



恒生銀行  
HANG SENG BANK

# Interim Report 2019

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## 2019年中期報告

The printed version of Hang Seng Bank's Interim Report 2019  
will replace this version in late August 2019.

恒生銀行2019年中期報告之印刷本將於2019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

	<b>30 June 2019</b>	30 June 2018
<b>For the half-year ended</b>	<b>HK\$m</b>	HK\$m
Profit attributable to shareholders	<b>13,656</b>	12,647
Profit before tax	<b>15,894</b>	14,864
Operating profit	<b>15,561</b>	14,662
Operating profit excluding change in expected credit losses and other credit impairment charges	<b>16,071</b>	14,900
Net operating income before change in expected credit losses and other credit impairment charges	<b>22,409</b>	20,649
	<b>%</b>	%
Return on average ordinary shareholders' equity	<b>17.0</b>	17.4
Cost efficiency ratio	<b>28.2</b>	27.7
	<b>HK\$</b>	HK\$
Earnings per share	<b>6.98</b>	6.62
Dividends per share	<b>2.80</b>	2.60
	<b>At 30 June 2019</b>	At 31 December 2018
<b>At period-end</b>	<b>HK\$m</b>	HK\$m
Shareholders' equity	<b>172,721</b>	162,082
Total assets	<b>1,656,652</b>	1,571,297
	<b>%</b>	%
Capital ratios		
- Common Equity Tier 1 ("CET1") Capital Ratio	<b>16.4</b>	16.6
- Tier 1 Capital Ratio	<b>18.2</b>	17.8
- Total Capital Ratio	<b>20.4</b>	20.2
Liquidity ratios		
- Liquidity coverage ratio	<b>224.5</b>	214.7
- Net stable funding ratio	<b>152.5</b>	154.0

## CHAIRMAN'S STATEMENT

In a challenging operating environment, Hang Seng maintained good business momentum in the first half of 2019. We continued with transformative initiatives to enhance the customer experience. More investments in technology, operational infrastructure and our people supported the launch of new in-branch service models and the expanding functionality of our digital platforms, particularly our mobile banking app.

We continue to move closer to our vision for a fully integrated multi-channel service that allows customers to manage their banking in a way that best suits their lifestyle and needs. Our progress is enabling us to better leverage our existing competitive strengths, take advantage of new business opportunities and advance our market leadership for innovation in the banking industry, which is undergoing rapid change.

The Bank's solid first-half results affirm the soundness of our strategy.

Attributable profit increased by 8% to HK\$13,656m. Earnings per share rose by 5% to HK\$6.98 per share. Compared with the second half of 2018, attributable profit and earnings per share were up 18% and 19% respectively.

Return on average ordinary shareholders' equity was 17.0%, compared with 17.4% and 14.9% for the first and second halves of 2018. Return on average total assets was 1.7%, compared with 1.7% and 1.5% for the first and second halves of the previous year.

The Directors have declared a second interim dividend of HK\$1.40 per share. This brings the total distribution for the first half of 2019 to HK\$2.80 per share, compared with HK\$2.60 per share for the same period in 2018.

### **Economic Outlook**

Signs of a global slowdown have begun to emerge and the world's major central banks have adopted an increasingly dovish stance in the face of continuing uncertainties over international trade and other geopolitical factors.

With its highly open economy, Hong Kong is susceptible to these developments. After reaching a seven-year high of 4.6% in the first quarter of 2018, the city's economic growth has since slowed to just 0.6% in the first and second quarters this year. With unemployment continuing to hold steady at a multi-year low, the tightness of the labour market will help to support the domestic economy, but downshifts in retail sales and trade growth signal that the economic environment will remain challenging. We forecast full-year GDP growth of between 1% and 1.5% for 2019, down from the 3% recorded for 2018.

Mainland China's economic expansion averaged 6.3% in the first half of the year, compared with 6.6% for 2018. While trade and manufacturing activity have softened, reflecting the impact of developments in the external environment, retail sales growth has been relatively stable. As the Mainland's economy shifts towards a greater reliance on services, private spending will continue to play an important role in driving broader growth. At the same time, the government is likely to maintain its programme of economic stimulus policies. We anticipate full-year GDP growth of between 6.2% and 6.4% for 2019, compared with 6.6% for 2018.

In a fluid operating environment, we will continue to face new challenges. Our strategy for sustainable growth is simple: we will deliver customer-centric service excellence through investment and innovation to further leverage and amplify the competitive strengths that make us a market leader. These strengths include our large customer base, extensive network of service touchpoints, Greater Bay Area expertise and the trusted Hang Seng brand. By being innovative and steadfast in equal measure, we will expand and deepen relationships with new and existing customers and create long-term value for shareholders.

**Raymond Ch'ien**

Chairman

5 August 2019

## CHIEF EXECUTIVE'S REPORT

Hang Seng put in a robust performance in challenging operating conditions during the first six months of 2019. Central to the story of our solid first-half results is a sharp focus on the customer experience, our ability to respond quickly to the changing needs of our clients and the continuing investments we are making in technology and our people.

We are rolling out new service concepts at our branches and making major changes to our workplace environment that go beyond design and aesthetics. They are part of a broader and deeper transformation in how we provide banking services. We are steadily moving towards an integrated and interactive online-offline offering that enables customers to conduct banking through a wide choice of channels – anytime, anywhere. Customers enjoy easier, faster and more convenient banking, while continuing to benefit from the strong wealth management capabilities, security and excellent service that have long been hallmarks of the Hang Seng brand.

Our initiatives to transform our business are delivering positive results. Year on year, we increased net operating income before change in expected credit losses and other credit impairment charges by 9% and profit before tax by 7%, despite the more favourable market environment that prevailed in the first half of 2018. Compared with the second half of last year, which was weakened by the US-China trade dispute, profit before tax was up by an even stronger 17%.

Technology is enabling us to serve customers better. It is also helping us to amplify the advantages of our existing competitive strengths, capitalise more effectively on new business opportunities and enhance our leading market position as our industry evolves.

Supported by improved data analytics, we leveraged our large customer base and deep understanding of local businesses to acquire new deposits and prudently expand lending, resulting in an 11% increase in net interest income on the back of good balance sheet growth.

Benefitting from our in-house investment expertise, time-to-market capability and agile business infrastructure, we responded swiftly to shifts in customer focus, providing more fixed-income products and tailored insurance solutions to maintain solid growth momentum in non-interest income as investors grew more cautious.

We supported commercial clients by rolling out new and enhanced services that enable them to capture more business opportunities in fast-moving market conditions and improve the efficiency of their operations with faster transaction and processing times. For example, we extended One Collect – our all-in-one digital payment collection solution – to online as well as offline merchants and introduced greater support for FPS payments. We are proud that both One Collect and BERI, our AI chatbot for commercial customers, have been recognised with service innovation awards.

The close connectivity of our Hong Kong and mainland China operations and our in-depth understanding of local industry sectors underpin our attractive cross-border proposition, which delivers seamless solutions for a wide array of cross-border banking needs. This competitive strength has us well positioned to win more business on the Mainland, particularly in the economically dynamic Greater Bay Area.

Our proposition is reflected in a strong first half for Hang Seng China, which achieved a 50% increase in operating profit that was driven by balanced double-digit growth in both net interest income and non-interest income. Compared with the second half of last year, operating profit was up 174%.

Our ongoing initiatives to put the customer experience at the centre of what we do will ensure our business continues to thrive in a wide variety of market conditions. The strength of this strategy is reflected in our key financials for the first half.

## **Financial Performance**

Attributable profit rose by 8% to HK\$13,656m and earnings per share were up 5% at HK\$6.98 per share. Profit before tax increased by 7% to HK\$15,894m. Compared with the second half of 2018, attributable profit and earnings per share rose by 18% and 19% respectively, and profit before tax grew by 17%.

Operating profit increased by 6% to HK\$15,561m. Operating profit excluding change in expected credit losses and other credit impairment charges grew by 8% to HK\$16,071m. Compared with the second half of 2018, operating profit rose by 17% and operating profit excluding change in expected credit losses was up 14%.

Net operating income increased by 7% to HK\$21,899m. Compared with the second half of 2018, net operating income rose by 11%.

Net interest income grew by 11% to HK\$15,853m, due mainly to the 6% increase in average interest-earning assets, improved deposit spreads and increased contribution from net-free funds. Compared with the second half of 2018, net interest income was broadly unchanged. The net interest margin increased by 11 basis points to 2.21% compared with a year earlier.

Non-interest income rose by 2% to HK\$6,556m. Insurance income increased, reflecting successful efforts to leverage our diverse range of products and improved investment returns from the life insurance portfolio. Growing investor caution in response to financial markets volatility led to declines in income from stockbroking and related services and retail investment fund sales. Overall, wealth management income grew by 7%. Compared with the second half of 2018, non-interest income grew by 38% and wealth management income was up 54%.

We continued to actively manage our lending portfolio to maintain a high level of overall asset quality. Change in expected credit losses and other credit impairment charges was HK\$510m, compared with HK\$238m and HK\$758m for the first and second halves of 2018. The year-on-year increase in expected credit losses reflects portfolio growth as well as increased provisions in light of the increasingly complex economic outlook.

Operating expenses rose by 11% year on year to HK\$6,328m, reflecting higher investments in people, technology and services enhancement. Compared with the second half of 2018, operating expenses were down 2%.

Our cost efficiency ratio was 28.2%, compared with 27.7% and 31.3% for the first and second halves of last year.

At 30 June 2019, our common equity tier 1 capital ratio was 16.4% and our tier 1 capital ratio was 18.2%, compared with 16.6% and 17.8% respectively at 31 December 2018. Our total capital ratio was 20.4%, compared with 20.2% at the end of last year.

## **Transforming the Future of Banking for Customers**

Turning to the outlook for the rest of the year, the operating environment will remain challenging. There are growing signs of a slowdown in the global economy, with continuing uncertainty over international trade policies and geopolitical developments. Financial market and interest rate volatility have the potential to cause companies to reassess their business investment plans and affect consumer spending activity.

At the same time, the banking and financial services industry is undergoing significant change. An exciting future lies ahead with innovative new product and service propositions in the pipeline.

Technology is enabling us to integrate the best of online and offline banking to meet the varying needs of our customers. We will continue to transform in this direction, drawing on our partnerships with fintech innovators to strengthen our digital capabilities, create new business opportunities, benefit from early exposure to new technological advances, and support our efforts to spearhead the development of customer-centred banking services. For example, our collaboration with Hong Kong Science and Technology Parks Corporation includes developing an experimental ‘branch of the future’ to explore how banking could evolve as a way to drive innovation in our industry.

Service excellence for customers remains the keystone of our business. Our goal is to continue making it easier for people to manage their day-to-day banking needs, plan for major life milestones and achieve their long-term aspirations.

Backed by the expertise and experience of our employees and the reassurance of the Hang Seng brand, we will focus on initiatives that give customers greater control and choice over when and where they manage their financial needs, with customised services that are efficient, convenient and easy to use.

Underlining all of this, our professional and qualified team will provide the personal touch and in-depth market expertise needed to build deep relationships with customers and deliver wealth management propositions that are closely tailored to their priorities and objectives. To unlock the full potential of our people, we are investing in their personal development as well as providing a more comfortable and agile workplace to support them in performing at their best. We are delighted that Hong Kong’s working population has recognised our efforts by naming Hang Seng the Most Attractive Employer in the Banking and Financial sector this year.

I wish to thank my colleagues for their valuable contributions to our business in the first half of 2019, and for demonstrating creativity, commitment and a willingness to embrace the change that will be key to remaining competitive in the new era of banking. We will step up our efforts to ensure they continue to thrive in a working environment where they feel valued, involved and inspired.

With our dynamic team and forward-thinking strategy, we will drive sustainable growth and bright futures for the markets and people we serve to the sustained benefit of our customers, shareholders and the wider community.

**Louisa Cheang**

Vice-Chairman and Chief Executive

5 August 2019



# FINANCIAL REVIEW

## FINANCIAL PERFORMANCE

### Income Analysis

#### Summary of financial performance

<i>Figures in HK\$m</i>	<i>Half-year ended 30 June 2019</i>	<i>Half-year ended 30 June 2018</i>
Total operating income	33,800	29,595
Operating expenses	6,328	5,722
Operating profit	15,561	14,662
Profit before tax	15,894	14,864
Profit attributable to shareholders	13,656	12,647
Earnings per share (in HK\$)	6.98	6.62

#### First half of 2019 compared with first half of 2018

Under challenging operating conditions, Hang Seng Bank Limited ('the Bank') and its subsidiaries ('the Group') reported **profit attributable to shareholders** of HK\$13,656m for first half of 2019, a rise of 8% over the same period last year. **Profit before tax** was up 7% at HK\$15,894m. **Operating profit excluding change in expected credit losses and other credit impairment charges** increased by 8% to HK\$16,071m and **operating profit** rose by 6% to HK\$15,561m, driven by higher net interest income and stable growth in non-interest income. Wealth management business income increased by 7% when compared with same period last year with the increase in insurance business-related income partly offset by decreases in income from securities broking-related services and retail investment funds.

**Net interest income** increased by HK\$1,625m, or 11%, to HK\$15,853m, benefitting from the increase in average interest-earning assets and improvement in net interest margin.

<i>Figures in HK\$m</i>	<i>Half-year ended 30 June 2019</i>	<i>Half-year ended 30 June 2018</i>
Net interest income/(expense) arising from:		
- financial assets and liabilities that are not at fair value through profit and loss	16,442	15,093
- trading assets and liabilities	128	90
- financial instruments designated and otherwise mandatorily measured at fair value	(717)	(955)
	<u>15,853</u>	<u>14,228</u>
Average interest-earning assets	1,445,615	1,367,995
Net interest spread	2.02 %	1.97 %
Net interest margin	2.21 %	2.10 %

**Average interest-earning assets** rose by HK\$78bn, or 6%, when compared with the first half of 2018. Average customer lending increased by 7%, with notable growth in corporate and commercial and mortgage lending. Average financial investments grew by 8% while average interbank placements decreased by 14%.

**Net interest margin** improved by 11 basis points to 2.21%, mainly from the widening of customer deposits spreads and higher contribution from net free funds as market interest rates rose in the first half of 2019. Average loan spread on customer lending reduced, notably in corporate and commercial term lending. The adverse effects of the yield curve flattening and credit spread tightening have limited opportunities for growing revenue from deploying the new and maturing balance sheet management portfolios. However, these adverse effects were partly offset by the Bank's effective balance sheet management, including steps to proactively defend the interest margin and achieve yield enhancement.

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

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

<i>Figures in HK\$m</i>	<i>Half-year ended 30 June 2019</i>	<i>Half-year ended 30 June 2018</i>
Net interest income and expense reported as 'Net interest income'		
- Interest income	<b>20,912</b>	16,967
- Interest expense	<b>(4,493)</b>	(1,882)
- Net interest income	<b>16,419</b>	15,085
Net interest income and expense reported as 'Net income from financial instruments measured at fair value'	<b>(566)</b>	(857)
Average interest-earning assets	<b>1,401,690</b>	1,318,550
Net interest spread	<b>2.17 %</b>	2.21 %
Net interest margin	<b>2.36 %</b>	2.31 %

**Net fee income** fell by HK\$504m, or 13%, to HK\$3,485m. Net fee income excluding income from securities broking-related services and retail investment funds maintained growth momentum, rising by 4% with notable increases in fee income from credit facilities and insurance business. In challenging market conditions for investment services, income from retail investment funds fell by 24% from the high level achieved in the same period last year. With greater investor caution on the back of the less favourable equities markets, income from securities broking-related services fell by 32%, in line with the market-wide fall in securities turnover for Hong Kong during the first half of the year.

**Net income from financial instruments measured at fair value** increased by HK\$1,040m, or 105%, to HK\$2,035m.

Net trading income and net income from financial instruments designated at fair value together decreased by HK\$168m, or 15%, to HK\$972m<sup>\*</sup>. Foreign exchange income was lower, affected by subdued customer activity levels as market volatility was low. There was also a decrease in funding swaps income and an unfavourable revaluation of foreign currency swaps. Income from debt securities, equities and other trading activities was up when compared with same period last year.

*\* In 2018, the Bank considered market practices for the presentation of certain financial liabilities that contain both deposit and derivative components and determined a change in accounting policy and presentation with respect to 'trading liabilities - structured deposits and structured debt securities in issue' to better align with the presentation of similar financial instruments by the industry. Accordingly, rather than classifying 'trading liabilities - structured deposits and structured debt securities in issue' as held for trading, such financial liabilities are now designated as at fair value through profit or loss since they are managed and their performance is evaluated on a fair-value basis.*

Net income from assets and liabilities of insurance business measured at fair value recorded a gain of HK\$1,064m compared with a loss of HK\$145m for the same period last year. Investment returns on financial assets supporting insurance liabilities contracts improved when compared with first half of 2018 as a result of positive movements in the equities and upward commercial property markets. To the extent that these investment returns were attributable to policyholders, there was 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')' under other operating income.

## Analysis of income from wealth management business

<i>Figures in HK\$m</i>	<i>Half-year ended 30 June 2019</i>	<i>Half-year ended 30 June 2018 (restated)</i>
Investment services income <sup>†</sup> :		
- retail investment funds	810	1,064
- structured investment products	256	348
- securities broking and related services	701	1,028
- margin trading and others	42	43
	<u>1,809</u>	<u>2,483</u>
Insurance income:		
- life insurance:		
- net interest income and fee income	1,919	1,856
- investment returns on life insurance funds (including share of associate's profit and surplus on property revaluation backing insurance contracts)	1,250	(326)
- net insurance premium income	9,224	8,732
- net insurance claims and benefits paid and movement in liabilities to policyholders	(11,391)	(8,946)
- movement in present value of in-force long-term insurance business	2,744	1,379
	<u>3,746</u>	<u>2,695</u>
- general insurance and others	137	141
	<u>3,883</u>	<u>2,836</u>
Total	<u><u>5,692</u></u>	<u><u>5,319</u></u>

<sup>†</sup> Income from retail investment funds and securities broking and related services are net of fee expenses. 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 income from financial instruments measured at fair value.

Wealth management income increased by 7% when compared with same period last year. Investment services income decreased by 27% while insurance business income increased by 37%.

Net interest income and fee income from life insurance business rose by 3%. Investment returns on the life insurance portfolio recorded a gain of HK\$1,250m compared with a loss of HK\$326m for the same period last year mainly reflecting favourable movements in equities markets. 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 'movement in PVIF' under other operating income.

Net insurance premium income increased by 6%, reflecting higher new premiums attributable to the success of the Bank's total-solution retirement planning propositions as well as an increase in renewal premiums.

Riding on the Hong Kong Government's initiatives to increase voluntary retirement saving by individuals, the Bank's new deferred annuity plan – which qualifies as a tax-deductible deferred annuity policy under new regulations – was well received by customers.

Net insurance claims and benefits paid and movement in liabilities to policyholders increased by 27%. The increase was mainly due to regular review of discount rate reflecting the lower prevalent interest rate. This would have an offsetting impact of increasing PVIF and overall profit or loss impact was insignificant.

The movement in PVIF increased by 99%, attributable mainly to the lower discount rate on insurance contract liabilities described above, which was partly offset by the adjustment to PVIF accounting for sharing of investment returns attributable to policyholders.

General insurance income was broadly in line with the same period last year.

**Change in expected credit losses and other credit impairment charges** increased by HK\$272m, or 114%, to HK\$510m.

Hong Kong Financial Reporting Standard ('HKFRS') 9 'Financial Instruments' requires the recognition of impairment earlier in the lifecycle of a financial asset, taking forward-looking information into consideration. As a result, measurement involves more complex judgement with impairment likely to be more volatile as the economic outlook changes.

Change in expected credit losses ('ECL') and other credit impairment charges for unimpaired credit exposures (stage 1 & 2) recorded a net charge of HK\$232m, compared with a net release of HK\$112m in the first half of 2018, attributable mainly to change in the size of the loans portfolio and a less favourable forward-looking macroeconomic forecast for Hong Kong during the updating of key macroeconomic variables in the ECL assessment model. Increase in ECL charges for stage 1 & 2 amounted to HK\$344m. Retail Banking and Wealth Management ('RBWM') accounted for HK\$79m and the remaining HK\$265m was related to Commercial Banking ('CMB') and Global Banking and Markets ('GBM').

ECL charges for impaired credit exposures (stage 3 & purchased or originated credit-impaired) decreased by HK\$72m. The downgrading of several CMB customers in first half of 2018 did not reoccur in the first half of 2019, although the positive impact of this was partly offset by higher charges on credit card and personal loan portfolios under RBWM.

Gross impaired loans and advances were down by HK\$137m, or 6%, to HK\$2,023m against 2018 year-end. Gross impaired loans and advances as a percentage of gross loans and advances to customers stood at 0.22% at the end of June 2019, compared with 0.25% at the end of December 2018 and 0.31% at the end of June 2018. Overall credit quality remained robust.

The Bank's senior management will continue to closely monitor market developments and shifts in the economic environment in its management and assessment of the credit performance of financial assets.

**Operating expenses** increased by HK\$606m, or 11%, to HK\$6,328m, due mainly to the Bank's continued investment in people, technology and operational infrastructure to drive service enhancement and business development in Hong Kong and the Mainland in support of long-term sustainable growth. Staff costs were up 9%, due primarily to the salary increment and higher performance-related pay expenses.

Depreciation charges increased by 45%, due mainly to higher depreciation charges on business premises following the upward commercial property revaluation at last year-end. Depreciation charges for the first half of 2019 also include depreciation of right-of-use assets amounting to HK\$251m following the adoption of HKFRS 16 'Leases', which came into effect on 1 January 2019. Correspondingly, there was a similar decrease in rental expenses under general and administrative expenses.

General and administrative expenses increased by 2%. Further investment in systems and the development of distribution channels to advance the Group's growth initiatives and an increase in processing fee led to higher technology costs. These were partly offset by lower marketing and advertising expense and rental expenses as stated in the previous paragraph.

The Group continued to focus on enhancing operational efficiency while maintaining growth momentum. The cost efficiency ratio was 28.2%, one of the lowest among banks in Hong Kong.

<i>Full-time equivalent staff numbers by region</i>	<i>At 30 June 2019</i>	<i>At 30 June 2018</i>
Hong Kong and others	<b>8,614</b>	8,365
Mainland	<b>1,757</b>	1,727
Total	<b>10,371</b>	10,092
	<i>Half-year ended 30 June 2019</i>	<i>Half-year ended 30 June 2018</i>
Cost efficiency ratio	<b>28.2 %</b>	27.7 %

**Operating profit** rose HK\$899m, or 6%, to HK\$15,561m compared with the first half of 2018.

**Net surplus on property revaluation** increased by HK\$109m, or 140%, to HK\$187m.

**Share of profits of associates** increased by HK\$22m, or 18%, to HK\$146m, mainly reflecting higher revaluation surplus of a property investment company.

### **First half of 2019 compared with second half of 2018**

The Group recorded a strong performance against the second half of 2018. Attributable profit grew by HK\$2,092m, or 18%. Operating profit rose by HK\$2,276m, or 17%, reflecting the combined effect of higher non-interest income, lower ECL charges and reduced operating expenses. Operating profit excluding changes in expected credit losses and other credit impairment charges rose by HK\$2,028m, or 14%.

Net interest income was broadly in line with the second half of 2018. The favourable impact of the increase in average interest-earning assets and increased contribution from net free funds was mostly offset by the change in liability mix as rising market interest rates prompted customers to shift from current and savings accounts to time deposits, the narrowing of the net interest margin as a result of lower market interest rate level in the first quarter of 2019 and more calendar days in the second half of 2018.

Non-interest income grew by HK\$1,809m or 38%. With the Bank's diverse portfolio of products and well-established reputation for service excellence, wealth management business remained a core income driver. In challenging operating conditions for investment business, the Bank leveraged its strong life insurance proposition to achieve a 54% increase in wealth management income. Credit facilities fee income grew by 90%, due mainly to higher fees from corporate lending.

Operating expenses decreased by HK\$118m, or 2%, with savings in general and administrative expenses and premises and equipment outweighing the increase in staff costs. ECL charges decreased by HK\$248m, or 33%, due mainly to additional ECL charges on impaired customer loans and the downgrading of several CMB customers in the second half of 2018.

## Segmental Analysis

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

<i>Figures in HK\$m</i>	<i>Retail Banking and Wealth Management</i>	<i>Commercial Banking</i>	<i>Global Banking and Markets</i>	<i>Other</i>	<i>Total</i>
<b>Half-year ended 30 June 2019</b>					
Profit before tax	<u>8,396</u>	<u>4,964</u>	<u>2,426</u>	<u>108</u>	<u>15,894</u>
Share of profit before tax	<u>52.8%</u>	<u>31.2%</u>	<u>15.3%</u>	<u>0.7%</u>	<u>100.0%</u>
<b>Half-year ended 30 June 2018</b>					
Profit before tax	<u>7,683</u>	<u>4,439</u>	<u>2,734</u>	<u>8</u>	<u>14,864</u>
Share of profit before tax	<u>51.7%</u>	<u>29.9%</u>	<u>18.4%</u>	<u>0.0%</u>	<u>100.0%</u>

**Retail Banking and Wealth Management ('RBWM')** recorded an 11% year-on-year increase in operating profit excluding change in expected credit losses and other credit impairment charges to HK\$8,564m. Operating profit increased by 9% to HK\$8,249m and profit before tax rose by 9% to HK\$8,396m.

Net interest income increased by 10% to HK\$8,644m. Despite keen market competition, enhanced analytics supported our efforts to target key customer segments, enabling us to grow new funds. Deposit balances rose by 2% in Hong Kong compared with 2018 year-end.

Non-interest income grew by 14% to HK\$3,867m. Wealth management business revenue increased by 12%.

The Hong Kong property market recorded a higher transaction volume in the first half of 2019 against last year. We maintained our leadership position in the government-subsidised housing market by uplifting our distribution capability in strategic segments, supporting a 6% increase in mortgage balances in Hong Kong compared with 2018 year-end. Our new mortgage business continued to rank among the top three in Hong Kong.

Effective marketing campaigns and deep understanding of our client base enabled us to achieve 6% year-on-year growth in card receivables.

The global investment market continued to be volatile. Our investment services income declined against the high base established in the more favourable investment conditions of the first half of 2018. Securities turnover and revenue declined by 43% and 34% respectively. Investment services revenue excluding securities-related income dropped by 24% compared with last year. As customers grew more risk adverse in the uncertain market environment, we launched more fixed-income products to meet their changing needs.

Insurance income grew by 51%. Our prudent investment strategy resulted in better investment return from the life insurance investment portfolio. We enriched our holistic retirement planning and life protection solutions with the launch of new insurance products, including the PrimeLife Deferred Annuity Life Insurance Plan, which enables customers to benefit from the Hong Kong Government's new tax concession measures. Our strong retirement planning and annuity propositions enabled us to increase our insurance distribution revenue.

Enhancements to our customer segmentation strategy and strengthened analytics, powered by machine learning, enabled us to deepen relationships with our clients and provides more timely needs-based financial products and services. In the Prestige Banking segment, we leveraged our high-value proposition and premium wealth management solutions to drive new business. We grew our Prestige Signature customer base by 14% year-on-year in Hong Kong. On the Mainland, we grew the number of Prestige customers by 5% year-on-year.

We are committed to investing in fintech and building a robust digital infrastructure to better engage our customers. We continued to uplift our mobile banking and e-Banking user experiences to provide our clients with smarter, easier and more relevant banking services. We upgraded the mobile banking user interface to allow greater personalisation. We expanded the capabilities and features of our AI chatbot, HARO, which now allows customers to conduct foreign exchange services and transfers and foreign exchange ATM location enquiries using the conversational interface. We continued to roll out new online products and services, including new insurance products, a credit card activation service and mobile e-statements. Year-on-year, the number of Personal e-Banking customers increased by 8% in Hong Kong and the number of active mobile users increased by 40%.

**Commercial Banking ('CMB')** achieved a 13% increase in operating profit excluding change in expected credit losses and other credit impairment charges to HK\$5,120m. Operating profit and profit before tax rose by 12% to HK\$4,964m.

Net interest income rose by 20% to HK\$5,195m, reflecting good growth in loan and deposit balances, as well as the rise in market interest rates.

Non-interest income declined by 12% to HK\$1,552m, due mainly to the downturn in investment sentiment and uncertainties arising from the US-China trade dispute. Amid the challenging external environment, we remained active in the syndicated loan market, resulting in a 22% increase in credit facilities fee income.

We launched further initiatives to improve customer experience in transactional banking. To support the launch of the Faster Payment System ('FPS'), we enhanced our bill payment services to accept FPS QR codes. We extended One Collect, our integrated point-of-sale terminal, from offline merchants to online merchants and introduced support for payments by FPS. In addition, we significantly enhanced the speed and accuracy of trade transactions with the adoption of new optical character recognition technology and the automation of the vessel-checking process.

Riding on the Bank's strategic alliance with Hong Kong Science and Technology Parks Corporation, we launched 'Inno Booster', a tailor-made banking and finance solution for eligible innovation and technology companies that allows them to enjoy pre-approved loans and other preferential banking service offers.

We continued to expand our digital capabilities to make services faster, easier and more convenient for customers. We upgraded the functionality of digital foreign exchange services to allow for orders to be executed automatically upon hitting the designated exchange rate. We took steps to cut waiting times with initiatives such as the launch of an online business loan application form. Our virtual customer service assistant, BERI, was enhanced to support more general enquiries.

To further improve the customer experience, we upgraded our Tsim Sha Tsui Business Banking Centre to provide a more spacious and comfortable service environment.

We continued to be proactive and vigilant in managing our credit risk and uphold good overall credit quality.

Our digital innovations have received positive recognition in the industry. We received rewards from *The Assets* for One Collect ('Most Innovative Corporate Payment Project') and our AI Chatbot ('Most Innovative Emerging Digital Technologies Project'). We were also named 'Best Payment Bank in Hong Kong' and received the 'Best Automated Advisory/ Chatbot Initiative, Application or Programme' award at *The Asian Banker* Transaction Banking Awards.



**Global Banking and Markets ('GBM')** reported 9% decline in operating profit excluding change in expected credit losses and other credit impairment charges to HK\$2,465m and an 11% decrease in both operating profit and profit before tax to HK\$2,426m.

**Global Banking ('GB')** reported a 14% growth in operating profit excluding change in expected credit losses and other credit impairment charges to HK\$1,160m. Operating profit and profit before tax were both up 9% at HK\$1,123m.

Net interest income increased by 12% to HK\$1,219m. In a challenging market environment, we achieved an enhanced lending portfolio mix and better deposit returns, reflecting the strong trust we have established with large corporate clients as well as improvements to our cash management capabilities.

Key drivers included successful steps to grow the deposit base, which was increased by 18% compared with 2018 year-end, and good growth in non-interest income, which rose by 17% compared with a year earlier. Compared with the second half of 2018, non-interest income grew by 34%.

**Global Markets ('GM')** reported a 23% decrease in operating profit excluding change in expected credit losses and other credit impairment charges to HK\$1,305m. Operating profit and profit before tax both decreased by 24% to HK\$1,303m.

Net interest income decreased by 5% to HK\$1,037m. The adverse effects of the yield curve flattening and tightening credit spreads limited the revenue gained from deploying new and maturing balance sheet management portfolios. The balance sheet management team continued to manage interest rate risk effectively, taking steps to proactively defend the interest margin and achieve yield enhancement while upholding prudent risk management standards.

Non-interest income decreased by 33% to HK\$565m. Uncertainty related to the US-China trade dispute and low foreign exchange volatility decreased customer demand for foreign exchange products. Together with the unfavourable flattening yield curve environment, this resulted in a decline in non-fund income from sales and trading activities. We continued with initiatives to deepen GM product penetration among Bank customers through close collaboration with the RBWM, CMB and GB teams.

## Balance Sheet Analysis

### Assets

Total assets increased by HK\$85bn, or 5%, to HK\$1,657bn compared with last year-end, with the Group maintaining good business momentum and advancing its strategy of enhancing profitability through sustainable growth.

Cash and sight balances at central banks decreased by HK\$6bn, or 39%, to HK\$10bn, reflecting the redeployment of the commercial surplus. Placing with banks increased by HK\$20bn, or 25%, to HK\$99bn and trading assets rose by HK\$3bn, or 5%, to HK\$50bn.

Customer loans and advances (net of ECL allowances) grew by HK\$45bn, or 5%, to HK\$920bn against 2018 year-end. Loans for use in Hong Kong increased by 5%, mainly reflecting growth in lending to the property development and investment sector, manufacturers and working capital financing for certain large corporate customers. Lending to individuals increased by 5%. The Group continued to maintain its market share for mortgage business, with residential mortgages and Government Home Ownership Scheme/Private Sector Participation Scheme/Tenants Purchase Scheme lending growing by 6% and 9% respectively. Trade finance lending grew by 8%. Loans and advances for use outside Hong Kong increased by 7%, due mainly to the combined effect of the increase in lending granted by the Hong Kong office and the Group's Mainland banking subsidiary.

Financial investments increased by HK\$21bn, or 5%, to HK\$450bn, mainly reflecting funds redeployment of the issued Additional Tier 1 ('AT1') capital instruments and the non-capital loss-absorbing capacity debt instruments to meet regulatory requirements and further optimise the Bank's capital and funding structure. There was also an increase in the insurance financial instruments portfolio.

### Liabilities and equity

Customer deposits, including certificates of deposit and other debt securities in issue, increased by HK\$49bn, or 4%, to HK\$1,241bn against last year-end. Rising market interest rates resulted in higher growth in time deposits. At 30 June 2019, the advances-to-deposits ratio was 74.1%, compared with 73.4% at 31 December 2018.

The Bank issued subordinated liabilities amounting to HK\$19.5bn during the first half of 2019 to meet loss-absorbing capacity requirements and further strengthen the Bank's financial resilience.

At 30 June 2019, shareholders' equity was up HK\$11bn, or 7%, at HK\$173bn against last year-end. Retained profits grew by HK\$4bn, or 3%, reflecting profit accumulation partly offset by the payment of the 2018 fourth interim dividend and the 2019 first interim dividend. Other equity instruments, specifically AT1 capital instruments, increased by HK\$5bn, or 68% as the Bank has cancelled and repaid the AT1 capital instrument of US\$900m and issued new AT1 capital instruments of US\$1,500m to further optimise its capital structure and comply with regulatory requirements. The premises revaluation reserve increased by HK\$0.4bn, or 2%, reflecting the upward trend in the commercial property market. Financial assets at fair value through other comprehensive income reserve increased by HK\$1.3bn, or 86%, mainly reflecting the fair value movement of the Group's investments in financial assets measured at fair value.

## Risk and Capital Management

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

### Risk Management

#### Principal risks and uncertainties

The Group continuously monitors and identifies risks. Our principal risks are credit risk, liquidity and funding risk, market risk, operational risk, regulatory compliance risk, financial crime risk, reputational risk, pension risk, sustainability risk and insurance risk. The description of principal risks and a summary of our current policies and practices regarding the management of risk is set out in the "Risk Management" section of the Annual Report 2018.

#### Key developments in the first half of 2019

There were no material changes to the policies and practices for the management of risk, as described in the Annual Report 2018, in the first half of 2019 except for the following:

- We continued to strengthen our approach to managing operational risk, as set out in the operational risk management framework. The framework sets out our governance and appetite. It provides a single view of non-financial risks that matter the most and associated controls. It incorporates a risk management system to enable active risk management.
- We continued to strengthen our management of conduct and embed conduct considerations as a key part of risk management across the Group. We set out clear expectations and guidance for all our people, illustrating the link between our values and good conduct. Our goal is for good conduct, through our people's behaviour and decision making, to deliver fair outcomes for customers and preserve market integrity.
- The Global Standards programme continued to integrate the final elements of our capabilities for Anti-Money Laundering ("AML") and sanctions into our day to day operations throughout the first half of 2019. We continue to enhance our financial crime risk management capabilities and the effectiveness of our financial crime controls, and we are maintaining our investment in the next generation of tools to fight financial crime through the application of advanced analytics and artificial intelligence.

#### Update on the nature of our Ibor risks

The impact of the replacement of interbank offered rates ("Ibors") with alternative risk-free rates on our products and services remains a key area of focus. The programme to coordinate our transition activities is significant in terms of scale and complexity and will impact all global businesses and jurisdictions as well as multiple products, currencies, systems and processes. In addition to the consequent execution risks, the process of adopting new reference rates exposes the Group to a wide range of material conduct, operational and financial risks. We continue to engage with industry participants, the official sector and our clients to support an orderly transition and the mitigation of the risks resulting from the transition.

#### (a) Credit Risk

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. Credit risk arises principally from direct lending, trade finance and leasing business, but also from certain other products, such as guarantees and derivatives.

#### Maximum exposure to credit risk before collateral held or other credit enhancements

Our credit exposure is spread across a broad range of asset classes, including those measured at amortised cost and fair value, and off-balance sheet financial instruments. The following table presents the maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements (unless such credit enhancements meet accounting offsetting requirements). For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees and similar contracts granted, it is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments, it is generally the full amount of the committed facilities.

	At 30 June 2019	At 31 December 2018
Cash and sight balances at central banks	10,082	16,421
Placings with and advances to banks	99,066	79,400
Trading assets	49,720	47,148
Financial assets designated and otherwise mandatorily measured at fair value	1,397	1,331
Derivative financial instruments	6,310	8,141
Loans and advances to customers	919,845	874,456
Financial investments	444,079	424,388
Other assets	24,470	27,019
Financial guarantees and other credit related contingent liabilities	4,079	4,167
Loan commitments and other credit related commitments	586,062	594,457
	<u>2,145,110</u>	<u>2,076,928</u>

## Risk and Capital Management (continued)

### Risk Management (continued)

#### (a) Credit Risk (continued)

##### Summary of credit risk

The following tables analyse the financial instruments to which the impairment requirements of HKFRS 9 are applied and the related allowance for expected credit losses ("ECL").

##### Summary of financial instruments to which the impairment requirements in HKFRS 9 are applied

	At 30 June 2019		At 31 December 2018	
	Gross carrying/ nominal amount	Allowance for ECL <sup>1</sup>	Gross carrying/ nominal amount	Allowance for ECL <sup>1</sup>
Loans and advances to customers at amortised cost:	<b>922,753</b>	<b>(2,908)</b>	877,134	(2,678)
– personal	<b>331,906</b>	<b>(1,079)</b>	317,463	(1,023)
– corporate and commercial	<b>572,650</b>	<b>(1,782)</b>	540,530	(1,613)
– non-bank financial institutions	<b>18,197</b>	<b>(47)</b>	19,141	(42)
Placings with and advances to banks at amortised cost	<b>71,141</b>	<b>(1)</b>	70,608	(2)
Other financial assets measured at amortised costs:	<b>149,753</b>	<b>(47)</b>	142,834	(42)
– cash and sight balances at central banks	<b>10,082</b>	-	16,421	-
– reverse repurchase agreements – non-trading	-	-	-	-
– financial investments	<b>115,194</b>	<b>(40)</b>	99,389	(37)
– other assets <sup>2</sup>	<b>24,477</b>	<b>(7)</b>	27,024	(5)
<b>Total gross carrying amount on balance sheet</b>	<b>1,143,647</b>	<b>(2,956)</b>	1,090,576	(2,722)
Loans and other credit related commitments	<b>336,804</b>	<b>(66)</b>	314,620	(55)
Financial guarantee and similar contracts	<b>4,081</b>	<b>(2)</b>	4,168	(1)
<b>Total nominal amount off balance sheet <sup>3</sup></b>	<b>340,885</b>	<b>(68)</b>	318,788	(56)
<b>Total</b>	<b>1,484,532</b>	<b>(3,024)</b>	1,409,364	(2,778)
	<b>Fair value</b>	<b>Memorandum Allowance for ECL</b>	<b>Fair value</b>	<b>Memorandum Allowance for ECL</b>
Debt instruments measured at Fair Value through Other Comprehensive Income ("FVOCI") <sup>4</sup>	<b>328,925</b>	<b>(7)</b>	325,036	(5)

<sup>1</sup> For retail unsecured revolving facilities, e.g. overdrafts and credit cards, the total ECL is recognised against the financial asset unless the total ECL exceeds the gross carrying amount of the financial asset, in which case the ECL is recognised against the loan commitments.

<sup>2</sup> Includes only those financial instruments which are subject to the impairment requirements of HKFRS 9. "Other assets" as presented within the Condensed Consolidated Balance Sheet includes both financial and non-financial assets.

<sup>3</sup> The figure does not include some loans commitments and financial guarantee contracts not subject to impairment requirements under HKFRS 9. As such, the amount does not agree with the figure shown in note 35(a) of the Condensed Consolidated Financial Statements which represents the maximum amount at risk should the contracts be fully drawn upon and clients default.

<sup>4</sup> For debt instruments measured at FVOCI, the allowance for ECL is a memorandum item and the debt instruments continue to be measured at fair value without netting off the ECL in the Condensed Consolidated Balance Sheet.

<sup>5</sup> The above table does not include balances due from HSBC Group companies.

## **Risk and Capital Management** *(continued)*

### **Risk Management** *(continued)*

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

##### **Measurement uncertainty and sensitivity analysis of ECL estimates**

The recognition and measurement of expected credit loss ("ECL") is highly complex and involves the use of significant judgement and estimation. This includes the formulation and incorporation of multiple forward-looking economic conditions into the ECL estimates to meet the measurement objective of HKFRS 9.

##### **Methodology**

Impairment is calculated in three stages and financial instruments are allocated into one of the three stages where the transfer mechanism depends on whether there is a significant increase/decrease in credit risk in the relevant reporting period. After the allocation, the measurement of expected credit loss ("ECL"), which is the product of probability of default ("PD"), loss given default ("LGD") and exposure at default ("EAD"), will reflect the change in risk of default occurring over the remaining life of the instruments. The model monitoring on ECL parameters will be performed quarterly.

For most portfolios, the Group has adopted the use of three economic scenarios. They represent a "most likely outcome", (the Central scenario) and two, less likely, "outer" scenarios on either side of the Central, referred to as an "Upside" and a "Downside" scenario respectively.

There were no material changes to economic scenarios in the first half of 2019 except for the update of key economic assumptions.

The Upside and Downside scenarios are generated at year end and are only updated during the year if economic conditions change significantly. The Central scenario is generated every quarter.

The Group recognises that the Consensus Economic Scenario approach using three scenarios will be insufficient in certain economic environments. Additional analysis may be requested at management's discretion, including the production of extra scenarios. For instance, the recent continued escalation of trade and tariff-related tensions started from 2018 resulted in management modelling deeper effects of a trade war scenario than currently captured by the consensus Downside scenario for key Asia-Pacific economies. This additional trade war scenario models the effects of a significant escalation in global tensions, stemming from trade disputes but going beyond increases in tariffs to affect non-tariff barriers, cross-border investment flows and threatens the international trade architecture. This scenario assumes actions that lie beyond currently enacted and proposed tariffs and has been modelled as an addition to the three consensus-driven scenarios for these economies.

The conditions that resulted in departure from the consensus economic forecasts will be reviewed regularly as economic conditions change in future to determine whether these adjustments continue to be necessary.

**Risk and Capital Management** (continued)

**Risk Management** (continued)

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

**Reconciliation of gross exposure and allowances/provision for loans and advances to banks and customers including loan commitments and financial guarantees**

	Non credit - impaired				Credit - impaired				Total	
	Stage 1		Stage 2		Stage 3		POCI <sup>1</sup>		Gross exposure	Allowance/provision for ECL
	Gross exposure	Allowance/provision for ECL	Gross exposure	Allowance/provision for ECL	Gross exposure	Allowance/provision for ECL	Gross exposure	Allowance/provision for ECL		
At 1 January 2019	1,210,584	(777)	53,786	(1,000)	2,154	(959)	6	-	1,266,530	(2,736)
Transfers of financial instruments:										
- transfers from Stage 1 to Stage 2	(17,487)	44	17,487	(44)	-	-	-	-	-	-
- transfers from Stage 2 to Stage 1	22,410	(218)	(22,410)	218	-	-	-	-	-	-
- transfers to Stage 3	(106)	-	(111)	10	217	(10)	-	-	-	-
- transfers from Stage 3	-	-	17	(1)	(17)	1	-	-	-	-
Net remeasurement of ECL arising from transfer of stage	-	128	-	(141)	-	(2)	-	-	-	(15)
Changes due to modifications not derecognised	-	-	-	-	-	-	-	-	-	-
Net new and further lending / (repayments)	71,156	(55)	(2,467)	117	(22)	113	-	-	68,667	175
Changes to risk parameters (model inputs)	-	(67)	-	(213)	-	(435)	-	-	-	(715)
Changes to model used for ECL calculation	-	-	-	-	-	-	-	-	-	-
Assets written off	-	-	-	-	(314)	314	-	-	(314)	314
Foreign exchange and others	(191)	-	(22)	-	(1)	-	-	-	(214)	-
At 30 June 2019	<u>1,286,366</u>	<u>(945)</u>	<u>46,280</u>	<u>(1,054)</u>	<u>2,017</u>	<u>(978)</u>	<u>6</u>	<u>-</u>	<u>1,334,669</u>	<u>(2,977)</u>

	Total
Change in ECL in income statement (charge)/release for the period	(555)
Add: Recoveries	58
Add/(less): Others	(6)
Total ECL (charge)/release for the period	<u>(503)</u>

	At 30 June 2019		For the half-year ended
	Gross carrying/nominal amount	Allowance for ECL	30 June 2019 ECL (charge)/release
Placings with and advances to banks and loans and advances to customers, including loan commitments and financial guarantees	1,334,669	(2,977)	(503)
Other financial assets measured at amortised cost	149,753	(47)	(5)
Forward asset purchases	110	-	-
<b>Summary of financial instruments to which the impairment requirements in HKFRS 9 are applied/ Summary Condensed Consolidated Income Statement</b>	<b>1,484,532</b>	<b>(3,024)</b>	<b>(508)</b>
Debt instruments measured at FVOCI <sup>2</sup>	328,226	(7)	(2)
Performance and other guarantees	17,166	(2)	-
<b>Total allowance for ECL/ total ECL charge for the period</b>	<b>1,829,924</b>	<b>(3,033)</b>	<b>(510)</b>

<sup>1</sup> Purchased or originated credit-impaired ("POCI") represented distressed restructuring.

<sup>2</sup> For the purposes of this disclosure, gross carrying value is defined as the amortised cost of a financial asset, before adjusting for any loss allowance. As such, the gross carrying value of debt instruments at FVOCI as presented above will not reconcile to the Condensed Consolidated Balance Sheet as it excludes fair value gains and losses.

<sup>3</sup> The above table does not include balances due from HSBC Group companies.

<sup>4</sup> The financial information included in this table forms part of the Condensed Consolidated Financial Statements which have been reviewed by PricewaterhouseCoopers.

**Risk and Capital Management** (continued)

**Risk Management** (continued)

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

Reconciliation of gross exposure and allowances/provision for loans and advances to banks and customers including loan commitments and financial guarantees (continued)

	Non credit - impaired				Credit - impaired				Total	
	Stage 1		Stage 2		Stage 3		POCI <sup>1</sup>		Gross exposure	Allowance/provision for ECL
	Gross exposure	Allowance/provision for ECL	Gross exposure	Allowance/provision for ECL	Gross exposure	Allowance/provision for ECL	Gross exposure	Allowance/provision for ECL		
At 1 January 2018	1,110,402	(692)	77,109	(1,175)	2,001	(745)	173	(18)	1,189,685	(2,630)
Transfers of financial instruments:										
- transfers from Stage 1 to Stage 2	(31,781)	61	31,781	(61)	-	-	-	-	-	-
- transfers from Stage 2 to Stage 1	44,845	(427)	(44,845)	427	-	-	-	-	-	-
- transfers to Stage 3	(880)	2	(526)	7	1,406	(9)	-	-	-	-
- transfers from Stage 3	-	-	22	-	(22)	-	-	-	-	-
Net remeasurement of ECL arising from transfer of stage	-	286	-	(219)	-	(5)	-	-	-	62
Changes due to modifications not derecognised	-	-	-	-	-	-	-	-	-	-
Net new and further lending/(repayments)	93,785	(65)	(7,898)	206	(226)	109	(159)	10	85,502	260
Changes to risk parameters (model inputs)	-	54	-	(191)	-	(1,313)	-	2	-	(1,448)
Changes to model used for ECL calculation	-	-	-	-	-	-	-	-	-	-
Assets written off	-	-	-	-	(999)	999	(6)	6	(1,005)	1,005
Foreign exchange and others	(5,787)	4	(1,857)	6	(6)	5	(2)	-	(7,652)	15
At 31 December 2018	1,210,584	(777)	53,786	(1,000)	2,154	(959)	6	-	1,266,530	(2,736)

	Total
Change in ECL in income statement (charge)/release for the period	(1,126)
Add: Recoveries	143
Add/(less): Others	(13)
Total ECL (charge)/release for the period	(996)

	At 31 December 2018		For the year ended 31 December 2018
	Gross carrying/nominal amount	Allowance for ECL	ECL (charge)/release
Placings with and advances to banks and loans and advances to customers, including loan commitments and financial guarantees	1,266,530	(2,736)	(996)
Other financial assets measured at amortised cost	142,834	(42)	2
Summary of financial instruments to which the impairment requirements in HKFRS 9 are applied/ Summary Consolidated Income Statement	1,409,364	(2,778)	(994)
Debt instruments measured at FVOCI <sup>2</sup>	325,191	(5)	-
Performance and other guarantees	12,046	(2)	(2)
Total allowance for ECL/ total income statement ECL charge for the period	1,746,601	(2,785)	(996)

<sup>1</sup> Purchased or originated credit-impaired ("POCI") represented distressed restructuring.

<sup>2</sup> For the purposes of this disclosure, gross carrying value is defined as the amortised cost of a financial asset, before adjusting for any loss allowance. As such, the gross carrying value of debt instruments at FVOCI as presented above will not reconcile to the Consolidated Balance Sheet as it excludes fair value gains and losses.

<sup>3</sup> The above table does not include balances due from HSBC Group companies.

## Risk and Capital Management (continued)

### Risk Management (continued)

#### (a) Credit Risk (continued)

The five credit quality classifications defined in the table below each encompass a range of granular internal credit rating grades assigned to wholesale and retail lending businesses and the external ratings attributed by external agencies to debt securities, as shown in the table below. Under HKFRS 9 retail lending credit quality is now disclosed based on a twelve-month probability-weighted PD. The credit quality classifications for wholesale lending are unchanged and are based on internal credit risk ratings.

Credit Quality classification	Debt securities and other bills	Wholesale lending		Retail lending	
	External credit rating	Internal credit rating	12-month Basel probability of default %	Internal credit rating	12-month probability-weighted PD %
Strong	A- and above	CRR1 to CRR2	0–0.169	Band 1-2	0–0.500
Good	BBB+ to BBB-	CRR3	0.170–0.740	Band 3	0.501–1.500
Satisfactory	BB+ to B and unrated	CRR4 to CRR5	0.741–4.914	Band 4-5	1.501–20.000
Sub-standard	B- to C	CRR6 to CRR8	4.915–99.999	Band 6	20.001–99.999
Credit-impaired	Default	CRR9 to CRR10	100	Band 7	100

#### Quality classification definitions

- *Strong: Exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default.*
- *Good: Exposures demonstrate a good capacity to meet financial commitments, with low default risk.*
- *Satisfactory: Exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk.*
- *Sub-standard: Exposures require varying degrees of special attention and default risk is of greater concern.*
- *Credit-impaired: Exposures have been assessed as impaired.*



## Risk and Capital Management (continued)

### Risk Management (continued)

#### (a) Credit Risk (continued)

##### Credit quality of financial instruments

Distribution of financial instruments to which the impairment requirements in HKFRS 9 are applied, by credit quality and stage allocation

	Gross carrying / notional amount					Total	Allowance for ECL	Net
	Strong	Good	Satisfactory	Sub- standard	Credit impaired			
Placings with and advances to banks at amortised cost	70,037	1,101	3	-	-	71,141	(1)	71,140
– stage 1	70,037	1,101	3	-	-	71,141	(1)	71,140
– stage 2	-	-	-	-	-	-	-	-
– stage 3	-	-	-	-	-	-	-	-
– POCI	-	-	-	-	-	-	-	-
Loans and advances to customers at amortised cost	442,197	248,710	225,480	4,343	2,023	922,753	(2,908)	919,845
– stage 1	440,461	237,394	197,197	1,190	-	876,242	(887)	875,355
– stage 2	1,736	11,316	28,283	3,153	-	44,488	(1,043)	43,445
– stage 3	-	-	-	-	2,017	2,017	(978)	1,039
– POCI	-	-	-	-	6	6	-	6
Other financial assets measured at amortised cost	122,070	18,869	8,810	4	-	149,753	(47)	149,706
– stage 1	121,954	18,193	8,715	-	-	148,862	(41)	148,821
– stage 2	116	676	95	4	-	891	(6)	885
– stage 3	-	-	-	-	-	-	-	-
– POCI	-	-	-	-	-	-	-	-
Loan and other credit-related commitments <sup>2</sup>	273,460	43,525	19,535	284	-	336,804	(66)	336,738
– stage 1	273,460	42,978	18,669	143	-	335,250	(56)	335,194
– stage 2	-	547	866	141	-	1,554	(10)	1,544
– stage 3	-	-	-	-	-	-	-	-
– POCI	-	-	-	-	-	-	-	-
Financial guarantees and similar contracts <sup>2</sup>	558	2,805	712	6	-	4,081	(2)	4,079
– stage 1	558	2,765	518	2	-	3,843	(1)	3,842
– stage 2	-	40	194	4	-	238	(1)	237
– stage 3	-	-	-	-	-	-	-	-
– POCI	-	-	-	-	-	-	-	-
<b>At 30 June 2019</b>	<b>908,322</b>	<b>315,010</b>	<b>254,540</b>	<b>4,637</b>	<b>2,023</b>	<b>1,484,532</b>	<b>(3,024)</b>	<b>1,481,508</b>
<b>Debt instruments at FVOCI<sup>1</sup></b>								
– stage 1	325,291	2,935	-	-	-	328,226	(7)	328,219
– stage 2	-	-	-	-	-	-	-	-
– stage 3	-	-	-	-	-	-	-	-
– POCI	-	-	-	-	-	-	-	-
<b>At 30 June 2019</b>	<b>325,291</b>	<b>2,935</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>328,226</b>	<b>(7)</b>	<b>328,219</b>

<sup>1</sup> For the purposes of this disclosure gross carrying value is defined as the amortised cost of a financial asset, before adjusting for any loss allowance. As such the gross carrying value of debt instruments at FVOCI as presented above will not reconcile to the figure shown in Condensed Consolidated Financial Statements as it excludes fair value gains and losses.

<sup>2</sup> Figures do not include commitments and financial guarantee contracts not subject to impairment requirements under HKFRS 9. As such, the amounts do not agree with the figures shown in note 35(a) of the Condensed Consolidated Financial Statements.

<sup>3</sup> The above table does not include balances due from HSBC Group companies.

<sup>4</sup> The financial information included in this table forms part of the Condensed Consolidated Financial Statements which have been reviewed by PricewaterhouseCoopers.

## Risk and Capital Management (continued)

### Risk Management (continued)

#### (a) Credit Risk (continued)

Distribution of financial instruments to which the impairment requirements in HKFRS 9 are applied, by credit quality and stage allocation (continued)

	Gross carrying / notional amount					Total	Allowance for ECL	Net
	Strong	Good	Satisfactory	Sub- standard	Credit impaired			
Placings with and advances to banks at amortised cost	69,493	1,111	4	-	-	70,608	(2)	70,606
– stage 1	69,421	984	4	-	-	70,409	(2)	70,407
– stage 2	72	127	-	-	-	199	-	199
– stage 3	-	-	-	-	-	-	-	-
– POCI	-	-	-	-	-	-	-	-
Loans and advances to customers at amortised cost	434,917	217,902	219,602	2,553	2,160	877,134	(2,678)	874,456
– stage 1	432,339	206,471	186,749	633	-	826,192	(732)	825,460
– stage 2	2,578	11,431	32,853	1,920	-	48,782	(987)	47,795
– stage 3	-	-	-	-	2,154	2,154	(959)	1,195
– POCI	-	-	-	-	6	6	-	6
Other financial assets measured at amortised cost	118,380	16,721	7,731	1	1	142,834	(42)	142,792
– stage 1	117,878	16,384	7,627	-	-	141,889	(34)	141,855
– stage 2	502	337	104	1	-	944	(8)	936
– stage 3	-	-	-	-	1	1	-	1
– POCI	-	-	-	-	-	-	-	-
Loan and other credit- related commitments <sup>2</sup>	256,094	32,083	25,954	489	-	314,620	(55)	314,565
– stage 1	256,094	30,267	23,494	263	-	310,118	(42)	310,076
– stage 2	-	1,816	2,460	226	-	4,502	(13)	4,489
– stage 3	-	-	-	-	-	-	-	-
– POCI	-	-	-	-	-	-	-	-
Financial guarantees and similar contracts <sup>2</sup>	745	2,845	568	10	-	4,168	(1)	4,167
– stage 1	745	2,765	355	-	-	3,865	(1)	3,864
– stage 2	-	80	213	10	-	303	-	303
– stage 3	-	-	-	-	-	-	-	-
– POCI	-	-	-	-	-	-	-	-
At 31 December 2018	<u>879,629</u>	<u>270,662</u>	<u>253,859</u>	<u>3,053</u>	<u>2,161</u>	<u>1,409,364</u>	<u>(2,778)</u>	<u>1,406,586</u>
Debt instruments at FVOCI <sup>1</sup>								
– stage 1	324,037	1,154	-	-	-	325,191	(5)	325,186
– stage 2	-	-	-	-	-	-	-	-
– stage 3	-	-	-	-	-	-	-	-
– POCI	-	-	-	-	-	-	-	-
At 31 December 2018	<u>324,037</u>	<u>1,154</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>325,191</u>	<u>(5)</u>	<u>325,186</u>

<sup>1</sup> For the purposes of this disclosure gross carrying value is defined as the amortised cost of a financial asset, before adjusting for any loss allowance. As such the gross carrying value of debt instruments at FVOCI as presented above will not reconcile to the figure shown in Consolidated Financial Statements as it excludes fair value gains and losses.

<sup>2</sup> Figures do not include commitments and financial guarantee contracts not subject to impairment requirements under HKFRS 9. As such, the amounts do not agree with the figures shown in note 45 of the Consolidated Financial Statements in Annual Report 2018.

<sup>3</sup> The above table does not include balances due from HSBC Group companies.

## Risk and Capital Management (continued)

### Risk Management (continued)

#### (b) Liquidity and funding risk

Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. Funding risk is the risk that funding considered to be sustainable, and therefore used to fund assets, is not sustainable over time.

The Group has an internal liquidity and funding risk management framework which aims to allow it to withstand very severe liquidity stresses. It is designed to be adaptable to changing business models, markets and regulations.

There is no material change to the policies and practices for the management of liquidity and funding risk in the first half of 2019.

A summary of the Group's current policies and practices for the management of liquidity and funding risk is set out in "Liquidity and funding risk" section on pages 69 to 73 of the Group's Annual Report 2018.

#### Liquidity information

In accordance with rule 11(1) of the Banking (Liquidity) Rules ("BLR"), the Group is required to calculate its Liquidity Coverage Ratio ("LCR") on a consolidated basis. From 1 January 2019, the Group is required to maintain a LCR of not less than 100%.

The LCR for the reportable periods are as follows:

	Quarter ended 30 June 2019	Quarter ended 31 March 2019	Quarter ended 30 June 2018	Quarter ended 31 March 2018
Average Liquidity Coverage Ratio	<u>198.5%</u>	<u>210.8%</u>	<u>209.6%</u>	<u>207.0%</u>

The liquidity position of the Group remained strong for the first half of 2019. The average LCR were 198.5% and 210.8% for the quarters ended 30 June and 31 March 2019 respectively, compared with 209.6% and 207.0% for the quarters ended 30 June and 31 March 2018 respectively.

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 consist mainly of government debt securities.

	Weighted amount (average value) at quarter ended			
	30 June 2019	31 March 2019	30 June 2018	31 March 2018
Level 1 assets	305,849	309,073	262,800	265,754
Level 2A assets	12,539	11,577	11,615	12,866
Level 2B assets	550	548	551	552
Total weighted amount of HQLA	<u>318,938</u>	<u>321,198</u>	<u>274,966</u>	<u>279,172</u>

During 2019, the Group is required to calculate NSFR on a consolidated basis and maintain a NSFR of not less than 100% in accordance with the BLR.

The NSFR at the reportable quarter-end are as follows:

	Quarter ended 30 June 2019	Quarter ended 31 March 2019	Quarter ended 30 June 2018	Quarter ended 31 March 2018
Net Stable Funding Ratio	<u>152.5%</u>	<u>150.3%</u>	<u>153.6%</u>	<u>152.9%</u>

The funding position of the Group remained strong and stable for the first half of 2019. The period end NSFR were 152.5% and 150.3% for the quarters ended 30 June and 31 March 2019 respectively, compared with 153.6% and 152.9% for the quarters ended 30 June and 31 March 2018 respectively.

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](http://www.hangseng.com).

## **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 is no material change to the Group's policies and practices for the management of market risk for the first half of 2019.

A summary of the Group's current policies and practices for the management of market risk is set out in "Market Risk" section on pages 74 to 81 of the Group's Annual Report 2018.

#### ***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.

#### ***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. RNIV is not viewed as being a material component of the Group's market risk capital requirement. For the average of the first half of 2019, the capital requirement derived from these stress tests represented 2.7% of the total internal model-based market risk requirement.

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)

##### Trading portfolios

##### VaR of the trading portfolios

Trading VaR predominantly resides within Global Markets. The VaR for trading activity at 30 June 2019 was lower while comparing with 30 June 2018, mainly led by interest rate trading activities.

The table below shows the Group's trading VaR for the following periods.

##### Trading

	At 30 June 2019	Minimum during the first half of 2019	Maximum during the first half of 2019	Average for the first half of 2019
<b>VaR</b>				
Trading	28	14	30	20
Foreign exchange trading	22	7	24	12
Interest rate trading	21	11	28	19
Portfolio diversification	(15)	-	-	(11)
<b>Stressed VaR</b>				
Trading	166	56	207	115
Foreign exchange trading	121	9	121	32
Interest rate trading	191	54	213	122
Portfolio diversification	(146)	-	-	(39)

	At 30 June 2018	Minimum during the first half of 2018	Maximum during the first half of 2018	Average for the first half of 2018
<b>VaR</b>				
Trading	48	19	48	32
Foreign exchange trading	13	12	21	16
Interest rate trading	42	14	42	27
Portfolio diversification	(7)	-	-	(11)
<b>Stressed VaR</b>				
Trading	238	133	253	183
Foreign exchange trading	21	21	141	61
Interest rate trading	251	112	251	177
Portfolio diversification	(34)	-	-	(55)

## **Risk and Capital Management** *(continued)*

### **Risk Management** *(continued)*

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

##### **Backtesting**

While comparing the daily VaR measures to the actual and hypothetical profit and loss for the backtesting in the Group, one loss side exception and one profit side exception were observed in the first half of 2019 for both of the actual and hypothetical profit and loss at the Group consolidated level, which were due to exceptional market volatility.

##### **Non-trading portfolios**

Non-traded interest rate risk is the risk of an adverse impact to earnings or capital due to changes in market interest rates. The risk arises from timing mismatches in the re-pricing of non-traded assets and liabilities and is the potential adverse impact of changes in interest rates on earnings and capital.

In its management of the risk, the Group aims to mitigate the impact of future interest rate movements which could reduce future net interest income, while balancing the cost of hedging activities to the current revenue stream. Monitoring the sensitivity of projected net interest income under varying interest rate scenarios is a key part of this.

In order to manage structural interest rate risk, non-traded assets and liabilities are transferred to Balance Sheet Management ("BSM") based on their re-pricing and maturity characteristics. For assets and liabilities with no defined maturity or re-pricing characteristics, behaviouralisation is used to assess the interest rate risk profile. BSM manages the banking book interest rate positions transferred to it within the approved limits. The Asset, Liability and Capital Management Committee ("ALCO") is responsible for monitoring and reviewing its overall structural interest rate risk position. Interest rate behaviouralisation policies have to be formulated in line with the Group's behaviouralisation policies and approved at least annually by ALCO.

##### **Foreign exchange exposures**

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 Group's Chief Risk Officer, noting the support of Risk Management Meeting. The net options position is calculated on the basis of delta-weighted positions of all foreign exchange options contracts.

The Group's structural foreign exchange exposures, monitored by using sensitivity analysis, represents 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 exchange 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 largely protected from the effect of changes in exchange rates.

The Group's foreign exchange exposures are prepared in accordance with the HKMA "Return of Foreign Currency Position - (MA(BS)6)".

For details of the Group's non-structural and structural foreign currency positions, please refer to the Banking Disclosure Statement that is available in the "Regulatory Disclosure" section of the Bank's website.

##### **Equities exposures**

The Group's equities exposures in the first half of 2019 and for the year 2018 are mainly long-term equity investments which are reported as "Financial investments". Equities held for trading purpose are included under "Trading assets" and subject to trading limit and risk management control procedures and other market risk regime.

## **Risk and Capital Management** *(continued)*

### **Risk Management** *(continued)*

#### **(d) Insurance risk**

The majority of the risk in the Group's insurance business derives from manufacturing activities and can be categorised as financial risk and insurance risk. Financial risks include market risk, credit risk and liquidity risk. Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to the insurer.

There is no material change to the Group's policies and practices for the management of risk arising in our insurance operations. A summary of the Group's policies and practices regarding the risk management of our insurance operations, insurance model and the main insurance contracts we manufacture are provided on pages 81 to 88 of the Group's Annual Report 2018.

#### **(e) Operational risk**

The Group's Operational Risk Management Framework ("ORMF") is our overarching approach for managing operational risk. The approach sets out the governance, appetite and provides a single view of non-financial risks that matter the most, and associated controls. A centralised database is used to record the results of the operational risk management process. The delivery of the framework provides us with a platform to further improve our operational risk management capability across the Group.

Responsibility for minimising operational risk lies with the Group's management and staff. All staff are required to manage the operational risks of the business and operational activities for which they are responsible.

A summary of the Group's current policies and practices for the management of operational risk is set out in "Operational Risk" section on pages 89 to 90 of the Group's Annual Report 2018.

## Risk and Capital Management (continued)

### Capital Management

The following tables show the capital base, risk-weighted assets and capital ratios as contained in the "Capital Adequacy Ratio" return required to be submitted to the 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 basis is different from that for accounting purposes. Further information on the regulatory consolidation basis is set out in the Banking Disclosure Statement that is available in the Regulatory Disclosures section of our website [www.hangseng.com](http://www.hangseng.com).

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

We closely monitor and consider future regulatory change and continue to evaluate the impact upon our capital requirements of regulatory developments. This includes the Basel III reforms package, over which there remains a significant degree of uncertainty due to the number of national discretions within Basel's reforms. It remains premature to provide details of an impact although we currently anticipate the potential for an increase in risk-weighted assets.

### Capital Base

The following table sets out the composition of the Group's capital base under Basel III at 30 June 2019 and 31 December 2018. A more detailed breakdown of the capital position and a full reconciliation between the Group's accounting and regulatory balance sheets can be viewed in the Banking Disclosure Statement in the Regulatory Disclosures section of our website [www.hangseng.com](http://www.hangseng.com).

	At 30 June 2019	At 31 December 2018
<b>Common Equity Tier 1 ("CET1") Capital</b>		
Shareholders' equity	138,263	133,990
- Shareholders' equity per Condensed Consolidated Balance Sheet	172,721	162,082
- Additional Tier 1 ("AT1") perpetual capital instruments	(11,744)	(6,981)
- Unconsolidated subsidiaries	(22,714)	(21,111)
Non-controlling interests	-	-
- Non-controlling interests per Condensed Consolidated Balance Sheet	117	25
- Non-controlling interests in unconsolidated subsidiaries	(117)	(25)
Regulatory deductions to CET1 capital	(32,318)	(32,266)
- Cash flow hedging reserve	(34)	4
- Changes in own credit risk on fair valued liabilities	(12)	(12)
- Property revaluation reserves*	(27,160)	(26,543)
- Regulatory reserve	(4,112)	(4,982)
- Intangible assets	(725)	(463)
- Defined benefit pension fund assets	(15)	(11)
- Deferred tax assets net of deferred tax liabilities	(113)	(111)
- Valuation adjustments	(147)	(148)
<b>Total CET1 Capital</b>	<b>105,945</b>	<b>101,724</b>
<b>AT1 Capital</b>		
Total AT1 capital before and after regulatory deductions	11,744	6,981
- Perpetual capital instruments	11,744	6,981
<b>Total AT1 Capital</b>	<b>11,744</b>	<b>6,981</b>
<b>Total Tier 1 ("T1") Capital</b>	<b>117,689</b>	<b>108,705</b>
<b>Tier 2 ("T2") Capital</b>		
Total T2 capital before regulatory deductions	14,973	15,517
- Property revaluation reserves*	12,222	11,944
- Impairment allowances and regulatory reserve eligible for inclusion in T2 capital	2,751	3,573
Regulatory deductions to T2 capital	(915)	(915)
- Significant capital investments in unconsolidated financial sector entities	(915)	(915)
<b>Total T2 Capital</b>	<b>14,058</b>	<b>14,602</b>
<b>Total Capital</b>	<b>131,747</b>	<b>123,307</b>

\* 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.



## Risk and Capital Management (continued)

### Capital Management (continued)

#### Risk-weighted assets by risk type

	At 30 June 2019	At 31 December 2018
Credit risk	574,999	541,542
Market risk	8,522	11,020
Operational risk	63,546	59,323
Total	<u>647,067</u>	<u>611,885</u>

#### 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 2019	At 31 December 2018
CET1 capital ratio	16.4%	16.6%
Tier 1 capital ratio	18.2%	17.8%
Total capital ratio	20.4%	20.2%

In addition, the capital ratios of all tiers as of 30 June 2019 would be reduced by approximately 0.4 percentage point after the prospective second interim dividend payment for 2019. The following table shows the pro-forma basis position of the capital ratios after the prospective interim dividend.

	Pro-forma At 30 June 2019	Pro-forma At 31 December 2018
CET1 capital ratio	16.0%	15.5%
Tier 1 capital ratio	17.8%	16.6%
Total capital ratio	20.0%	19.0%

#### Loss-absorbing capacity requirements

During the period, the HKMA has classified the Bank as a material subsidiary of HSBC's Asian resolution group and required the Bank to comply with internal loss-absorbing capacity requirements under the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules, with phased implementation periods starting from 1 July 2019. To meet the requirements, the Bank has cancelled and repaid the perpetual capital instrument of US\$900m, issued new perpetual capital instruments of US\$1,500m and non-capital loss-absorbing capacity debt instruments totalling HK\$19,503m to its immediate holding company in the first half of 2019.

#### Dividend policy

##### Objective

The Bank's medium to long term dividend objective is to maintain steady dividends in light of profitability, regulatory requirements, growth opportunities and the operating environment. Its roadmap is designed to generate increasing shareholders' value through strategic business growth. The Bank would balance solid yields with the longer-term reward of sustained share price appreciation.

##### Considerations

The declaration of dividends is made at the discretion of the Board, which will take into account all relevant factors including the following:

- financial results;
- level of distributable reserves;
- general business conditions and strategies;
- regulatory requirements;
- strategic business plan and capital plan;
- statutory and regulatory restrictions on dividend payment;
- any other factors the Board may deem relevant.

##### Phasing and Timing

Under normal circumstances and if the Board determines to declare a dividend at its discretion, dividends would be declared on a quarterly basis. The phasing of dividends would be planned on a prudent basis to allow for any unforeseen events, which might arise towards the end of an accounting period. Phasing of dividends would also take account of the volatility of the Bank's profits.

## CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

unaudited

(Expressed in millions of Hong Kong dollars)

### Condensed Consolidated Income Statement

		Half-year ended 30 June 2019	Half-year ended 30 June 2018
	note		
Interest income	4	21,373	17,363
Interest expense	5	(5,520)	(3,135)
<b>Net interest income</b>		<b>15,853</b>	<b>14,228</b>
Fee income		4,808	5,247
Fee expense		(1,323)	(1,258)
<b>Net fee income</b>	6	<b>3,485</b>	<b>3,989</b>
Net income from financial instruments measured at fair value	7	2,035	995
Gains less losses from financial investments	8	1	24
Dividend income	9	136	6
Net insurance premium income		9,224	8,732
Other operating income	10	3,066	1,621
<b>Total operating income</b>		<b>33,800</b>	<b>29,595</b>
Net insurance claims and benefits paid and movement in liabilities to policyholders		(11,391)	(8,946)
<b>Net operating income before change in expected credit losses and other credit impairment charges</b>		<b>22,409</b>	<b>20,649</b>
Change in expected credit losses and other credit impairment charges	11	(510)	(238)
<b>Net operating income</b>		<b>21,899</b>	<b>20,411</b>
Employee compensation and benefits		(3,118)	(2,866)
General and administrative expenses		(2,173)	(2,133)
Depreciation expenses		(967)	(668)
Amortisation of intangible assets		(70)	(55)
<b>Operating expenses</b>	12	<b>(6,328)</b>	<b>(5,722)</b>
Impairment loss on intangible assets		(10)	(27)
<b>Operating profit</b>		<b>15,561</b>	<b>14,662</b>
Net surplus on property revaluation		187	78
Share of profits of associates		146	124
<b>Profit before tax</b>		<b>15,894</b>	<b>14,864</b>
Tax expense	13	(2,248)	(2,227)
<b>Profit for the period</b>		<b>13,646</b>	<b>12,637</b>
<b>Attributable to:</b>			
Shareholders of the company		13,656	12,647
Non-controlling interests		(10)	(10)
(Figures in HK\$)			
Earnings per share - basic and diluted	14	6.98	6.62

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 39 to 63 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 2019	Half-year ended 30 June 2018
<b>Profit for the period</b>	<b>13,646</b>	12,637
<b>Other comprehensive income</b>		
<b>Items that will be reclassified subsequently to the Condensed Consolidated Income Statement when specific conditions are met:</b>		
Debt instruments at fair value through other comprehensive income ("FVOCI") reserve:		
- fair value changes taken to equity	855	(103)
- fair value changes transferred to Condensed Consolidated Income Statement:		
-- on hedged items	(789)	303
-- on disposal	-	(24)
- expected credit losses recognised in the Condensed Consolidated Income Statement	2	(1)
- deferred taxes	(8)	(51)
- exchange difference	1	13
Cash flow hedging reserve:		
- fair value changes taken to equity	71	22
- fair value changes transferred to Condensed Consolidated Income Statement	10	(96)
- deferred taxes	(13)	13
Exchange differences on translation of:		
- financial statements of overseas branches, subsidiaries and associates	(33)	(176)
<b>Items that will not be reclassified subsequently to the Condensed Consolidated Income Statement:</b>		
Change in fair value of financial liabilities designated at fair value arising from changes in own credit risk	3	(11)
Equity instrument:		
- fair value changes taken to equity	1,298	(456)
- exchange difference	(15)	(44)
Premises:		
- unrealised surplus on revaluation of premises	926	1,040
- deferred taxes	(155)	(174)
- exchange difference	-	(3)
Defined benefit plans:		
- actuarial gains/(losses) on defined benefit plans	(81)	(37)
- deferred taxes	13	6
Exchange difference and others <sup>1</sup>	(76)	-
<b>Other comprehensive income for the period, net of tax</b>	<b>2,009</b>	221
<b>Total comprehensive income for the period</b>	<b>15,655</b>	12,858
<b>Total comprehensive income for the period attributable to:</b>		
- shareholders of the company	15,665	12,868
- non-controlling interests	(10)	(10)
	<b>15,655</b>	12,858

<sup>1</sup> Include mainly exchange difference arising from cancellation of AT1 capital instrument.

The notes on pages 39 to 63 form part of these Condensed Consolidated Financial Statements.

## CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

unaudited (continued)

(Expressed in millions of Hong Kong dollars)

Condensed Consolidated Balance Sheet		At 30 June 2019	At 31 December 2018
	note		
<b>ASSETS</b>			
Cash and sight balances at central banks	17	10,082	16,421
Placings with and advances to banks	18	99,066	79,400
Trading assets	19	49,737	47,164
Financial assets designated and otherwise mandatorily measured at fair value	20	15,976	13,070
Derivative financial instruments	21	6,310	8,141
Loans and advances to customers	22	919,845	874,456
Financial investments	23	449,507	428,532
Interest in associates	24	2,546	2,444
Investment properties	25	10,344	10,108
Premises, plant and equipment	25	31,054	30,510
Intangible assets	26	19,788	16,751
Other assets	27	42,397	44,300
<b>Total assets</b>		<b>1,656,652</b>	<b>1,571,297</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Liabilities</b>			
Current, savings and other deposit accounts	28	1,186,938	1,154,415
Repurchase agreements – non-trading		6,664	410
Deposits from banks		9,586	2,712
Trading liabilities	29	34,037	33,649
Financial liabilities designated at fair value	30	37,382	33,454
Derivative financial instruments	21	7,069	8,270
Certificates of deposit and other debt securities in issue	31	16,676	3,748
Other liabilities	32	29,546	45,247
Liabilities under insurance contracts		126,941	120,195
Current tax liabilities		2,550	696
Deferred tax liabilities		6,922	6,394
Subordinated liabilities	33	19,503	-
<b>Total liabilities</b>		<b>1,483,814</b>	<b>1,409,190</b>
<b>Equity</b>			
Share capital		9,658	9,658
Retained profits		127,395	123,350
Other equity instruments	34	11,744	6,981
Other reserves		23,924	22,093
Total shareholders' equity		172,721	162,082
Non-controlling interests		117	25
<b>Total equity</b>		<b>172,838</b>	<b>162,107</b>
<b>Total equity and liabilities</b>		<b>1,656,652</b>	<b>1,571,297</b>

The notes on pages 39 to 63 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								Total shareholders' equity	Non-controlling interests	Total equity
	Share capital	Other equity instruments <sup>2</sup>	Retained profits <sup>3</sup>	Premises revaluation reserve	Financial assets at FVOCI reserve	Cash flow hedge reserve	Foreign exchange reserve	Others <sup>1</sup>			
At 1 January 2019	9,658	6,981	123,350	19,822	1,570	(11)	42	670	162,082	25	162,107
Profit for the period	-	-	13,656	-	-	-	-	-	13,656	(10)	13,646
Other comprehensive income (net of tax)	-	-	(144)	771	1,344	68	(33)	3	2,009	-	2,009
Debt instruments at fair value through other comprehensive income	-	-	-	-	61	-	-	-	61	-	61
Equity instruments at fair value through other comprehensive income	-	-	-	-	1,283	-	-	-	1,283	-	1,283
Cash flow hedges	-	-	-	-	-	68	-	-	68	-	68
Change in fair value of financial liabilities designated at fair value arising from changes in own credit risk	-	-	-	-	-	-	-	3	3	-	3
Property revaluation	-	-	-	771	-	-	-	-	771	-	771
Actuarial losses on defined benefit plans	-	-	(68)	-	-	-	-	-	(68)	-	(68)
Exchange differences and others <sup>4</sup>	-	-	(76)	-	-	-	(33)	-	(109)	-	(109)
Total comprehensive income for the period	-	-	13,512	771	1,344	68	(33)	3	15,665	(10)	15,655
Cancellation and repayment of AT1 capital instrument	-	(6,981)	-	-	-	-	-	-	(6,981)	-	(6,981)
Issue of new AT1 capital instruments	-	11,744	-	-	-	-	-	-	11,744	-	11,744
Dividends paid <sup>5</sup>	-	-	(9,560)	-	-	-	-	-	(9,560)	-	(9,560)
Coupon paid to holder of AT1 capital instrument	-	-	(232)	-	-	-	-	-	(232)	-	(232)
Movement in respect of share-based payment arrangements	-	-	-	-	-	-	-	3	3	-	3
Others	-	-	-	-	-	-	-	-	-	102	102
Transfers	-	-	325	(325)	-	-	-	-	-	-	-
At 30 June 2019	9,658	11,744	127,395	20,268	2,914	57	9	676	172,721	117	172,838

<sup>1</sup> Other reserves comprise share-based payment reserve and own credit reserve. The share-based payment reserve is used to record the corresponding amount of share options granted by ultimate holding company to the Group's employees and other cost of share-based payment arrangement. The own credit reserve is for the change in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk.

<sup>2</sup> In the first half of 2019, the Bank has cancelled and repaid the AT1 capital instrument of US\$900m and issued new AT1 capital instruments of US\$1,500m.

<sup>3</sup> 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 2019, the effect of this requirement is to restrict the amount of reserves which can be distributed by the Group to shareholders by HK\$4,112m (31 December 2018: HK\$4,982m).

<sup>4</sup> Include mainly exchange difference arising from cancellation of AT1 capital instrument.

<sup>5</sup> Dividend paid in the first half of 2019 represented the payment of fourth interim dividend of 2018 and the first interim dividend of 2019 amounted to HK\$6,883m and HK\$2,677m respectively.

<sup>6</sup> 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 2019.

The notes on pages 39 to 63 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 (continued)**

	Other reserves								Total shareholders' equity	Non-controlling interests	Total equity
	Share capital	Other equity instruments	Retained profits	Premises revaluation reserve	Financial assets at FVOCI reserve	Cash flow hedge reserve	Foreign exchange reserve	Others <sup>1</sup>			
At 1 January 2018	9,658	6,981	112,870	18,379	2,038	(99)	706	643	151,176	49	151,225
Profit for the period	-	-	12,647	-	-	-	-	-	12,647	(10)	12,637
Other comprehensive income (net of tax)	-	-	(31)	863	(363)	(61)	(176)	(11)	221	-	221
Debt instruments at fair value through other comprehensive income	-	-	-	-	137	-	-	-	137	-	137
Equity instruments at fair value through other comprehensive income	-	-	-	-	(500)	-	-	-	(500)	-	(500)
Cash flow hedges	-	-	-	-	-	(61)	-	-	(61)	-	(61)
Change in fair value of financial liabilities designated at fair value arising from changes in own credit risk	-	-	-	-	-	-	-	(11)	(11)	-	(11)
Property revaluation	-	-	-	863	-	-	-	-	863	-	863
Actuarial losses on defined benefit plans	-	-	(31)	-	-	-	-	-	(31)	-	(31)
Exchange differences and others	-	-	-	-	-	-	(176)	-	(176)	-	(176)
Total comprehensive income for the period	-	-	12,616	863	(363)	(61)	(176)	(11)	12,868	(10)	12,858
Dividends paid	-	-	(8,412)	-	-	-	-	-	(8,412)	-	(8,412)
Coupon paid to holder of AT1 capital instrument	-	-	-	-	-	-	-	-	-	-	-
Movement in respect of share-based payment arrangements	-	-	(3)	-	-	-	-	6	3	-	3
Others	-	-	-	-	-	-	-	-	-	-	-
Transfers	-	-	289	(289)	-	-	-	-	-	-	-
At 30 June 2018	9,658	6,981	117,360	18,953	1,675	(160)	530	638	155,635	39	155,674
At 1 July 2018	9,658	6,981	117,360	18,953	1,675	(160)	530	638	155,635	39	155,674
Profit for the period	-	-	11,564	-	-	-	-	-	11,564	(13)	11,551
Other comprehensive income (net of tax)	-	-	(556)	1,172	(105)	149	(488)	7	179	-	179
Debt instruments at fair value through other comprehensive income	-	-	-	-	120	-	-	-	120	-	120
Equity instruments at fair value through other comprehensive income	-	-	-	-	(225)	-	-	-	(225)	-	(225)
Cash flow hedges	-	-	-	-	-	149	-	-	149	-	149
Change in fair value of financial liabilities designated at fair value arising from changes in own credit risk	-	-	-	-	-	-	-	7	7	-	7
Property revaluation	-	-	-	1,172	-	-	-	-	1,172	-	1,172
Actuarial losses on defined benefit plans	-	-	(556)	-	-	-	-	-	(556)	-	(556)
Exchange differences and others	-	-	-	-	-	-	(488)	-	(488)	-	(488)
Total comprehensive income for the period	-	-	11,008	1,172	(105)	149	(488)	7	11,743	(13)	11,730
Dividends paid	-	-	(4,970)	-	-	-	-	-	(4,970)	-	(4,970)
Coupon paid to holder of AT1 capital instrument	-	-	(418)	-	-	-	-	-	(418)	-	(418)
Movement in respect of share-based payment arrangements	-	-	(2)	-	-	-	-	25	23	-	23
Others	-	-	69	-	-	-	-	-	69	(1)	68
Transfers	-	-	303	(303)	-	-	-	-	-	-	-
At 31 December 2018	9,658	6,981	123,350	19,822	1,570	(11)	42	670	162,082	25	162,107

The notes on pages 39 to 63 form part of these Condensed Consolidated Financial Statements.

## CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

unaudited (continued)

(Expressed in millions of Hong Kong dollars)

Condensed Consolidated Cash Flow Statement	Half-year ended 30 June 2019	Half-year ended 30 June 2018
<b>Profit before tax</b>	<b>15,894</b>	14,864
<b>Adjustments for non-cash items:</b>		
Depreciation expenses	967	668
Amortisation of intangible assets	70	55
Net interest income	(15,853)	(14,228)
Dividend income	(136)	(6)
Gains less losses from financial investments	(1)	(24)
Share of profits in associates	(146)	(124)
Net surplus on property revaluation	(187)	(78)
Change in expected credit losses and other credit impairment charges	510	238
Impairment loss on intangible assets	10	27
Loans and advances written off net of recoveries	(256)	(365)
Movement in present value of in-force long-term insurance business ("PVIF")	(2,744)	(1,379)
Interest received	18,267	14,550
Interest paid	(5,054)	(2,852)
Elimination of exchange differences and other non-cash items	(2,341)	(657)
<b>Changes in operating assets and liabilities</b>		
Change in financial assets designated at fair value	(2,906)	(3,150)
Change in trading assets	(2,404)	693
Change in derivative financial instruments	630	4
Change in reverse repurchase agreements - non-trading	-	(3,172)
Change in placings with and advances to banks maturing after one month	(13,780)	5,229
Change in loans and advances to customers	(46,687)	(49,335)
Change in other assets	2,046	(7,840)
Change in current, savings and other deposit accounts	32,523	41,940
Change in deposits from banks	6,874	1,876
Change in repurchase agreements - non-trading	6,254	3,407
Change in certificates of deposit and other debt securities in issue	12,928	(600)
Change in financial liabilities designated at fair value	3,928	45,002
Change in trading liabilities	388	(46,349)
Change in liabilities under insurance contracts	6,746	3,186
Change in other liabilities	(14,401)	4,013
Interest received from financial investments	3,046	2,800
Dividends received from financial investments	138	15
Tax paid	(20)	(9)
<b>Net cash from operating activities</b>	<b>4,303</b>	8,399
Purchase of financial investments	(353,735)	(285,382)
Proceeds from sale or redemption of financial investments	314,018	273,163
Repayment of shareholders' loan from an associated company	-	74
Purchase of property, plant and equipment and intangible assets (excluding PVIF)	(696)	(647)
Net cash inflow from the sales of loan portfolio	1,066	798
<b>Net cash from investing activities</b>	<b>(39,347)</b>	(11,994)
Principal and interest elements of lease payments	(266)	-
Dividends paid	(9,560)	(8,412)
Coupon paid to holder of AT1 capital instrument	(232)	-
Cancellation and repayment of AT1 capital instrument	(7,058)	-
Proceeds from issuance of new AT1 capital instruments	11,744	-
Proceeds from issuance of subordinated liabilities	19,503	-
<b>Net cash from financing activities</b>	<b>14,131</b>	(8,412)
Net decrease in cash and cash equivalents	(20,913)	(12,007)
Cash and cash equivalents at 1 January	108,844	110,673
Exchange differences in respect of cash and cash equivalents	103	(357)
<b>Cash and cash equivalents at 30 June</b>	<b>88,034</b>	98,309

The notes on pages 39 to 63 form part of these Condensed Consolidated Financial Statements.

## CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

*unaudited (continued)*

(Expressed in millions of Hong Kong dollars)

### Condensed Consolidated Cash Flow Statement *(continued)*

	<b>Half-year ended 30 June 2019</b>	Half-year ended 30 June 2018
Cash and cash equivalents comprise <sup>1</sup> :		
- cash and sight balances at central banks	<b>10,082</b>	10,387
- balances with banks	<b>8,725</b>	7,180
- items in the course of collection from other banks	<b>7,662</b>	7,920
- placings with and advances to banks maturing within one month	<b>50,946</b>	54,096
- treasury bills	<b>19,160</b>	26,891
- certificates of deposit	-	4
- less: items in the course of transmission to other banks	<b>(8,541)</b>	(8,169)
	<b><u>88,034</u></b>	<u>98,309</u>

<sup>1</sup> 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\$10,425m at 30 June 2019 (30 June 2018: HK\$15,814m).

The notes on pages 39 to 63 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**

The Condensed Consolidated Financial Statements of Hang Seng Bank Limited (“the Bank”) and all its subsidiaries (“the Group”) 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”). The Condensed Consolidated Financial Statements were reviewed by the Audit Committee. The Board of Directors of the Bank has approved the Condensed Consolidated Financial Statements on 5 August 2019.

The Condensed Consolidated Financial Statements should be read in conjunction with the consolidated financial statements for the year ended 31 December 2018, which have been prepared in accordance with Hong Kong Financial Reporting Standard (“HKFRS”).

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 judgements 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 2018.

The following disclosures in the Risk and Capital Management sections form an integral part of the Condensed Consolidated Financial Statements:

- Reconciliation of gross exposure and allowances/provision for loans and advances to banks and customers including loan commitments and financial guarantees; and
- Distribution of financial instruments to which the impairment requirements in HKFRS 9 are applied, by credit quality and stage allocation

In accordance with the Group’s policy to provide disclosures that help stakeholders to understand the Group’s performance, financial position and changes thereto, the information provided in the Notes on the Condensed Consolidated Financial Statements and the risk disclosures in the Risk and Capital Management sections goes beyond the minimum levels required by accounting standards, statutory and regulatory requirements.

The Condensed Consolidated Financial Statements are unaudited, but has been reviewed by PricewaterhouseCoopers (“PwC”) 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 HKICPA. PwC’s independent review report to the Board of Directors is included on page 64.

### **2 Accounting policies**

Except as described below, the accounting policies applied in preparing this Condensed Consolidated Financial Statements are the same as those applied in preparing the consolidated financial statements for the year ended 31 December 2018, as disclosed in the Annual Report for 2018.

## NOTES ON THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)(continued)

### 2 Accounting policies (continued)

#### Standards applied during the half-year ended 30 June 2019

##### *HKFRS 16 “Leases”*

On 1 January 2019, the Group adopted the requirements of HKFRS 16 and recognised lease liabilities in relation to leases which had previously been classified as “operating leases” in accordance with HKAS 17 “Leases”. These liabilities were measured at the present value of the remaining lease payments, discounted at the lessee’s incremental borrowing rate as at 1 January 2019. The associated right of use (“ROU”) assets were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments recognised on balance sheet at 31 December 2018. In addition, the practical expedients permitted by the standard was applied where operating leases with a remaining lease term of less than 12 months as at 1 January 2019 were treated as short-term leases.

The differences between HKAS 17 and HKFRS 16 are summarised in the table below:

<b>HKAS 17</b>	<b>HKFRS 16</b>
Leases were classified as either finance or operating leases. Payments made under operating leases were charged to profit or loss on a straight-line basis over the period of the lease.	<p>Leases are recognised as a ROU asset and a corresponding liability at the date at which the leased asset is made available for use. Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease term so as to produce a constant period rate of interest on the remaining balance of the liability. The ROU asset is depreciated over the shorter of the ROU asset’s useful economic life and the lease term on a straight-line basis.</p> <p>In determining lease term, the Group considers all facts and circumstances that create an economic incentive to exercise an extension option or not exercise a termination option over the planning horizon of five years.</p> <p>In general, it is not expected that the discount rate implicit in the lease is available so the lessee’s incremental borrowing rate is used. This is the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of a similar value in a similar economic environment with similar terms and conditions. The rates are determined for each economic environment in which the Group operates by adjusting swap rates with funding spreads (OCS) and cross currency basis where appropriate.</p>

## NOTES ON THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)(continued)

### 2 Accounting policies (continued)

The Group adopted the requirements of HKFRS 16 retrospectively, with the cumulative effect of initially applying the standard recognised as an adjustment to the opening balance of retained earnings at that date. Comparatives were not restated. In relation to the operating lease that were under HKAS17 “Leases”, the adoption of the standard increased assets by HK\$1.4bn and increased financial liabilities by the same amount with no effect on net assets or retained earnings.

#### *Amendment to HKAS 12 “Income Taxes”*

An amendment to HKAS 12 was issued in February 2018 as part of the Annual Improvement Cycle. The amendment clarifies that an entity should recognise the tax consequences of dividends where the transactions or events that generated the distributable profits are recognised. This amendment was applied on 1 January 2019 to the income tax consequences of distributions recognised on or after the beginning of the earliest comparative period. As a consequence, income tax related to distributions on perpetual subordinated loans will be presented in profit or loss rather than equity. As a result of its application, the impact on profit after tax in the six months to 30 June 2019 was immaterial (six months to 30 June 2018: nil) with no effect on equity.

#### Future accounting developments

HKFRS 17 “Insurance contracts” was issued in January 2018 and sets out the requirements that an entity should apply in accounting for insurance contracts it issues and reinsurance contracts it holds. HKFRS 17 is effective from 1 January 2021. However, HKICPA is considering delaying the mandatory implementation date by one year and may make additional changes to the standard. The Group is in the process of implementing HKFRS 17. Industry practice and interpretation of the standard is still developing and there may be changes to implementation decisions as practice evolves, therefore the likely impact of its implementation remains uncertain.

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

### 3 Basis of consolidation

These Condensed Consolidated Financial Statements cover the consolidated position of 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.

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### 4 Interest income

	<b>Half-year ended 30 June 2019</b>	Half-year ended 30 June 2018
Interest income arising from:		
- financial assets that are not at fair value through profit and loss	20,912	16,967
- trading assets	436	373
- financial assets designated and otherwise mandatorily measured at fair value	25	23
	<u>21,373</u>	<u>17,363</u>
of which:		
- interest income from impaired financial assets	18	28

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### 5 Interest expense

	<b>Half-year ended 30 June 2019</b>	Half-year ended 30 June 2018
Interest expense arising from:		
- financial liabilities that are not at fair value through profit and loss	4,470	1,874
- trading liabilities	308	283
- financial liabilities designated at fair value	742	978
	<u>5,520</u>	<u>3,135</u>
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	47	-

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

6 Net fee income

	Half-year ended 30 June 2019	Half-year ended 30 June 2018
- securities broking and related services	718	1,049
- retail investment funds	816	1,070
- insurance	336	310
- account services	252	255
- remittances	262	307
- cards	1,520	1,468
- credit facilities	448	364
- trade services	232	223
- other	224	201
Fee income	4,808	5,247
Fee expense	(1,323)	(1,258)
	<u>3,485</u>	<u>3,989</u>
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	1,259	1,177
- fee income	2,463	2,319
- fee expense	(1,204)	(1,142)
Net fee income on trust and other fiduciary activities where the Group holds or invests on behalf of its customers	413	497
- fee income	446	526
- fee expense	(33)	(29)

7 Net income from financial instruments measured at fair value

	Half-year ended 30 June 2019	Half-year ended 30 June 2018
Net trading income	936	709
- trading income	935	701
- other trading income - hedging ineffectiveness		
- on cash flow hedges	-	-
- on fair value hedges	1	8
Net income from financial instruments designated at fair value	36	431
Net income/(expense) from assets and liabilities of insurance businesses measured at fair value	1,064	(145)
- financial assets held to meet liabilities under insurance and investment contracts	1,082	(138)
- liabilities to customers under investment contracts	(18)	(7)
Changes in fair value of other financial instruments mandatorily measured at fair value	(1)	-
	<u>2,035</u>	<u>995</u>

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

8 Gains less losses from financial investments

	Half-year ended 30 June 2019	Half-year ended 30 June 2018
Net gains from disposal of debt securities measured at amortised cost	1	-
Net gains from disposal of debt securities measured at fair value through other comprehensive income	-	24
	<u>1</u>	<u>24</u>

9 Dividend income

	Half-year ended 30 June 2019	Half-year ended 30 June 2018
Dividend income:		
- listed investments	130	-
- unlisted investments	6	6
	<u>136</u>	<u>6</u>

10 Other operating income

	Half-year ended 30 June 2019	Half-year ended 30 June 2018
Rental income from investment properties	172	166
Movement in present value of in-force long-term insurance business	2,744	1,379
Net losses from disposal of fixed assets	(3)	(3)
Net losses from the derecognition of loans and advances to customers measured at amortised cost	(2)	(2)
Others	155	81
	<u>3,066</u>	<u>1,621</u>

11 Change in expected credit losses and other credit impairment charges

	Half-year ended 30 June 2019	Half-year ended 30 June 2018
Loans and advances to banks and customers	491	251
- new allowances net of allowance releases	543	323
- recoveries of amounts previously written off	(58)	(72)
- other movements	6	-
Loan commitments and guarantees	12	(8)
Other financial assets	7	(5)
	<u>510</u>	<u>238</u>

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

12 Operating expenses

	Half-year ended 30 June 2019	Half-year ended 30 June 2018
Employee compensation and benefits:		
- salaries and other costs	2,876	2,656
- retirement benefit costs		
- defined benefit scheme	97	85
- defined contribution scheme	145	125
	<b>3,118</b>	2,866
General and administrative expenses:		
- rental expenses	59	304
- other premises and equipment	758	536
- marketing and advertising expenses	184	241
- other operating expenses	1,172	1,052
	<b>2,173</b>	2,133
Depreciation of premises, plant and equipment (note 25)	716	668
Depreciation of right-of-use assets	251	N/A
Amortisation of intangible assets	70	55
	<b>6,328</b>	5,722

13 Tax expense

Taxation in the Condensed Consolidated Income Statement represents:

	Half-year ended 30 June 2019	Half-year ended 30 June 2018
<b>Current tax - provision for Hong Kong profits tax</b>		
Tax for the period	1,856	1,988
<b>Current tax - taxation outside Hong Kong</b>		
Tax for the period	29	19
<b>Deferred tax</b>		
Origination and reversal of temporary differences	363	220
<b>Total tax expense</b>	<b>2,248</b>	2,227

The current tax provision is based on the estimated assessable profit for the first half of 2019, 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 (2018: 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 2019 is based on earnings of HK\$13,347m (HK\$12,647m for the first half of 2018), adjusted for the AT1 capital instrument related deductions and on the weighted average number of ordinary shares in issue of 1,911,842,736 shares (unchanged from the first half of 2018).

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

### 15 Dividends/Distribution

#### (a) Dividends to ordinary shareholders

	Half-year ended 30 June 2019		Half-year ended 30 June 2018	
	per share HK\$	HK\$m	per share HK\$	HK\$m
First interim	1.40	2,677	1.30	2,485
Second interim	1.40	2,677	1.30	2,485
	<b>2.80</b>	<b>5,354</b>	2.60	4,970

On 5 August 2019, the Directors of the Bank declared a second interim dividend in respect of the year ending 31 December 2019 of HK\$1.40 per ordinary share (HK\$2,677m). This distribution will be paid on 5 September 2019. No Liability is recognised in the Condensed Consolidated Financial Statements in respect of this dividend.

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

	Half-year ended 30 June 2019	Half-year ended 30 June 2018
Coupon paid on AT1 capital instrument	232	-

Coupon of HK\$232m was paid in the first half of 2019 upon the cancellation and repayment of the US\$900m AT1 capital instrument. Coupon of HK\$418m on the aforesaid AT1 capital instrument for full year 2018 was paid in the second half of 2018.

### 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** offers 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, time deposits, mortgages and personal loans, credit cards, insurance and wealth management;
- **Commercial Banking** offers a comprehensive suite of products and services to corporate, commercial and small and medium-sized enterprises ("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 the Bank's holdings of premises, investment properties, equity shares and subordinated debt funding as well as central support and functional costs with associated recoveries.

#### (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 of central support services and functions are allocated to business segments based on cost drivers which reflect or correlate with the use of services. Bank-owned premises are reported under the "Other" segment. When these premises are utilised by business segments, notional rent will be charged to the relevant business segments with reference to market rates.



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

16 Segmental analysis (continued)

(a) Segmental result (continued)

	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Other	Total
<b>Half-year ended 30 June 2019</b>					
Net interest income/(expense)	8,644	5,195	2,256	(242)	15,853
Net fee income	2,076	1,095	185	129	3,485
Net income/(loss) from financial instruments measured at fair value	1,272	216	580	(33)	2,035
Gains less losses from financial investments	1	-	-	-	1
Dividend income	-	-	-	136	136
Net insurance premium income	7,953	1,271	-	-	9,224
Other operating income/(loss)	2,869	57	(1)	141	3,066
<b>Total operating income</b>	<b>22,815</b>	<b>7,834</b>	<b>3,020</b>	<b>131</b>	<b>33,800</b>
Net insurance claims and benefits paid and movement in liabilities to policyholders	(10,304)	(1,087)	-	-	(11,391)
<b>Net operating income before change in expected credit losses and other credit impairment charges</b>	<b>12,511</b>	<b>6,747</b>	<b>3,020</b>	<b>131</b>	<b>22,409</b>
Change in expected credit losses and other credit impairment charges	(315)	(156)	(39)	-	(510)
<b>Net operating income</b>	<b>12,196</b>	<b>6,591</b>	<b>2,981</b>	<b>131</b>	<b>21,899</b>
Operating expenses *	(3,947)	(1,627)	(555)	(199)	(6,328)
Impairment loss on intangible assets	-	-	-	(10)	(10)
<b>Operating profit/(loss)</b>	<b>8,249</b>	<b>4,964</b>	<b>2,426</b>	<b>(78)</b>	<b>15,561</b>
Net surplus on property revaluation	-	-	-	187	187
Share of profits/(losses) of associates	147	-	-	(1)	146
<b>Profit before tax</b>	<b>8,396</b>	<b>4,964</b>	<b>2,426</b>	<b>108</b>	<b>15,894</b>
Share of profit before tax	52.8%	31.2%	15.3%	0.7%	100.0%
Operating profit/(loss) excluding change in expected credit losses and other credit impairment charges	8,564	5,120	2,465	(78)	16,071
* Depreciation/amortisation included in operating expenses	(12)	(2)	-	(1,023)	(1,037)
<b>At 30 June 2019</b>					
Total assets	501,349	406,036	702,219	47,048	1,656,652
Total liabilities	956,713	312,712	188,355	26,034	1,483,814
Interest in associates	2,545	-	-	1	2,546
<b>Half-year ended 30 June 2019</b>					
<b>Net fee income by segment</b>					
- securities broking and related services	616	87	15	-	718
- retail investment funds	804	12	-	-	816
- insurance	260	44	32	-	336
- account services	158	91	3	-	252
- remittances	34	208	20	-	262
- cards	701	801	18	-	1,520
- credit facilities	13	340	95	-	448
- trade services	-	212	20	-	232
- other	37	44	18	125	224
Fee income	2,623	1,839	221	125	4,808
Fee expense	(547)	(744)	(36)	4	(1,323)
Net fee income	2,076	1,095	185	129	3,485

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

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 2018					
Net interest income/(expense)	7,873	4,329	2,184	(158)	14,228
Net fee income	2,631	1,097	156	105	3,989
Net income/(loss) from financial instruments measured at fair value	(115)	274	830	6	995
Gains less losses from financial investments	-	-	24	-	24
Dividend income	-	-	-	6	6
Net insurance premium income	7,982	750	-	-	8,732
Other operating income	1,254	236	3	128	1,621
<b>Total operating income</b>	<b>19,625</b>	<b>6,686</b>	<b>3,197</b>	<b>87</b>	<b>29,595</b>
Net insurance claims and benefits paid and movement in liabilities to policyholders	(8,356)	(590)	-	-	(8,946)
<b>Net operating income before change in expected credit losses and other credit impairment charges</b>	<b>11,269</b>	<b>6,096</b>	<b>3,197</b>	<b>87</b>	<b>20,649</b>
Change in expected credit losses and other credit impairment charges	(169)	(80)	11	-	(238)
<b>Net operating income</b>	<b>11,100</b>	<b>6,016</b>	<b>3,208</b>	<b>87</b>	<b>20,411</b>
Operating expenses *	(3,539)	(1,577)	(474)	(132)	(5,722)
Impairment loss on intangible assets	-	-	-	(27)	(27)
<b>Operating profit/(loss)</b>	<b>7,561</b>	<b>4,439</b>	<b>2,734</b>	<b>(72)</b>	<b>14,662</b>
Net surplus on property revaluation	-	-	-	78	78
Share of profits of associates	122	-	-	2	124
<b>Profit before tax</b>	<b>7,683</b>	<b>4,439</b>	<b>2,734</b>	<b>8</b>	<b>14,864</b>
Share of profit before tax	51.7%	29.9%	18.4%	0.0%	100.0%
Operating profit/(loss) excluding change in expected credit losses and other credit impairment charges					
	7,730	4,519	2,723	(72)	14,900
* Depreciation/amortisation included in operating expenses					
	(12)	(2)	(2)	(707)	(723)
At 31 December 2018					
Total assets	475,964	382,359	661,736	51,238	1,571,297
Total liabilities	931,201	307,798	163,123	7,068	1,409,190
Interest in associates	2,442	-	-	2	2,444
Half-year ended 30 June 2018					
Net fee income by segment					
- securities broking and related services	930	106	13	-	1,049
- retail investment funds	1,059	11	-	-	1,070
- insurance	229	48	33	-	310
- account services	153	99	3	-	255
- remittances	53	236	18	-	307
- cards	672	780	16	-	1,468
- credit facilities	11	278	75	-	364
- trade services	-	211	12	-	223
- other	38	35	18	110	201
Fee income	3,145	1,804	188	110	5,247
Fee expense	(514)	(707)	(32)	(5)	(1,258)
Net fee income	2,631	1,097	156	105	3,989

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

16 Segmental analysis (continued)

(b) Information by geographical region

The geographical regions in this analysis are classified by the location of the principal operations of the subsidiary companies or, in the case of the Bank itself, by the location of the branches responsible for reporting the results or advancing the funds. Consolidation adjustments made in preparing the Group's financial statements upon consolidation are included in the "Inter-region elimination".

	Hong Kong	Mainland China	Others	Inter-region elimination	Total
<b>Half-year ended 30 June 2019</b>					
Total operating income	32,441	1,242	137	(20)	33,800
Profit before tax	15,350	458	86	-	15,894
<b>At 30 June 2019</b>					
Total assets	1,558,040	113,889	24,804	(40,081)	1,656,652
Total liabilities	1,389,798	100,610	23,717	(30,311)	1,483,814
Equity	168,242	13,279	1,087	(9,770)	172,838
Share capital	9,658	10,183	-	(10,183)	9,658
Interest in associates	2,545	1	-	-	2,546
Non-current assets*	61,288	1,317	7	-	62,612
<b>Half-year ended 30 June 2018</b>					
Total operating income	28,437	1,037	144	(23)	29,595
Profit before tax	14,472	297	95	-	14,864
<b>At 31 December 2018</b>					
Total assets	1,482,980	106,124	22,103	(39,910)	1,571,297
Total liabilities	1,324,871	93,611	21,093	(30,385)	1,409,190
Equity	158,109	12,513	1,010	(9,525)	162,107
Share capital	9,658	9,857	-	(9,857)	9,658
Interest in associates	2,442	2	-	-	2,444
Non-current assets*	56,235	1,125	9	-	57,369

\* Non-current assets consist of investment properties, premises, plant and equipment, intangible assets and right-of-use assets.

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

**17 Cash and sight balances at central banks**

	<b>At 30 June 2019</b>	At 31 December 2018
Cash in hand	7,639	7,816
Sight balances at central banks	2,443	8,605
	<u>10,082</u>	<u>16,421</u>

**18 Placings with and advances to banks**

	<b>At 30 June 2019</b>	At 31 December 2018
Balances with banks	8,725	7,765
Placings with and advances to banks maturing within one month	50,946	46,021
Placings with and advances to banks maturing after one month but less than one year	38,055	24,302
Placings with and advances to banks maturing after one year	1,341	1,314
Less: Expected credit losses	(1)	(2)
	<u>99,066</u>	<u>79,400</u>
of which:		
Placings with and advances to central banks	8,143	9,155

**19 Trading assets**

	<b>At 30 June 2019</b>	At 31 December 2018
Treasury bills	26,936	26,700
Other debt securities	22,784	20,448
Debt securities	49,720	47,148
Investment funds	17	16
	<u>49,737</u>	<u>47,164</u>

**20 Financial assets designated and otherwise mandatorily measured at fair value**

	<b>At 30 June 2019</b>	At 31 December 2018
Debt securities	2	6
Equity shares	6,688	5,472
Investment funds	7,891	6,267
Other	1,395	1,325
	<u>15,976</u>	<u>13,070</u>

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

21 Derivative financial instruments

Use of derivatives

The Group transacts derivatives for three primary purposes: to create risk management solutions for clients, to manage the portfolio risk arising from client business, and to manage and hedge the Group's own risks. Derivatives (except for derivatives which are designated as effective hedging instruments) are held for trading. Within the held for trading classification are two types of derivative instruments: those used in sales and trading activities, and those used for risk management purposes but which for various reasons do not meet the qualifying criteria for hedge accounting. The second category includes derivatives managed in conjunction with financial instruments designated at fair value.

The Group's derivative activities give rise to significant open positions in portfolios of derivatives. These positions are managed constantly to ensure that they remain within acceptable risk levels. When entering into derivative transactions, the Group employs the same credit risk management framework to assess and approve potential credit exposures that it uses for traditional lending.

The following table shows the notional contract amounts and fair value of assets and liabilities by each class of derivatives.

	Notional contract amount			Fair value - Assets			Fair value - Liabilities		
	Trading	Hedging	Total	Trading	Hedging	Total	Trading	Hedging	Total
Exchange rate	1,046,122	16,362	1,062,484	3,758	181	3,939	4,005	312	4,317
Interest rate	432,406	61,340	493,746	1,869	215	2,084	1,850	640	2,490
Equity and other	27,157	-	27,157	287	-	287	262	-	262
At 30 June 2019	<u>1,505,685</u>	<u>77,702</u>	<u>1,583,387</u>	<u>5,914</u>	<u>396</u>	<u>6,310</u>	<u>6,117</u>	<u>952</u>	<u>7,069</u>

	Notional contract amount			Fair value - Assets			Fair value - Liabilities		
	Trading	Hedging	Total	Trading	Hedging	Total	Trading	Hedging	Total
Exchange rate	830,511	22,468	852,979	5,265	254	5,519	5,197	542	5,739
Interest rate	388,463	62,699	451,162	1,741	591	2,332	1,766	185	1,951
Equity and other	34,795	-	34,795	290	-	290	580	-	580
At 31 December 2018	<u>1,253,769</u>	<u>85,167</u>	<u>1,338,936</u>	<u>7,296</u>	<u>845</u>	<u>8,141</u>	<u>7,543</u>	<u>727</u>	<u>8,270</u>

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

**22 Loans and advances to customers**

	<b>At 30 June 2019</b>	At 31 December 2018
Gross loans and advances to customers	<b>922,753</b>	877,134
Less: Expected credit losses	<b>(2,908)</b>	(2,678)
	<b><u>919,845</u></b>	<u>874,456</u>
	%	%
Expected credit losses as a percentage of gross loans and advances to customers	<b>0.32</b>	0.31
Gross impaired loans and advances	<b>2,023</b>	2,160
	%	%
Gross impaired loans and advances as a percentage of gross loans and advances to customers	<b>0.22</b>	0.25

**23 Financial investments**

	<b>At 30 June 2019</b>	At 31 December 2018
Financial investments measured at fair value through other comprehensive income		
- treasury bills	<b>202,226</b>	217,636
- debt securities	<b>126,699</b>	107,400
- equity shares	<b>5,428</b>	4,144
	<b><u>334,353</u></b>	<u>329,180</u>
Debt instruments measured at amortised cost		
- treasury bills	<b>500</b>	1,842
- debt securities	<b>114,694</b>	97,547
Less: Expected credit losses	<b>(40)</b>	(37)
	<b><u>115,154</u></b>	<u>99,352</u>
	<b><u>449,507</u></b>	<u>428,532</u>

There were no overdue financial investments at 30 June 2019 and 31 December 2018 for the Group. The Group did not hold any asset-backed securities, mortgage-backed securities and collateralised debt obligations.

**24 Interest in associates**

	<b>At 30 June 2019</b>	At 31 December 2018
Share of net assets	<b><u>2,546</u></b>	<u>2,444</u>

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

25 Property, plant and equipment

Movement of property, plant and equipment

	Premises	Investment properties	Plant and equipment	Total
Cost or valuation:				
At 1 January 2019	29,344	10,108	5,368	44,820
Additions	114	-	206	320
Disposals	-	-	(58)	(58)
Elimination of accumulated depreciation on revalued premises	(507)	-	-	(507)
Surplus on revaluation:				
- credited to premises revaluation reserve	926	-	-	926
- credited to income statement	-	257	-	257
Transfer	21	(21)	-	-
Exchange adjustments and other	(1)	-	1	-
At 30 June 2019	<u>29,897</u>	<u>10,344</u>	<u>5,517</u>	<u>45,758</u>
Accumulated depreciation:				
At 1 January 2019	-	-	(4,202)	(4,202)
Charge for the period (note 12)	(507)	-	(209)	(716)
Disposals	-	-	55	55
Elimination of accumulated depreciation on revalued premises	507	-	-	507
Exchange adjustments and other	-	-	(4)	(4)
At 30 June 2019	<u>-</u>	<u>-</u>	<u>(4,360)</u>	<u>(4,360)</u>
Net book value at 30 June 2019	<u>29,897</u>	<u>10,344</u>	<u>1,157</u>	<u>41,398</u>
Representing:				
- measure at cost	-	-	1,157	1,157
- measure at valuation	29,897	10,344	-	40,241
	<u>29,897</u>	<u>10,344</u>	<u>1,157</u>	<u>41,398</u>

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

**25 Property, plant and equipment** (continued)

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

	Premises	Investment properties	Plant and equipment	Total
Cost or valuation:				
At 1 January 2018	27,157	10,166	5,241	42,564
Additions	60	278	171	509
Disposals	-	-	(35)	(35)
Elimination of accumulated depreciation on revalued premises	(458)	-	-	(458)
Surplus on revaluation:				
- credited to premises revaluation reserve	1,040	-	-	1,040
- credited to income statement	-	71	-	71
Transfer	657	(657)	-	-
Exchange adjustments and other	(13)	-	(6)	(19)
At 30 June 2018	<u>28,443</u>	<u>9,858</u>	<u>5,371</u>	<u>43,672</u>
Accumulated depreciation:				
At 1 January 2018	-	-	(3,899)	(3,899)
Charge for the period (note 12)	(458)	-	(210)	(668)
Disposals	-	-	32	32
Elimination of accumulated depreciation on revalued premises	458	-	-	458
Exchange adjustments and other	-	-	5	5
At 30 June 2018	<u>-</u>	<u>-</u>	<u>(4,072)</u>	<u>(4,072)</u>
Net book value at 30 June 2018	<u>28,443</u>	<u>9,858</u>	<u>1,299</u>	<u>39,600</u>
Representing:				
- measure at cost	-	-	1,299	1,299
- measure at valuation	28,443	9,858	-	38,301
	<u>28,443</u>	<u>9,858</u>	<u>1,299</u>	<u>39,600</u>
Cost or valuation:				
At 1 July 2018	28,443	9,858	5,371	43,672
Additions	-	-	90	90
Disposals	-	-	(72)	(72)
Elimination of accumulated depreciation on revalued premises	(478)	-	-	(478)
Surplus on revaluation:				
- credited to premises revaluation reserve	1,418	-	-	1,418
- credited to income statement	-	250	-	250
Transfer	-	-	-	-
Exchange adjustments and other	(39)	-	(21)	(60)
At 31 December 2018	<u>29,344</u>	<u>10,108</u>	<u>5,368</u>	<u>44,820</u>
Accumulated depreciation:				
At 1 July 2018	-	-	(4,072)	(4,072)
Charge for the period	(478)	-	(217)	(695)
Disposals	-	-	70	70
Elimination of accumulated depreciation on revalued premises	478	-	-	478
Exchange adjustments and other	-	-	17	17
At 31 December 2018	<u>-</u>	<u>-</u>	<u>(4,202)</u>	<u>(4,202)</u>
Net book value at 31 December 2018	<u>29,344</u>	<u>10,108</u>	<u>1,166</u>	<u>40,618</u>
Representing:				
- measure at cost	-	-	1,166	1,166
- measure at valuation	29,344	10,108	-	39,452
	<u>29,344</u>	<u>10,108</u>	<u>1,166</u>	<u>40,618</u>



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

26 Intangible assets

	At 30 June 2019	At 31 December 2018
Present value of in-force long-term insurance business	18,654	15,910
Internally developed software	725	434
Acquired software	80	78
Goodwill	329	329
	<u>19,788</u>	<u>16,751</u>

27 Other assets

	At 30 June 2019	At 31 December 2018
Items in the course of collection from other banks	7,662	7,236
Bullion	3,591	5,257
Prepayments and accrued income	4,372	4,276
Acceptances and endorsements	7,509	6,868
Less: Expected credit losses	(7)	(5)
Reinsurers' share of liabilities under insurance contracts	8,432	8,788
Settlement accounts	3,887	4,796
Cash collateral	2,007	1,838
Right-of-use assets	1,426	N/A
Other accounts	3,518	5,246
	<u>42,397</u>	<u>44,300</u>

Other accounts included "Assets held for sale" of HK\$12m (31 December 2018: HK\$18m). It also included "Retirement benefit assets" of HK\$18m (31 December 2018: HK\$13m).

28 Current, savings and other deposit accounts

	At 30 June 2019	At 31 December 2018
Current, savings and other deposit accounts:		
- as stated in Condensed Consolidated Balance Sheet	1,186,938	1,154,415
- structured deposits reported as financial liabilities designated as fair value (note 30)	29,962	28,594
	<u>1,216,900</u>	<u>1,183,009</u>
By type:		
- demand and current accounts	106,638	106,096
- savings accounts	693,201	707,158
- time and other deposits	417,061	369,755
	<u>1,216,900</u>	<u>1,183,009</u>

29 Trading liabilities

	At 30 June 2019	At 31 December 2018
Short positions in securities	<u>34,037</u>	<u>33,649</u>

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

**30 Financial liabilities designated at fair value**

	<b>At 30 June 2019</b>	At 31 December 2018
Certificates of deposit in issue (note 31)	<b>2,022</b>	2,008
Structured deposits (note 28)	<b>29,962</b>	28,594
Other structured debt securities in issue (note 31)	<b>4,956</b>	2,404
Liabilities to customers under investment contracts	<b>442</b>	448
	<b><u>37,382</u></b>	<u>33,454</u>

At 30 June 2019, the accumulated loss in fair value attributable to changes in own credit risk for financial liabilities designated at fair value was HK\$5m (31 December 2018: accumulated loss of HK\$1m).

**31 Certificates of deposit and other debt securities in issue**

	<b>At 30 June 2019</b>	At 31 December 2018
Certificates of deposit and other debt securities in issue:		
- as stated in Condensed Consolidated Balance Sheet	<b>16,676</b>	3,748
- certificates of deposit in issue designated at fair value (note 30)	<b>2,022</b>	2,008
- other structured debt securities in issue reported as financial liabilities designated at fair value (note 30)	<b>4,956</b>	2,404
	<b><u>23,654</u></b>	<u>8,160</u>
By type:		
- certificates of deposit in issue	<b>18,698</b>	5,756
- other debt securities in issue	<b>4,956</b>	2,404
	<b><u>23,654</u></b>	<u>8,160</u>

**32 Other liabilities**

	<b>At 30 June 2019</b>	At 31 December 2018
Items in the course of transmission to other banks	<b>8,541</b>	10,053
Accruals	<b>4,096</b>	4,190
Acceptances and endorsements	<b>7,509</b>	6,868
Retirement benefit liabilities	<b>958</b>	834
Settlement accounts	<b>2,723</b>	17,213
Cash collateral	<b>255</b>	995
Lease liabilities	<b>1,387</b>	N/A
Other	<b>4,077</b>	5,094
	<b><u>29,546</u></b>	<u>45,247</u>

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

**33 Subordinated liabilities**

Nominal value	Description	At 30 June 2019	At 31 December 2018
HK\$5,460 million	Floating rate subordinated loan due May 2028, callable from 2027 <sup>1</sup>	5,460	-
HK\$4,680 million	Floating rate subordinated loan due June 2029, callable from 2028 <sup>2</sup>	4,680	-
HK\$6,240 million	Floating rate subordinated loan due June 2026, callable from 2025 <sup>3</sup>	6,240	-
US\$400 million	Floating rate subordinated loan due June 2030, callable from 2029 <sup>4</sup>	3,123	-
		<b>19,503</b>	<b>-</b>
Representing:			
- measured at amortised cost		<b>19,503</b>	<b>-</b>

<sup>1</sup> Interest rate at three-month HK dollar HIBOR plus 1.425 per cent per annum, payable quarterly, to the maturity date.

<sup>2</sup> Interest rate at three-month HK dollar HIBOR plus 1.564 per cent per annum, payable quarterly, to the maturity date.

<sup>3</sup> Interest rate at three-month HK dollar HIBOR plus 1.342 per cent per annum, payable quarterly, to the maturity date.

<sup>4</sup> Interest rate at three-month US dollar LIBOR plus 1.789 per cent per annum, payable quarterly, to the maturity date.

During the period, the Bank has issued non-capital loss-absorbing capacity debt instruments totalling HK\$19,503m which rank higher than additional tier 1 capital instruments in the event of a winding-up.

The Bank has not had any defaults of principal, interest or other breaches with respect to its debt instruments during the first half of 2019.

**34 Other equity instruments**

Nominal value	Description	At 30 June 2019	At 31 December 2018
US\$900 million	Floating rate perpetual capital instrument callable from December 2019 <sup>1</sup>	-	6,981
US\$900 million	Fixed to floating rate perpetual capital instrument callable from September 2024 <sup>1</sup>	7,044	-
US\$600 million	Fixed to floating rate perpetual capital instrument callable from June 2024 <sup>2</sup>	4,700	-
		<b>11,744</b>	<b>6,981</b>

<sup>1</sup> The US\$900 million floating rate perpetual capital instrument was cancelled and reissued as fixed to floating rate perpetual capital instrument in June 2019. Coupon rate is 6.03% and then three-month US dollar LIBOR plus 4.02 per cent from the first call date.

<sup>2</sup> Coupon rate is 6% and then three-month US dollar LIBOR plus 4.06 per cent from the first call date.

The additional tier 1 capital instruments, which are qualified as loss-absorbing capacity, are perpetual and subordinated. The coupon payments of these capital instruments 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.

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

35 Contingent liabilities and commitments

(a) Off-balance sheet contingent liabilities and commitments

	At 30 June 2019	At 31 December 2018
<b>Contingent liabilities and financial guarantee contracts</b>		
Guarantee and irrevocable letters of credit pledged as collateral security	21,247	16,216
Other contingent liabilities	180	172
	<u>21,427</u>	<u>16,388</u>
<b>Commitments</b>		
Documentary credits and short-term trade-related transactions	2,131	3,310
Forward asset purchases and forward deposits placed	3,992	2,895
Undrawn formal standby facilities, credit lines and other commitments to lend	476,659	461,480
	<u>482,782</u>	<u>467,685</u>

The above table discloses the nominal principal amounts of commitments (excluding capital commitments), guarantees and other contingent liabilities, which represents the amounts at risk should contracts be fully drawn upon and clients default. As a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not indicative of future liquidity requirements.

(b) Contingencies

There is no material litigation expected to result in a significant adverse effect on the financial position of the Group, either collectively or individually. Management believes that adequate provisions have been made in respect of such litigation.

36 Material related-party transactions

During the first half of 2019, the Hong Kong Monetary Authority has classified the Bank as a material subsidiary of HSBC's Asian resolution group and required the Bank to comply with internal loss-absorbing capacity requirements under the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules. To meet the requirements, the Bank has refinanced the perpetual capital instrument of US\$900m, issued additional perpetual capital instruments of US\$600m and non-capital loss-absorbing capacity debt instruments of HK\$19,503m to its immediate holding company. The Bank has also paid coupon on the existing perpetual capital instrument amounting to HK\$232m to its immediate holding company upon cancellation.

Except on the above, all related party transactions that took place in the half-year to 30 June 2019 were similar in nature to those disclosed in the 2018 Annual Report. There were no changes in the related party transactions described in the 2018 Annual Report that have had a material effect on the financial position or performance of the Group in the half-year to 30 June 2019.

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

37 Fair value of financial instruments

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

The accounting policies, control framework and hierarchy used to determine fair values at 30 June 2019 are consistent with those applied for the Annual Report 2018. The following table provides an analysis of financial instruments carried at fair value and bases of valuation:

	Fair value hierarchy			Third party total	Amounts with HSBC entities *	Total
	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3			
<b>Recurring fair value measurements</b>						
<b>At 30 June 2019</b>						
<b>Assets</b>						
Trading assets	43,699	6,038	-	49,737	-	49,737
Financial assets designated and otherwise mandatorily measured at fair value	9,918	1,399	4,659	15,976	-	15,976
Derivative financial instruments	379	4,275	7	4,661	1,649	6,310
Financial investments	279,282	53,124	1,947	334,353	-	334,353
<b>Liabilities</b>						
Trading liabilities	34,037	-	-	34,037	-	34,037
Financial liabilities designated at fair value	-	26,913	10,469	37,382	-	37,382
Derivative financial instruments	42	4,560	1	4,603	2,466	7,069
<b>At 31 December 2018</b>						
<b>Assets</b>						
Trading assets	44,591	2,573	-	47,164	-	47,164
Financial assets designated and otherwise mandatorily measured at fair value	6,386	2,595	4,089	13,070	-	13,070
Derivative financial instruments	386	5,804	24	6,214	1,927	8,141
Financial investments	284,696	43,197	1,287	329,180	-	329,180
<b>Liabilities</b>						
Trading liabilities	33,649	-	-	33,649	-	33,649
Financial liabilities designated at fair value	-	21,140	12,314	33,454	-	33,454
Derivative financial instruments	29	6,026	71	6,126	2,144	8,270

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

Transfers between Level 1 and Level 2 fair values

	Assets				Liabilities		
	Financial Investments	Trading Assets	Financial assets designated and otherwise mandatorily measured at fair value	Derivatives	Trading Liabilities	Financial liabilities designated at fair value	Derivatives
<b>At 30 June 2019</b>							
Transfer from Level 1 to Level 2	-	-	-	-	-	-	-
Transfer from Level 2 to Level 1	-	-	1,268	-	-	-	-
<b>At 31 December 2018</b>							
Transfer from Level 1 to Level 2	-	-	-	-	-	-	-
Transfer from Level 2 to Level 1	55,329	7,217	-	-	-	-	-

Transfers between levels of the fair value hierarchy are deemed to occur at the end of each quarterly reporting period. Transfers into and out of levels of the fair value hierarchy are primarily attributable to changes in observability of valuation inputs and price transparency.

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

37 Fair value of financial instruments (continued)

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

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

	Assets				Liabilities		
	Financial Investments	Trading Assets	Financial assets designated and otherwise mandatorily measured at fair value	Derivatives	Trading Liabilities	Financial liabilities designated at fair value	Derivatives
<b>At 30 June 2019</b>							
Private equity	1,947	-	4,659	-	-	-	-
Structured notes	-	-	-	-	-	10,469	-
Derivatives	-	-	-	7	-	-	1
	<b>1,947</b>	<b>-</b>	<b>4,659</b>	<b>7</b>	<b>-</b>	<b>10,469</b>	<b>1</b>
<b>At 31 December 2018</b>							
Private equity	1,287	-	4,089	-	-	-	-
Structured notes	-	-	-	-	-	12,314	-
Derivatives	-	-	-	24	-	-	71
	<b>1,287</b>	<b>-</b>	<b>4,089</b>	<b>24</b>	<b>-</b>	<b>12,314</b>	<b>71</b>

Movement in Level 3 financial instruments

	Assets				Liabilities		
	Financial Investments	Trading Assets	Financial assets designated and otherwise mandatorily measured at fair value	Derivatives	Trading Liabilities	Financial liabilities designated at fair value	Derivatives
At 1 January 2019	1,287	-	4,089	24	-	12,314	71
Total gains or losses recognised in profit or loss							
- net income from financial instruments measured at fair value	-	-	33	(17)	-	(149)	(70)
Total gains or losses recognised in other comprehensive income							
- fair value gains	660	-	-	-	-	-	-
- exchange differences	-	-	-	-	-	-	-
Purchases	-	-	790	-	-	-	-
Issues/deposit taking	-	-	-	-	-	16,854	-
Sales	-	-	(3)	-	-	-	-
Settlements	-	-	(171)	-	-	(18,361)	-
Transfers out	-	-	(79)	-	-	(192)	-
Transfers in	-	-	-	-	-	3	-
At 30 June 2019	<b>1,947</b>	<b>-</b>	<b>4,659</b>	<b>7</b>	<b>-</b>	<b>10,469</b>	<b>1</b>
Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of reporting period							
- net income from financial instruments measured at fair value	-	-	32	3	-	131	-

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

37 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		
	Financial Investments	Trading Assets	Financial assets designated and otherwise mandatorily measured at fair value	Derivatives	Trading Liabilities	Financial liabilities designated at fair value	Derivatives
At 1 January 2018	1,455	-	1,832	8	392	-	3
Total gains or losses recognised in profit or loss							
- net income from financial instruments measured at fair value	-	-	95	17	6	(131)	(2)
Total gains or losses recognised in other comprehensive income							
- fair value gains	59	-	-	-	-	-	-
- exchange differences	-	-	-	-	-	-	-
Purchases	-	-	1,690	-	-	-	-
Issues/deposit taking	-	-	-	-	-	1,660	-
Settlements	-	-	(201)	-	-	(47)	-
Transfers out	(32)	-	-	(7)	(398)	(33)	(1)
Transfers in	-	-	32	-	-	72	-
At 30 June 2018	<u>1,482</u>	<u>-</u>	<u>3,448</u>	<u>18</u>	<u>-</u>	<u>1,521</u>	<u>-</u>

Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of reporting period

- net income from financial instruments measured at fair value

	Assets				Liabilities		
	Financial Investments	Trading Assets	Financial assets designated and otherwise mandatorily measured at fair value	Derivatives	Trading Liabilities	Financial liabilities designated at fair value	Derivatives
At 1 July 2018	1,482	-	3,448	18	-	1,521	-
Total gains or losses recognised in profit or loss							
- net income from financial instruments measured at fair value	-	-	239	9	-	182	11
Total gains or losses recognised in other comprehensive income							
- fair value losses	(229)	-	-	-	-	-	-
- exchange differences	-	-	-	-	-	-	-
Purchases	34	-	770	-	-	1	-
Issues/deposit taking	-	-	-	-	-	7,656	-
Settlements	-	-	(368)	-	-	(1,111)	-
Transfers out	-	-	-	(10)	-	(131)	(4)
Transfers in	-	-	-	7	-	4,196	64
At 31 December 2018	<u>1,287</u>	<u>-</u>	<u>4,089</u>	<u>24</u>	<u>-</u>	<u>12,314</u>	<u>71</u>

Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of reporting period

- net income from financial instruments measured at fair value

For the first half of 2019, the transfer out/in of Level 3 financial liabilities designated at fair value reflected the change in observability of equity volatility for pricing the instrument. The transfer out of Level 3 financial assets designated and otherwise mandatorily measured at fair value reflected the change in observability of valuation inputs and price transparency.

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

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

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

**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 Level 3 fair values to reasonably possible alternative assumptions by instrument type*

	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes	Unfavourable changes	Favourable changes	Unfavourable changes
<b>At 30 June 2019</b>				
Private equity	233	(233)	72	(72)
Derivatives	-	-	-	-
	<u>233</u>	<u>(233)</u>	<u>72</u>	<u>(72)</u>
<b>At 31 December 2018</b>				
Private equity	204	(204)	51	(51)
Derivatives	20	(20)	-	-
	<u>224</u>	<u>(224)</u>	<u>51</u>	<u>(51)</u>

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 (31 December 2018: 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 amenable to statistical analysis, quantification of uncertainty is judgemental.

*Quantitative information about significant unobservable inputs in Level 3 valuations*

	Valuation technique(s)	Unobservable input(s)	Range
<b>Assets</b>			
Private equity	Net asset value	N/A	N/A
		Market-comparable approach	Earnings Multiple (31 Dec 2018: 24 - 31)
	Option model	P/B ratios	0.56 - 2.16 (31 Dec 2018: 0.52 - 1.25)
		Liquidity Discount	10% - 50% (31 Dec 2018: 10% - 30%)
Derivatives	Option model	Equity Volatility (31 Dec 2018: 26.99% - 38.27%)	23.92% - 52.41%
<b>Liabilities</b>			
Structured notes	Option model	FX Volatility (31 Dec 2018: 1.04% - 16.66%)	0.87% - 18.44%
		Equity Volatility (31 Dec 2018: 14.95% - 55.96%)	15.31% - 52.41%
	Option model	Equity and Equity Index Correlation (31 Dec 2018: 0.17 - 0.69)	N/A
Derivatives	Option model	Equity Volatility (31 Dec 2018: 24.52% - 34.53%)	16.85% - 31.62%

**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 2019. Detailed description of the categories of key unobservable inputs are set out in note 51(a) of the Group's Annual Report 2018.



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

### 37 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 2019		At 31 December 2018	
	Carrying Amounts	Fair Value	Carrying Amounts	Fair Value
<b>Financial Assets</b>				
Placings with and advances to banks	99,066	98,984	79,400	79,345
Loans and advances to customers	919,845	920,848	874,456	875,505
Financial investments - at amortised cost	115,154	119,172	99,352	99,260
<b>Financial Liabilities</b>				
Current, savings and other deposit accounts	1,186,938	1,186,883	1,154,415	1,154,216
Repurchase agreements – non-trading	6,664	6,664	410	410
Deposits from banks	9,586	9,586	2,712	2,712
Certificates of deposit and other debt securities in issue	16,676	16,782	3,748	3,748
Subordinated liabilities	19,503	19,862	-	-

Other financial instruments not carried at fair value are typically short-term in nature or reprice to current market rates frequently. Accordingly, their carrying amounts are reasonable approximations of their fair values.

Details of how the fair values of financial instruments that are not carried at fair value on the balance sheet are calculated are set out in note 51(b) of the Group's Annual Report 2018.

### 38 Condensed Consolidated Financial Statements and statutory financial statements

The financial information relating to the year ended 31 December 2018 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 statutory financial statements for the year ended 31 December 2018. 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 2018, which includes the statutory financial statements, can be obtained from the Bank's website ([www.hangseng.com](http://www.hangseng.com)) and the website of HKEX ([www.hkexnews.hk](http://www.hkexnews.hk)).

The Banking Disclosure Statement, together with the disclosures in the Group's Interim Report, contained all the disclosures required by the Banking (Disclosure) Rules issued by the HKMA. The disclosures as required under the Banking (Disclosures) Rules can be viewed in the Banking Disclosure Statement that is available in the Regulatory Disclosures section of the Bank's website ([www.hangseng.com](http://www.hangseng.com)).

### 39 Immediate and ultimate holding companies

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

### 40 Comparative figures

Certain comparative figures in the Condensed Consolidated Financial Statements have been reclassified to conform with 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 32 to 63, which comprises the condensed consolidated balance sheet of Hang Seng Bank Limited (the “Bank”) and its subsidiaries (together, the “Group”) as at 30 June 2019 and the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed consolidated statement of changes in equity and the condensed consolidated cash flow statement for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes<sup>1</sup>. 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.

*<sup>1</sup>As described in Note 1 on the condensed consolidated financial statements, certain other disclosures have been presented elsewhere in the Interim Report 2019, rather than in the notes on the condensed consolidated financial statements. These are cross-referenced from the condensed consolidated financial statements and are identified as reviewed.*

**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 of the Group are not prepared, in all material respects, in accordance with Hong Kong Accounting Standard 34 “Interim Financial Reporting”.

**PricewaterhouseCoopers**  
Certified Public Accountants

Hong Kong, 5 August 2019

## **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 2019.

### **Changes in Directors’ Details**

Changes in Directors’ details since the date of the Annual Report 2018 of the Bank or (as the case may be) the date of announcement for the appointment of Director issued by the Bank subsequent to the date of the Annual Report 2018, 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.

#### **Ms Irene LEE Yun Lien**

##### Cessation of appointments

- Cathay Pacific Airways Limited<sup>(1)</sup> (Independent Non-executive Director; Chairman of Audit Committee; Chairman of Remuneration Committee)

#### **Dr Eric LI Ka Cheung GBS, OBE, JP**

##### Cessation of appointments

- Home Affairs Bureau (Member of the Board of Trustees of the Sir Edward Youde Memorial Fund)
- The Financial Reporting Council (Member of Honorary Advisory Panel)

#### **Dr Vincent LO Hong Sui GBM, JP**

##### Cessation of appointment

- Hong Kong Trade Development Council (Chairman)

#### **Mr Kenneth NG Sing Yip**

##### New appointment

- Ping An Insurance (Group) Company of China, Ltd.<sup>(1)</sup> (Independent Non-executive Director)

#### **Mr Peter WONG Tung Shun JP**

##### Cessation of appointment

- Bank of Communications Co., Ltd.<sup>(1)</sup> (Vice Chairman and Non-executive Director)

Notes:

- (1) The securities of these companies are listed on a securities market in Hong 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 2019, 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
<b>Number of ordinary shares in the Bank</b>						
<u>Directors:</u>						
Dr John C C Chan	1,000 <sup>(1)</sup>	-	-	-	1,000	0.00
Ms Margaret W H Kwan	65	-	-	-	65	0.00
<b>Number of ordinary shares of US\$0.50 each in HSBC Holdings plc</b>						
<u>Directors:</u>						
Dr Raymond K F Ch'ien	59,799	-	-	-	59,799	0.00
Ms Louisa Cheang	468,284	-	-	187,464 <sup>(2)</sup>	655,748	0.00
Dr John C C Chan	24,605 <sup>(1)</sup>	-	-	-	24,605	0.00
Mr Nixon L S Chan	143,054	-	-	12,073 <sup>(2)</sup>	155,127	0.00
Ms Kathleen C H Gan	255,649	-	-	55,332 <sup>(2)</sup>	310,981	0.00
Ms Margaret W H Kwan	58,199	10,041	-	20,009 <sup>(2)</sup>	88,249	0.00
Ms Irene Y L Lee	11,456	-	-	-	11,456	0.00
Dr Eric K C Li	-	62,362	-	-	62,362	0.00
Mr Kenneth S Y Ng	440,465	-	-	-	440,465	0.00
Mr Peter T S Wong	2,334,725	26,405	-	980,781 <sup>(2)</sup>	3,341,911	0.02
<b>Alternate Chief Executives:</b>						
Mrs Eunice L C Y Chan	16,474	-	-	11,767 <sup>(2)</sup>	28,241	0.00
Mr Donald Y S Lam	145,378	-	-	23,694 <sup>(2)</sup>	169,072	0.00
Mr Andrew W L Leung	17,910	-	-	20,037 <sup>(2)</sup>	37,947	0.00

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) 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 2019, 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 2019	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 2019
<u>Directors:</u>				
Ms Louisa Cheang	199,074	112,656	128,051	187,464 <sup>(1)</sup>
Mr Nixon L S Chan	11,773	-	-	12,073 <sup>(1)</sup>
Ms Kathleen C H Gan	55,332 <sup>(2)</sup>	-	-	55,332 <sup>(1)</sup>
Ms Margaret W H Kwan	14,224	28,240	22,604	20,009 <sup>(1)</sup>
Mr Kenneth S Y Ng	7,474	-	7,665	-
Mr Peter T S Wong	718,038	263,343	562,525	434,246 <sup>(1)</sup>
<u>Alternate Chief Executives:</u>				
Mrs Eunice L C Y Chan	11,883	6,251	6,670	11,767 <sup>(1)</sup>
Mr Donald Y S Lam	19,824	27,231	23,649	23,694 <sup>(1)</sup>
Mr Andrew W L Leung	17,448	13,019	10,874	20,037 <sup>(1)</sup>

Notes:

- (1) This included additional shares arising from scrip dividends.
- (2) This represented the awards held by Ms Kathleen C H Gan on 10 May 2019 when she was appointed as a Non-executive Director of the Bank.

During the first half of 2019, Ms Kathleen C H Gan, 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 2019, 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.

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 2019.

## Substantial Interests in Share Capital

The register maintained by the Bank pursuant to the SFO recorded that, as at 30 June 2019, 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 (“HBAP”)	1,188,057,371 (62.14%)
HSBC Asia Holdings Limited	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 Limited, 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 Limited 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 2019, 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 2019.

## Remuneration and Staff Development

There have been no material changes to the information disclosed in the Annual Report 2018 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 2019. Further, the Bank constantly reviews and enhances its corporate governance framework, by making reference to market trend as well as guidelines and requirements issued by regulatory authorities, 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 2019.

## 2019 Second Interim Dividend

Announcement date	5 August 2019
Ex-dividend date	16 August 2019
Book close and record date	20 August 2019
Payment date	5 September 2019

**Register of Shareholders**

The Register of Shareholders of the Bank will be closed on Tuesday, 20 August 2019, 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, 19 August 2019.

## **Board and Committees**

### **Board**

#### Independent Non-executive Chairman

Raymond CH' IEN Kuo Fung

#### Executive Directors

Louisa CHEANG (Vice-Chairman and Chief Executive)

Margaret KWAN Wing Han

#### Non-executive Directors

Nixon CHAN Lik Sang

Kathleen GAN Chieh Huey

Vincent LO Hong Sui

Kenneth NG Sing Yip

Peter WONG Tung Shun

#### Independent Non-executive Directors

John CHAN Cho Chak

CHIANG Lai Yuen

Irene LEE Yun Lien

Eric LI Ka Cheung

Michael WU Wei Kuo

### **Committees**

#### Executive Committee

Louisa CHEANG (Chairman)

Eunice CHAN

Ivy CHAN Shuk Pui

Crystal CHEUNG Pui Sze

Liz CHOW Tan Ling

Margaret KWAN Wing Han

Donald LAM Yin Shing

Gilbert LEE Man Lung

Andrew LEUNG Wing Lok

Godwin LI Chi Chung

Ryan SONG Yue Sheng

Elaine WANG Yee Ning

Daphne WAT Wing Kam

WONG May Kay

Katie YIP Kay Chun

#### Audit Committee

Eric LI Ka Cheung (Chairman)

CHIANG Lai Yuen

Irene LEE Yun Lien

#### Remuneration Committee

John CHAN Cho Chak (Chairman)

CHIANG Lai Yuen

Raymond CH' IEN Kuo Fung



Risk Committee

Irene LEE Yun Lien (Chairman)

Eric LI Ka Cheung

NG Sing Yip, Kenneth

Michael WU Wei Kuo

Nomination Committee

Raymond CH' IEN Kuo Fung (Chairman)

John CHAN Cho Chak

Louisa CHEANG

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](http://www.hangseng.com)

Email: [hangseng@computershare.com.hk](mailto: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

**Depository\***

BNY Mellon Shareowner Services

PO Box 505000

Louisville, KY 40233-5000

USA

Website: [www.mybnyhdr.com](http://www.mybnyhdr.com)

Email: [shrrelations@cpushareownerservices.com](mailto: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 2019**

This Interim Report 2019 in both English and Chinese is now available in printed form and on the Bank's website ([www.hangseng.com](http://www.hangseng.com)) and the website of HKEx ([www.hkexnews.hk](http://www.hkexnews.hk)).

Shareholders who:

- A) browse this Interim Report 2019 on the Bank's website and wish to receive a printed copy; or
- B) receive this Interim Report 2019 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](http://www.hangseng.com)) or HKEx's website ([www.hkexnews.hk](http://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](mailto:hangseng@computershare.com.hk)

If shareholders who have chosen (or are deemed to have chosen) to read this Interim Report 2019 on the Bank's website, have difficulty in reading or gaining access to this Interim Report 2019 via the Bank's website for any reason, the Bank will promptly send this Interim Report 2019 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](mailto:hangseng@computershare.com.hk).