10,307	4,294

(ii) Major classes of exposures under the standardised (credit risk) approach by counterparty type

	2014			2013		
	Contract amount	Credit equivalent amount	Risk-weighted amount	Contract amount	Credit equivalent amount	Risk-weighted amount
Sovereign	**–**	**–**	**–**	–	–	–
Public sector entities	**–**	**–**	**–**	–	–	–
Banks	**–**	**–**	**–**	–	–	–
Corporates	**7,127**	**476**	**461**	6,670	237	226
	7,127	**476**	**461**	6,670	237	226

The Group had no credit exposures that are risk-weighted at 1250% at 31 December 2014 (2013: Nil).

6. Asset securitisation

There was no asset securitisation for which the Group is an originating institution or an investing institution at 31 December 2014 (2013: Nil).

7. Market risk

(a) Market risk is the risk that movements in market factors, including foreign exchange rates, interest rates, credit spreads or equity and commodity prices will result in profits or losses to the Group. The Hong Kong Monetary Authority has granted approval under sections 18(2)(a) and 18(5) of the Capital Rules for the Group to use the internal models approach to calculate its market risk for foreign exchange risk and general interest rate risk. Standardised approach is used for the calculation of specific interest rate risk, equity risk and commodity risk.

	2014	2013
Market risk calculated by:		
– Internal models approach:		
– Value at Risk ("VAR")	**130**	49
– Stressed VAR	**275**	278
– Standardised approach:		
– specific interest rate exposures	**55**	17
– equity exposures	**–**	–
– commodity exposures	**–**	–
Total capital charge for market risk	**460**	344

Capital charge means an amount of regulatory capital which the Group is required to hold for an exposure to a relevant risk which, if multiplied by 12.5, becomes the risk-weighted amount of that exposure for that risk.

(b) Methodology for valuation of market risk position under internal model approach

VAR is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. A Historical Simulation approach is used to model foreign currency and interest rate risk. Standard 1-day VAR is generated by revaluing the portfolio for each of 500 historical scenarios from one-day market movements, and is derived from a clean two-year time series of historic market risk factor data. Apart from the standard 1-day VAR, 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 continuous one-year historical period of significant stress for the trading portfolio, assuming a 10-day holding period.

(c) Characteristics and coverage of VAR model

The VAR models cover all material sources of price risk relating to foreign exchange risk and general interest rate risk. Foreign exchange risk factors include, but are not limited to, foreign currency prices and foreign currency option volatilities. General interest rate risk factors include, but are not limited to, interest rate curves and interest rate option volatilities.

Historical simulation approach is used for all outright interest rate and foreign exchange in VAR calculation. Standard VAR uses a 99% confidence interval and a one day time horizon based on 500 historical scenarios. The result is then scaled up to a ten day holding period. Stressed VAR uses a 10-day holding period and a 99% confidence interval based on a continuous one-year historical significant stress period.

Historical, hypothetical and technical scenario stress testing is performed on positions on a bi-weekly basis. Back-testing of the interest rate and foreign exchange uses clean and hypothetical profits and losses from trading operations and compares these to overall and individual business level VAR on a daily basis.

Add-ons are used to capture the risks that are not adequately captured in the VaR models. The add-ons include, but are not limited to, interest rate basis risks on LIBOR tenor and bond futures. These add-ons are calibrated at least as conservatively as comparable risk factors under the internal models approach.

8. Operational risk

The Hong Kong Monetary Authority has granted approval under section 25(2) of the Capital Rules for the Group to use the standardised approach to calculate its operational risk.

	2014	2013
Capital charge for operational risk	**3,643**	3,288

9. Equity exposures in banking book

Investments in equity shares which are intended to be held on a continuing basis, but which do not comprise investments in associates, jointly controlled entities or subsidiaries, are classified as available-for-sale securities and are reported in the balance sheet as "Financial investments". Available-for-sale securities are measured at fair value as described in notes 3(g)(i) and 3(h) to the financial statements. Included within this category are investments made by the Group for strategic purposes, which are subject to additional internal procedures and approvals to ensure that the investment is in accordance with the Group's strategy and to ensure compliance with all relevant regulatory and legal restrictions. In some cases, additional investments may be made later such that the investee becomes an associate, jointly controlled entity or subsidiary, at which point the investment is reclassified in accordance with the Group's accounting policies.

	2014	2013
Cumulative realised gains/(losses)		
– on disposal	**33**	–
– due to impairment	**(2,188)**	–
Unrealised gains/(losses):		
– recognised in reserve but not through the income statement	**16,733**	(1,521)

10. Disclosure for selected exposure

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.

11. Analysis of gross loans and advances to customers by categories based on internal classification used by the Group

Gross advances, overdue advances, impaired advances, individually assessed and collectively assessed loan impairment allowances, the amount of new impairment allowances charged to income statement, and the amount of impaired loans and advances written off during the year in respect of industry sectors which constitute not less than 10 per cent of gross loans and advances to customers are analysed as follows:

	Group						
	Gross advances	Overdue advances	Impaired advances	Individually assessed loan impairment allowances	Collectively assessed loan impairment allowances	New impairment allowances	Advances written off during the year
2014							
Residential mortgages	**165,481**	**60**	**193**	**(11)**	**–**	**11**	**7**
Commercial, industrial and international trade	**158,231**	**883**	**1,583**	**(963)**	**(599)**	**848**	**263**
Commercial real estate	**87,882**	**27**	**44**	**–**	**(3)**	**–**	**–**
Other property-related lending	**126,112**	**–**	**19**	**–**	**(16)**	**5**	**1**
2013							
Residential mortgages	159,094	54	119	(7)	–	9	–
Commercial, industrial and international trade	155,392	620	931	(691)	(533)	341	69
Commercial real estate	79,670	26	1	–	(3)	–	–
Other property-related lending	93,664	–	47	(1)	(13)	3	1

12. 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 Hong Kong Monetary Authority under the draft Banking (Disclosure) (Amendment) Rules 2014 with reference to the Hong Kong Monetary Authority return of non-bank Mainland exposures, which includes the Mainland exposures extended by the Bank and its Mainland branch and Mainland subsidiary bank only.

No restatement for 2013 comparative figures is necessary as the analysis of non-bank Mainland exposures is based on the categories of non-bank counterparties under the prevailing Banking (Disclosure) Rules, which includes the Mainland exposures extended by the Bank and its overseas branches and oversea subsidiaries.

	On-balance sheet exposure	**Off-balance sheet exposure**	**Total exposures**
2014			
1. Central government, central government-owned entities and their subsidiaries and joint ventures (JVs)	**67,005**	**9,690**	**76,695**
2. Local governments, local government-owned entities and their subsidiaries and JVs	**32,216**	**5,968**	**38,184**
3. PRC nationals residing in Mainland China or other entities incorporated in Mainland China and their subsidiaries and JVs	**47,578**	**18,380**	**65,958**
4. Other entities of central government not reported in item 1 above	**2,071**	**810**	**2,881**
5. Other entities of local governments not reported in item 2 above	**4,960**	**949**	**5,909**
6. PRC nationals residing outside Mainland China or entities incorporated outside Mainland China where the credit is granted for use in Mainland China	**51,119**	**3,110**	**54,229**
7. Other counterparties where the exposures are considered by exposures the reporting institution to be non-bank Mainland China exposures	**451**	**10**	**461**
	205,400	**38,917**	**244,317**
Total assets after provision	**1,183,020**		
On-balance sheet exposures as percentage of total assets	**17.36%**		

	On-balance sheet exposure	Off-balance sheet exposure	Total exposures	Individually assessed allowances
2013				
Mainland entities	53,711	8,672	62,383	–
Companies and individuals outside Mainland where the credit is granted for use in Mainland	29,968	4,442	34,410	39
Other counterparties where the exposure is considered by the Bank to be non-bank Mainland exposure	153	–	153	–
	83,832	13,114	96,946	39
Exposures incurred by the Bank's mainland subsidiary	73,396	10,747	84,143	175
	157,228	23,861	181,089	214

13. Cross-border claims

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

	Banks & other financial institutions	Public sector entities	Sovereign & other	Total
2014				
Asia-Pacific excluding Hong Kong:				
– China	**87,611**	**–**	**67,491**	**155,102**
– Japan	**14,765**	**–**	**20,638**	**35,403**
– Other	**42,814**	**2,713**	**24,443**	**69,970**
	145,190	**2,713**	**112,572**	**260,475**
The Americas:				
– United States	**3,801**	**–**	**9,594**	**13,395**
– Other	**4,586**	**1,621**	**15,835**	**22,042**
	8,387	**1,621**	**25,429**	**35,437**
Europe:				
– United Kingdom	**9,824**	**–**	**5,861**	**15,685**
– Other	**11,063**	**8,736**	**14,166**	**33,965**
	20,887	**8,736**	**20,027**	**49,650**
2013				
Asia-Pacific excluding Hong Kong:				
– China	84,678	–	58,957	143,635
– Japan	12,876	–	25,847	38,723
– Other	42,749	2,838	19,808	65,395
	140,303	2,838	104,612	247,753
The Americas:				
– United States	4,036	–	7,468	11,504
– Other	3,563	1,514	17,047	22,124
	7,599	1,514	24,515	33,628
Europe:				
– United Kingdom	7,150	–	2,834	9,984
– Other	12,731	7,394	9,269	29,394
	19,881	7,394	12,103	39,378

Analysis of Shareholders

As at 31 December 2014	Shareholders Number	Shareholders Percentage of total	Number of Shares Number in millions	Number of Shares Percentage of total
Number of shares held				
1 – 500	6,696	33.74	1.6	0.08
501 – 2,000	6,245	31.47	7.7	0.40
2,001 – 5,000	3,250	16.38	11.2	0.59
5,001 – 20,000	2,754	13.88	28.2	1.48
20,001 – 50,000	595	3.00	18.5	0.97
50,001 – 100,000	163	0.82	11.5	0.60
100,001 – 200,000	79	0.40	11.3	0.59
Over 200,000	62	0.31	1,821.8	95.29
	19,844	100.00	1,911.8	100.00
Geographical Distribution				
Hong Kong	19,532	98.43	1,908.8	99.84
Malaysia	66	0.33	0.4	0.02
Canada	50	0.25	0.1	0.01
United States of America	35	0.18	0.2	0.01
Singapore	43	0.22	2.0	0.10
United Kingdom	32	0.16	0.0	0.00
Australia	31	0.16	0.1	0.00
Macau	30	0.15	0.1	0.01
Others	25	0.12	0.1	0.01
	19,844	100.00	1,911.8	100.00

Subsidiaries*

Fulcher Enterprises Company Limited

Hang Seng Asset Management Pte Ltd *(in members' voluntary liquidation)*

Hang Seng Bank (China) Limited

Hang Seng Bank (Trustee) Limited

Hang Seng Bullion Company Limited

Hang Seng Credit Limited

Hang Seng Data Services Limited

Hang Seng Finance Limited

Hang Seng Financial Information Limited

Hang Seng Futures Limited

Hang Seng Indexes Company Limited

Hang Seng Insurance Company Limited

Hang Seng Investment Management Limited

Hang Seng Investment Services Limited

Hang Seng Life Limited

Hang Seng (Nominee) Limited

Hang Seng Real Estate Management Limited

Hang Seng Security Management Limited

Hang Seng Securities Limited

Haseba Investment Company Limited

High Time Investments Limited

HSI International Limited

Imenson Limited

Yan Nin Development Company Limited

* As defined in Section 15 of the New Hong Kong Companies Ordinance (Cap 622).

Corporate Information and Calendar

Corporate Information

Board of Directors

Chairman

Raymond K F Ch'ien GBS, CBE, JP

Vice-Chairman

Rose W M Lee JP

Directors

John C C Chan GBS, JP
Nixon L S Chan
Henry K S Cheng GBS
L Y Chiang JP
Andrew H C Fung JP
Fred Zuliu Hu
Irene Y L Lee
Sarah C Legg
Eric K C Li GBS, OBE, JP
Vincent H S Lo GBS, JP
Kenneth S Y Ng
Richard Y S Tang BBS, JP
Peter T S Wong JP
Michael W K Wu

Secretary

C C Li

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*

BNY Mellon Shareowner Services
PO Box 30170
College Station, TX 77842-3170, USA
Telephone: 1-201-680-6825
Toll free (domestic): 1-888-BNY-ADRS
Website: www.mybnymdr.com
Email: shrrelations@cpushareownerservices.com

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

Annual Report 2014

This Annual Report 2014 in both English and Chinese is now available in printed form and on the Bank's website (www.hangseng.com) and the website of Hong Kong Exchanges and Clearing Limited ("HKEx") (www.hkexnews.hk).

Shareholders who:

A) browse this Annual Report 2014 on the Bank's website and wish to receive a printed copy; or

B) receive this Annual Report 2014 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 are deemed to have chosen) to read this Annual Report 2014 on the Bank's website have difficulty in reading or gaining access to this Annual Report 2014 via the Bank's website for any reason, the Bank will promptly send this Annual Report 2014 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.

Calendar

2014 Full Year Results	
Announcement date	23 February 2015
2014 Fourth Interim Dividend*	
Announcement date	23 February 2015
Book close and record date	11 March 2015
Payment date	26 March 2015

2014 Annual Report
to be posted to shareholders in late March 2015

Annual General Meeting
to be held on 7 May 2015

Tentative date for 2015 Half Year Results	
Announcement date	3 August 2015

2015 Interim Report
tentative to be posted to shareholders in late August 2015

Tentative dates for 2015:

2015 First Interim Dividend	
Announcement date	5 May 2015
Book close and record date	21 May 2015
Payment date	9 June 2015
2015 Second Interim Dividend	
Announcement date	3 August 2015
Book close and record date	19 August 2015
Payment date	8 September 2015
2015 Third Interim Dividend	
Announcement date	5 October 2015
Book close and record date	22 October 2015
Payment date	10 November 2015
2015 Full Year Results	
Announcement date	22 February 2016
2015 Fourth Interim Dividend	
Announcement date	22 February 2016
Book close and record date	9 March 2016
Payment date	29 March 2016

* The Register of Shareholders of the Bank will be closed on Wednesday, 11 March 2015, during which no transfer of shares can be registered. To qualify for the fourth 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, 10 March 2015. The fourth interim dividend will be payable on Thursday, 26 March 2015 to shareholders on the Register of Shareholders of the Bank on Wednesday, 11 March 2015. Shares of the Bank will be traded ex-dividend as from Monday, 9 March 2015.

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