恒生銀行
HANG SENG BANK

# Interim Report 2016

# 2016中期報告

The printed version of Hang Seng Bank's Interim Report 2016 will replace this version in late August 2016.

恒生銀行2016中期報告之印刷本將於2016年8月下旬取代此版本。

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

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

# RESULTS IN BRIEF

| For the half-year ended | **30 June 2016** | 30 June 2015 |
|---|---|---|
| | **HK$m** | HK$m |
| Operating profit excluding loan impairment charges | **10,237** | 11,414 |
| Operating profit | **9,516** | 10,820 |
| Profit before tax[1] | **9,499** | 21,720 |
| Profit attributable to shareholders[1] | **8,005** | 20,048 |
| | **%** | % |
| Return on average ordinary shareholders' equity[1] | **12.4** | 31.0 |
| Cost efficiency ratio | **32.7** | 31.0 |
| Average liquidity coverage ratio (quarter ended 30 Jun) | **257.1** | 221.6 |
| Average liquidity coverage ratio (quarter ended 31 Mar) | **257.1** | 167.4 |
| | **HK$** | HK$ |
| Earnings per share[1] | **4.19** | 10.49 |
| Dividends per share | **2.20** | 2.20 |

| At period-end | **At 30 June 2016** | At 31 December 2015 |
|---|---|---|
| | **HK$m** | HK$m |
| Shareholders' funds | **136,713** | 141,981 |
| Total assets | **1,321,367** | 1,334,429 |
| | **%** | % |
| Capital ratios under Basel III | | |
| - Common Equity Tier 1 ("CET1") Capital Ratio | **16.8** | 17.7 |
| - Tier 1 Capital Ratio | **18.1** | 19.1 |
| - Total Capital Ratio | **21.2** | 22.1 |

[1] ***Partial disposal of shareholding in Industrial Bank Co., Ltd. ("Industrial Bank") in the first half of 2015***

*Reported results for the first half of 2015 include a gain on partial disposal of the ordinary shares of Industrial Bank of HK$10,636m. Figures quoted as "excluding the gain on partial disposal of Industrial Bank" have been adjusted for the above item. Excluding the gain on partial disposal of Industrial Bank, key financial results and performance metrics are set out below for comparison purpose:*

| | ***Half-year ended 30 June 2016*** | *Half-year ended 30 June 2015* |
|---|---|---|
| *Profit before tax (HK$m)* | ***9,499*** | *11,084* |
| *Profit attributable to shareholders (HK$m)* | ***8,005*** | *9,412* |
| *Earnings per share (HK$)* | ***4.19*** | *4.92* |
| *Return on average ordinary shareholders' equity (%)* | ***12.4*** | *14.5* |

# CHAIRMAN'S STATEMENT

The international economy was characterised by weak growth in the first half of 2016. In the US, growth was only 1% and concerns over the strength of the labour market led the Federal Reserve to scale back its planned cycle of interest rate hikes. In Europe, the uncertainty and financial market volatility created by the UK referendum on EU membership cast a cloud over the economic outlook for the region.

Against this backdrop, Hang Seng leveraged its competitive strengths to maintain momentum for long-term growth.

Due mainly to the active investment market's impact on the Bank's bottom line in the first half of 2015, profit attributable to shareholders and earnings per share were down 15% year on year at HK$8,005m and HK$4.19 per share respectively after excluding the 2015 HK$10,636m gain on the partial disposal of our holding in Industrial Bank. Compared with the second half of 2015, profit attributable to shareholders grew by 8% and earnings per share were up 12%.

The Directors have declared a second interim dividend of HK$1.10 per share, bringing the total distribution for the first half of 2016 to HK$2.20 per share, the same as in the first half of 2015.

## Economic Environment

The slowdown in Mainland growth and rising signs of softness in the global recovery are posing downside risks for the economic performance of Hong Kong. GDP growth in the first quarter of 2016 hit a four-year low of 0.8%. In particular, consumer concerns over the uncertain economic outlook saw private consumption expenditure, which has been a primary driver of growth in recent years, ease to 1.1% – its slowest rate since the third quarter of 2009. Given the current economic challenges, our forecast for Hong Kong's 2016 full-year GDP growth is 1.3%.

On the Mainland, the process of economic deleveraging is continuing to moderate the pace of expansion. GDP growth was 6.7% in the second quarter, the same as in the first quarter. The shift from an economy driven largely by investment and exports to one that is more reliant on consumption and services will remain a drag on growth in the months ahead, although scope exists for the authorities to implement macroeconomic policies that will minimise the risk of a sharper slowdown. We expect 2016 full-year GDP growth on the Mainland to be 6.7%.

Volatility in the international markets and the ongoing effects of the Mainland's economic transition will remain as challenges to economic growth in Asia in the short-to-medium term. However, the further opening up of the financial sector on the Mainland as well as its push to extend and strengthen regional and international economic ties, particularly as part of the 'One Belt, One Road' initiative, will generate new opportunities for business growth.

In an increasingly uncertain global economic environment, our strong market position and solid capital base will support our ability to drive forward with our long-term growth strategy and meet the diverse needs of our client base. We will leverage our competitive strengths and deploy our resources to enhance efficiency, deepen relationships with customers and acquire new business to achieve increasing value for shareholders.

**Raymond Ch'ien**
*Chairman*
Hong Kong, 3 August 2016

# CHIEF EXECUTIVE'S REPORT

In challenging operating conditions, Hang Seng Bank returned solid results in the first half of 2016.

Profitability and income were down against the high baseline created by the buoyant investment sector and exceptional market conditions in the first half of 2015, but we recorded satisfactory growth in net operating income, operating profit and profit attributable to shareholders compared with the second half of 2015.

We maintained a healthy liquidity position and strong capital base to enable us to proactively manage evolving regulatory requirements and support future growth.

With increasing pressure on lending spreads, net interest margin was maintained through effective management of our asset liability structure and improved returns from the balance sheet management portfolio.

Enhancements to the distribution network further expanded our target customer base and deepened customer engagement. We maintained our competitive cost structure with upgrades to technology and our digital platform.

We stepped up cross-border connectivity initiatives to capitalise on business opportunities arising from policy developments in mainland China. In February this year, our Hang Seng China H-Share Index Fund was among the first batch of northbound funds offered to Mainland investors under the Mainland-Hong Kong Mutual Recognition of Funds initiative. In June, we received approval to establish the Mainland's first onshore foreign-majority-owned joint venture fund management company in Qianhai.

## Financial Performance

Operating profit before loan impairment charges fell by 10% year on year to HK$10,237m and operating profit was down 12% to HK$9,516m. Compared with the second half of 2015, however, operating profit before loan impairment charges and operating profit were up 12% and 10% respectively.

Excluding the impact of HK$10,636m gain on the partial disposal of our holding in Industrial Bank in the first half of 2015, profit attributable to shareholders fell by 15% to HK$8,005m, earnings per share were down 15% at HK$4.19 and profit before tax declined by 14% to HK$9,499m. Compared with the second half of 2015, profit attributable to shareholders grew by 8%, earnings per share increased by 12% and profit before tax was up 8%. On a reportable basis, year-on-year profit attributable to shareholders and earnings per share were both down 60% and profit before tax fell by 56%, reflecting the impact of the Industrial Bank disposal gain.

A 6% rise in average interest-earning assets supported 5% growth in net interest income to HK$11,003m. Net interest margin was 1.85%, compared with 1.86% and 1.80% for the first and second halves of 2015.

Non-interest income fell by 31% to HK$4,214m, mainly reflecting the significant decline in investment market activity versus the buoyant investment environment in the first half of 2015. Compared with the second half of 2015, non-interest income was up 12%, due primarily to an improvement in returns from the life insurance funds investment portfolio.

Operating expenses were HK$4,980m, down 3% year on year and 7% compared with the second half of 2015. Our cost efficiency ratio was 32.7%.

At 30 June 2016, our total capital ratio was 21.2%, compared with 22.1% at 31 December 2015. Our common equity tier 1 capital ratio was 16.8% and our tier 1 capital ratio was 18.1%, compared with 17.7% and 19.1% respectively at the end of last year.

## The 'Ever-growing Bank'

Operating conditions will remain challenging with the uncertain global environment and economic adjustment on the Mainland.

To sustain Hang Seng's 'Ever-growing Bank' objective, we will continue to sharpen our competitive edge by leveraging our leading domestic bank's attributes to grow stable and quality earnings.

Based on our strong capital and healthy liquidity, we are well positioned to pursue our sustainable growth strategies. Our integrated wholesale and retail banking propositions will continue to anchor quality deposits, maintain funding competitiveness and maximise income from cross-selling opportunities.

Hang Seng's loyal customer base of 3.5 million is our most valuable asset. Our focus in strengthening analytics and refining client segmentation has been rewarded by an increase in target Prestige Banking customers, driving revenue growth. At the same time, we are able to offer our retail customers greater convenience and enhanced service as we deepen our knowledge about their needs and behaviour.

The upgrade of our branch network, digital and mobile platforms have strengthened customer engagement and enhanced our operational cost effectiveness.

We offer time-to-market wealth propositions in response to volatile market developments and increasing customer preference for principal-protected, well-diversified investment options with stable yields.

The industrial, commerce, retail and service sectors are the pillars of the Hong Kong economy. Our Commercial Banking teams have been enhancing their sector expertise to support our corporate clients by offering timely market information, and tailored funding, investment, liquidity and risk management propositions.

As the leading domestic bank, Hang Seng has greatly benefitted from policy developments under CEPA. In addition to Hang Seng Bank (China) Ltd's branch network, Hang Seng has developed a 'mixed business' model in the Pearl River Delta, with the establishment of our securities investment advisory joint venture, GZHS Research Co. Ltd.; our recently approved majority foreign owned asset management joint venture in Qianhai; and the launch of the northbound Hang Seng China H-Share Index Fund. Leveraging our exclusive partnership, we are working closely with Bupa to expand our integrated health services proposition. We will ride on our successful experience to further develop cross-border investment and insurance initiatives.

I would like to thank my colleagues for their dedication in driving our customer-focused strategy. We are committed to embedding a value-based corporate culture that recognises, nurtures and rewards talent.

Currently ranked by IMD as the most competitive economy in the world, Hong Kong is an important international centre for finance and trade, and a primary gateway for cross-border commercial activities between the Mainland and the international community. As the leading local bank in our home market, we will leverage our competitive strengths and unique market position to sustain growth and deliver service excellence for customers and value for shareholders.

**Rose Lee**
*Vice-Chairman and Chief Executive*
Hong Kong, 3 August 2016

# FINANCIAL REVIEW

## FINANCIAL PERFORMANCE

### Income Analysis

**Summary of financial performance**

| *Figures in HK$m* | ***Half-year ended 30 June 2016*** | *Half-year ended 30 June 2015* | *Half-year ended 31 December 2015* |
|---|---|---|---|
| Total operating income | **21,851** | 24,675 | 19,346 |
| Operating expenses | **4,980** | 5,136 | 5,346 |
| Operating profit | **9,516** | 10,820 | 8,619 |
| Profit before tax | **9,499** | 21,720 | 8,768 |
| Profit attributable to shareholders | **8,005** | 20,048 | 7,446 |
| Earnings per share (in HK$) | **4.19** | 10.49 | 3.73 |

**First half of 2016 compared with first half of 2015**

In the challenging global market conditions, Hang Seng Bank Limited ('the Bank') and its subsidiaries ('the Group') returned solid results in the first half of 2016 and maintained broad-based business momentum, reflecting the success of our customer-focused strategy for sustainable growth. **Operating profit excluding loan impairment charges and other credit risk provisions** was HK$10,237m, down 10% on the first half of 2015, due mainly to the reduction in wealth management income against the high baseline created by the favourable investment market sentiment in the first half of 2015. The decline in wealth management income was partially offset by higher net interest income resulting from initiatives to leverage our strong balance sheet and success with efforts to contain operating expenses at a lower level than in the same period in 2015.

**Net interest income** rose by HK$562m, or 5%, to HK$11,003m, driven mainly by the 6% increase in average interest-earning assets and the increased interest income from the life insurance funds investment portfolio.

| *Figures in HK$m* | ***Half-year ended 30 June 2016*** | *Half-year ended 30 June 2015* | *Half-year ended 31 December 2015* |
|---|---|---|---|
| Net interest income/(expense) arising from: | | | |
| - financial assets and liabilities that are not at fair value through profit and loss | **11,488** | 11,270 | 11,372 |
| - trading assets and liabilities | **(467)** | (819) | (631) |
| - financial instruments designated at fair value | **(18)** | (10) | (17) |
| | **11,003** | 10,441 | 10,724 |
| Average interest-earning assets | **1,199,059** | 1,132,121 | 1,180,549 |
| Net interest spread | **1.74 %** | 1.72 % | 1.69 % |
| Net interest margin | **1.85 %** | 1.86 % | 1.80 % |

**Average interest-earning assets** increased by HK$67bn, or 6%, compared with the same period last year. Average customer lending increased by 1%, mainly affected by subdued loan demand together with the decrease in cross-border funding activities and early repayments of foreign currency loans. Average financial investments increased by 34% partly offset by the 32% fall in interbank placement.

**Net interest margin** narrowed by one basis point to 1.85% whilst the net interest spread increased by two basis points to 1.74%. Average loan spread on customer lending reduced, notably on corporate and commercial term lending. Higher balance sheet management income was recorded as a result of Treasury's active management of the interest rate risk and efforts to enhance returns on commercial surplus. Customer deposits spread also widen as a result of the change in deposit mix, with low cost savings balance increased.

The contribution from net free funds fell by three basis points to 0.11%, reflecting the decrease in the average market interest rates.

Compared with the second half of 2015, net interest income grew by HK$279m, or 3%, mainly supported by 2% increase in average interest-earning assets, notwithstanding more calendar days in the second half. The net interest margin increased by five basis points.

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 the Group, as included in the HSBC Group financial statements:

| *Figures in HK$m* | ***Half-year ended 30 June 2016*** | *Half-year ended 30 June 2015* | *Half-year ended 31 December 2015* |
|---|---|---|---|
| Net interest income and expense reported as 'Net interest income' | | | |
| - Interest income | **13,161** | 13,482 | 13,261 |
| - Interest expense | **(1,693 )** | (2,227 ) | (1,908 ) |
| - Net interest income | **11,468** | 11,255 | 11,353 |
| Net interest income and expense reported as 'Net trading income' | **(467 )** | (819 ) | (631 ) |
| Net interest income and expense reported as 'Net income from financial instruments designated at fair value' | **2** | 5 | 2 |
| Average interest-earning assets | **1,153,941** | 1,092,097 | 1,139,761 |
| Net interest spread | **1.91 %** | 1.96 % | 1.87 % |
| Net interest margin | **2.00 %** | 2.08 % | 1.98 % |

**Net fee income** decreased by HK$1,031m, or 27%, to HK$2,853m, driven by lower wealth management business income as investment sentiment weakened in the unfavourable market conditions. Income from securities broking dropped by 53%, reflecting the decline in stock market trading turnover. Income from retail investment fund sales declined by 29%. However, income from credit card, insurance, account services and remittances grew by 3%, 5%, 6% and 13% respectively.

**Net trading income** decreased by HK$922m, or 67%, to HK$455m. Foreign exchange income was down by HK$698m, or 56%, as increased revenue from higher customer activity was more than offset by reduced demand for foreign exchange-linked structured treasury products – particularly renminbi-linked structured products – and lower income from funding swaps. Income from securities, derivatives and other trading activities recorded a loss of HK$113m, compared with a gain of HK$141m for the same period last year, mainly reflecting the unfavourable movement in equity options trading under the life insurance business investment portfolio and the movement in market interest rates.

**Net income/(loss) from financial instruments designated at fair value** recorded net loss of HK$30m, compared with a net gain of HK$721m for the first half 2015, reflecting the fair value changes of assets held by the life insurance business due mainly to a favourable equity market movements in the first half of 2015. To the extent that this fair value (loss)/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')'. Compared with second half of 2015, the net loss reduced by HK$809m, or 96%, reflecting a more stable fair value movement since last year-end.

**Analysis of income from wealth management business**

| *Figures in HK$m* | ***Half-year ended 30 June 2016*** | *Half-year ended 30 June 2015* | *Half-year ended 31 December 2015* |
|---|---|---|---|
| Investment income: | | | |
| - retail investment funds | **741** | 1,051 | 712 |
| - structured investment products[ǂ] | **209** | 538 | 122 |
| - securities broking and related services | **529** | 1,143 | 686 |
| - margin trading and others | **52** | 50 | 50 |
| | **1,531** | 2,782 | 1,570 |
| Insurance income: | | | |
| - life insurance | **1,759** | 2,104 | 1,019 |
| - general insurance and others | **139** | 138 | 121 |
| | **1,898** | 2,242 | 1,140 |
| Total | **3,429** | 5,024 | 2,710 |

ǂ *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.*

In challenging operating conditions, wealth management business income fell by HK$1,595m, or 32%, to HK$3,429m. Investment income fell by 45%, mainly due to the decrease in income from retail investment funds, structured investment products and securities broking and related services as investment sentiment weakened. Insurance business income decreased by 15%, reflecting a more favourable market conditions in the first half of 2015.

Compared with the second half of 2015, wealth management business income grew by 27%, driven by the increase of 66% in insurance income which benefitted from a less volatile market conditions while investment income remained intact.

**Analysis of insurance business income**

| *Figures in HK$m* | ***Half-year ended 30 June 2016*** | *Half-year ended 30 June 2015* | *Half-year ended 31 December 2015* |
|---|---|---|---|
| Life insurance: | | | |
| - net interest income and fee income | **1,759** | 1,553 | 1,677 |
| - investment return on life insurance funds (including share of associate's profit and surplus on property revaluation backing insurance contracts) | **(394)** | 918 | (1,070) |
| - net insurance premium income | **5,608** | 6,247 | 3,598 |
| - net insurance claims and benefits paid and movement in liabilities to policyholders | **(6,634)** | (8,125) | (4,843) |
| - movement in present value of in-force long-term insurance business | **1,420** | 1,511 | 1,657 |
| | **1,759** | 2,104 | 1,019 |
| General insurance and others | **139** | 138 | 121 |
| Total | **1,898** | 2,242 | 1,140 |

Income from insurance business was HK$1,898m, down 15% on the first half of 2015, but up 66% on the second half. Net interest income and fee income from life insurance business grew by 13% compared with the first half of 2015, driven by the increase in average debt securities portfolios. The investment return on life insurance business recorded a loss of HK$394m compared with a gain of HK$918m for the first half of 2015, reflecting the unfavourable market conditions. To the extent that these investment returns were attributable to policyholders, there was an offsetting movement in net insurance claims and benefits paid and movement in liabilities to policyholders or present value of in-force long-term insurance business ('PVIF').

Net insurance premium income decreased by 10% due mainly to the combined effect of the decrease in new and renewal premiums and increased reinsurance premiums on new treaty arrangements for the in-force portfolio. Total policies in-force rose by 2% year-on-year. The decline in insurance premiums resulted in a corresponding decrease in net insurance claims and benefits paid and movement in liabilities to policyholders.

The movement in PVIF decreased by 6%, due mainly to the unfavourable change in market conditions update during the first half of 2016. The decrease was partly offset by an increase in the value of new business written. General insurance income was broadly in line with that for same period last year.

**Loan impairment charges and other credit risk provisions** increased by HK$127m, or 21%, to HK$721m, reflecting the more challenging credit environment in mainland China. Gross impaired loans and advances increased by HK$977m, or 36%, to HK$3,714m against last year-end, due mainly to certain corporate exposures in mainland China. Gross impaired loans and advances as a percentage of gross loans and advances to customers stood at 0.55% at the end of June 2016, compared with 0.43% at the end of June 2015 and 0.40% at the end of December 2015. Overall credit quality remained sound and we remain alert and monitor portfolio indicators for early signs of weakness.

| *Figures in HK$m* | ***Half-year ended 30 June 2016*** | *Half-year ended 30 June 2015* | *Half-year ended 31 December 2015* |
|---|---|---|---|
| Net charge for impairment of loans and advances to customers: | | | |
| Individually assessed impairment allowances: | | | |
| - new allowances | **379** | 334 | 260 |
| - releases | **(35)** | (34) | (16) |
| - recoveries | **(5)** | (6) | (10) |
| | **339** | 294 | 234 |
| Net charge for collectively assessed impairment allowances | **382** | 300 | 280 |
| Loan impairment charges and other credit risk provisions | **721** | 594 | 514 |

Individually assessed impairment charges increased by HK$45m, or 15%, to HK$339m, mainly due to the downgrade of certain numbers of individually assessed impairments in Commercial Banking in Hong Kong and mainland China due to a more challenging credit environment in mainland China.

Collectively assessed impairment charges increased by HK$82m, or 27%, to HK$382m, mainly reflecting the increase in the collective impairment charges on the credit card portfolio. Impairment allowances for loans not individually identified as impaired remained relatively stable. The Group maintains a cautious outlook on the credit environment and will proactively enhance asset quality by continuing our conservative approach in growing our loan portfolio.

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

| | ***At 30 June 2016*** | *At 30 June 2015* | *At 31 December 2015* |
|---|---|---|---|
| | **%** | % | % |
| Loan impairment allowances: | | | |
| - individually assessed | **0.13** | 0.18 | 0.12 |
| - collectively assessed | **0.12** | 0.12 | 0.12 |
| Total loan impairment allowances | **0.25** | 0.30 | 0.24 |

**Operating expenses** decreased by HK$156m, or 3%, to HK$4,980m, reflecting careful cost control. Staff costs were down by 4%, reflecting lower performance-related pay expenses, which were partly offset by the annual salary increment. The Group will continue to grow its digital capabilities and realise efficiency gains through increased automation and enhancement of our operational infrastructure. We will also step up training to build a more flexible and productive workforce to drive efficient growth.

Depreciation charges were up 19%, reflecting higher depreciation charges on business premises following the upward commercial property revaluation last year and branch renovation costs, which partly offset by the 7% decrease in general and administrative expenses.

The Group continued to focus on enhancing operational efficiency while maintaining growth momentum. The cost efficiency ratio rose by 1.7 percentage points to 32.7% when compared with the first half of 2015. The combined effect of the 5% increase in net operating income before loan impairment charges and the 7% reduction in operating expenses contributed to a 4.2-percentage-points improvement in the cost efficiency ratio compared to the 36.9% recorded in the second half of 2015.

| ***Full-time equivalent staff numbers by region*** | ***At 30 June 2016*** | *At 30 June 2015* | *At 31 December 2015* |
|---|---|---|---|
| Hong Kong and others | **7,919** | 7,993 | 8,306 |
| Mainland China | **1,719** | 1,837 | 1,835 |
| Total | **9,638** | 9,830 | 10,141 |

**Operating profit** decreased by HK$1,304m, or 12%, to HK$9,516m when compared with first half of 2015.

**Profit before tax** decreased by HK$12,221m, or 56%, to HK$9,499m (down 14% after excluding the gain on partial disposal of Industrial Bank in the first half of 2015) after taking the following major items into account:

- the gain on partial disposal of Industrial Bank of HK$10,636m in the first half of 2015;
- a revaluation deficit of HK$77m in the first half of 2016 compared with a revaluation surplus of HK$178m in the first half of 2015 in **net surplus on property revaluation**; and
- a HK$26m decrease in **share of profits from associates**, mainly from a property investment company.

**Property revaluation**

| *Figures in HK$m* | ***Half-year ended 30 June 2016*** | *Half-year ended 30 June 2015* | *Half-year ended 31 December 2015* |
|---|---|---|---|
| Net (deficit) / surplus on property revaluation | **(77)** | 178 | 83 |

The Group's premises and investment properties were revalued at 30 June 2016 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$277m was credited to the premises revaluation reserve. The related deferred tax provision for Group premises was HK$47m. Excluding the fair value gain on properties backing insurance contracts, revaluation deficit of HK$77m on investment properties were recognised through the condensed consolidated income statement.

**First half of 2016 compared with second half of 2015**

Against the second half of 2015, the Group continued to made good progress and achieved sustainable growth in revenues to return solid results for first half of 2016. Operating profit excluding loan impairment charges and other credit risk provisions increased by HK$1,104m, or 12%, driven by the increase in both net interest income and non-interest income and the reduction in operating expenses.

Net interest income grew by HK$279m, or 3%, due mainly to a 2% increase in average interest earning assets and a stable net interest margin despite continuous downward pressure in the wake of continued challenging market conditions and more calendar days in the second-half.

Non-interest income increased by HK$435m, or 12%, contributed by the strong growth of 27% in wealth management income. Investment income was broadly in line with second half of 2015, with higher income from retail investment funds and structured investment products more than offset by lower brokerage income as a result of sluggish equity markets. Income from life insurance business achieved good growth, reflecting the decrease in net loss on the investment return from life insurance funds, benefiting from a less volatile fair value movement in global equity market.

Operating expenses dropped by 7%, largely attributable to decreased headcount through increased automation and enhancement of our operational infrastructure, reduced performance-related pay expenses and good cost containment in general and administrative expenses.

Operating profit was up 10%, despite higher loan impairment charges. Profit attributable to shareholders grew by 8%, to HK$8,005m in the first half of 2016, after taking into account the revaluation deficit on property revaluation in first half of 2016 compared with a revaluation gain for second half of 2015.

**Segmental Analysis**

The table below set out the profit before tax contributed by the business segments at the periods stated.

| *Figures in HK$m* | *Retail Banking and Wealth Management* | *Commercial Banking* | *Global Banking and Markets* | *Other* | *Total* |
|---|---|---|---|---|---|
| ***Half-year ended 30 June 2016*** | | | | | |
| Profit before tax | **4,460** | **2,492** | **2,474** | **73** | **9,499** |
| Share of profit before tax | **47.0 %** | **26.2 %** | **26.0 %** | **0.8 %** | **100.0 %** |
| *Half-year ended 30 June 2015* | | | | | |
| Profit before tax | 5,454 | 2,715 | 2,252 | 11,299 | 21,720 |
| Share of profit before tax | 25.1 % | 12.5 % | 10.4 % | 52.0 % | 100.0 % |
| Share of profit before tax (excluding the gain on partial disposal of Industrial Bank) | 49.2 % | 24.5 % | 20.3 % | 6.0 % | 100.0 % |
| *Half-year ended 31 December 2015* | | | | | |
| Profit before tax | 3,796 | 2,497 | 2,254 | 221 | 8,768 |
| Share of profit before tax | 43.3 % | 28.5 % | 25.7 % | 2.5 % | 100.0 % |

**Retail Banking and Wealth Management ('RBWM')** recorded a 16% year-on-year decline in operating profit before loan impairment charges to HK$4,766m, an 18% drop in operating profit to HK$4,400m and an 18% decrease in profit before tax to HK$4,460m. This mainly reflects the higher level of market activity in the first half of 2015, as well as the adverse impact of the subsequent downturn in global investment sentiment on wealth management business. Compared with the second half of 2015, operating profit before loan impairment charges increased by 18%, operating profit rose by 18% and profit before tax was up 17%.

In the uncertain economic environment, we made good use of our extensive network and trusted brand to achieve solid balance sheet growth. Together with improved returns from fixed-income investments in our insurance investment portfolio, this balance sheet growth drove a 9% year-on-year increase in net interest income to HK$6,016m. Customer deposits grew by 3% and the lending portfolio remained the same compared with 2015 year-end, notwithstanding the seasonal impact of card receivables.

The poor investment market sentiment compared with the upbeat conditions in the first half of 2015 led to a 47% year-on-year decline in non-interest income to HK$1,836m. Wealth management business income fell by 32% to HK$2,901m. Compared with the second half of 2015, however, we recorded increases in non-interest income and wealth management income of 16% and 18% respectively.

Unsecured lending continued to be a stable revenue driver. With effective marketing campaigns and a good quality credit card customer base, card spending achieved year-on-year growth of 3% in Hong Kong. We retained our position as Hong Kong's second-largest and third-largest card issuer for VISA and MasterCard cards respectively. Supported by strong customer analytics and enhancements to our digital services platform, we grew the personal loan portfolio in Hong Kong by 2% compared with 2015 year-end.

In a slow property market during the first half of 2016, we sustained our top-three position for mortgage business in Hong Kong, with a market share of 16% in terms of new mortgage registrations. Mortgage balances remained the same in Hong Kong and grew by 2% on the Mainland compared with 2015 year-end.

The unfavourable global investment market conditions had an adverse impact on investment income in the first half of 2016, which dropped by 41%. In line with the slump in equities market transactions against the high base of the first half of 2015, our securities turnover and revenue declined by 65% and 57% respectively. Retail investment funds turnover and revenue dropped by 41% and 29% respectively. We capitalised on our time-to-market strength to accommodate the increase in customer demand for capital-protected products. We continued to capture cross-border business opportunities created by ongoing policy relaxation on the Mainland. The Hang Seng China H-Share Index Fund was among the first batch of northbound funds offered to retail investors on the Mainland under the Mainland-Hong Kong Mutual Recognition of Funds scheme.

Insurance income decreased by 21% compared with the first half of 2015, due mainly to lower returns from the insurance investment portfolio. Leveraging our broad range of insurance products we grew new annualised premium by 9% year-on-year. The distribution of the Hang Seng Bupa PreciousHealth Series continued to underpin our ability to provide tailored 'wealth-and-health' solutions to customers. We launched the PreciousWay Education Life Insurance Plan to assist customers with planning for the future education needs of their younger family members.

Strong customer analytics enabled us to improve customer segmentation and needs-based selling. We leveraged our high-value proposition and tailored products and services to drive a 32% increase in the number of premium clients within our Prestige Banking customer base in Hong Kong.

We continued to invest in new technology and expand our digital services to deepen and broaden customer engagement by providing a wider range of products and bringing better value through interactive lifestyle partnerships. Recent initiatives include adding online document submission for lending products to our personal mobile banking app and e-banking platform. We also introduced an online 'Investment Corner' service that includes timely commentaries on market developments to help customers better plan their investment strategies.

**Commercial Banking ('CMB')** reported a 4% year-on-year drop in operating profit before loan impairment charges to HK$2,864m and an 8% decline in both operating profit and profit before tax to HK$2,492m. Compared with the second half of 2015, operating profit before loan impairment charges grew by 4%, and operating profit and profit before tax were both broadly unchanged.

In the challenging economic conditions, net interest income grew by 1% compared with a year earlier and was up 2% against the second half of 2015, driven by higher current and savings deposit balances particularly for small and medium-sized enterprises (SMEs). Customer loans were down by 4% compared with last year-end as a result of softer loan demand in Hong Kong and on the Mainland.

Non-interest income declined by 15%, due mainly to a reduction in income from renminbi-related business and a fall in wealth management income due to market volatility. A reduction in hedging activities by customers as a result of renminbi exchange fluctuations led to an 86% drop in structured foreign exchange income. Income from securities trading also fell by 12% due to lower market turnover. These drops were partly offset by good growth in insurance, remittances and vanilla foreign exchange transactions. Insurance income recorded a 31% increase, reflecting efficient and collaborative sales distribution efforts. Effective marketing drove a 15% growth in remittance income. Income from vanilla foreign exchange transactions rose by 31%, reflecting focused efforts to deepen relationships with customers. Compared with the second half of 2015, non-interest income was up by 2%.

SME business continued to be an important driver of sustainable revenue growth. Acquiring quality new customers remained a key focus, with mainland customers representing 61% of newly acquired SME customers in the first half of 2016. Net interest income from SME business reported satisfactory growth of 7%, due mainly to a rise in average customer deposits. Remittances and account-related fees achieved good growth of 15%. We further enriched our SME service propositions with the launch of Business Insurance Solutions (BIS), a packaged general insurance product covering 10 different insurance classes, that provides SME customers with a flexible one-stop insurance solution. We continued to upgrade our digital services to offer greater convenience to customers. SME customers that apply for Business Loans or Commercial Cards can now submit applications and upload supporting documents through our Business e-Banking website.

We focused on enhancing our cash management capabilities to further differentiate our offerings from our peers and capture an increased share of our customers' banking business. We implemented a two-way cross-border renminbi sweeping solution to help customers better manage their liquidity needs. On the Mainland, we are one of the first foreign banks to provide retailers with support for collection consumer payments through Apple Pay and WeChat.

Approval to open free-trade accounts for commercial customers enabled us to offer a wider range of financial solutions to clients engaged in cross-border business.

Credit quality remained robust as we continued to proactively manage credit risk and asset quality. We also enhanced our portfolio management to optimise returns on risk-weighted assets.

Our continued efforts to provide dedicated services has been recognised by a number of awards, including 'Best in Treasury and Working Capital - SMEs, Hong Kong' in The Asset Triple A Treasury, Trade and Risk Management Awards 2016 and 'The Best Payment Bank in Hong Kong' in The Asian Banker Transaction Banking Awards 2016. We were also named 'Best Trade Finance Product Innovation Bank' at the fifth China Trade Finance Annual Conference.

**Global Banking and Markets** reported year-on-year growth of 8% in operating profit before loan impairment charges to HK$2,457m and a 10% rise in operating profit and profit before tax to HK$2,474m. Compared with the second half of 2015, operating profit before loan impairment charges grew by 12%, and operating profit and profit before tax were both up 10%.

**Global Banking ('GB')** recorded a 1% year-on-year decline in total operating income to HK$1,157m. Operating profit before loan impairment charges also dropped by 1% to HK$936m. A net release in loan impairment charges resulted in 2% growth of profit before tax to HK$953m.

Net interest income increased by 1% to HK$988m. Customer advances grew by 1% compared with 2015 year-end. Customer deposits were down by 9%.

Non-interest income fell by 12% to HK$169m, due mainly to the decline in fee income from credit-related activities.

**Global Markets ('GM')** reported a 15% year-on-year rise in both operating profit and profit before tax to HK$1,521m.

We achieved a 42% increase in net interest income to HK$1,032m, driven mainly by higher returns resulting from effective balance sheet management.

Non-interest income fell by 16% to HK$709m, due primarily to the 19% drop in trading income. Reduced customer demand for foreign-exchange structured products was partly offset by an increase in income from vanilla foreign exchange products.

Under the challenging and low interest rate environment, we focused on growing non-fund income. Leveraging the Bank's strong relationships with customers, we collaborated closely with RBWM and CMB to increase cross-selling of GM products.

In response to further liberalisation in renminbi-related business, we strived to provide timely market information and products to meet customer needs in the volatile foreign exchange market.

In response to PBOC's announcement of introducing qualified foreign players at the end of last year, the Bank has submitted the application for China Interbank FX Market membership to China Foreign Exchange Trade System (CFETS) in the first half of 2016. In early July, CFETS officially approved the Bank's application for the membership, which will enable us to conduct foreign exchange transactions through CFETS directly for renminbi purchases and sales business.

**Balance Sheet Analysis**

**Assets**

Total assets were HK$1,321bn at 30 June 2016, maintaining broadly the same level as last year-end.

Cash and sight balances at central banks increased by HK$9bn, or 87%, to HK$19bn, reflecting the increase in the commercial surplus placed with the Hong Kong Monetary Authority.

Trading assets rose by HK$12bn, or 29%, to HK$52bn, primarily as a result of the switching of interbank lending to treasury bills and government securities, mainly Exchange Fund Bills and Notes.

Customer loans and advances decreased by HK$11bn, or 2%, to HK$678bn, since the end of 2015 in the wake of subdued credit demand. Loan for use in Hong Kong increased by 2%, primarily in property development and investment, financial concerns, information technology and working capital financing for certain large corporate customers. Lending to individuals maintained broadly the same level as last year end. The Group continued to maintain its market share for the mortgage business and grew its residential mortgage lending compared with the end of 2015. Trade finance declined by 13% against last year-end due mainly to the contraction in cross-border lending activities and sluggish market conditions leading to drop in trade finance coupled with keen pricing competition amongst banks. Loans and advances for use outside Hong Kong fell by 8% compared with the end of 2015, attributable to the decline in cross-border funding activities and early repayment of loans granted by Hong Kong Office and our mainland banking subsidiary. Overall credit quality remained sound.

Financial investments increased by HK$3bn, or 1%, to HK$375bn, reflecting the increased deployment of commercial surplus in debt securities given the subdued credit demand. The increase was also contributed by the growth in life insurance business during the period.

**Customer deposits**

Customer deposits, including certificates of deposit and other debt securities in issue, decreased marginally by HK$7bn, or 1%, to HK$991bn compared with last year-end. There was an increase in savings and current deposit accounts more than offset by the decrease in time deposit. At 30 June 2016, the advances-to-deposits ratio was 68.5%, compared with 69.1% at 31 December 2015.

**Equity**

At 30 June 2016, shareholders' funds were HK$137bn, fell by HK$5bn, or 4%, against last year-end. Retained profits decreased by HK$5bn, or 5%, reflecting profit accumulation more than offset by the payment of 2016 first interim dividend and 2015 special and fourth interim dividends. The premises revaluation reserve remained relatively stable. The available-for-sale investment reserve decreased by HK$0.2bn, or 12%, against last year-end, mainly reflecting the fair value movement of the Group's investment in Industrial Bank.

## Risk and Capital Management

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

### Risk Management

All the Group's activities involve the analysis, evaluation, measurement, 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. There have been no material changes to our policies and practices regarding risk management and governance as described in the Group's Annual Report 2015.

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 framework/policies policies and risk appetite statement or major risk 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").

Robust risk governance and accountability are embedded throughout the Group through an established framework that ensures appropriate oversight of and accountability for the effective management of risk at all levels of the organization and across all risk types.

The Board has ultimate responsibility for approving the Group's risk appetite statement and the effective management of risk. The Risk Committee advises the Board on risk appetite and its alignment with strategy, risk governance and internal controls and high-level risk related matters.

The ongoing monitoring, assessment and management of the risk environment and the effectiveness of risk management policies resides with the Risk Management Committee.

Risk appetite statement is a key component of risk management framework. The Group’s Risk Appetite Statement for 2016 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 achieving our medium and long-term strategic goals.

The RMC regular reviews and monitors the Group’s risk appetite profile against the limits set out in the Risk Appetite Statement and determine appropriate management action if material deviation from approved limits. The risk appetite profile is also reported to the Risk Committee and Board from Chief Risk Officer 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.

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

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 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.

**Risk Management** *(continued)*

**(a) Credit Risk** *(continued)*

**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 risk rating framework on counterparty credit risk based on default probability and loss estimates is implemented across the Group. The rating methodology 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.

**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 condensed consolidated 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 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 following other pre-agreed termination events. It is common, and our 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.

**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 16 on the condensed consolidated financial statements and credit risk concentration of respective financial assets is disclosed in notes 20, 21, 23 and 24 on the condensed consolidated financial statements.

## Risk and Capital Management *(continued)*

**Risk Management** *(continued)*

**(a) Credit Risk** *(continued)*

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

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Cash and sight balances at central banks | **18,938** | 40,317 | 10,118 |
| Placings with and advances to banks | **97,307** | 152,767 | 123,990 |
| Trading assets | **52,063** | 44,772 | 40,352 |
| Financial assets designated at fair value | **419** | 70 | 1,136 |
| Derivative financial instruments | **9,084** | 6,004 | 11,595 |
| Reverse repurchase agreements-non-trading | **-** | 1,904 | - |
| Loans and advances to customers | **678,442** | 673,022 | 688,946 |
| Financial investments | **371,196** | 323,181 | 367,630 |
| Other assets | **18,677** | 19,976 | 18,876 |
| Financial guarantees and other credit related contingent liabilities | **17,352** | 14,892 | 16,500 |
| Loan commitments and other credit related commitments | **496,484** | 520,714 | 512,729 |
| | **1,759,962** | 1,797,619 | 1,791,872 |

(ii) Credit quality

A summary of the five classifications and risk rating scales describing the credit quality of the Group's lending and debt securities portfolios are provided on page 45 of the Annual Report 2015.

***Impaired loans and advances***

Special attention is paid to problem loans and appropriate action is initiated to protect the Group's position on a timely basis and to ensure that loan impairment methodologies result in losses being recognised when they are incurred.

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) on the consolidated financial statements for the year ended 31 December 2015.

Analysis of impairment allowances at 30 June 2016 and the movement of such allowances during the periods are disclosed in note 23 on the condensed consolidated financial statements.

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;
  - classified as EL 1 to EL 8 with 90 days and over past due;
  - have been restructured with 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***

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) on the consolidated financial statements for the year ended 31 December 2015.

## Risk and Capital Management *(continued)*

### Risk Management *(continued)*

**(a) Credit Risk** *(continued)*

**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.

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.

Historical loss methodology is applied to estimate the collective impairment allowances under wholesale portfolio which have been incurred but not individually identified. 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, 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.

## Risk and Capital Management *(continued)*

### Risk Management *(continued)*

**(b) Liquidity and funding risk**

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 Asset and Liability Management Committee ("ALCO") at Group level and in 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.

Compliance with liquidity and funding requirements is monitored by the ALCO and is reported to the Risk Management Committee ("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 funding contingency 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.

## Risk and Capital Management *(continued)*

### Risk Management *(continued)*

**(b) Liquidity and funding risk** *(continued)*

**Liquidity information**

The Banking (Liquidity) Rules ("BLR"), effective on 1 January 2015, signified the implementation of Liquidity Coverage Ratio ("LCR") for category 1 Institution under Basel III liquidity standards in Hong Kong.

The Group is required under rule 11(1) of the BLR to calculate its LCR on a consolidated basis, under the Basel III LCR standard which came into effect from 1 January 2015. During the year of 2016, the Group is required to maintain a LCR of not less than 70%, increasing to not less than 100% by January 2019. The average LCR for the reportable periods are as follows:

| | Quarter ended 30 June 2016 | Quarter ended 31 March 2016 | Quarter ended 30 June 2015 | Quarter ended 31 March 2015 |
|---|---|---|---|---|
| Average Liquidity Coverage Ratio | **257.1%** | **257.1%** | 221.6% | 167.4% |

Under the Banking (Liquidity) Rules, the average LCR was 257.1% for both the quarters ended 30 June and 31 March 2016 respectively, compared with 221.6% and 167.4% for the quarters ended 30 June and 31 March 2015. The liquidity position of the Group remained strong for the first half of 2016 as the Group has deployed the commercial surplus in high quality liquid assets given the subdued credit demand.

To comply with the Banking (Disclosure) Rules, the details of liquidity information can be found in the Regulatory Disclosures section of our website www.hangseng.com.

The composition of the Group's high quality liquid assets ("HQLA") as defined under Schedule 2 of the BLR is shown as below. The majority of the HQLA held by the Group are Level 1 assets which mainly consist of government debt securities.

| | Weighted amount (Average value) | | | |
|---|---|---|---|---|
| | Quarter ended 30 June 2016 | Quarter ended 31 March 2016 | Quarter ended 30 June 2015 | Quarter ended 31 March 2015 |
| Level 1 assets | **290,202** | **249,886** | 215,120 | 166,084 |
| Level 2A assets | **16,139** | **14,492** | 10,177 | 7,391 |
| Level 2B assets | **599** | **589** | 1,214 | 1,097 |
| Total weighted amount of HQLA | **306,940** | **264,967** | 226,511 | 174,572 |

## Risk and Capital Management *(continued)*

### Risk Management *(continued)*

**(b) Liquidity and funding risk** *(continued)*

***Wholesale debt monitoring***

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***

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.

***Contingent liquidity risk***

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

***Currency mismatch***

The Group allows currency mismatches to provide some flexibility in managing the balance sheet structure and to carry out foreign exchange trading, on the basis that there is sufficient liquidity in the swap market to support currency conversion in periods of stress. The Group sets limits on cash flow projection for all material currencies based on liquidity in the swap markets. These limits are approved and monitored by ALCO.

***Additional contractual obligations***

Most of the Group's derivative transactions are exchange rate contracts and interest rate contracts. Under the terms of our current collateral obligations under derivative contracts (which are ISDA compliant CSA contracts), in the event of a three-notch downgrade in credit ratings, the additional collateral required to post is immaterial.

## Risk and Capital Management *(continued)*

### Risk Management *(continued)*

#### (c) Market risk

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 for the first half of 2016.

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**

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 and business need being primary factors 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.

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***

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")***

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 no 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 market 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.

## Risk and Capital Management *(continued)*

### Risk Management *(continued)*

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

***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.

***Risk not in VAR ("RNIV") framework***

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 RNIV 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. For the average of the first half of 2016, the capital requirement derived from these stress tests represented 0.7% 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 0.7% 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.

## Risk and Capital Management *(continued)*

### Risk Management *(continued)*

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

#### Stress testing

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. A scoring framework is in place for management to effectively assess the severity of the potential stress losses and the likelihood of occurrence of the stress scenarios.

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.

#### Trading portfolios

***VAR of the trading portfolios***

Trading VAR predominantly resides within Global Markets. The VAR for trading activity at 30 June 2016 was lower than at 30 June 2015, mainly led by foreign exchange trading activities.

## Risk and Capital Management *(continued)*

### Risk Management *(continued)*

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

The Group's trading VAR for the period ended 30 June 2016 is shown in the table below.

***Trading, 99% 1 day***

| | **At 30 June 2016** | **Minimum during the year** | **Maximum during the year** | **Average for the year** |
|---|---|---|---|---|
| **VAR** | | | | |
| Trading | **29** | **17** | **45** | **33** |
| Foreign exchange trading | **19** | **6** | **21** | **13** |
| Interest rate trading | **29** | **17** | **48** | **32** |
| Portfolio diversification | **(19)** | **-** | **-** | **(12)** |
| **Stressed VAR** | | | | |
| Trading | **129** | **103** | **220** | **151** |
| Foreign exchange trading | **33** | **3** | **42** | **23** |
| Interest rate trading | **138** | **115** | **226** | **159** |

| | At 30 June 2015 | Minimum during the year | Maximum during the year | Average for the year |
|---|---|---|---|---|
| **VAR** | | | | |
| Trading | 42 | 12 | 52 | 29 |
| Foreign exchange trading | 44 | 6 | 48 | 26 |
| Interest rate trading | 15 | 8 | 18 | 14 |
| Portfolio diversification | (17) | - | - | (11) |
| **Stressed VAR** | | | | |
| Trading | 174 | 25 | 219 | 116 |
| Foreign exchange trading | 188 | 18 | 226 | 112 |
| Interest rate trading | 49 | 22 | 94 | 50 |

| | At 31 December 2015 | Minimum during the year | Maximum during the year | Average for the year |
|---|---|---|---|---|
| **VAR** | | | | |
| Trading | 28 | 12 | 52 | 29 |
| Foreign exchange trading | 5 | 5 | 48 | 22 |
| Interest rate trading | 28 | 8 | 32 | 18 |
| Portfolio diversification | (5) | - | - | (11) |
| **Stressed VAR** | | | | |
| Trading | 188 | 25 | 219 | 136 |
| Foreign exchange trading | 3 | 1 | 226 | 78 |
| Interest rate trading | 222 | 22 | 246 | 110 |

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

**Non-trading portfolios**

***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 Group's non-trading VAR for the period ended 30 June 2016 is shown in the table below.

***Non-trading VAR, 99% 1 day***

| | **At 30 June 2016** | **Minimum during the year** | **Maximum during the year** | **Average for the year** |
|---|---|---|---|---|
| **VAR** | | | | |
| Non-trading | **46** | **33** | **68** | **52** |
| Interest rate non-trading | **38** | **28** | **52** | **40** |
| Credit spread non-trading | **27** | **19** | **38** | **29** |
| Portfolio diversification | **(19)** | **-** | **-** | **(17)** |

| | At 30 June 2015 | Minimum during the year | Maximum during the year | Average for the year |
|---|---|---|---|---|
| **VAR** | | | | |
| Non-trading | 36 | 29 | 46 | 35 |
| Interest rate non-trading | 30 | 24 | 39 | 31 |
| Credit spread non-trading | 17 | 9 | 21 | 13 |
| Portfolio diversification | (10) | - | - | (9) |

| | At 31 December 2015 | Minimum during the year | Maximum during the year | Average for the year |
|---|---|---|---|---|
| **VAR** | | | | |
| Non-trading | 36 | 28 | 50 | 36 |
| Interest rate non-trading | 32 | 24 | 39 | 32 |
| Credit spread non-trading | 19 | 9 | 30 | 16 |
| Portfolio diversification | (15) | - | - | (12) |

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.

## Risk and Capital Management *(continued)*

### Risk Management *(continued)*

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

***Non-trading VAR, 99% 1 day*** *(continued)*

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**

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$27 million (at 30 June 2015 : HK$17 million) at 30 June 2016.

The increase in credit spread VAR at 30 June 2016 compared with 30 June 2015 was mainly due to the expanded credit spread delta position during the year.

**Interest rate exposure**

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***

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.

***Non-trading interest rate risk***

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.

In order to manage this risk optimally, non-trading interest rate risks is transferred to BSM or to separate books managed under the supervision of the Asset, Liability and Capital Management Committee ('ALCO'). The transfer of market risk to books managed by BSM or supervised by ALCO is usually achieved by a series of internal deals between the business units and these books. When the behavioural characteristics of a product differ from its contractual characteristics, the behavioural characteristics are assessed to determine the true underlying interest rate risk. ALCO regularly monitors all such behavioural assumptions and interest rate risk positions, to ensure they comply with interest rate risk limits established by senior management.

## Risk Management *(continued)*

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

***Sensitivity of net interest income***

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

**Foreign exchange exposure**

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.

## Risk and Capital Management *(continued)*

### Risk Management *(continued)*

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

**Foreign exchange exposure** *(continued)*

At 30 June 2016, the US dollar ("USD") was the currency in which the Group had non-structural foreign currency position that was not less than 10% of the total net position in all foreign currencies. The Group also had a Chinese renminbi ("RMB") structural foreign currency position, which was not less than 10% of the total net structural position in all foreign currencies.

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

| | USD | RMB | Other foreign currencies | Total foreign currencies |
|---|---|---|---|---|
| **At 30 June 2016** | | | | |
| **Non-structural position** | | | | |
| Spot assets | **180,635** | **131,142** | **132,201** | **443,978** |
| Spot liabilities | **(158,187)** | **(114,052)** | **(67,832)** | **(340,071)** |
| Forward purchases | **395,772** | **179,633** | **43,793** | **619,198** |
| Forward sales | **(415,813)** | **(196,786)** | **(108,086)** | **(720,685)** |
| Net options position | **202** | **(60)** | **(237)** | **(95)** |
| Net long/(short) non-structural position | **2,609** | **(123)** | **(161)** | **2,325** |
| **Structural position** | **-** | **14,536** | **895** | **15,431** |
| At 30 June 2015 | | | | |
| **Non-structural position** | | | | |
| Spot assets | 190,834 | 169,403 | 103,328 | 463,565 |
| Spot liabilities | (153,429) | (144,863) | (64,860) | (363,152) |
| Forward purchases | 292,420 | 123,125 | 61,251 | 476,796 |
| Forward sales | (327,490) | (136,603) | (99,772) | (563,865) |
| Net options position | 179 | (257) | 40 | (38) |
| Net long/(short) non-structural position | 2,514 | 10,805 | (13) | 13,306 |
| **Structural position** | - | 14,215 | 750 | 14,965 |
| At 31 December 2015 | | | | |
| **Non-structural position** | | | | |
| Spot assets | 204,267 | 148,933 | 137,573 | 490,773 |
| Spot liabilities | (169,779) | (128,759) | (66,796) | (365,334) |
| Forward purchases | 320,566 | 153,574 | 35,151 | 509,291 |
| Forward sales | (355,062) | (170,630) | (106,024) | (631,716) |
| Net options position | 212 | (328) | 121 | 5 |
| Net long non-structural position | 204 | 2,790 | 25 | 3,019 |
| **Structural position** | - | 15,238 | 816 | 16,054 |

**Equities exposure**

The Group's equities exposures in 2016 and 2015 are mainly long-term equity investments which are reported as "Financial investments" set out in note 24 on the condensed consolidated financial statements. Equities held for trading purpose are included under "Trading assets" set out in note 20 on the condensed consolidated financial statements. These are subject to trading limit and risk management control procedures and other market risk regime.

**Risk Management** *(continued)*

**(d) Insurance risk**

**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 asset and liability management, 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 apply.

The Group uses several methods to assess and monitor insurance risk exposures both for 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 timing and severity of claims is different from expected. Insurance events are, by their nature, incorporated with 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 of the Group's insurance subsidiary 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.

**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. The Group buys a combination of proportionate and non-proportionate reinsurance to reduce the retained sum-at-risk so that it falls within specified insurance risk appetite. The Group also utilises reinsurance to manage the risk arising from guarantees provided to the policyholders under the non-linked traditional non-participating insurance product. In addition, the Group uses reinsurance agreements with non-affiliated reinsurers to manage its exposure to losses resulting from certain catastrophes. However, the Group remains liable to its policyholders with respect to ceded insurance if any reinsurer fails to meet the obligations it assumes.

**Concentration of insurance risks**

Within the insurance process, concentrations of risk may arise where a particular event or series of events could impact heavily upon the Group's liabilities. Such concentrations may arise from a single insurance contract or through a number of related contracts, and relate to 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 properties, physical conditions and lives of the policyholders insured by the Group. To mitigate some of these risks, catastrophe reinsurance arrangements have been made by the Group.

***Financial risks***

The Group's insurance businesses are exposed to a range of financial risks, including market risk, credit risk and liquidity risk.

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.

**Risk Management** *(continued)*

### (e) Operational risk

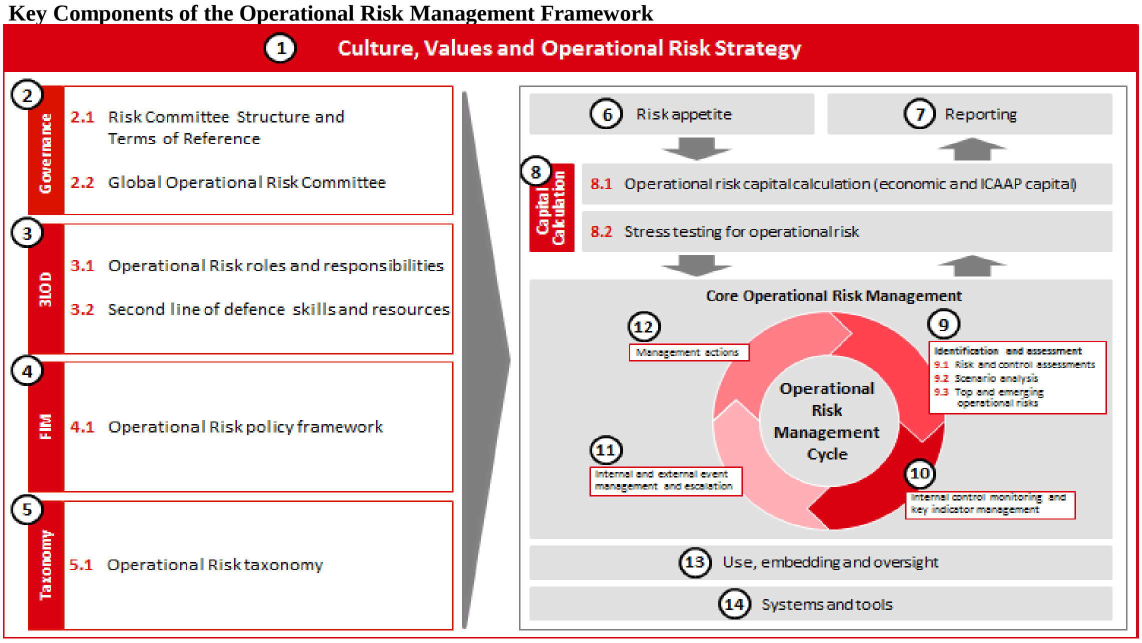
Operational risk is relevant to every aspect of our business and covers a wide spectrum of issues, in particular legal, compliance, security and fraud. Losses arising from breaches of regulation and law, unauthorised activities, error, omission, inefficiency, fraud, systems failure or external events all fall within the definition of operational risk.

Responsibility for minimising operational risk lies with HASE's management and staff in particular every employee plays a role in managing operational risk at HASE. Accountability for managing and controlling risks lies directly with individual risk owners.

*Operational risk management framework*

HASE's Operational Risk Management Framework (ORMF) is our overarching approach for managing operational risk in accordance with our business and operational risk strategies. The purpose of the ORMF is to make sure we fully identify and manage our operational risks in an effective manner and maintain our targeted levels of operational risk within the Bank's risk appetite, as defined by the Board. HASE adopts the HSBC Group's ORMF which comprises the 14 key components set below.

**Key Components of the Operational Risk Management Framework**




*Three lines of defence*

The Three Lines of Defence model is essential to delivering strong risk management within the Bank. It defines who is responsible to do what to identify, assess, measure, manage, monitor, and mitigate operational risks, encouraging collaboration and enabling efficient coordination of risk and control activities.

- The first line of defence is accountable for managing and monitoring operational risk in the business.
- The second line is responsible for providing risk oversight, challenge, advice and insights to the business.
- The third line of defence independently assures that the Bank is managing operational risk effectively.

Having a strong Three Lines of Defence model in operation across the Bank enables us to identify and effectively manage operational risks.

Activity to strengthen our operational risk culture and to better embed the use of our ORMF continued in 2016. In particular, we continued to streamline our operational risk management processes, procedures and tool sets to provide more forward-looking risk insights and more effective operation of the ORMF. A diagrammatic representation of the ORMF is presented above.

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

**Capital Management**

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

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

The Bank and its subsidiaries maintain a regulatory reserve to satisfy the provisions of the Banking Ordinance and local regulatory requirements for prudential supervision purposes. At 30 June 2016, the effect of this requirement is to restrict the amount of reserves which can be distributed to shareholders by HK$5,823m (31 December 2015: HK$6,610m).

There are no relevant capital shortfalls in any of the Group's subsidiaries at 30 June 2016 (31 December 2015: nil) which are not included in its consolidation group for regulatory purposes.

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 phase-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 risk-weighted assets ("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 ("HLA") requirements for Domestic Systemically Important Banks ("D-SIB"). On 27 January 2015 and 14 January 2016, the HKMA announced a CCyB for Hong Kong of 0.625% and 1.25% of RWAs from 1 January 2016 and 1 January 2017 respectively under the phase-in arrangements of Basel III, equivalent to 2.5% once fully phased in. On 16 March 2015 and 31 December 2015, the HKMA announced its designation of the Bank as a D-SIB in Hong Kong and required the Bank to establish 0.375% and 0.75% of RWAs for HLA from 1 January 2016 and 1 January 2017 respectively under the phase-in arrangement, equivalent to 1.5% on full implementation.

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

## Risk and Capital Management *(continued)*

### Capital Management *(continued)*

#### Capital Base

The following table sets out the composition of the Group's capital base under Basel III at 30 June 2016, 30 June 2015 and 31 December 2015. A more detailed breakdown of the capital position is available in the Regulatory Disclosures section of our website www.hangseng.com.

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| **Common Equity Tier 1 ("CET1") Capital** | | | |
| Shareholders' equity | **114,350** | 119,201 | 120,963 |
| - Shareholders' equity per condensed consolidated balance sheet | **136,713** | 139,474 | 141,981 |
| - Additional Tier 1 ("AT1") perpetual capital instrument | **(6,981)** | (6,981) | (6,981) |
| - Unconsolidated subsidiaries | **(15,382)** | (13,292) | (14,037) |
| Regulatory deductions to CET1 capital | **(29,783)** | (29,975) | (30,687) |
| - Cash flow hedging reserve | **(8)** | (22) | (11) |
| - Changes in own credit risk on fair valued liabilities | **(17)** | (7) | (6) |
| - Property revaluation reserves* | **(23,042)** | (22,654) | (23,135) |
| - Regulatory reserve | **(5,823)** | (6,382) | (6,610) |
| - Intangible assets | **(421)** | (433) | (421) |
| - Defined benefit pension fund assets | **(22)** | (34) | (35) |
| - Deferred tax assets net of deferred tax liabilities | **(142)** | (104) | (115) |
| - Valuation adjustments | **(308)** | (339) | (354) |
| **Total CET1 Capital** | **84,567** | 89,226 | 90,276 |
| **AT1 Capital** | | | |
| Total AT1 capital before and after regulatory deductions | **6,981** | 6,981 | 6,981 |
| - Perpetual capital instrument | **6,981** | 6,981 | 6,981 |
| **Total AT1 Capital** | **6,981** | 6,981 | 6,981 |
| **Total Tier 1 ("T1") Capital** | **91,548** | 96,207 | 97,257 |
| **Tier 2 ("T2") Capital** | | | |
| Total T2 capital before regulatory deductions | **15,651** | 18,000 | 15,746 |
| - Term subordinated debt | **2,328** | 4,767 | 2,325 |
| - Property revaluation reserves* | **10,368** | 10,194 | 10,411 |
| - Impairment allowances and regulatory reserve eligible for inclusion in T2 capital | **2,955** | 3,039 | 3,010 |
| Regulatory deductions to T2 capital | **(315)** | (315) | (315) |
| - Significant capital investments in unconsolidated financial sector entities | **(315)** | (315) | (315) |
| **Total T2 Capital** | **15,336** | 17,685 | 15,431 |
| **Total Capital** | **106,884** | 113,892 | 112,688 |

* *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.*

**Capital Management** *(continued)*

**Capital Base** *(continued)*

**Risk-weighted assets by risk type**

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Credit risk | **444,700** | 453,899 | 446,753 |
| Market risk | **9,876** | 20,028 | 13,698 |
| Operational risk | **50,180** | 47,516 | 49,023 |
| Total | **504,756** | 521,443 | 509,474 |

**Market risk-weighted assets**

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Internal models approach | | | |
| Value at Risk ("VAR") | **3,913** | 4,956 | 3,553 |
| Stressed VAR | **5,589** | 13,654 | 8,811 |
| Standardised approach | | | |
| Specific interest rate exposures | **374** | 1,418 | 1,334 |
| Total | **9,876** | 20,028 | 13,698 |

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

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

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| CET1 capital ratio | **16.8%** | 17.1% | 17.7% |
| Tier 1 capital ratio | **18.1%** | 18.5% | 19.1% |
| Total capital ratio | **21.2%** | 21.8% | 22.1% |

The Basel III rules set out the minimum capital requirements, to be phased in sequentially from 1 January 2013 and become fully effective on 1 January 2019. On a pro-forma basis that takes no account of, for example, any future profits or management action and any change in the current regulations or their application before full implementation, the Group's capital ratios at Basel III end point are the same as above as at 30 June 2016. The pro-forma Basel III end point basis position is a mechanical application of the current rules to the capital base as at 30 June 2016, it is not a projection.

**Capital buffers (as a percentage of risk-weighted assets)**

With effect from 1 January 2016, the following capital buffers are phased-in and the applicable ratios to the Group on a consolidated basis are as follows:

| | **At 30 June 2016** |
|---|---|
| Capital conservation buffer ratio | **0.625%** |
| Higher loss absorbency ratio | **0.375%** |
| Countercyclical capital buffer ("CCyB") ratio | **0.537%** |
| Total | **1.537%** |

The geographical breakdown of risk-weighted assets in relation to private sector credit exposures and the applicable CCyB ratio for each jurisdiction using the standard template as specified by the HKMA can be viewed in the Regulatory Disclosures section of our website www.hangseng.com.

## Risk and Capital Management *(continued)*

### Capital Management *(continued)*

#### Principal subsidiaries and basis of consolidation

The basis of consolidation for financial accounting purposes is in accordance with Hong Kong Financial Reporting Standards ("HKFRS"), as described in note 3 on the condensed consolidated 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:

| | | **At 30 June 2016** | | At 31 December 2015 | |
|---|---|---|---|---|---|
| | Principal activities | **Total assets*** | **Total equity*** | Total assets* | Total equity* |
| Hang Seng Futures Ltd | Futures brokerages | **102** | **102** | 102 | 102 |
| Hang Seng Investment Management Ltd | Fund management | **1,146** | **1,075** | 946 | 910 |
| Hang Seng Investment Services Ltd | Provision of investment commentaries | **9** | **9** | 9 | 9 |
| Hang Seng Securities Ltd | Stockbroking | **3,257** | **1,656** | 2,493 | 1,596 |
| Hang Seng Insurance Co. Ltd and its subsidiaries | Retirement benefits and life assurance | **118,050** | **9,074** | 112,857 | 9,139 |

** Prepared in accordance with HKFRS*

For insurance entities, the figures shown above exclude deferred acquisition cost assets as these are derecognised for consolidation purpose due to the recognition of the present value of in-force long-term insurance business ('PVIF') on long-term insurance contracts and investment contracts with discretionary participation features at group level. The PVIF asset of HK$12,851m (31 December 2015: HK$11,431m) and the related deferred tax liability, however, are recognised at the consolidated group level only, and are therefore also not included in the asset or equity positions for the standalone entities shown above.

As at 30 June 2016, 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

The following is a summary of the Group's CET1, AT1 and T2 capital instruments issued by the Bank.

| | Amount recognised in regulatory capital | | |
|---|---|---|---|
| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
| **CET1 capital instruments** | | | |
| Ordinary shares:<br>1,911,842,736 issued and fully paid ordinary shares | **9,658** | 9,658 | 9,658 |
| **AT1 capital instruments** | | | |
| Perpetual capital instrument (nominal value: US$900m) | **6,981** | 6,981 | 6,981 |
| **T2 capital instruments** | | | |
| Subordinated loan due 2021 (nominal value: US$450m) | **-** | 2,441 | - |
| Subordinated loan due 2022 (nominal value: US$300m) | **2,328** | 2,326 | 2,325 |

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.

## Risk and Capital Management *(continued)*

### Capital Management *(continued)*

#### Leverage ratio

The Leverage Ratio ('LR') was introduced into the Basel III framework as a non-risk based backstop limit, to supplement risk-based capital requirements. The ratio is a volume-based measure calculated as Basel III T1 capital divided by exposure measure representing total on and off balance sheet exposures. In accordance with the Basel III framework, there will be a parallel run period for the LR from 2013 to 2017. The Group is required under section 24A(6) of the Banking (Disclosure) Rules to disclose its LR calculated on a consolidated basis.

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Leverage ratio | **7.4%** | 7.7% | 7.8% |
| *Figures in HK$m* | | | |
| T1 capital | **91,548** | 96,207 | 97,257 |
| Exposure measure | **1,236,337** | 1,255,187 | 1,248,642 |

The decrease in the LR from 31 December 2015 to 30 June 2016 was mainly due to a decrease in T1 capital, attributed to the payment of special interim dividend for 2015.

Detailed breakdown of the Group's leverage exposure measure and a summary comparison table reconciling the assets of the Group’s accounting balance sheet with the leverage exposure measure using the standard templates as specified by the HKMA can be viewed 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.

## CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

*unaudited*

*(Expressed in millions of Hong Kong dollars)*

| **Condensed Consolidated Income Statement** | note | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|---|
| Interest income | 4 | **13,303** | 13,645 | 13,418 |
| Interest expense | 5 | **(2,300)** | (3,204) | (2,694) |
| **Net interest income** | | **11,003** | 10,441 | 10,724 |
| Fee income | | **3,776** | 4,638 | 3,986 |
| Fee expense | | **(923)** | (754) | (832) |
| **Net fee income** | 6 | **2,853** | 3,884 | 3,154 |
| Net trading income | 7 | **455** | 1,377 | 653 |
| Net income/(loss) from financial instruments designated at fair value | 8 | **(30)** | 721 | (839) |
| Dividend income | 9 | **174** | 125 | 17 |
| Net insurance premium income | | **5,608** | 6,247 | 3,598 |
| Other operating income | 10 | **1,788** | 1,880 | 2,039 |
| **Total operating income** | | **21,851** | 24,675 | 19,346 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders | | **(6,634)** | (8,125) | (4,843) |
| **Net operating income before loan impairment charges and other credit risk provisions** | | **15,217** | 16,550 | 14,503 |
| Loan impairment charges and other credit risk provisions | 11 | **(721)** | (594) | (514) |
| **Net operating income** | | **14,496** | 15,956 | 13,989 |
| Employee compensation and benefits | | **(2,441)** | (2,537) | (2,356) |
| General and administrative expenses | | **(1,937)** | (2,081) | (2,441) |
| Depreciation of premises, plant and equipment | | **(551)** | (462) | (495) |
| Amortisation of intangible assets | | **(51)** | (56) | (54) |
| **Operating expenses** | 12 | **(4,980)** | (5,136) | (5,346) |
| Impairment loss on intangible assets | | **-** | - | (24) |
| **Operating profit** | | **9,516** | 10,820 | 8,619 |
| Net gain on partial disposal of Industrial Bank | | **-** | 10,636 | - |
| Net surplus/(deficit) on property revaluation | | **(77)** | 178 | 83 |
| Share of profits from associates | | **60** | 86 | 66 |
| **Profit before tax** | | **9,499** | 21,720 | 8,768 |
| Tax expense | 13 | **(1,494)** | (1,672) | (1,322) |
| **Profit for the period** | | **8,005** | 20,048 | 7,446 |
| Profit attributable to shareholders | | **8,005** | 20,048 | 7,446 |
| *(Figures in HK$)* | | | | |
| Earnings per share - basic and diluted | 14 | **4.19** | 10.49 | 3.73 |

Details of dividends payable to shareholders of the Bank attributable to the profit for the half year are set out in note 15.

The notes on pages 45 to 89 form part of these condensed consolidated financial statements.

## CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

*unaudited (continued)*

*(Expressed in millions of Hong Kong dollars)*

| **Condensed Consolidated Statement of Comprehensive Income** | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|
| **Profit for the period** | **8,005** | 20,048 | 7,446 |
| **Other comprehensive income** | | | |
| **Items that will be reclassified subsequently to the condensed consolidated income statement when specific conditions are met:** | | | |
| Available-for-sale investment reserve: | | | |
| - fair value changes taken to equity: | | | |
| -- on debt securities | **839** | (9) | (407) |
| -- on equity shares | **(356)** | 406 | (223) |
| - fair value changes transferred to condensed consolidated income statement: | | | |
| -- on hedged items | **(564)** | 11 | 80 |
| -- on disposal | **(75)** | (14,786) | 27 |
| - share of changes in equity of associates: | | | |
| -- fair value changes | **-** | - | (5) |
| - deferred taxes | **(27)** | (25) | 44 |
| - exchange difference and others | **(48)** | (40) | (146) |
| Cash flow hedging reserve: | | | |
| - fair value changes taken to equity | **(1,165)** | 157 | 34 |
| - fair value changes transferred to condensed consolidated income statement | **1,145** | (139) | (49) |
| - deferred taxes | **3** | (3) | 2 |
| Exchange differences on translation of: | | | |
| - financial statements of overseas branches, subsidiaries and associates | **(257)** | (6) | (534) |
| **Items that will not be reclassified subsequently to the condensed consolidated income statement:** | | | |
| Premises: | | | |
| - unrealised surplus on revaluation of premises | **277** | 1,103 | 775 |
| - deferred taxes | **(47)** | (184) | (130) |
| - exchange difference | **(4)** | - | (7) |
| Defined benefit plans: | | | |
| - actuarial (losses)/gains on defined benefit plans | **(688)** | 292 | 130 |
| - deferred taxes | **113** | (48) | (22) |
| Share-based payments | **6** | 2 | - |
| **Other comprehensive income for the period, net of tax** | **(848)** | (13,269) | (431) |
| **Total comprehensive income for the period** | **7,157** | 6,779 | 7,015 |
| Total comprehensive income for the period attributable to shareholders | **7,157** | 6,779 | 7,015 |

## CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

*unaudited (continued)*

*(Expressed in millions of Hong Kong dollars)*

| **Condensed Consolidated Balance Sheet** | note | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and sight balances at central banks | 18 | **18,938** | 40,317 | 10,118 |
| Placings with and advances to banks | 19 | **97,307** | 152,767 | 123,990 |
| Trading assets | 20 | **52,091** | 44,772 | 40,373 |
| Financial assets designated at fair value | 21 | **9,897** | 8,218 | 7,903 |
| Derivative financial instruments | 22 | **9,084** | 6,004 | 11,595 |
| Reverse repurchase agreements – non-trading | | **-** | 1,904 | - |
| Loans and advances to customers | 23 | **678,442** | 673,022 | 688,946 |
| Financial investments | 24 | **375,403** | 328,198 | 372,272 |
| Interest in associates | 25 | **2,291** | 2,258 | 2,275 |
| Investment properties | 26 | **10,329** | 9,899 | 10,075 |
| Premises, plant and equipment | 27 | **26,074** | 25,664 | 26,186 |
| Intangible assets | 28 | **13,641** | 10,577 | 12,221 |
| Other assets | 29 | **27,870** | 27,838 | 28,475 |
| **Total assets** | | **1,321,367** | 1,331,438 | 1,334,429 |
| **LIABILITIES AND EQUITY** | | | | |
| **Liabilities** | | | | |
| Current, savings and other deposit accounts | 30 | **951,545** | 947,495 | 959,228 |
| Repurchase agreements – non-trading | | **1,761** | 3,032 | 2,315 |
| Deposits from banks | | **14,159** | 13,964 | 18,780 |
| Trading liabilities | 31 | **58,156** | 77,543 | 62,917 |
| Financial liabilities designated at fair value | 32 | **4,004** | 4,027 | 3,994 |
| Derivative financial instruments | 22 | **11,590** | 5,877 | 9,988 |
| Certificates of deposit and other debt securities in issue | 33 | **6,416** | 7,738 | 5,191 |
| Other liabilities | 34 | **23,817** | 22,887 | 20,891 |
| Liabilities under insurance contracts | | **104,425** | 96,986 | 101,817 |
| Current tax liabilities | | **1,546** | 1,906 | 185 |
| Deferred tax liabilities | | **4,907** | 4,695 | 4,817 |
| Subordinated liabilities | 35 | **2,328** | 5,814 | 2,325 |
| **Total liabilities** | | **1,184,654** | 1,191,964 | 1,192,448 |
| **Equity** | | | | |
| Share capital | | **9,658** | 9,658 | 9,658 |
| Retained profits | | **100,615** | 102,085 | 105,363 |
| Other equity instruments | 37 | **6,981** | 6,981 | 6,981 |
| Other reserves | | **19,459** | 20,750 | 19,979 |
| Shareholders' funds | 36 | **136,713** | 139,474 | 141,981 |
| **Total equity and liabilities** | | **1,321,367** | 1,331,438 | 1,334,429 |

The notes on pages 45 to 89 form part of these condensed consolidated financial statements.

**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

*unaudited (continued)*

*(Expressed in millions of Hong Kong dollars)*

**Condensed Consolidated Statement of Changes in Equity**

| | | | | Other reserves | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Other equity instruments | Retained profits and proposed dividend | Premises revaluation reserve | Available-for-sale investment reserve | Cash flow hedge reserve | Foreign exchange reserve | Others | Total share-holders' equity |
| At 1 January 2016 | **9,658** | **6,981** | **105,363** | **16,777** | **1,939** | **(9)** | **600** | **672** | **141,981** |
| Profit for the period | - | - | **8,005** | - | - | - | - | - | **8,005** |
| Other comprehensive income (net of tax) | - | - | **(569)** | **226** | **(231)** | **(17)** | **(257)** | - | **(848)** |
| Available-for-sale investments | - | - | - | - | **(231)** | - | - | - | **(231)** |
| Cash flow hedges | - | - | - | - | - | **(17)** | - | - | **(17)** |
| Property revaluation | - | - | - | **226** | - | - | - | - | **226** |
| Actuarial losses on defined benefit plans | - | - | **(575)** | - | - | - | - | - | **(575)** |
| Share of other comprehensive income of associates | - | - | - | - | - | - | - | - | - |
| Exchange differences and others | - | - | **6** | - | - | - | **(257)** | - | **(251)** |
| Total comprehensive income for the period | - | - | **7,436** | **226** | **(231)** | **(17)** | **(257)** | - | **7,157** |
| Dividends paid | - | - | **(12,427)** | - | - | - | - | - | **(12,427)** |
| Coupon paid to holder of AT1 capital instrument | - | - | - | - | - | - | - | - | - |
| Movement in respect of share-based payment arrangements | - | - | - | - | - | - | - | **2** | **2** |
| Transfers | - | - | **243** | **(243)** | - | - | - | - | - |
| At 30 June 2016 | **9,658** | **6,981** | **100,615** | **16,760** | **1,708** | **(26)** | **343** | **674** | **136,713** |
| At 1 January 2015 | 9,658 | 6,981 | 88,064 | 15,687 | 17,012 | (11) | 1,140 | 662 | 139,193 |
| Profit for the period | - | - | 20,048 | - | - | - | - | - | 20,048 |
| Other comprehensive income (net of tax) | - | - | 246 | 919 | (14,443) | 15 | (6) | - | (13,269) |
| Available-for-sale investments | - | - | - | - | (14,443) | - | - | - | (14,443) |
| Cash flow hedges | - | - | - | - | - | 15 | - | - | 15 |
| Property revaluation | - | - | - | 919 | - | - | - | - | 919 |
| Actuarial gains on defined benefit plans | - | - | 244 | - | - | - | - | - | 244 |
| Share of other comprehensive income of associates | - | - | - | - | - | - | - | - | - |
| Exchange differences and others | - | - | 2 | - | - | - | (6) | - | (4) |
| Total comprehensive income for the period | - | - | 20,294 | 919 | (14,443) | 15 | (6) | - | 6,779 |
| Dividends paid | - | - | (6,500) | - | - | - | - | - | (6,500) |
| Coupon paid to holder of AT1 capital instrument | - | - | - | - | - | - | - | - | - |
| Movement in respect of share-based payment arrangements | - | - | - | - | - | - | - | 2 | 2 |
| Transfers | - | - | 227 | (227) | - | - | - | - | - |
| At 30 June 2015 | 9,658 | 6,981 | 102,085 | 16,379 | 2,569 | 4 | 1,134 | 664 | 139,474 |

**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
*unaudited (continued)*
*(Expressed in millions of Hong Kong dollars)*

**Condensed Consolidated Statement of Changes in Equity** *(continued)*

| | | | | Other reserves | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Other equity instruments | Retained profits and proposed dividend | Premises revaluation reserve | Available-for-sale investment reserve | Cash flow hedge reserve | Foreign exchange reserve | Others | Total share-holders' equity |
| At 1 July 2015 | 9,658 | 6,981 | 102,085 | 16,379 | 2,569 | 4 | 1,134 | 664 | 139,474 |
| Profit for the period | - | - | 7,446 | - | - | - | - | - | 7,446 |
| Other comprehensive income (net of tax) | - | - | 108 | 638 | (630) | (13) | (534) | - | (431) |
| Available-for-sale investments | - | - | - | - | (625) | - | - | - | (625) |
| Cash flow hedges | - | - | - | - | - | (13) | - | - | (13) |
| Property revaluation | - | - | - | 638 | - | - | - | - | 638 |
| Actuarial gains on defined benefit plans | - | - | 108 | - | - | - | - | - | 108 |
| Share of other comprehensive income of associates | - | - | - | - | (5) | - | - | - | (5) |
| Exchange differences and others | - | - | - | - | - | - | (534) | - | (534) |
| Total comprehensive income for the period | - | - | 7,554 | 638 | (630) | (13) | (534) | - | 7,015 |
| Dividends paid | - | - | (4,206) | - | - | - | - | - | (4,206) |
| Coupon paid to holder of AT1 capital instrument | - | - | (310) | - | - | - | - | - | (310) |
| Movement in respect of share-based payment arrangements | - | - | - | - | - | - | - | 8 | 8 |
| Transfers | - | - | 240 | (240) | - | - | - | - | - |
| At 31 December 2015 | 9,658 | 6,981 | 105,363 | 16,777 | 1,939 | (9) | 600 | 672 | 141,981 |

*(Expressed in millions of Hong Kong dollars)*

**Condensed Consolidated Cash Flow Statement**

| | note | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 |
|---|---|---|---|
| **Net cash inflow from operating activities** | 38(a) | **14,821** | 38,787 |
| **Cash flows from investing activities** | | | |
| Purchase of available-for-sale investments | | **(50,857)** | (45,623) |
| Purchase of held-to-maturity debt securities | | **(383)** | (1,283) |
| Proceeds from sale or redemption of available-for-sale investments | | **49,802** | 72,058 |
| Proceeds from redemption of held-to-maturity debt securities | | **709** | 105 |
| Net cash inflow from sale of loan portfolio | | **-** | 3,981 |
| Purchase of properties, plant and equipment and intangible assets | | **(550)** | (454) |
| Proceeds from sale of properties, plant and equipment and assets held for sale | | **1** | 1 |
| Interest received from available-for-sale investments | | **1,325** | 964 |
| Dividends received from available-for-sale investments | | **175** | 125 |
| Net cash inflow from investing activities | | **222** | 29,874 |
| **Cash flows from financing activities** | | | |
| Dividends paid | | **(12,427)** | (6,500) |
| Interest paid for subordinated liabilities | | **(102)** | (91) |
| Net cash outflow from financing activities | | **(12,529)** | (6,591) |
| **Increase in cash and cash equivalents** | | **2,514** | 62,070 |
| **Cash and cash equivalents at 1 January** | | **104,335** | 105,350 |
| Effect of foreign exchange rate changes | | **(2,703)** | (521) |
| **Cash and cash equivalents at 30 June** | 38(b) | **104,146** | 166,899 |

The notes on pages 45 to 89 form part of these condensed consolidated financial statements.

## NOTES ON THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(unaudited)*

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

### 1 Basis of preparation

These condensed consolidated financial statements have been prepared in accordance with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and in compliance with Hong Kong Accounting Standard ("HKAS") 34, Interim Financial Reporting, issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). It also contains the disclosure information required under the Banking (Disclosure) Rules made under section 60A of the Banking Ordinance. The condensed consolidated financial statements were authorised for issue on 3 August 2016.

The preparation of the condensed consolidated financial statements in conformity with HKAS 34 requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses on a year to date basis. Actual results may differ from these estimates. In preparing the condensed consolidated financial statements, the significant judgement made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements for the year ended 31 December 2015.

The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended 31 December 2015, which have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs").

The condensed consolidated financial statements are unaudited, but have been reviewed by PricewaterhouseCoopers ("PwC") in accordance with Hong Kong Standards on Review Engagements 2410, Review of Interim Financial Information Performed by the Independent Auditor of the Entity, issued by HKICPA. PwC's independent review report to the Board of Directors is included on page 90.

### 2 Accounting policies

Except as described below, the accounting policies applied in preparing these condensed consolidated financial statements are the same as those applied in preparing the consolidated financial statements for the year ended 31 December 2015, as disclosed in the 2015 Annual Report.

During the period, the Group has adopted the following amendments to standards which have insignificant or no effect on the condensed consolidated financial statements:
- Amendments to HKAS 1 "Disclosure Initiative"
- Amendments to HKAS 16 " Property, Plant and Equipment" and HKAS 38 "Intangible Assets"
- Amendments to HKAS 27 "Separate Financial Statements"
- Amendments to Hong Kong Financial Reporting Standard ("HKFRS") 10, HKFRS 12 and HKAS 28 "Investment Entities"
- Amendments to HKFRS 11 "Joint Arrangements"

Information on future accounting developments and their potential effect on the condensed consolidated financial statements of the Group are provided in note 1 on the consolidated financial statements of the Bank's 2015 Annual Report.

In addition, in May 2016, the HKICPA issued HKFRS 16 "Leases". The standard is effective for annual periods beginning on or after 1 January 2019 with early application permitted. 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 condensed consolidated financial statements.

### 3 Basis of consolidation

These condensed consolidated financial statements cover the consolidated positions of Hang Seng Bank Limited ("the Bank") and all its subsidiaries ("the Group"), unless otherwise stated, and include the attributable share of the results and reserves of its associates. For regulatory reporting, the basis of consolidation is different from the basis of consolidation for accounting purposes. They are disclosed under the "Risk and Capital Management" section.

## 4 Interest income

| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|
| Interest income arising from: | | | |
| - financial assets that are not at fair value through profit and loss | **13,161** | 13,482 | 13,261 |
| - trading assets | **140** | 158 | 155 |
| - financial assets designated at fair value | **2** | 5 | 2 |
| | **13,303** | 13,645 | 13,418 |
| of which: | | | |
| - interest income from impaired financial assets | **30** | 21 | 20 |

## 5 Interest expense

| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|
| Interest expense arising from: | | | |
| - financial liabilities that are not at fair value through profit and loss | **1,673** | 2,212 | 1,889 |
| - trading liabilities | **607** | 977 | 786 |
| - financial liabilities designated at fair value | **20** | 15 | 19 |
| | **2,300** | 3,204 | 2,694 |
| 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 | **55** | 91 | 65 |

## 6 Net fee income

| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|
| - securities broking and related services | **545** | 1,167 | 705 |
| - retail investment funds | **741** | 1,051 | 712 |
| - insurance | **262** | 249 | 223 |
| - account services | **229** | 216 | 223 |
| - remittances | **234** | 208 | 236 |
| - cards | **1,180** | 1,146 | 1,240 |
| - credit facilities | **204** | 204 | 216 |
| - trade services | **209** | 231 | 260 |
| - other | **172** | 166 | 171 |
| Fee income | **3,776** | 4,638 | 3,986 |
| Fee expense | **(923)** | (754) | (832) |
| | **2,853** | 3,884 | 3,154 |
| of which: | | | |
| Net fee income, other than amounts included in determining the effective interest rate, arising from financial assets or financial liabilities that are not held for trading nor designated at fair value | **1,084** | 1,207 | 1,294 |
| - fee income | **1,846** | 1,816 | 1,963 |
| - fee expense | **(762)** | (609) | (669) |
| Net fee income on trust and other fiduciary activities where the Group holds or invests on behalf of its customers | **391** | 533 | 455 |
| - fee income | **473** | 610 | 539 |
| - fee expense | **(82)** | (77) | (84) |

## 7 Net trading income

| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|
| Dealing profits | **428** | 1,380 | 653 |
| - foreign exchange | **541** | 1,239 | 861 |
| - interest rate derivatives | **(64)** | (47) | 15 |
| - debt securities | **49** | 75 | - |
| - equities and other trading | **(98)** | 113 | (223) |
| Net gain/(loss) from hedging activities | **27** | (3) | - |
| - fair value hedges | | | |
| -- net gain/(loss) on hedged items attributable to the hedged risk | **564** | (11) | (80) |
| -- net (loss)/gain on hedging instruments | **(556)** | 8 | 80 |
| - cash flow hedges | | | |
| -- net hedging gain | **19** | - | - |
| | **455** | 1,377 | 653 |

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

| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|
| Net (loss)/income on assets designated at fair value which back insurance and investment contracts | **(26)** | 716 | (855) |
| Net change in fair value of other financial instruments designated at fair value | **(4)** | 5 | 16 |
| | **(30)** | 721 | (839) |
| of which dividend income from: | | | |
| - listed investments | **73** | 92 | 38 |
| - unlisted investments | **-** | - | 1 |
| | **73** | 92 | 39 |

## 9 Dividend income

| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|
| Dividend income: | | | |
| - listed investments | **120** | 119 | 4 |
| - unlisted investments | **54** | 6 | 13 |
| | **174** | 125 | 17 |

## 10 Other operating income

| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|
| Rental income from investment properties | **181** | 191 | 191 |
| Movement in present value of in-force long-term insurance business | **1,420** | 1,511 | 1,657 |
| Gains less losses from financial investments and fixed assets | **65** | 35 | (29) |
| Others | **122** | 143 | 220 |
| | **1,788** | 1,880 | 2,039 |

## 11 Loan impairment charges and other credit risk provisions

| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|
| Net charge for impairment of loans and advances to customers (note 23(b)): | | | |
| Individually assessed impairment allowances: | | | |
| - new allowances | **379** | 334 | 260 |
| - releases | **(35)** | (34) | (16) |
| - recoveries | **(5)** | (6) | (10) |
| | **339** | 294 | 234 |
| Net charge for collectively assessed impairment allowances | **382** | 300 | 280 |
| Loan impairment charges and other credit risk provisions | **721** | 594 | 514 |

There were no impairment charges for the first half of 2016 (nil for the first and second halves of 2015) provided for available-for-sale debt securities, held-to-maturity debt securities and placings with and advances to banks by the Group.

## 12 Operating expenses

| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|
| Employee compensation and benefits: | | | |
| - salaries and other costs | **2,232** | 2,316 | 2,132 |
| - retirement benefit costs | | | |
| - defined benefit scheme | **110** | 130 | 129 |
| - defined contribution scheme | **99** | 91 | 95 |
| | **2,441** | 2,537 | 2,356 |
| General and administrative expenses: | | | |
| - rental expenses | **342** | 346 | 350 |
| - other premises and equipment | **585** | 570 | 631 |
| - marketing and advertising expenses | **215** | 389 | 513 |
| - other operating expenses | **795** | 776 | 947 |
| | **1,937** | 2,081 | 2,441 |
| Depreciation of premises, plant and equipment (note 27) | **551** | 462 | 495 |
| Amortisation of intangible assets | **51** | 56 | 54 |
| | **4,980** | 5,136 | 5,346 |

## 13 Tax expense

Taxation in the consolidated income statement represents:

| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|
| **Current tax - provision for Hong Kong profits tax** | | | |
| Tax for the period | **1,354** | 1,558 | 1,334 |
| Adjustment in respect of prior periods | **-** | (31) | (25) |
| | **1,354** | 1,527 | 1,309 |
| **Current tax - taxation outside Hong Kong** | | | |
| Tax for the period | **38** | 38 | 12 |
| Adjustment in respect of prior periods | **(1)** | - | - |
| | **37** | 38 | 12 |
| **Deferred tax** | | | |
| Origination and reversal of temporary differences | **103** | 107 | 1 |
| **Total tax expense** | **1,494** | 1,672 | 1,322 |

The current tax provision is based on the estimated assessable profit for the first half of 2016, 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 (2015: 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.

## 14 Earnings per share - basic and diluted

The calculation of basic and diluted earnings per share for the first half of 2016 is based on earnings of HK$8,005m (HK$20,048m for the first half of 2015 and HK$7,136m for the second half of 2015 after deducting the coupon paid on AT1 capital instrument of HK$310m) and on the weighted average number of ordinary shares in issue of 1,911,842,736 shares (unchanged from the first and second halves of 2015).

## 15 Dividends per share

### (a) Dividend to ordinary shareholders

| | **Half-year ended 30 June 2016** | | Half-year ended 30 June 2015 | | Half-year ended 31 December 2015 | |
|---|---|---|---|---|---|---|
| | **HK$ per share** | **HK$m** | HK$ per share | HK$m | HK$ per share | HK$m |
| First interim | **1.10** | **2,103** | 1.10 | 2,103 | - | - |
| Second interim | **1.10** | **2,103** | 1.10 | 2,103 | - | - |
| Third interim | - | - | - | - | 1.10 | 2,103 |
| Fourth interim | - | - | - | - | 2.40 | 4,588 |
| Special interim dividend | - | - | - | - | 3.00 | 5,736 |
| | **2.20** | **4,206** | 2.20 | 4,206 | 6.50 | 12,427 |

### (b) Distribution to holder of AT1 capital instrument classified as equity

| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|
| | **HK$m** | HK$m | HK$m |
| Coupon paid on AT1 capital instrument | **-** | - | 310 |

## 16 Segmental analysis

Hong Kong Financial Reporting Standard 8 (‘HKFRS 8’) requires segmental disclosure to be based on the way that the Group’s chief operating decision maker regards and manages the Group, with the amounts reported for each reportable segment being the measures reported to the Group’s chief operating decision maker for the purpose of assessing segmental performance and making decisions about operating matters. To align with the internal reporting information, the Group has presented the following four reportable segments.

- **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;

- **Other** mainly represents management of shareholders’ funds and investments in premises, investment properties, equity shares and subordinated debt funding.

### (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.

**16 Segmental analysis** *(continued)*

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

| | Retail Banking and Wealth Management | Commercial Banking | Global Banking and Markets | Other | Total |
|---|---|---|---|---|---|
| **Half-year ended 30 June 2016** | | | | | |
| Net interest income/(expense) | 6,016 | 3,011 | 2,020 | (44) | 11,003 |
| Net fee income | 1,788 | 828 | 143 | 94 | 2,853 |
| Net trading (loss)/income | (282) | 14 | 702 | 21 | 455 |
| Net loss from financial instruments designated at fair value | (22) | (3) | (4) | (1) | (30) |
| Dividend income | 1 | - | - | 173 | 174 |
| Net insurance premium income | 5,222 | 386 | - | - | 5,608 |
| Other operating income | 1,460 | 142 | 37 | 149 | 1,788 |
| **Total operating income** | 14,183 | 4,378 | 2,898 | 392 | 21,851 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders | (6,331) | (303) | - | - | (6,634) |
| **Net operating income before loan impairment charges and other credit risk provisions** | 7,852 | 4,075 | 2,898 | 392 | 15,217 |
| Loan impairment (charges)/releases and other credit risk provisions | (366) | (372) | 17 | - | (721) |
| **Net operating income** | 7,486 | 3,703 | 2,915 | 392 | 14,496 |
| Operating expenses * | (3,086) | (1,211) | (441) | (242) | (4,980) |
| **Operating profit** | 4,400 | 2,492 | 2,474 | 150 | 9,516 |
| Net deficit on property revaluation | - | - | - | (77) | (77) |
| Share of profits from associates | 60 | - | - | - | 60 |
| **Profit before tax** | 4,460 | 2,492 | 2,474 | 73 | 9,499 |
| Share of profit before tax | 47.0% | 26.2% | 26.0% | 0.8% | 100.0% |
| Operating profit excluding loan impairment charges and other credit risk provisions | 4,766 | 2,864 | 2,457 | 150 | 10,237 |
| ** Depreciation/amortisation included in operating expenses* | (14) | (3) | (1) | (584) | (602) |
| **At 30 June 2016** | | | | | |
| Total assets | 398,830 | 288,496 | 555,052 | 78,989 | 1,321,367 |
| Total liabilities | 775,100 | 233,755 | 151,925 | 23,874 | 1,184,654 |
| Interest in associates | 2,276 | 15 | - | - | 2,291 |

**16 Segmental analysis** *(continued)*

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

| | Retail Banking and Wealth Management | Commercial Banking | Global Banking and Markets | Other | Total |
|---|---|---|---|---|---|
| Half-year ended 30 June 2015 | | | | | |
| Net interest income | 5,503 | 2,991 | 1,705 | 242 | 10,441 |
| Net fee income | 2,803 | 844 | 147 | 90 | 3,884 |
| Net trading income/(loss) | 286 | 249 | 863 | (21) | 1,377 |
| Net income from financial instruments designated at fair value | 715 | - | - | 6 | 721 |
| Dividend income | 1 | - | - | 124 | 125 |
| Net insurance premium income | 5,874 | 373 | - | - | 6,247 |
| Other operating income | 1,622 | 86 | 24 | 148 | 1,880 |
| **Total operating income** | 16,804 | 4,543 | 2,739 | 589 | 24,675 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders | (7,819) | (306) | - | - | (8,125) |
| **Net operating income before loan impairment charges and other credit risk provisions** | 8,985 | 4,237 | 2,739 | 589 | 16,550 |
| Loan impairment charges and other credit risk provisions | (299) | (278) | (17) | - | (594) |
| **Net operating income** | 8,686 | 3,959 | 2,722 | 589 | 15,956 |
| Operating expenses * | (3,317) | (1,245) | (470) | (104) | (5,136) |
| **Operating profit** | 5,369 | 2,714 | 2,252 | 485 | 10,820 |
| Net gain on partial disposal of Industrial Bank | - | - | - | 10,636 | 10,636 |
| Net surplus on property revaluation | - | - | - | 178 | 178 |
| Share of profits from associates | 85 | 1 | - | - | 86 |
| **Profit before tax** | 5,454 | 2,715 | 2,252 | 11,299 | 21,720 |
| Share of profit before tax | 25.1% | 12.5% | 10.4% | 52.0% | 100.0% |
| Share of profit before tax (excluding the gain on partial disposal of Industrial Bank) | 49.2% | 24.5% | 20.3% | 6.0% | 100.0% |
| Operating profit excluding loan impairment charges and other credit risk provisions | 5,668 | 2,992 | 2,269 | 485 | 11,414 |
| ** Depreciation/amortisation included in operating expenses* | (27) | (14) | (3) | (474) | (518) |
| **At 30 June 2015** | | | | | |
| Total assets | 377,134 | 291,505 | 541,001 | 121,798 | 1,331,438 |
| Total liabilities | 751,324 | 236,701 | 178,054 | 25,885 | 1,191,964 |
| Interest in associates | 2,245 | 13 | - | - | 2,258 |

**16 Segmental analysis** *(continued)*

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

| | Retail Banking and Wealth Management | Commercial Banking | Global Banking and Markets | Other | Total |
|---|---|---|---|---|---|
| Half-year ended 31 December 2015 | | | | | |
| Net interest income | 5,778 | 2,938 | 1,793 | 215 | 10,724 |
| Net fee income | 2,061 | 828 | 173 | 92 | 3,154 |
| Net trading (loss)/income | (214) | 161 | 713 | (7) | 653 |
| Net (loss)/income from financial instruments designated at fair value | (847) | (8) | - | 16 | (839) |
| Dividend income | - | - | - | 17 | 17 |
| Net insurance premium income | 3,492 | 106 | - | - | 3,598 |
| Other operating income/(loss) | 1,848 | 41 | (2) | 152 | 2,039 |
| **Total operating income** | 12,118 | 4,066 | 2,677 | 485 | 19,346 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders | (4,756) | (87) | - | - | (4,843) |
| **Net operating income before loan impairment charges and other credit risk provisions** | 7,362 | 3,979 | 2,677 | 485 | 14,503 |
| Loan impairment (charges)/releases and other credit risk provisions | (321) | (246) | 53 | - | (514) |
| **Net operating income** | 7,041 | 3,733 | 2,730 | 485 | 13,989 |
| Operating expenses * | (3,306) | (1,236) | (476) | (328) | (5,346) |
| Impairment loss on intangible assets | (5) | - | - | (19) | (24) |
| **Operating profit** | 3,730 | 2,497 | 2,254 | 138 | 8,619 |
| Net surplus on property revaluation | - | - | - | 83 | 83 |
| Share of profits from associates | 66 | - | - | - | 66 |
| **Profit before tax** | 3,796 | 2,497 | 2,254 | 221 | 8,768 |
| Share of profit before tax | 43.3% | 28.5% | 25.7% | 2.5% | 100.0% |
| Operating profit excluding loan impairment charges and other credit risk provisions | 4,051 | 2,743 | 2,201 | 138 | 9,133 |
| ** Depreciation/amortisation included in operating expenses* | (30) | (13) | (3) | (503) | (549) |
| **At 31 December 2015** | | | | | |
| Total assets | 392,667 | 302,086 | 571,178 | 68,498 | 1,334,429 |
| Total liabilities | 753,208 | 253,626 | 167,178 | 18,436 | 1,192,448 |
| Interest in associates | 2,261 | 14 | - | - | 2,275 |

**16 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. Consolidation adjustments made in preparing the Group's financial statements upon consolidation are included in the "Inter-segment elimination".

| | Hong Kong | Mainland China | Others | Inter-segment elimination | Total |
|---|---|---|---|---|---|
| **Half-year ended 30 June 2016** | | | | | |
| **Income and expense** | | | | | |
| Total operating income | **20,736** | **1,029** | **130** | **(44)** | **21,851** |
| Profit before tax | **9,359** | **55** | **85** | **-** | **9,499** |
| **At 30 June 2016** | | | | | |
| Total assets | **1,240,205** | **101,653** | **19,294** | **(39,785)** | **1,321,367** |
| Total liabilities | **1,106,309** | **90,040** | **18,619** | **(30,314)** | **1,184,654** |
| Equity | **133,896** | **11,613** | **675** | **(9,471)** | **136,713** |
| Share capital | **9,658** | **9,873** | **-** | **(9,873)** | **9,658** |
| Interest in associates | **2,290** | **1** | **-** | **-** | **2,291** |
| Non-current assets* | **49,019** | **1,005** | **20** | **-** | **50,044** |
| Contingent liabilities and commitments | **343,595** | **42,276** | **5,963** | **-** | **391,834** |
| Half-year ended 30 June 2015 | | | | | |
| Income and expense | | | | | |
| Total operating income | 23,662 | 946 | 115 | (48) | 24,675 |
| Profit before tax | 21,627 | 14 | 79 | - | 21,720 |
| At 30 June 2015 | | | | | |
| Total assets | 1,235,776 | 116,241 | 17,635 | (38,214) | 1,331,438 |
| Total liabilities | 1,099,668 | 105,912 | 17,097 | (30,713) | 1,191,964 |
| Equity | 136,108 | 10,329 | 538 | (7,501) | 139,474 |
| Share capital | 9,658 | 8,697 | 12 | (8,709) | 9,658 |
| Interest in associates | 2,237 | 21 | - | - | 2,258 |
| Non-current assets* | 45,025 | 1,111 | 4 | - | 46,140 |
| Contingent liabilities and commitments | 317,051 | 41,795 | 4,832 | - | 363,678 |
| Half-year ended 31 December 2015 | | | | | |
| Income and expense | | | | | |
| Total operating income | 18,144 | 1,112 | 134 | (44) | 19,346 |
| Profit before tax | 8,597 | 87 | 84 | - | 8,768 |
| At 31 December 2015 | | | | | |
| Total assets | 1,244,606 | 113,718 | 19,260 | (43,155) | 1,334,429 |
| Total liabilities | 1,105,668 | 101,806 | 18,655 | (33,681) | 1,192,448 |
| Equity | 138,938 | 11,912 | 605 | (9,474) | 141,981 |
| Share capital | 9,658 | 10,093 | - | (10,093) | 9,658 |
| Interest in associates | 2,272 | 3 | - | - | 2,275 |
| Non-current assets* | 47,414 | 1,046 | 22 | - | 48,482 |
| Contingent liabilities and commitments | 334,682 | 38,545 | 5,645 | - | 378,872 |

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

## 17 Analysis of assets and liabilities by remaining maturity

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

| | Repayable on demand | One month or less but not on demand | Over one month but within three months | Over three months but within one year | Over one year but within five years | Over five years | Trading | No contractual maturity | Total |
|---|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | | |
| Cash and sight balances at central banks | **18,938** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **18,938** |
| Placings with and advances to banks | **15,578** | **47,005** | **29,560** | **2,920** | **1,251** | **993** | **-** | **-** | **97,307** |
| Trading assets | **-** | **-** | **-** | **-** | **-** | **-** | **52,091** | **-** | **52,091** |
| Financial assets designated at fair value | **-** | **-** | **-** | **-** | **10** | **409** | **-** | **9,478** | **9,897** |
| Derivative financial instruments | **-** | **-** | **-** | **138** | **131** | **-** | **8,815** | **-** | **9,084** |
| Reverse repurchase agreements - non trading | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| Loans and advances to customers | **13,833** | **53,254** | **54,194** | **125,276** | **234,945** | **196,940** | **-** | **-** | **678,442** |
| Financial investments: | | | | | | | | | |
| - available-for-sale investments | **-** | **39,015** | **95,873** | **74,769** | **71,517** | **5,388** | **-** | **4,810** | **291,372** |
| - held-to-maturity debt securities | **-** | **-** | **1,292** | **4,809** | **31,461** | **46,469** | **-** | **-** | **84,031** |
| Interest in associates | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **2,291** | **2,291** |
| Investment properties | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **10,329** | **10,329** |
| Premises, plant and equipment | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **26,074** | **26,074** |
| Intangible assets | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **13,641** | **13,641** |
| Other assets | **9,684** | **5,494** | **3,325** | **1,573** | **6,867** | **199** | **-** | **728** | **27,870** |
| **At 30 June 2016** | **58,033** | **144,768** | **184,244** | **209,485** | **346,182** | **250,398** | **60,906** | **67,351** | **1,321,367** |
| At 30 June 2015 | 100,136 | 181,500 | 186,021 | 205,035 | 306,507 | 239,412 | 50,454 | 62,373 | 1,331,438 |
| At 31 December 2015 | 48,087 | 149,792 | 196,460 | 245,687 | 331,671 | 248,349 | 51,476 | 62,907 | 1,334,429 |
| **Liabilities** | | | | | | | | | |
| Current, savings and other deposit accounts | **732,722** | **95,332** | **81,253** | **41,185** | **1,053** | **-** | **-** | **-** | **951,545** |
| Repurchase agreements - non trading | **-** | **1,761** | **-** | **-** | **-** | **-** | **-** | **-** | **1,761** |
| Deposits from banks | **5,931** | **8,228** | **-** | **-** | **-** | **-** | **-** | **-** | **14,159** |
| Trading liabilities | **-** | **-** | **-** | **-** | **-** | **-** | **58,156** | **-** | **58,156** |
| Financial liabilities designated at fair value | **4** | **-** | **-** | **-** | **3,508** | **492** | **-** | **-** | **4,004** |
| Derivative financial instruments | **-** | **205** | **115** | **632** | **1,243** | **69** | **9,326** | **-** | **11,590** |
| Certificates of deposit and other debt securities in issue: | | | | | | | | | |
| - certificates of deposit in issue | **-** | **1,250** | **-** | **4,000** | **-** | **-** | **-** | **-** | **5,250** |
| - other debt securities in issue | **-** | **-** | **-** | **-** | **1,166** | **-** | **-** | **-** | **1,166** |
| Other liabilities | **9,083** | **7,153** | **3,542** | **1,239** | **136** | **2** | **-** | **2,662** | **23,817** |
| Liabilities under insurance contracts | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **104,425** | **104,425** |
| Current tax liabilities | **-** | **-** | **9** | **1,527** | **10** | **-** | **-** | **-** | **1,546** |
| Deferred tax liabilities | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **4,907** | **4,907** |
| Subordinated liabilities | **-** | **-** | **-** | **-** | **-** | **2,328** | **-** | **-** | **2,328** |
| **At 30 June 2016** | **747,740** | **113,929** | **84,919** | **48,583** | **7,116** | **2,891** | **67,482** | **111,994** | **1,184,654** |
| At 30 June 2015 | 686,587 | 148,911 | 105,289 | 46,878 | 11,007 | 6,390 | 82,894 | 104,008 | 1,191,964 |
| At 31 December 2015 | 718,091 | 151,013 | 90,582 | 38,653 | 10,347 | 2,862 | 72,313 | 108,587 | 1,192,448 |

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

| | Repayable on demand | One month or less but not on demand | Over one month but within three months | Over three months but within one year | Over one year but within five years | Over five years | Trading | No contractual maturity | Total |
|---|---|---|---|---|---|---|---|---|---|
| of which: | | | | | | | | | |
| Certificates of deposit included in: | | | | | | | | | |
| - trading assets | - | - | - | - | - | - | - | - | - |
| - financial assets designated at fair value | - | - | - | - | - | - | - | - | - |
| - available-for-sale investments | - | 1,473 | 674 | 3,606 | 303 | - | - | - | 6,056 |
| - held-to-maturity debt securities | - | - | 182 | 320 | 2,301 | 1,280 | - | - | 4,083 |
| **At 30 June 2016** | **-** | **1,473** | **856** | **3,926** | **2,604** | **1,280** | **-** | **-** | **10,139** |
| At 30 June 2015 | - | 611 | 1,618 | 5,055 | 2,566 | 2,202 | - | - | 12,052 |
| At 31 December 2015 | - | 282 | 2,325 | 4,877 | 2,990 | 1,579 | - | - | 12,053 |

| | 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 |
|---|---|---|---|---|---|---|---|---|---|
| Debt securities included in: | | | | | | | | | |
| - trading assets | - | - | - | - | - | - | 51,502 | - | 51,502 |
| - financial assets designated at fair value | - | - | - | - | 10 | 409 | - | - | 419 |
| - available-for-sale investments | - | 37,542 | 95,199 | 71,163 | 71,214 | 5,388 | - | 603 | 281,109 |
| - held-to-maturity debt securities | - | - | 1,110 | 4,489 | 29,160 | 45,189 | - | - | 79,948 |
| **At 30 June 2016** | **-** | **37,542** | **96,309** | **75,652** | **100,384** | **50,986** | **51,502** | **603** | **412,978** |
| At 30 June 2015 | - | 47,383 | 66,063 | 77,404 | 77,018 | 43,115 | 41,534 | 216 | 352,733 |
| At 31 December 2015 | - | 36,509 | 83,881 | 103,310 | 84,244 | 48,746 | 38,080 | 23 | 394,793 |

| | 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 |
|---|---|---|---|---|---|---|---|---|---|
| Certificates of deposit in issue included in: | | | | | | | | | |
| - trading liabilities | - | - | - | - | - | - | - | - | - |
| - financial liabilities designated at fair value | - | - | - | - | 3,508 | - | - | - | 3,508 |
| - issued at amortised cost | - | 1,250 | - | 4,000 | - | - | - | - | 5,250 |
| **At 30 June 2016** | **-** | **1,250** | **-** | **4,000** | **3,508** | **-** | **-** | **-** | **8,758** |
| At 30 June 2015 | - | - | - | 2,492 | 7,510 | - | - | - | 10,002 |
| At 31 December 2015 | - | - | - | - | 7,491 | - | - | - | 7,491 |

## 18 Cash and sight balances at central banks

| | At 30 June 2016 | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Cash in hand | **4,640** | 4,642 | 5,259 |
| Sight balances at central banks | **14,298** | 35,675 | 4,859 |
| | **18,938** | 40,317 | 10,118 |

## 19 Placings with and advances to banks

| | At 30 June 2016 | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Balances with banks | **13,689** | 30,079 | 13,446 |
| Placings with and advances to banks maturing within one month | **48,894** | 71,315 | 56,163 |
| Placings with and advances to banks maturing after one month but less than one year | **32,480** | 49,218 | 52,182 |
| Placings with and advances to banks maturing after one year | **2,244** | 2,155 | 2,199 |
| | **97,307** | 152,767 | 123,990 |
| of which: | | | |
| Placings with and advances to central banks | **10,900** | 11,368 | 10,305 |

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

## 20 Trading assets

| | At 30 June 2016 | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Treasury bills | **36,651** | 24,405 | 21,405 |
| Other debt securities | **14,851** | 17,129 | 16,675 |
| Debt securities | **51,502** | 41,534 | 38,080 |
| Investment funds | **28** | 23 | 21 |
| **Total trading securities** | **51,530** | 41,557 | 38,101 |
| Other* | **561** | 3,215 | 2,272 |
| **Total trading assets** | **52,091** | 44,772 | 40,373 |
| **Debt securities:** | | | |
| Issued by public bodies: | | | |
| - central governments and central banks | **50,868** | 37,699 | 35,386 |
| | **50,868** | 37,699 | 35,386 |
| Issued by other bodies: | | | |
| - banks | **330** | 718 | 768 |
| - corporate entities | **304** | 3,117 | 1,926 |
| | **634** | 3,835 | 2,694 |
| | **51,502** | 41,534 | 38,080 |
| **Investment funds:** | | | |
| Issued by corporate entities | **28** | 23 | 21 |
| **Total trading securities** | **51,530** | 41,557 | 38,101 |

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

## 21 Financial assets designated at fair value

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Treasury bills | **-** | - | 1,070 |
| Other debt securities | **419** | 70 | 66 |
| Debt securities | **419** | 70 | 1,136 |
| Equity shares | **4,453** | 4,258 | 1,838 |
| Investment funds | **5,025** | 3,890 | 4,929 |
| | **9,897** | 8,218 | 7,903 |
| **Debt securities:** | | | |
| Issued by public bodies: | | | |
| - central governments and central banks | **-** | - | 1,070 |
| - other public sector entities | **1** | 1 | 1 |
| | **1** | 1 | 1,071 |
| Issued by other bodies: | | | |
| - banks | **-** | 12 | 6 |
| - corporate entities | **418** | 57 | 59 |
| | **418** | 69 | 65 |
| | **419** | 70 | 1,136 |
| **Equity shares:** | | | |
| Issued by banks | **721** | 751 | 423 |
| Issued by public sector entities | **140** | 10 | 6 |
| Issued by corporate entities | **3,592** | 3,497 | 1,409 |
| | **4,453** | 4,258 | 1,838 |
| **Investment funds:** | | | |
| Issued by corporate entities | **5,025** | 3,890 | 4,929 |
| | **5,025** | 3,890 | 4,929 |
| | **9,897** | 8,218 | 7,903 |

**22 Derivative financial instruments**

Derivative financial instruments are held for trading, as financial instruments designated at fair value, or designated as either fair value hedges or cash flow hedges. The Group primarily traded over-the-counter derivatives and also participated in exchange traded derivatives. The following table shows the nominal contract amounts and marked-to-market value of assets and liabilities by class of derivatives.

| | **At 30 June 2016** | | | At 30 June 2015 | | | At 31 December 2015 | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Contract amounts** | **Derivative assets** | **Derivative liabilities** | Contract amounts | Derivative assets | Derivative liabilities | Contract amounts | Derivative assets | Derivative liabilities |
| **Derivatives held for trading** | | | | | | | | | |
| Exchange rate contracts: | | | | | | | | | |
| - spot and forward foreign exchange | **763,117** | **4,408** | **5,175** | 618,719 | 2,986 | 2,802 | 623,963 | 5,572 | 4,066 |
| - currency swaps | **89,223** | **1,262** | **1,366** | 47,353 | 237 | 255 | 62,549 | 1,516 | 1,399 |
| - currency options purchased | **43,979** | **1,349** | **-** | 117,659 | 1,025 | - | 68,008 | 2,787 | - |
| - currency options written | **44,071** | **-** | **1,362** | 114,836 | - | 1,009 | 64,812 | - | 2,808 |
| | **940,390** | **7,019** | **7,903** | 898,567 | 4,248 | 4,066 | 819,332 | 9,875 | 8,273 |
| Interest rate contracts: | | | | | | | | | |
| - interest rate swaps | **239,074** | **1,216** | **1,283** | 183,267 | 1,047 | 1,022 | 207,984 | 873 | 867 |
| - interest rate options written | **6,514** | **-** | **-** | 4,287 | - | - | 4,482 | - | - |
| - other interest rate contracts | **1,819** | **2** | **3** | 1,141 | 1 | 1 | 948 | 2 | - |
| | **247,407** | **1,218** | **1,286** | 188,695 | 1,048 | 1,023 | 213,414 | 875 | 867 |
| Equity and other contracts: | | | | | | | | | |
| - equity swaps | **3,858** | **6** | **62** | 4,439 | 2 | 141 | 2,687 | 2 | 92 |
| - equity options purchased | **11,628** | **336** | **-** | 9,839 | 353 | - | 11,599 | 351 | - |
| - equity options written | **7,317** | **-** | **75** | 4,761 | - | 121 | 9,204 | - | 162 |
| - spot and forward contracts and others | **2,181** | **236** | **-** | 690 | 7 | - | 411 | - | 2 |
| | **24,984** | **578** | **137** | 19,729 | 362 | 262 | 23,901 | 353 | 256 |
| Total derivatives held for trading | **1,212,781** | **8,815** | **9,326** | 1,106,991 | 5,658 | 5,351 | 1,056,647 | 11,103 | 9,396 |
| **Derivatives managed in conjunction with financial assets designated at fair value** | | | | | | | | | |
| Interest rate contracts: | | | | | | | | | |
| - interest rate swaps | **3,500** | **30** | **-** | 3,500 | 24 | - | 3,500 | 20 | - |
| **Cash flow hedge derivatives** | | | | | | | | | |
| Exchange rate contracts: | | | | | | | | | |
| - currency swaps | **20,804** | **222** | **1,294** | 7,034 | 255 | 32 | 15,359 | 388 | 163 |
| Interest rate contracts: | | | | | | | | | |
| - interest rate swaps | **4,890** | **15** | **3** | 32,286 | 59 | 13 | 28,259 | 44 | 10 |
| | **25,694** | **237** | **1,297** | 39,320 | 314 | 45 | 43,618 | 432 | 173 |
| **Fair value hedge derivatives** | | | | | | | | | |
| Interest rate contracts: | | | | | | | | | |
| - interest rate swaps | **42,064** | **2** | **967** | 22,982 | 8 | 481 | 29,381 | 40 | 419 |
| **Total derivatives** | **1,284,039** | **9,084** | **11,590** | 1,172,793 | 6,004 | 5,877 | 1,133,146 | 11,595 | 9,988 |

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

## 23 Loans and advances to customers

### (a) Loans and advances to customers

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Gross loans and advances to customers | **680,184** | 675,086 | 690,561 |
| Less: loan impairment allowances | | | |
| - individually assessed | **(896)** | (1,223) | (807) |
| - collectively assessed | **(846)** | (841) | (808) |
| | **678,442** | 673,022 | 688,946 |

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

| | **At 30 June 2016 %** | At 30 June 2015 % | At 31 December 2015 % |
|---|---|---|---|
| Loan impairment allowances: | | | |
| - individually assessed | **0.13** | 0.18 | 0.12 |
| - collectively assessed | **0.12** | 0.12 | 0.12 |
| Total loan impairment allowances | **0.25** | 0.30 | 0.24 |

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

| | **Individually assessed** | **Collectively assessed** | **Total** |
|---|---|---|---|
| At 1 January 2016 | **807** | **808** | **1,615** |
| Amounts written off | **(222)** | **(371)** | **(593)** |
| Recoveries of loans and advances written off in previous years | **5** | **36** | **41** |
| New impairment allowances charged to condensed consolidated income statement (note 11) | **379** | **418** | **797** |
| Impairment allowances released to condensed consolidated income statement (note 11) | **(40)** | **(36)** | **(76)** |
| Unwinding of discount of loan impairment allowances recognised as "interest income" | **(27)** | **(3)** | **(30)** |
| Exchange difference | **(6)** | **(6)** | **(12)** |
| At 30 June 2016 | **896** | **846** | **1,742** |
| | | | |
| At 1 January 2015 | 999 | 839 | 1,838 |
| Amounts written off | (56) | (331) | (387) |
| Recoveries of loans and advances written off in previous years | 6 | 36 | 42 |
| New impairment allowances charged to condensed consolidated income statement (note 11) | 334 | 342 | 676 |
| Impairment allowances released to condensed consolidated income statement (note 11) | (40) | (42) | (82) |
| Unwinding of discount of loan impairment allowances recognised as "interest income" | (18) | (3) | (21) |
| Exchange difference | (2) | - | (2) |
| At 30 June 2015 | 1,223 | 841 | 2,064 |
| | | | |
| At 1 July 2015 | 1,223 | 841 | 2,064 |
| Amounts written off | (620) | (343) | (963) |
| Recoveries of loans and advances written off in previous years | 10 | 40 | 50 |
| New impairment allowances charged to condensed consolidated income statement (note 11) | 260 | 370 | 630 |
| Impairment allowances released to condensed consolidated income statement (note 11) | (26) | (90) | (116) |
| Unwinding of discount of loan impairment allowances recognised as "interest income" | (18) | (2) | (20) |
| Exchange difference | (22) | (8) | (30) |
| At 31 December 2015 | 807 | 808 | 1,615 |

**23 Loans and advances to customers** *(continued)*

**(c) Impaired loans and advances to customers and allowances**

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Gross impaired loans and advances | **3,714** | 2,871 | 2,737 |
| Individually assessed allowances | **(896)** | (1,223) | (807) |
| Net impaired loans and advances | **2,818** | 1,648 | 1,930 |
| Individually assessed allowances as a percentage of gross impaired loans and advances | **24.1%** | 42.6% | 29.5% |
| Gross impaired loans and advances as a percentage of gross loans and advances to customers | **0.55%** | 0.43% | 0.40% |

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

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Gross individually assessed impaired loans and advances | **3,483** | 2,696 | 2,505 |
| Individually assessed allowances | **(896)** | (1,223) | (807) |
| | **2,587** | 1,473 | 1,698 |
| Gross individually assessed impaired loans and advances as a percentage of gross loans and advances to customers | **0.51%** | 0.40% | 0.36% |
| Amount of collateral which has been taken into account in respect of individually assessed impaired loans and advances to customers | **2,086** | 1,095 | 1,651 |

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.

**23 Loans and advances to customers** *(continued)*

**(d) Overdue loans and advances to customers**

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

| | **At 30 June 2016** | **%** | At 30 June 2015 | % | At 31 December 2015 | % |
|---|---|---|---|---|---|---|
| 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 | **680** | **0.1** | 557 | 0.1 | 696 | 0.1 |
| - more than six months but not more than one year | **740** | **0.1** | 937 | 0.1 | 543 | 0.1 |
| - more than one year | **1,185** | **0.2** | 590 | 0.1 | 912 | 0.1 |
| | **2,605** | **0.4** | 2,084 | 0.3 | 2,151 | 0.3 |
| of which: | | | | | | |
| - individually impaired allowances | **(627)** | | (1,136) | | (759) | |
| - covered portion of overdue loans and advances | **1,778** | | 549 | | 1,141 | |
| - uncovered portion of overdue loans and advances | **827** | | 1,535 | | 1,010 | |
| - current market value of collateral held against the covered portion of overdue loans and advances | **3,767** | | 1,722 | | 2,527 | |

Collateral held with respect to overdue loans and advances is mainly residential properties, industrial properties, commercial properties and customer deposits. The current market value of residential properties, industrial properties, commercial properties and customer deposits were HK$2,096m, HK$262m, HK$129m and HK$1,123m respectively.

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

**(e) Rescheduled loans and advances to customers**

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

| | **At 30 June 2016** | **%** | At 30 June 2015 | % | At 31 December 2015 | % |
|---|---|---|---|---|---|---|
| Rescheduled loans and advances to customers | **120** | **-** | 296 | - | 140 | - |

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 23d).

**23 Loans and advances to customers** *(continued)*

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

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

| | Gross loans and advances | Individually impaired loans and advances | Overdue loans and advances | Individually assessed allowances | Collectively assessed allowances |
|---|---|---|---|---|---|
| **At 30 June 2016** | | | | | |
| Hong Kong | **571,374** | **2,145** | **1,977** | **492** | **622** |
| Mainland China | **79,818** | **1,323** | **627** | **396** | **167** |
| Others | **28,992** | **15** | **1** | **8** | **57** |
| | **680,184** | **3,483** | **2,605** | **896** | **846** |
| At 30 June 2015 | | | | | |
| Hong Kong | 560,975 | 1,671 | 1,117 | 570 | 690 |
| Mainland China | 88,762 | 1,018 | 964 | 652 | 126 |
| Others | 25,349 | 7 | 3 | 1 | 25 |
| | 675,086 | 2,696 | 2,084 | 1,223 | 841 |
| At 31 December 2015 | | | | | |
| Hong Kong | 567,668 | 1,667 | 1,539 | 414 | 605 |
| Mainland China | 97,131 | 829 | 611 | 392 | 171 |
| Others | 25,762 | 9 | 1 | 1 | 32 |
| | 690,561 | 2,505 | 2,151 | 807 | 808 |

**(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 ("HKMA") is as follows:

| | **At 30 June 2016** | | At 30 June 2015 | | At 31 December 2015 | |
|---|---|---|---|---|---|---|
| | | **% of gross advances covered by collateral** | | % 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 | **48,178** | **42.9** | 44,861 | 46.0 | 43,951 | 46.7 |
| - property investment | **110,863** | **87.6** | 107,675 | 97.4 | 108,840 | 90.5 |
| - financial concerns | **6,731** | **44.7** | 5,342 | 40.1 | 5,556 | 28.7 |
| - stockbrokers | **183** | **83.6** | 1,532 | 1.9 | 32 | 96.9 |
| - wholesale and retail trade | **25,461** | **47.2** | 25,672 | 47.2 | 27,272 | 43.0 |
| - manufacturing | **20,098** | **42.1** | 20,833 | 55.4 | 21,478 | 43.2 |
| - transport and transport equipment | **8,920** | **65.1** | 9,011 | 70.6 | 9,608 | 68.5 |
| - recreational activities | **20** | **48.2** | 120 | 13.3 | 114 | 11.5 |
| - information technology | **5,342** | **18.6** | 3,048 | 31.3 | 3,821 | 18.1 |
| - other | **45,779** | **62.3** | 43,231 | 57.3 | 42,307 | 62.8 |
| | **271,575** | **65.1** | 261,325 | 70.2 | 262,979 | 66.7 |
| **Individuals** | | | | | | |
| - loans and advances for the purchase of flats under the Government Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme | **16,973** | **100.0** | 16,095 | 100.0 | 16,446 | 100.0 |
| - loans and advances for the purchase of other residential properties | **158,763** | **100.0** | 152,275 | 100.0 | 158,275 | 100.0 |
| - credit card loans and advances | **25,064** | **-** | 23,947 | - | 25,982 | - |
| - other | **20,124** | **40.8** | 19,372 | 42.4 | 19,737 | 40.6 |
| | **220,924** | **83.3** | 211,689 | 83.4 | 220,440 | 82.9 |
| **Total gross loans and advances for use in Hong Kong** | **492,499** | **73.2** | 473,014 | 76.1 | 483,419 | 74.1 |
| **Trade finance** | **40,593** | **24.8** | 40,484 | 26.0 | 46,885 | 22.0 |
| **Gross loans and advances for use outside Hong Kong** | **147,092** | **33.6** | 161,588 | 23.2 | 160,257 | 31.0 |
| **Gross loans and advances to customers** | **680,184** | **61.8** | 675,086 | 60.5 | 690,561 | 60.6 |

## 24 Financial investments

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Financial investments: | | | |
| - which may be repledged or resold by counterparties | **1,833** | 1,226 | 923 |
| - which may not be repledged or resold or are not subject to repledge or resale by counterparties | **373,570** | 326,972 | 371,349 |
| | **375,403** | 328,198 | 372,272 |
| Held-to-maturity debt securities at amortised cost | **84,031** | 76,591 | 81,822 |
| Available-for-sale at fair value: | | | |
| - debt securities | **287,165** | 246,590 | 285,808 |
| - equity shares | **4,207** | 5,007 | 4,633 |
| - investment funds | **-** | 10 | 9 |
| | **375,403** | 328,198 | 372,272 |
| Treasury bills | **151,383** | 139,176 | 152,014 |
| Certificates of deposit | **10,139** | 12,052 | 12,053 |
| Other debt securities | **209,674** | 171,953 | 203,563 |
| Debt securities | **371,196** | 323,181 | 367,630 |
| Equity shares | **4,207** | 5,007 | 4,633 |
| Investment funds | **-** | 10 | 9 |
| | **375,403** | 328,198 | 372,272 |

There were no overdue debt securities at 30 June 2016 and the comparative periods for the Group. The Group did not hold any asset-backed securities, mortgage-backed securities and collateralised debt obligations.

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

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Issued by public bodies: | | | |
| - central governments and central banks | **617** | 609 | 612 |
| - other public sector entities | **10,712** | 11,425 | 10,993 |
| | **11,329** | 12,034 | 11,605 |
| Issued by other bodies: | | | |
| - banks | **33,295** | 31,682 | 33,175 |
| - corporate entities | **39,407** | 32,875 | 37,042 |
| | **72,702** | 64,557 | 70,217 |
| | **84,031** | 76,591 | 81,822 |
| Fair value of held-to-maturity debt securities: | **88,717** | 79,210 | 84,571 |

There were no held-to-maturity debt securities determined to be impaired at 30 June 2016 and the comparative periods for the Group.

**24 Financial investments** *(continued)*

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

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Issued by public bodies: | | | |
| - central governments and central banks | **217,563** | 191,346 | 222,977 |
| - other public sector entities | **17,315** | 14,113 | 14,966 |
| | **234,878** | 205,459 | 237,943 |
| Issued by other bodies: | | | |
| - banks | **48,249** | 36,099 | 42,665 |
| - corporate entities | **4,038** | 5,032 | 5,200 |
| | **52,287** | 41,131 | 47,865 |
| | **287,165** | 246,590 | 285,808 |

For the periods indicated, 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.

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

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Issued by banks | **3,533** | 4,505 | 4,096 |
| Issued by corporate entities | **674** | 502 | 537 |
| | **4,207** | 5,007 | 4,633 |

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

**(d) Available-for-sale investment funds**

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Issued by corporate entities | **-** | 10 | 9 |

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

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

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| AA- to AAA | **271,183** | 246,941 | 277,556 |
| A- to A+ | **89,551** | 66,558 | 79,526 |
| B+ to BBB+ | **7,704** | 7,402 | 8,136 |
| Unrated | **2,758** | 2,280 | 2,412 |
| | **371,196** | 323,181 | 367,630 |

## 25 Interest in associates

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Share of net assets | **2,291** | 2,258 | 2,275 |

## 26 Investment properties

| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Half-year ended 31 December 2015 |
|---|---|---|---|
| Beginning of the period | **10,075** | 11,732 | 9,899 |
| Additions | **-** | 699 | - |
| (Deficit)/Surplus on revaluation (charged)/credited to condensed consolidated income statement | **(50)** | 216 | 201 |
| Transfer from/(to) premises (note 27) | **304** | (2,748) | (25) |
| End of the period | **10,329** | 9,899 | 10,075 |
| Representing: | | | |
| - measure at valuation | **10,329** | 9,899 | 10,075 |

## 27 Premises, plant and equipment

**Movement of premises, plant and equipment**

| | **Premises** | **Plant and equipment** | **Total** |
|---|---|---|---|
| Cost or valuation: | | | |
| At 1 January 2016 | **25,108** | **4,505** | **29,613** |
| Additions | **147** | **351** | **498** |
| Disposals | **-** | **(135)** | **(135)** |
| Elimination of accumulated depreciation on revalued premises | **(378)** | **-** | **(378)** |
| Surplus on revaluation: | | | |
| - credited to premises revaluation reserve | **277** | **-** | **277** |
| Transfer to investment properties (note 26) | **(304)** | **-** | **(304)** |
| Exchange difference | **(19)** | **(12)** | **(31)** |
| At 30 June 2016 | **24,831** | **4,709** | **29,540** |
| Accumulated depreciation: | | | |
| At 1 January 2016 | **-** | **(3,427)** | **(3,427)** |
| Charge for the period (note 12) | **(378)** | **(173)** | **(551)** |
| Written off on disposal | **-** | **124** | **124** |
| Elimination of accumulated depreciation on revalued premises | **378** | **-** | **378** |
| Exchange difference | **-** | **10** | **10** |
| At 30 June 2016 | **-** | **(3,466)** | **(3,466)** |
| Net book value at 30 June 2016 | **24,831** | **1,243** | **26,074** |
| Representing: | | | |
| - measure at cost | **-** | **1,243** | **1,243** |
| - measure at valuation | **24,831** | **-** | **24,831** |
| | **24,831** | **1,243** | **26,074** |

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

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

| | Premises | Plant and equipment | Total |
|---|---|---|---|
| Cost or valuation: | | | |
| At 1 January 2015 | 21,073 | 4,163 | 25,236 |
| Additions | - | 386 | 386 |
| Disposals | - | (135) | (135) |
| Elimination of accumulated depreciation on revalued premises | (320) | - | (320) |
| Surplus on revaluation: | | | |
| - credited to premises revaluation reserve | 1,103 | - | 1,103 |
| Transfer from investment properties (note 26) | 2,748 | - | 2,748 |
| Exchange difference | - | - | - |
| At 30 June 2015 | 24,604 | 4,414 | 29,018 |
| Accumulated depreciation: | | | |
| At 1 January 2015 | - | (3,338) | (3,338) |
| Charge for the period (note 12) | (320) | (142) | (462) |
| Written off on disposal | - | 126 | 126 |
| Elimination of accumulated depreciation on revalued premises | 320 | - | 320 |
| Exchange difference | - | - | - |
| At 30 June 2015 | - | (3,354) | (3,354) |
| Net book value at 30 June 2015 | 24,604 | 1,060 | 25,664 |
| Representing: | | | |
| - measure at cost | - | 1,060 | 1,060 |
| - measure at valuation | 24,604 | - | 24,604 |
| | 24,604 | 1,060 | 25,664 |
| Cost or valuation: | | | |
| At 1 July 2015 | 24,604 | 4,414 | 29,018 |
| Additions | 84 | 185 | 269 |
| Disposals | - | (66) | (66) |
| Elimination of accumulated depreciation on revalued premises | (340) | - | (340) |
| Surplus on revaluation: | | | |
| - credited to premises revaluation reserve | 775 | - | 775 |
| Transfer from investment properties (note 26) | 25 | - | 25 |
| Exchange difference | (40) | (28) | (68) |
| At 31 December 2015 | 25,108 | 4,505 | 29,613 |
| Accumulated depreciation: | | | |
| At 1 July 2015 | - | (3,354) | (3,354) |
| Charge for the period (note 12) | (340) | (155) | (495) |
| Written off on disposal | - | 62 | 62 |
| Elimination of accumulated depreciation on revalued premises | 340 | - | 340 |
| Exchange difference | - | 20 | 20 |
| At 31 December 2015 | - | (3,427) | (3,427) |
| Net book value at 31 December 2015 | 25,108 | 1,078 | 26,186 |
| Representing: | | | |
| - measure at cost | - | 1,078 | 1,078 |
| - measure at valuation | 25,108 | - | 25,108 |
| | 25,108 | 1,078 | 26,186 |

## 28 Intangible assets

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Present value of in-force long-term insurance business | **12,851** | 9,774 | 11,431 |
| Internally developed software | **409** | 387 | 379 |
| Acquired software | **52** | 87 | 82 |
| Goodwill | **329** | 329 | 329 |
| | **13,641** | 10,577 | 12,221 |

## 29 Other assets

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Items in the course of collection from other banks | **8,433** | 7,177 | 6,922 |
| Bullion | **1,945** | 3,854 | 3,536 |
| Prepayments and accrued income | **3,644** | 3,946 | 3,717 |
| Acceptances and endorsements | **4,224** | 6,326 | 5,724 |
| Reinsurers' share of liabilities under insurance contracts | **6,882** | 3,717 | 5,782 |
| Other accounts | **2,742** | 2,818 | 2,794 |
| | **27,870** | 27,838 | 28,475 |

Other accounts included "Assets held for sale" of HK$39m (30 June 2015: HK$11m, 31 December 2015: HK$33m). It also included "Retirement benefit assets" of HK$27m (30 June 2015: HK$41m, 31 December 2015: HK$42m).

There were no significant impaired, overdue or rescheduled other assets at the period-ends.

## 30 Current, savings and other deposit accounts

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Current, savings and other deposit accounts: | | | |
| - as stated in condensed consolidated balance sheet | **951,545** | 947,495 | 959,228 |
| - structured deposits reported as trading liabilities (note 31) | **25,624** | 36,715 | 27,440 |
| | **977,169** | 984,210 | 986,668 |
| By type: | | | |
| - demand and current accounts | **92,844** | 83,459 | 86,644 |
| - savings accounts | **638,640** | 580,379 | 615,135 |
| - time and other deposits | **245,685** | 320,372 | 284,889 |
| | **977,169** | 984,210 | 986,668 |

## 31 Trading liabilities

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Other structured debt securities in issue (note 33) | **3,822** | 4,680 | 2,351 |
| Structured deposits (note 30) | **25,624** | 36,715 | 27,440 |
| Short positions in securities and others | **28,710** | 36,148 | 33,126 |
| | **58,156** | 77,543 | 62,917 |

## 32 Financial liabilities designated at fair value

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Certificates of deposit in issue (note 33) | **3,508** | 3,510 | 3,491 |
| Liabilities to customers under investment contracts | **496** | 517 | 503 |
| | **4,004** | 4,027 | 3,994 |

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

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Certificates of deposit and other debt securities in issue: | | | |
| - as stated in condensed consolidated balance sheet | **6,416** | 7,738 | 5,191 |
| - certificates of deposit in issue designated at fair value (note 32) | **3,508** | 3,510 | 3,491 |
| - other structured debt securities in issue reported as trading liabilities (note 31) | **3,822** | 4,680 | 2,351 |
| | **13,746** | 15,928 | 11,033 |
| By type: | | | |
| - certificates of deposit in issue | **8,758** | 10,002 | 7,491 |
| - other debt securities in issue | **4,988** | 5,926 | 3,542 |
| | **13,746** | 15,928 | 11,033 |

## 34 Other liabilities

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Items in the course of transmission to other banks | **10,588** | 8,563 | 7,586 |
| Accruals | **2,833** | 3,463 | 3,531 |
| Acceptances and endorsements | **4,224** | 6,326 | 5,724 |
| Retirement benefit liabilities | **1,728** | 1,380 | 1,013 |
| Other | **4,444** | 3,155 | 3,037 |
| | **23,817** | 22,887 | 20,891 |

**35 Subordinated liabilities**

| Nominal value | Description | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|---|
| **Amounts owed to HSBC Group undertakings** | | | | |
| US$450 million | Floating rate subordinated loan due July 2021 (1) | **-** | 3,488 | - |
| US$300 million | Floating rate subordinated loan due July 2022 (2) | **2,328** | 2,326 | 2,325 |
| | | **2,328** | 5,814 | 2,325 |
| Representing: | | | | |
| - measured at amortised cost | | **2,328** | 5,814 | 2,325 |

(1) *The Bank exercised its option to redeem the subordinated loan at par of US$450 million.*

(2) *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 serves 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 for the periods indicated.

## 36 Shareholders' funds

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| Share capital | **9,658** | 9,658 | 9,658 |
| Retained profits | **100,615** | 102,085 | 105,363 |
| Other equity instruments | **6,981** | 6,981 | 6,981 |
| Premises revaluation reserve | **16,760** | 16,379 | 16,777 |
| Cash flow hedging reserve | **(26)** | 4 | (9) |
| Available-for-sale investment reserve | | | |
| - on debt securities | **225** | 277 | 23 |
| - on equity securities | **1,483** | 2,292 | 1,916 |
| Other reserves | **1,017** | 1,798 | 1,272 |
| Total reserves | **127,055** | 129,816 | 132,323 |
| Shareholders' funds | **136,713** | 139,474 | 141,981 |
| Return on average ordinary shareholders' equity* | **12.4%** | 31.0% | 10.6% |

** For the half-year ended*

To satisfy the provisions of the Hong Kong Banking Ordinance and local regulatory requirements for prudential supervision purposes, the Group has earmarked a "regulatory reserve" directly from retained profits. As at 30 June 2016, the effect of this requirement is to restrict the amount of reserves which can be distributed by the Group to shareholders by HK$5,823m (HK$6,382m and HK$6,610m at 30 June 2015 and 31 December 2015 respectively).

## 37 Other equity instruments

| Nominal value | Description | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|---|
| US$900 million | Floating rate perpetual capital instrument callable from December 2019 [1] | **6,981** | 6,981 | 6,981 |

[1] *Coupon rate at one-year US dollar LIBOR plus 3.84 per cent.*

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.

**38 Reconciliation of cash flow statement**

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

| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 |
|---|---|---|
| Operating profit | **9,516** | 10,820 |
| Net interest income | **(11,003)** | (10,441) |
| Dividend income | **(174)** | (125) |
| Loan impairment charges and other credit risk provisions | **721** | 594 |
| Depreciation | **551** | 462 |
| Amortisation of intangible assets | **51** | 56 |
| Amortisation of available-for-sale investments | **223** | 25 |
| Amortisation of held-to-maturity debt securities | **-** | (1) |
| Loans and advances written off net of recoveries | **(552)** | (345) |
| Movement in present value of in-force long-term insurance business | **(1,420)** | (1,511) |
| Interest received | **11,799** | 12,727 |
| Interest paid | **(1,964)** | (2,841) |
| **Operating profit before changes in working capital** | **7,748** | 9,420 |
| Change in treasury bills and certificates of deposit with original maturity more than three months | **(965)** | (16,986) |
| Change in placings with and advances to banks maturing after one month | **19,702** | 5,824 |
| Change in trading assets | **(9,861)** | (2,198) |
| Change in financial assets designated at fair value | **62** | - |
| Change in derivative financial instruments | **3,972** | 832 |
| Change in reverse repurchase agreements - non-trading | **-** | (608) |
| Change in loans and advances to customers | **10,347** | (18,227) |
| Change in other assets | **254** | (1,104) |
| Change in financial liabilities designated at fair value | **18** | 517 |
| Change in current, savings and other deposit accounts | **(7,683)** | 50,974 |
| Change in repurchase agreements - non-trading | **(554)** | 3,032 |
| Change in deposits from banks | **(4,068)** | 4,953 |
| Change in trading liabilities | **(4,761)** | 4,956 |
| Change in certificates of deposit and other debt securities in issue | **1,225** | (4,664) |
| Change in other liabilities | **187** | 3,739 |
| Elimination of exchange differences and other non-cash items | **(774)** | (1,651) |
| **Cash generated from operating activities** | **14,849** | 38,809 |
| Taxation paid | **(28)** | (22) |
| **Net cash inflow from operating activities** | **14,821** | 38,787 |

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

| | **At 30 June 2016** | At 30 June 2015 |
|---|---|---|
| Cash and sight balances at central banks | **18,938** | 40,317 |
| Balances with banks | **13,689** | 30,079 |
| Items in the course of collection from other banks | **8,433** | 7,177 |
| Placings with and advances to banks maturing within one month | **48,233** | 69,578 |
| Treasury bills | **24,777** | 28,311 |
| Certificates of deposit | **664** | - |
| Less: items in the course of transmission to other banks | **(10,588)** | (8,563) |
| | **104,146** | 166,899 |

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$17,199m at 30 June 2016 (HK$36,466m at 30 June 2015).

**39 Contingent liabilities, commitments and derivatives**

| | **At 30 June 2016** | At 30 June 2015 | At 31 December 2015 |
|---|---|---|---|
| **Contingent liabilities and commitments** | | | |
| **Contract amounts** | | | |
| Direct credit substitutes | **6,849** | 4,552 | 7,558 |
| Transaction-related contingencies | **4,442** | 3,108 | 3,336 |
| Trade-related contingencies | **10,137** | 13,541 | 11,217 |
| Commitments that are unconditionally cancellable without prior notice | **327,535** | 303,965 | 323,270 |
| Commitments which have an original maturity of not more than one year | **4,071** | 6,391 | 2,642 |
| Commitments which have an original maturity of more than one year | **28,353** | 24,275 | 22,126 |
| | **381,387** | 355,832 | 370,149 |
| **Risk-weighted amounts** | **39,414** | 32,568 | 36,227 |

The table above gives the nominal contract amounts and risk-weighted amounts of contingent liabilities and commitments. The information is consistent with that in the "Capital Adequacy Ratio" return submitted to the HKMA by the Group. The return is prepared on a consolidated basis as specified by the HKMA under the requirements of section 3C(1) of the Banking (Capital) Rules.

For accounting purposes, acceptances and endorsements are recognised on the condensed consolidated 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, acceptances and endorsements are included in the capital adequacy calculation as if they were contingencies.

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.

| | **Contract amounts** | **Risk-weighted amounts** | **Fair value** |
|---|---|---|---|
| **Derivative transactions** | | | |
| **At 30 June 2016** | | | |
| Exchange rate contracts: | | | |
| - foreign exchange | **666,790** | **1,295** | **832** |
| - currency swaps | **110,664** | **356** | **68** |
| - currency options purchased | **42,812** | **2,526** | **1,307** |
| | **820,266** | **4,177** | **2,207** |
| Interest rate contracts: | | | |
| - interest rate swaps | **289,328** | **240** | **173** |
| - other interest rate contracts | **1,362** | **-** | **1** |
| | **290,690** | **240** | **174** |
| Equity and other contracts: | | | |
| - equity swaps | **3,857** | **33** | **5** |
| - equity options purchased | **13,557** | **311** | **344** |
| | **17,414** | **344** | **349** |

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

| | Contract amounts | Risk-weighted amounts | Fair value |
|---|---|---|---|
| At 30 June 2015 | | | |
| Exchange rate contracts: | | | |
| - foreign exchange | 525,622 | 1,168 | 1,104 |
| - currency swaps | 54,650 | 383 | 306 |
| - currency options purchased | 117,196 | 4,336 | 1,016 |
| | 697,468 | 5,887 | 2,426 |
| Interest rate contracts: | | | |
| - interest rate swaps | 242,035 | 430 | 356 |
| - other interest rate contracts | 318 | - | - |
| | 242,353 | 430 | 356 |
| Equity and other contracts: | | | |
| - equity swaps | 4,439 | 37 | 2 |
| - equity options purchased | 6,604 | 323 | 187 |
| | 11,043 | 360 | 189 |
| At 31 December 2015 | | | |
| Exchange rate contracts: | | | |
| - foreign exchange | 556,913 | 1,365 | 1,858 |
| - currency swaps | 78,350 | 416 | 372 |
| - currency options purchased | 67,947 | 5,080 | 2,712 |
| | 703,210 | 6,861 | 4,942 |
| Interest rate contracts: | | | |
| - interest rate swaps | 268,924 | 263 | 32 |
| - other interest rate contracts | 948 | - | - |
| | 269,872 | 263 | 32 |
| Equity and other contracts: | | | |
| - equity swaps | 2,687 | 22 | 2 |
| - equity options purchased | 12,894 | 396 | 246 |
| | 15,581 | 418 | 248 |

The table above gives the contract amounts, risk-weighted amounts and fair value of derivative transactions. The information is consistent with that in the 'Capital Adequacy Ratio' return submitted to the HKMA. The return is prepared on a consolidated basis as specified by the HKMA under the requirements of section 3C(1) of the Banking (Capital) Rules.

The contract amounts of derivatives indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Fair value is a close approximation of the credit risk for these contracts at the balance sheet date. Credit risk for risk-weighting is measured as the sum of positive fair values and an estimate for the future fluctuation risk, using a future risk factor. Fair value is calculated after taking into account the effect of valid bilateral netting agreements amounting to HK$5,765m at 30 June 2016 (30 June 2015: HK$2,404m, 31 December 2015: HK$5,840m).

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

**40 Material related-party transactions**

There were no changes in the related party transactions described in the 2015 Annual Report that have had a material effect on the financial position or performance of the Group in the half-year to 30 June 2016. All related party transactions that took place in the half-year to 30 June 2016 were similar in nature to those disclosed in the 2015 Annual Report.

**41 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.

| | 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** | | | | | | |
| **At 30 June 2016** | | | | | | |
| **Assets** | | | | | | |
| Trading assets | **49,582** | **2,509** | **-** | **52,091** | **-** | **52,091** |
| Financial assets designated at fair value | **5,183** | **4,116** | **598** | **9,897** | **-** | **9,897** |
| Derivative financial instruments | **509** | **6,418** | **7** | **6,934** | **2,150** | **9,084** |
| Available-for-sale financial investments | **188,107** | **102,097** | **1,168** | **291,372** | **-** | **291,372** |
| **Liabilities** | | | | | | |
| Trading liabilities | **28,380** | **29,615** | **161** | **58,156** | **-** | **58,156** |
| Financial liabilities designated at fair value | **-** | **4,004** | **-** | **4,004** | **-** | **4,004** |
| Derivative financial instruments | **57** | **8,525** | **2** | **8,584** | **3,006** | **11,590** |
| At 30 June 2015 | | | | | | |
| **Assets** | | | | | | |
| Trading assets | 36,316 | 8,456 | - | 44,772 | - | 44,772 |
| Financial assets designated at fair value | 5,785 | 1,764 | 669 | 8,218 | - | 8,218 |
| Derivative financial instruments | 632 | 4,703 | 21 | 5,356 | 648 | 6,004 |
| Available-for-sale financial investments | 163,166 | 87,115 | 1,326 | 251,607 | - | 251,607 |
| **Liabilities** | | | | | | |
| Trading liabilities | 35,704 | 41,789 | 50 | 77,543 | - | 77,543 |
| Financial liabilities designated at fair value | - | 4,027 | - | 4,027 | - | 4,027 |
| Derivative financial instruments | 109 | 4,284 | 2 | 4,395 | 1,482 | 5,877 |
| At 31 December 2015 | | | | | | |
| **Assets** | | | | | | |
| Trading assets | 34,513 | 5,860 | - | 40,373 | - | 40,373 |
| Financial assets designated at fair value | 3,330 | 4,026 | 547 | 7,903 | - | 7,903 |
| Derivative financial instruments | 494 | 9,796 | 13 | 10,303 | 1,292 | 11,595 |
| Available-for-sale financial investments | 197,686 | 91,603 | 1,161 | 290,450 | - | 290,450 |
| **Liabilities** | | | | | | |
| Trading liabilities | 33,062 | 29,828 | 27 | 62,917 | - | 62,917 |
| Financial liabilities designated at fair value | - | 3,994 | - | 3,994 | - | 3,994 |
| Derivative financial instruments | 44 | 6,770 | 3 | 6,817 | 3,171 | 9,988 |

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

**41 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.

During the six months ended 30 June 2016, there were no material transfers between Level 1 and Level 2.

**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 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 access 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.

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.

**41 Fair value of financial instruments** *(continued)*

**(a) Fair value of financial instruments carried at fair value** *(continued)*

*Determination of fair value (continued)*

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 judgmental. 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.

**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.

**41 Fair value of financial instruments** *(continued)*

**(a) Fair value of financial instruments carried at fair value** *(continued)*

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.

- Funding fair value adjustment

The funding fair value adjustment is calculated by applying future market funding spreads to the expected future funding exposure of any uncollateralised component of the OTC derivative portfolio. This includes the uncollateralised component of collateralised derivatives in addition to derivatives that are fully uncollateralised. The expected future funding exposure is calculated by a simulation methodology, where available. The expected future funding exposure is adjusted for events that may terminate the exposure such as the default of the Group or the counterparty. The funding fair value adjustment and debit valuation adjustment are calculated independently.

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.

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

| | **Assets** | | | | **Liabilities** | | |
|---|---|---|---|---|---|---|---|
| | **Available-for-sale** | **Held for trading** | **Designated at fair value through profit or loss** | **Derivatives** | **Held for trading** | **Designated at fair value through profit or loss** | **Derivatives** |
| **At 30 June 2016** | | | | | | | |
| Private equity | **1,168** | **-** | **598** | **-** | **-** | **-** | **-** |
| Structured notes | **-** | **-** | **-** | **-** | **161** | **-** | **-** |
| Derivatives | **-** | **-** | **-** | **7** | **-** | **-** | **2** |
| | **1,168** | **-** | **598** | **7** | **161** | **-** | **2** |
| At 30 June 2015 | | | | | | | |
| Private equity | 1,326 | - | 669 | - | - | - | - |
| Structured notes | - | - | - | - | 50 | - | - |
| Derivatives | - | - | - | 21 | - | - | 2 |
| | 1,326 | - | 669 | 21 | 50 | - | 2 |
| At 31 December 2015 | | | | | | | |
| Private equity | 1,161 | - | 547 | - | - | - | - |
| Structured notes | - | - | - | - | 27 | - | - |
| Derivatives | - | - | - | 13 | - | - | 3 |
| | 1,161 | - | 547 | 13 | 27 | - | 3 |

**41 Fair value of financial instruments** *(continued)*

**(a) Fair value of financial instruments carried at fair value** *(continued)*

*Movement in Level 3 financial instruments*

| | Assets | | | | Liabilities | | |
|---|---|---|---|---|---|---|---|
| | **Available-for-sale** | **Held for trading** | **Designated at fair value through profit or loss** | **Derivatives** | **Held for trading** | **Designated at fair value through profit or loss** | **Derivatives** |
| At 1 January 2016 | **1,161** | **-** | **547** | **13** | **27** | **-** | **3** |
| Total gains or losses recognised in profit or loss | | | | | | | |
| - trading income | **-** | **-** | **-** | **(6)** | **(2)** | **-** | **(1)** |
| - net income from other financial instruments designated at fair value | **-** | **-** | **66** | **-** | **-** | **-** | **-** |
| - gains less losses from financial investments | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| Total gains or losses recognised in other comprehensive income | | | | | | | |
| - fair value gains | **7** | **-** | **-** | **-** | **-** | **-** | **-** |
| - exchange differences | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| Purchases | **-** | **-** | **1** | **-** | **-** | **-** | **-** |
| Issues/deposit taking | **-** | **-** | **-** | **-** | **143** | **-** | **-** |
| Sales | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| Settlements | **-** | **-** | **(16)** | **-** | **(6)** | **-** | **-** |
| Transfers out | **-** | **-** | **-** | **-** | **(1)** | **-** | **-** |
| Transfers in | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| At 30 June 2016 | **1,168** | **-** | **598** | **7** | **161** | **-** | **2** |
| 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 | **-** | **-** | **-** | **1** | **2** | **-** | **-** |
| - net income from other financial instruments designated at fair value | **-** | **-** | **66** | **-** | **-** | **-** | **-** |

**NOTES ON THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS** *(unaudited) (continued)*

**41 Fair value of financial instruments** *(continued)*

**(a) Fair value of financial instruments carried at fair value** *(continued)*

*Movement in Level 3 financial instruments (continued)*

| | Assets | | | | Liabilities | | |
|---|---|---|---|---|---|---|---|
| | Available-for-sale | Held for trading | Designated at fair value through profit or loss | Derivatives | Held for trading | Designated at fair value through profit or loss | Derivatives |
| At 1 January 2015 | 1,234 | - | 701 | 32 | 89 | - | 1 |
| Total gains or losses recognised in profit or loss | | | | | | | |
| - trading income | - | - | - | 9 | (1) | - | 1 |
| - net income from other financial instruments designated at fair value | - | - | 34 | - | - | - | - |
| - gains less losses from financial investments | - | - | - | - | - | - | - |
| Total gains or losses recognised in other comprehensive income | | | | | | | |
| - fair value gains | 92 | - | - | - | - | - | - |
| - exchange differences | - | - | - | - | - | - | - |
| Purchases | - | - | 80 | - | - | - | - |
| Issues/deposit taking | - | - | - | - | 51 | - | - |
| Sales | - | - | (11) | - | - | - | - |
| Settlements | - | - | (106) | - | (71) | - | - |
| Transfers out | - | - | (29) | (20) | (18) | - | - |
| Transfers in | - | - | - | - | - | - | - |
| At 30 June 2015 | 1,326 | - | 669 | 21 | 50 | - | 2 |
| 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 | - | - | - | 11 | 1 | - | (2) |
| - net income from other financial instruments designated at fair value | - | - | 33 | - | - | - | - |

**41 Fair value of financial instruments** *(continued)*

**(a) Fair value of financial instruments carried at fair value** *(continued)*

*Movement in Level 3 financial instruments (continued)*

| | Assets | | | | Liabilities | | |
|---|---|---|---|---|---|---|---|
| | Available-for-sale | Held for trading | Designated at fair value through profit or loss | Derivatives | Held for trading | Designated at fair value through profit or loss | Derivatives |
| At 1 July 2015 | 1,326 | - | 669 | 21 | 50 | - | 2 |
| Total gains or losses recognised in profit or loss | | | | | | | |
| - trading income | - | - | - | 2 | 1 | - | 1 |
| - net income from other financial instruments designated at fair value | - | - | 19 | - | - | - | - |
| - gains less losses from financial investments | - | - | - | - | - | - | - |
| Total gains or losses recognised in other comprehensive income | | | | | | | |
| - fair value losses | (165) | - | - | - | - | - | - |
| - exchange differences | - | - | - | - | - | - | - |
| Purchases | - | - | 118 | - | - | - | - |
| Issues/deposit taking | - | - | - | - | 27 | - | - |
| Sales | - | - | (20) | - | - | - | - |
| Settlements | - | - | (82) | - | (51) | - | - |
| Transfers out | - | - | (157) | (10) | - | - | - |
| Transfers in | - | - | - | - | - | - | - |
| At 31 December 2015 | 1,161 | - | 547 | 13 | 27 | - | 3 |
| 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 | - | - | - | (8) | (1) | - | (1) |
| - net income from other financial instruments designated at fair value | - | - | 18 | - | - | - | - |

**41 Fair value of financial instruments** *(continued)*

**(a) Fair value of financial instruments carried at fair value** *(continued)*

*Movement in Level 3 financial instruments (continued)*

Transfer out of Level 3 held for trading liabilities predominately resulted from the increase in observability of correlations between equity and equity index during the period.

**Effect of changes in significant unobservable assumptions to reasonably possible alternatives**

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*

| | **Reflected in profit or loss** | | **Reflected in other comprehensive income** | |
|---|---|---|---|---|
| | **Favourable changes** | **Unfavourable changes** | **Favourable changes** | **Unfavourable changes** |
| **At 30 June 2016** | | | | |
| Private equity | **30** | **(30)** | **84** | **(84)** |
| Structured notes | **-** | **-** | **-** | **-** |
| Derivatives | **-** | **-** | **-** | **-** |
| | **30** | **(30)** | **84** | **(84)** |
| At 30 June 2015 | | | | |
| Private equity | 67 | (67) | 134 | (134) |
| Structured notes | - | - | - | - |
| Derivatives | - | - | - | - |
| | 67 | (67) | 134 | (134) |
| At 31 December 2015 | | | | |
| Private equity | 27 | (27) | 74 | (74) |
| Structured notes | - | - | - | - |
| Derivatives | 1 | (1) | - | - |
| | 28 | (28) | 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.

For private equity, favourable and unfavourable changes are determined on the basis of 5% changes (30 June 2015: 10%; 31 December 2015: 5%) in the value of the instrument as a result of varying the levels of the unobservable parameters using statistical techniques. When parameters are not amendable to statistical analysis, quantification of uncertainty is judgemental.

**41 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*

| | Valuation technique(s) | Unobservable input(s) | | Range |
|---|---|---|---|---|
| **Assets** | | | | |
| Private equity | Net asset value | N/A | | **N/A** |
| | Market-comparable approach | Earnings Multiple | | **24 - 34** |
| | | | (30 Jun 2015: | 24 - 34) |
| | | | (31 Dec 2015: | 27 - 37) |
| | | P/B ratios | | **0.70 - 1.22** |
| | | | (30 Jun 2015: | 1.07 - 2.26) |
| | | | (31 Dec 2015: | 0.89 - 1.58) |
| | | Liquidity Discount | | **10% - 30%** |
| | | | (30 Jun 2015: | 10% - 30%) |
| | | | (31 Dec 2015: | 10% - 30%) |
| Derivatives | Option model | Equity Volatility | | **31.89% - 48.80%** |
| | | | (30 Jun 2015: | 17.00% - 49.00%) |
| | | | (31 Dec 2015: | 33.11% - 52.46%) |
| | | FX Volatility | | **5.06% - 13.79%** |
| | | | (30 Jun 2015: | 1.95% - 12.41%) |
| | | | (31 Dec 2015: | 6.44% - 13.80%) |
| | Discounted cash flow model | IR Curve | | **0.98% - 4.40%** |
| | | | (30 Jun 2015: | 3.00% - 3.96% ) |
| | | | (31 Dec 2015: | 1.76% - 5.46% ) |
| **Liabilities** | | | | |
| Structured notes | Option model | FX Volatility | | **4.83% - 13.79%** |
| | | | (30 Jun 2015: | 8.47% - 17.33%) |
| | | | (31 Dec 2015: | 7.10% - 13.80%) |
| | | Equity and Equity Index Correlation | | **0.17 - 0.20** |
| | | | (30 Jun 2015: | 0.28 - 0.28) |
| | | | (31 Dec 2015: | 0.26 - 0.26) |
| Derivatives | Option model | Equity Volatility | | **31.89% - 48.80%** |
| | | | (30 Jun 2015: | N/A) |
| | | | (31 Dec 2015: | N/A) |
| | | FX Volatility | | **5.06% - 13.79%** |
| | | | (30 Jun 2015: | 7.82% - 12.41%) |
| | | | (31 Dec 2015: | 6.44% - 13.80%) |
| | Discounted cash flow model | IR Curve | | **0.98% - 4.40%** |
| | | | (30 Jun 2015: | 3.00% - 3.96%) |
| | | | (31 Dec 2015: | 1.76% - 5.46%) |

**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 30 June 2016. A further description of the categories of key unobservable inputs is given as follows.

**41 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)*

**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 unobservable 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.

**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 to 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.

**41 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 condensed consolidated balance sheet. For all other instruments, the fair value is equal to the carrying value.

| | **At 30 June 2016** | | At 30 June 2015 | | At 31 December 2015 | |
|---|---|---|---|---|---|---|
| | **Carrying Amount** | **Fair Value** | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| **Financial Assets** | | | | | | |
| Placings with and advances to banks | **97,307** | **97,430** | 152,767 | 152,831 | 123,990 | 124,316 |
| Reverse repurchase agreements – non-trading | **-** | **-** | 1,904 | 1,904 | - | - |
| Loans and advances to customers | **678,442** | **677,700** | 673,022 | 670,626 | 688,946 | 690,248 |
| Held-to-maturity debt securities | **84,031** | **88,717** | 76,591 | 79,210 | 81,822 | 84,571 |
| **Financial Liabilities** | | | | | | |
| Current, savings and other deposit accounts | **951,545** | **951,585** | 947,495 | 947,501 | 959,228 | 959,216 |
| Repurchase agreements – non-trading | **1,761** | **1,761** | 3,032 | 3,032 | 2,315 | 2,315 |
| Deposits from banks | **14,159** | **14,159** | 13,964 | 13,964 | 18,780 | 18,780 |
| Certificates of deposit and other debt securities in issue | **6,416** | **6,442** | 7,738 | 7,801 | 5,191 | 5,223 |
| Subordinated liabilities | **2,328** | **2,887** | 5,814 | 6,864 | 2,325 | 2,915 |

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.

(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.

**41 Fair value of financial instruments** *(continued)*

**(b) Fair value of financial instruments not carried at fair value** *(continued)*

(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
Acceptances and Endorsements
Short-term receivables within "Other assets"

**Liabilities**

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

**42 Condensed consolidated financial statements and statutory financial statements**

The financial information relating to the year ended 31 December 2015 that is included in these condensed consolidated financial statements does not constitute the Bank's statutory financial statements for that year but is extracted from those financial statements which have been delivered to the Registrar of Companies as required by section 662(3) of, and Part 3 of Schedule 6 to, the Hong Kong Companies Ordinance (Cap. 622) and to the Hong Kong Monetary Authority.

The auditor has reported on those financial statements. The auditor's report was unqualified; did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying its report; and did not contain a statement under sections 406(2), 407(2) or (3) of the Hong Kong Companies Ordinance (Cap. 622).

The Annual Report for the year ended 31 December 2015, which includes the statutory financial statements, can be obtained on request from the Company Secretarial Services Department, Level 10, 83 Des Voeux Road Central, Hong Kong; or from the Bank's website www.hangseng.com.

**43 Major transaction – Partial disposal of the Bank’s shareholding in Industrial Bank**

During the first half of 2015, the Bank has sold 9.99% (representing 1,903,316,838 ordinary shares) of its shareholding of the ordinary shares of Industrial Bank Co., Ltd. (‘Industrial Bank’), and recognised a gain of HK$10,636m for the first half of 2015.

Since there are significant financial implications as a result of the recognition of the gain on partial disposal in the condensed consolidated income statement for the first half of 2015, the key financial results and performance metrics for the first half of 2016 are not directly comparable. For comparison, we have prepared the following key financial results and performance metrics by excluding the partial disposal gain in the first half of 2015.

| | **As Reported** | | | | | **Excluding the gain on partial disposal of Industrial Bank in the first half of 2015** | |
|---|---|---|---|---|---|---|---|
| | **Half-year ended 30 June 2016** | Half-year ended 30 June 2015 | Variance against half year ended 30 June 2015 * | Half-year ended 31 December 2015 | Variance against half year ended 31 December 2015 * | Half-year ended 30 June 2015 | Variance against half year ended 30 June 2015 * |
| Attributable profit | **8,005** | 20,048 | -60% | 7,446 | +8% | 9,412 | -15% |
| Profit before tax | **9,499** | 21,720 | -56% | 8,768 | +8% | 11,084 | -14% |
| Return on average ordinary shareholders' equity (%) | **12.4** | 31.0 | -18.6pp | 10.6 | +1.8pp | 14.5 | -2.1pp |
| Return on average total assets (%) | **1.2** | 3.1 | -1.9pp | 1.1 | +0.1pp | 1.5 | -0.3pp |
| Earnings per share (HK$) | **4.19** | 10.49 | -60% | 3.73 | +12% | 4.92 | -15% |

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

## 44 Property revaluation

The Group's premises and investment properties were revalued at 30 June 2016 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$277m was credited to the premises revaluation reserve. The related deferred tax provision for Group premises was HK$47m. Excluding the fair value gain on properties backing insurance contracts, revaluation deficit of HK$77m on investment properties were recognised through the condensed consolidated income statement.

## 45 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.

## 46 Comparative figures

Certain comparative figures have been adjusted to conform with the current period's presentation.

**REPORT ON REVIEW OF CONDENSED CONSOLIDATED FINANCIAL STATEMENTS TO THE BOARD OF DIRECTORS OF HANG SENG BANK LIMITED**
(incorporated in Hong Kong with limited liability)

**Introduction**

We have reviewed the condensed consolidated financial statements set out on pages 45 to 89, which comprises the condensed consolidated balance sheet of Hang Seng Bank Limited (the "Bank") and its subsidiaries (together, the "Group") as at 30 June 2016 and the related condensed consolidated income statement, condensed consolidated statement of comprehensive income, condensed consolidated statement of changes in equity and condensed consolidated cash flows statement for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes. The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of a report on condensed consolidated financial statements to be in compliance with the relevant provisions thereof and Hong Kong Accounting Standard 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants. The directors of the Bank are responsible for the preparation and presentation of these condensed consolidated financial statements in accordance with Hong Kong Accounting Standard 34 "Interim Financial Reporting". Our responsibility is to express a conclusion on these condensed consolidated financial statements based on our review and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

**Scope of Review**

We conducted our review in accordance with Hong Kong Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Hong Kong Institute of Certified Public Accountants. A review of condensed consolidated financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

**Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the condensed consolidated financial statements are not prepared, in all material respects, in accordance with Hong Kong Accounting Standard 34 "Interim Financial Reporting".

**PricewaterhouseCoopers**
Certified Public Accountants

Hong Kong, 3 August 2016

## SUPPLEMENTARY NOTES ON THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(unaudited)*

These notes set out on pages 91 to 93 are supplementary to and should be read in conjunction with the condensed consolidated financial statements set out on pages 45 to 89. The condensed consolidated financial statements and these supplementary notes taken together comply with the Banking (Disclosure) Rules ("Disclosure Rules") made under section 60A of the Banking Ordinance.

### 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.

**(b)** The accounting policies applied in preparing these supplementary notes are the same as those applied in preparing the condensed consolidated financial statements for the period ended 30 June 2016 as set out in note 2 on the condensed consolidated financial statements.

### 2 Disclosure for selected exposures

**Involvement with Special Purpose Entities ("SPEs")**

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

### 3 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 condensed consolidated 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:

| | Gross advances | Overdue advances | Impaired advances | Individually assessed loan impairment allowances | Collectively assessed loan impairment allowances | New impairment allowances | Advances written off during the period |
|---|---|---|---|---|---|---|---|
| **At 30 June 2016** | | | | | | | |
| Residential mortgages | **181,659** | **119** | **184** | **(4)** | **(3)** | **-** | **-** |
| Commercial, industrial and international trade | **154,366** | **1,987** | **2,836** | **(871)** | **(541)** | **432** | **220** |
| Commercial real estate | **82,241** | **208** | **21** | **(1)** | **(4)** | **1** | **-** |
| Other property-related lending | **134,853** | **100** | **397** | **(6)** | **(13)** | **6** | **-** |
| At 30 June 2015 | | | | | | | |
| Residential mortgages | 174,634 | 134 | 192 | (10) | (3) | 4 | - |
| Commercial, industrial and international trade | 155,333 | 1,748 | 2,206 | (1,193) | (589) | 460 | 54 |
| Commercial real estate | 85,971 | 39 | 66 | - | (3) | 1 | - |
| Other property-related lending | 130,301 | 1 | 189 | (1) | (18) | 3 | - |
| At 31 December 2015 | | | | | | | |
| Residential mortgages | 181,461 | 112 | 177 | (10) | (4) | 4 | - |
| Commercial, industrial and international trade | 164,391 | 1,671 | 1,970 | (787) | (536) | 855 | 670 |
| Commercial real estate | 86,006 | 208 | 50 | (1) | (3) | 2 | 1 |
| Other property-related lending | 134,486 | - | 284 | - | (14) | 3 | - |

**4 Mainland activities exposures**

The analysis of mainland activities exposures is based on the categories of non-bank counterparties and the type of direct exposures defined by the Hong Kong Monetary Authority ("HKMA") under the Banking (Disclosure) Rules with reference to the HKMA Return of Mainland activities - (MA(BS)20). This includes the mainland activities exposures extended by the Bank's Hong Kong offices and its wholly owned banking subsidiary in mainland China.

| | On-balance sheet exposure | Off-balance sheet exposure | Total exposures |
|---|---|---|---|
| **At 30 June 2016** | | | |
| **Types of Counterparties** | | | |
| 1. Central government, central government-owned entities and their subsidiaries and joint ventures (JVs) | **51,427** | **8,727** | **60,154** |
| 2. Local governments, local government-owned entities and their subsidiaries and JVs | **19,163** | **5,743** | **24,906** |
| 3. PRC nationals residing in Mainland China or other entities incorporated in Mainland China and their subsidiaries and JVs | **54,708** | **22,420** | **77,128** |
| 4. Other entities of central government not reported in item 1 above | **4,307** | **1,585** | **5,892** |
| 5. Other entities of local governments not reported in item 2 above | **2,702** | **130** | **2,832** |
| 6. PRC nationals residing outside Mainland China or entities incorporated outside Mainland China where the credit is granted for use in Mainland China | **49,373** | **2,372** | **51,745** |
| 7. Other counterparties where the exposures are considered by the reporting institution to be non-bank Mainland China exposures | **12,107** | **788** | **12,895** |
| Total | **193,787** | **41,765** | **235,552** |
| Total assets after provision | **1,209,897** | | |
| On-balance sheet exposures as percentage of total assets | **16.02%** | | |
| At 30 June 2015 | | | |
| Types of Counterparties | | | |
| 1. Central government, central government-owned entities and their subsidiaries and joint ventures (JVs) | 57,942 | 7,418 | 65,360 |
| 2. Local governments, local government-owned entities and their subsidiaries and JVs | 25,764 | 4,986 | 30,750 |
| 3. PRC nationals residing in Mainland China or other entities incorporated in Mainland China and their subsidiaries and JVs | 54,580 | 20,176 | 74,756 |
| 4. Other entities of central government not reported in item 1 above | 3,991 | 756 | 4,747 |
| 5. Other entities of local governments not reported in item 2 above | 3,530 | 690 | 4,220 |
| 6. PRC nationals residing outside Mainland China or entities incorporated outside Mainland China where the credit is granted for use in Mainland China | 42,672 | 1,658 | 44,330 |
| 7. Other counterparties where the exposures are considered by the reporting institution to be non-bank Mainland China exposures | 8,914 | 10 | 8,924 |
| Total | 197,393 | 35,694 | 233,087 |
| Total assets after provision | 1,232,737 | | |
| On-balance sheet exposures as percentage of total assets | 16.01% | | |
| At 31 December 2015 | | | |
| Types of Counterparties | | | |
| 1. Central government, central government-owned entities and their subsidiaries and joint ventures (JVs) | 48,144 | 9,643 | 57,787 |
| 2. Local governments, local government-owned entities and their subsidiaries and JVs | 26,278 | 5,002 | 31,280 |
| 3. PRC nationals residing in Mainland China or other entities incorporated in Mainland China and their subsidiaries and JVs | 60,665 | 21,172 | 81,837 |
| 4. Other entities of central government not reported in item 1 above | 3,514 | 1,513 | 5,027 |
| 5. Other entities of local governments not reported in item 2 above | 4,486 | 168 | 4,654 |
| 6. PRC nationals residing outside Mainland China or entities incorporated outside Mainland China where the credit is granted for use in Mainland China | 48,518 | 3,158 | 51,676 |
| 7. Other counterparties where the exposures are considered by the reporting institution to be non-bank Mainland China exposures | 10,611 | 24 | 10,635 |
| Total | 202,216 | 40,680 | 242,896 |
| Total assets after provision | 1,231,738 | | |
| On-balance sheet exposures as percentage of total assets | 16.42% | | |

## 5 International claims

The Group's country risk exposures in the table below are prepared in accordance with the Hong Kong Monetary Authority's (HKMA) Return of International Banking Statistics - (MA(BS)21) guidelines. International claims are on-balance sheet exposures to counterparties based on the location of the counterparties after taking into account the transfer of risk, and represent the sum of cross-border claims in all currencies and local claims in foreign currencies.

The table shows claims on individual countries and territories or areas, after recognised risk transfer, amounting to not less than 10% of the group's total international claims.

| | Banks | Official Sector | Non Bank Financial Institution | Non-Financial Private Sector | Others | Total |
|---|---|---|---|---|---|---|
| **As at 30 June 2016** | | | | | | |
| **Developed countries** | **59,937** | **84,288** | **13,518** | **35,810** | **-** | **193,553** |
| **Offshore centres** | **10,162** | **1,516** | **13,412** | **107,265** | **-** | **132,355** |
| of which : Hong Kong SAR | **3,204** | **1,381** | **4,739** | **80,368** | | **89,692** |
| **Developing Asia and Pacific** | **68,517** | **12,265** | **6,351** | **52,388** | **-** | **139,521** |
| of which : China | **43,750** | **12,211** | **5,087** | **47,909** | **-** | **108,957** |
| As at 30 June 2015 | | | | | | |
| **Developed countries** | 60,524 | 55,036 | 8,696 | 34,322 | - | 158,578 |
| **Offshore centres** | 34,870 | 5,626 | 12,175 | 109,219 | - | 161,890 |
| of which : Hong Kong SAR | 20,097 | 1,289 | 5,049 | 85,124 | - | 111,559 |
| **Developing Asia and Pacific** | 92,368 | 12,651 | 7,552 | 50,557 | - | 163,128 |
| of which : China | 60,936 | 12,593 | 6,271 | 43,528 | - | 123,328 |
| At 31 December 2015 | | | | | | |
| **Developed countries** | 74,451 | 91,609 | 12,047 | 39,007 | - | 217,114 |
| **Offshore centres** | 16,110 | 2,244 | 12,924 | 112,334 | - | 143,612 |
| of which : Hong Kong SAR | 2,589 | 1,353 | 3,728 | 87,461 | - | 95,131 |
| **Developing Asia and Pacific** | 82,746 | 10,675 | 6,425 | 53,685 | - | 153,531 |
| of which : China | 54,388 | 10,619 | 5,177 | 46,620 | - | 116,804 |

# ADDITIONAL INFORMATION

## The Code for Securities Transactions by Directors

The Bank has adopted a Code for Securities Transactions by Directors on terms no less exacting than the required standards as set out in the Model Code for Securities Transactions by Directors of Listed Issuers (as set out in Appendix 10 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules")). Specific enquiries have been made with all Directors who have confirmed that they have complied with the Bank's Code for Securities Transactions by Directors throughout the six months ended 30 June 2016.

## Changes in Directors' Details

Changes in Directors' details since the date of the Annual Report 2015 of the Bank and up to the date of release of the interim results of the Bank which are required to be disclosed pursuant to Rule 13.51(2) and Rule 13.51B(1) of the Listing Rules, are set out below.

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

Cessation of appointment
- University of Pennsylvania, USA (Trustee)

**Ms Rose LEE Wai Mun** JP

New appointment
- The Community Chest of Hong Kong (Deputy Chairman of Executive Committee)

Cessation of appointments
- The Community Chest of Hong Kong (Second Vice President; Chairman of Campaign Committee; Member of Executive Committee)

**Mr Nixon CHAN Lik Sang**

Re-designation
- Hang Seng Bank Limited(1) (Non-executive Director)

Cessation of appointments
- Employers' Federation of Hong Kong (Elected Member of General Committee; Chairman of Banking and Financial Services Group)
- EPS Company (Hong Kong) Limited (Director)
- Hang Seng Bank Limited(1) (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 Management College (Governor)
- Hang Seng School of Commerce (Director)
- Hang Seng Securities Limited (Director)
- Hang Seng Security Management Limited (Director)
- Haseba Investment Company Limited (Director)
- TransUnion Limited (Director)

**Mr Patrick CHAN Kwok Wai**

New appointments
- Hang Seng Bank (China) Limited (Non-executive Director; Member of Executive Committee)

Cessation of appointment
- The Community Chest of Hong Kong (Board Member)

**Mr Andrew FUNG Hau Chung** JP

Cessation of appointment
- Securities and Futures Commission (Member of Products Advisory Committee)

**Dr HU Zuliu, Fred**

Cessation of appointment
- Armada Holdings Limited[1] (formerly known as "SCMP Group Limited") (Independent Non-executive Director)

**Ms Irene LEE Yun Lien**

New appointments
- The Hongkong and Shanghai Banking Corporation Limited (Chairman of Audit Committee; Member of Risk Committee)

**Mr Kenneth NG Sing Yip**

Cessation of appointments
- The Hongkong and Shanghai Banking Corporation Limited (General Counsel, Asia Pacific)
- The Law Society of Hong Kong (Council Member)

**Mr Peter WONG Tung Shun** JP

New appointment
- Hong Kong General Chamber of Commerce (Vice Chairman)

**Mr Michael WU Wei Kuo**

Cessation of appointments
- The Community Chest of Hong Kong (Board Member; Member of Executive Committee)

Notes:

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

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

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

## Directors' and Alternate Chief Executives' Interests

As at 30 June 2016, 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 | 432,635 | 1,668 | - | 184,282[(3)] | 618,585 | 0.00 |
| Dr John C C Chan | 24,605[(1)] | - | - | - | 24,605 | 0.00 |
| Mr Nixon L S Chan | 115,556 | - | - | 32,096[(3)] | 147,652 | 0.00 |
| Mr Patrick K W Chan | 89,783 | - | - | - | 89,783 | 0.00 |
| Mr Andrew H C Fung | 123,327 | - | - | 32,757[(3)] | 156,084 | 0.00 |
| Ms Irene Y L Lee | 10,000 | - | - | - | 10,000 | 0.00 |
| Ms Sarah C Legg | 217,358 | 2,695 | - | 100,620[(3)] | 320,673 | 0.00 |
| Dr Eric K C Li | - | 52,132 | - | - | 52,132 | 0.00 |
| Mr Kenneth S Y Ng | 402,113 | - | - | 37,581[(3)] | 439,694 | 0.00 |
| Mr Peter T S Wong | 875,382 | 22,079 | - | 2,269,993[(3)] | 3,167,454 | 0.02 |
| Alternate Chief Executives: | | | | | | |
| Mrs Eunice L C Y Chan | 17,459 | - | - | 13,045[(3)] | 30,504 | 0.00 |
| Mr Donald Y S Lam | 78,520 | - | - | 17,945[(3)] | 96,465 | 0.00 |
| Mr Andrew W L Leung | 30,744 | - | - | 21,983[(3)] | 52,727 | 0.00 |
| **Number of perpetual non-cumulative preference shares of US$0.01 each in HSBC Holdings plc** | | | | | | |
| Director: | | | | | | |
| Ms Rose W M Lee | - | 131,000[(2)] | - | 75,075[(2)] | 206,075 | 0.14 |

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$ 3,275,000[(2)] | - | US$ 1,876,875[(2)] | US$ 5,151,875 |

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$1,876,875 of the 8.00% perpetual subordinated capital securities, series 2. Her spouse also had interests in the total principal amount of US$3,275,000 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 75,075 and 131,000 perpetual non-cumulative preference shares respectively 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 included interests in 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.

Conditional Awards of Shares

As at 30 June 2016, 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 various HSBC Share Plans were as follows:

| | Awards held as at 1 January 2016 | Awards made during the Director's/ Alternate Chief Executive's term of office in the first half of the year | Awards released during the Director's/ Alternate Chief Executive's term of office in the first half of the year | Awards held as at 30 June 2016 |
|---|---|---|---|---|
| Directors: | | | | |
| Ms Rose W M Lee | 137,241 | 123,320 | 83,532 | 184,282[(1)] |
| Mr Nixon L S Chan | 26,216 | 44,445 | 40,018 | 32,096[(1)] |
| Mr Andrew H C Fung | 29,723 | 42,855 | 41,369 | 32,757[(1)] |
| Ms Sarah C Legg | 68,781 | 75,809 | 47,910 | 100,620[(1)] |
| Mr Kenneth S Y Ng | 38,903 | 46,405 | 49,628 | 37,581[(1)] |
| Mr Peter T S Wong | 1,222,917 | 330,451 | 338,746 | 1,260,724[(1)] |

| | Awards held as at 1 January 2016 | Awards made during the Director's/ Alternate Chief Executive's term of office in the first half of the year | Awards released during the Director's/ Alternate Chief Executive's term of office in the first half of the year | Awards held as at 30 June 2016 |
|---|---|---|---|---|
| Alternate Chief Executives: | | | | |
| Mrs Eunice L C Y Chan | 12,818[2] | - | - | 13,045[1] |
| Mr Donald Y S Lam | 12,635 | 26,666 | 22,126 | 17,945[1] |
| Mr Andrew W L Leung | 11,318 | 36,840 | 27,033 | 21,983[1] |

Note:
(1) This included additional shares arising from scrip dividends.

(2) This represented the awards held by Mrs Eunice L C Y Chan on 11 April 2016 when she was appointed an Alternate Chief Executive of the Bank.

During the first half of 2016, Ms Sarah C Legg, Mrs Eunice L C Y Chan and Mr Donald Y S Lam also acquired and were awarded ordinary shares of HSBC Holdings plc under the HSBC International Employee Share Purchase Plan. Their interests in ordinary shares of HSBC Holdings plc under this plan have been included in their "Personal Interests" disclosed in the table under "Interests in shares".

All the interests stated above represented long positions. As at 30 June 2016, no short positions were recorded in the Register of Directors' and Alternate Chief Executives' Interests and Short Positions required to be kept under section 352 of the SFO.

Other than those disclosed above, no right to subscribe for equity or debt securities of the Bank has been granted by the Bank to, nor have any such rights been exercised by, any person during the six months ended 30 June 2016.

## Substantial Interests in Share Capital

The register maintained by the Bank pursuant to the SFO recorded that, as at 30 June 2016, 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 (62.14%).

All the interests stated above represented long positions. As at 30 June 2016, no short positions were recorded in the Register of Interests in Shares and Short Positions required to be kept under section 336 of the SFO.

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

There was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank's listed securities during the first half of 2016.

## Remuneration and Staff Development

There have been no material changes to the information disclosed in the Annual Report 2015 in respect of the remuneration of employees, remuneration policies and staff development.

## Corporate Governance Principles and Practices

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 issued by the Hong Kong Monetary Authority. 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 Listing Rules throughout the six months ended 30 June 2016. 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.

The Audit Committee of the Bank has reviewed the results of the Bank for the six months ended 30 June 2016.

## 2016 Second Interim Dividend

| | |
|---|---|
| Announcement date | 3 August 2016 |
| Ex-dividend date | 19 August 2016 |
| Book close and record date | 23 August 2016 |
| Payment date | 13 September 2016 |

## Register of Shareholders

The Register of Shareholders of the Bank will be closed on Tuesday, 23 August 2016, during which no transfer of shares can be registered. To qualify for the second interim dividend, all transfers, accompanied by the relevant share certificates, must be lodged with the Bank's Registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, for registration not later than 4:30 pm on Monday, 22 August 2016.

## Board and Committees

### Board

<u>Independent Non-executive Chairman</u>
Raymond CH'IEN Kuo Fung

<u>Executive Directors</u>
Rose LEE Wai Mun (Vice-Chairman and Chief Executive)
Patrick CHAN Kwok Wai
Andrew FUNG Hau Chung

<u>Non-executive Directors</u>
Nixon CHAN Lik Sang
Sarah Catherine LEGG
Vincent LO Hong Sui
Kenneth NG Sing Yip
Peter WONG Tung Shun

<u>Independent Non-executive Directors</u>
John CHAN Cho Chak
Henry CHENG Kar Shun
CHIANG Lai Yuen
HU Zuliu, Fred
Irene LEE Yun Lien
Eric LI Ka Cheung
Richard TANG Yat Sun
Michael WU Wei Kuo

### Committees

<u>Executive Committee</u>
Rose LEE Wai Mun (Chairman)
Eunice CHAN
Ivy CHAN Shuk Pui
Patrick CHAN Kwok Wai
Walter CHEUNG Shu Wai
Andrew FUNG Hau Chung
Margaret KWAN Wing Han
Donald LAM Yin Shing
Gordon LAM Wai Chung
LEE Sai Kit
Andrew LEUNG Wing Lok
LI Chi Chung
Elaine WANG Yee Ning
Katie YIP Kay Chun

<u>Audit Committee</u>
Eric LI Ka Cheung (Chairman)
Irene LEE Yun Lien
Richard TANG Yat Sun
Michael WU Wei Kuo

<u>Remuneration Committee</u>
John CHAN Cho Chak (Chairman)
CHIANG Lai Yuen
Raymond CH'IEN Kuo Fung

Risk Committee
Irene LEE Yun Lien (Chairman)
HU Zuliu, Fred
Eric LI Ka Cheung

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

Notes:

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

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

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

## Stock Code
The Stock Exchange of Hong Kong Limited: 11

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

## Depositary*
BNY Mellon Shareowner Services
PO Box 30170
College Station, TX 77842-3170, USA
Telephone: 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.

## Interim Report 2016
This Interim Report 2016 in both English and Chinese is now available in printed form and on the Bank's website (www.hangseng.com) and the website of HKEx (www.hkexnews.hk).

Shareholders who:
A) browse this Interim Report 2016 on the Bank's website and wish to receive a printed copy; or
B) receive this Interim Report 2016 in either English or Chinese and wish to receive a printed copy in the other language version,

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

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

If shareholders who have chosen (or deemed to have chosen) to read this Interim Report 2016 on the Bank's website have difficulty in reading or gaining access to this Interim Report 2016 via the Bank's website for any reason, the Bank will promptly send this Interim Report 2016 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.