NOTES TO THE FINANCIAL STATEMENTS

year ended 31 December 2011
(Figures expressed in millions of Hong Kong dollars unless otherwise indicated)

1. BASIS OF PREPARATION

(a) The consolidated financial statements comprise the statements of Hang Seng Bank Limited ("the Bank") and all its subsidiaries made up to 31 December. The consolidated financial statements include the attributable share of the results and reserves of associates, based on the financial statements made up to dates not earlier than three months prior to 31 December. All significant intra-group transactions have been eliminated on consolidation. The Bank and its subsidiaries and associates are collectively referred as "the Group".

(b) These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs"), which is a collective term that includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs"), and interpretations ("Ints") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. In addition, these financial statements comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. A summary of the principal accounting policies adopted by the Group is set out in note 4.

The HKICPA has issued certain amendments to HKFRSs and interpretations that are first effective or available for early adoption for the current accounting period of the Group. Note 5 provides information on the changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these financial statements.

(c) The measurement basis used in the preparation of the financial statements is historical cost except that the following assets and liabilities are stated at fair value as explained in the accounting policies set out below:

- financial instruments classified as trading, designated at fair value and available-for-sale (see note 4(g));
- derivative financial instruments (see note 4(h));
- investment property (see note 4(r));
- leasehold land and buildings held for own use, where the value of the land cannot be reliably separated from the value of the building at inception of the lease and the entire lease is therefore classified as a finance lease (see note 4(s)); and
- leasehold land and buildings held for own use, where the value of the land can be reliably separated from the value of the building at inception of the lease and the term of the lease is not less than 50 years (see note 4(s)).

(d) The preparation of financial statements in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The Group believes that the assumptions that have been made are appropriate and that the financial statements therefore present the financial position and results fairly, in all material respects.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of HKFRSs that have significant effect on the financial statements and major sources of estimation uncertainty are discussed in note 6. Disclosures under HKFRS 4 "Insurance Contract" and HKFRS 7 "Financial Instrument: Disclosure" relating to the nature and extent of risks have been included in note 61 "Financial risk management".

2. NATURE OF BUSINESS

The Group is engaged primarily in the provision of banking and related financial services.

3. BASIS OF CONSOLIDATION

The consolidated financial statements cover the consolidated positions of Hang Seng Bank Limited and all its subsidiaries, unless otherwise stated, and include the attributable share of results and reserves of its associates. For regulatory reporting, the basis of consolidation is different from the basis of consolidation for accounting purposes. They are set out in notes 34, 54 and 61 to the financial statements.

4. PRINCIPAL ACCOUNTING POLICIES

(a) Interest income and expense

Interest income and expense for all financial instruments are recognised in "Interest income" and "Interest expense" respectively in the income statement using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instruments or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but excluding future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

For impaired loans, the accrual of interest income based on the original terms of the loan is discounted to arrive at the net present value of impaired loans. Subsequent increase of such net present value of impaired loans due to the passage of time is recognised as interest income.

(b) Non-interest income

(i) Fee income

Fee income is earned from a diverse range of services provided to customers. Fee income is accounted for as follows:

– income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as an arrangement for the acquisition of shares or other securities);

– income earned from the provision of services is recognised as revenue when the services are provided (for example, asset management, portfolio and other management advisory and service fees); and

– income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and reported in "Interest income" (see note 4(a)).

(ii) Rental income from operating lease

Rental income received under an operating lease is recognised in "Other operating income" in equal instalments over the accounting periods covered by the lease term. Lease incentives granted are recognised in the income statement as an integral part of the aggregate net lease payments receivable. Contingent rentals receivable are recognised as income in the accounting period in which they are earned.

(iii) Dividend income

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders have approved the dividend for unlisted equity securities.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(b) Non-interest income (continued)

(iv) Trading income

Trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading and dividend income from equities held for trading. Gains or losses arising from changes in fair value of derivatives are recognised in "Trading income" to the extent as described in the accounting policy set out in notes 4(h) and 4(i). Gains and losses on foreign exchange trading and other transactions are also reported as "Trading income" except for those gains and losses on translation of foreign currencies recognised in other comprehensive income and accumulated separately in equity in the foreign exchange reserve in accordance with the accounting policy set out in note 4(z).

(v) Net income from financial instruments designated at fair value

Net income from financial instruments designated at fair value comprises all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value and dividends arising on those financial instruments and the changes in fair value of the derivatives managed in conjunction with the financial assets and liabilities designated at fair value.

(c) Segment reporting

The Group's operating segments are determined to be customer group segment because the chief operating decision maker uses customer group information in order to make decisions about allocating resources and assessing performance.

(d) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition. Cash and cash equivalents include cash and balances at central banks, treasury bills and other eligible bills, loans and advances to banks, and certificates of deposit.

(e) Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated or acquired by the Group, which have not been classified either as held for trading or designated at fair value. Loans and advances are recognised when cash is advanced to borrowers. They are derecognised when borrowers repay their obligations, the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest rate method, less impairment allowances.

(f) Loan impairment

Losses for impaired loans are promptly recognised when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances are assessed either individually for individually significant loans or collectively for loan portfolios with similar credit risk characteristics.

(i) Individually assessed loans

For all loans that are considered individually significant, the Group assesses on a case-by-case basis whether there is any objective evidence that a loan is impaired. The criteria used by the Group to determine that there is such objective evidence include:

- known cash flow difficulties experienced by the borrower;
- past due contractual payments of either principal or interest;
- breach of loan covenants or conditions;
- the probability that the borrower will enter bankruptcy or other financial restructuring; and
- a significant downgrading in credit rating by an external rating agency.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(f) Loan impairment (continued)

(i) Individually assessed loans (continued)

For those loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

– the Group's aggregate exposure to the borrower;

– the viability of the borrower's business model and capability to trade successfully out of financial difficulties and generate cash flow to service their debt obligations;

– the amount and timing of expected receipts and recoveries;

– the likely dividend available on liquidation or bankruptcy;

– the extent of other creditors' commitments ranking ahead of, or pari passu with, the Group and the likelihood of other creditors continuing to support the borrower;

– the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;

– the realisable value of collateral (or other credit mitigants) and likelihood of successful repossession;

– the likely deduction of any costs involved in recovery of amounts outstanding;

– the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and

– where available, the secondary market price for the debt.

Impairment losses are calculated by discounting the expected future cash flows of a loan at its original effective interest rate and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

(ii) Collectively assessed loans

Impairment allowances are calculated on a collective basis for the following:

– to cover losses which have been incurred but have not yet been identified as loans subject to individual assessment; and

– for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss. This reflects impairment losses that the Group has incurred as a result of events occurring before the balance sheet date, which the Group is not able to identify on an individual loan basis, and that can be reliably estimated. These losses will only be individually identified in the future. As soon as information becomes available which identifies losses on individual loans within the Group, those loans are removed from the Group and assessed on an individual basis for impairment. The collective impairment allowance is determined after taking into account:

– historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);

– the estimated period between a loss occurring and that loss being identified and evidenced by the establishment of an allowance against the loss on an individual loan; and

– management's judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience.

Homogeneous groups of loans

Portfolios of small homogeneous loans are collectively assessed using roll rate or historical loss rate methodologies.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(f) Loan impairment (continued)

(iii) Loan write-offs

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of collateral. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write off may be earlier.

(iv) Reversals of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed to the extent it is now excessive by reducing the loan impairment allowance account. The amount of any reversal is recognised in the income statement.

(v) Repossessed assets

Non-financial assets acquired in exchange for loans in order to achieve an orderly realisation are reported under "Assets held for sale" if the carrying amounts of the assets are recovered principally through sale, the assets are available for sale in their present condition and the sale is highly probable. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan, net of impairment allowance amounts, at the date of exchange. No depreciation is provided in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recorded as an impairment loss and included in the income statement. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative impairment loss, is recognised in the income statement.

Financial assets acquired in exchange for loans are classified and reported in accordance with the relevant accounting policies.

(vi) Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as new loans for measurement purposes once the minimum number of payments required under the new arrangements has been received. These renegotiated loans are segregated from other parts of the loan portfolio for the purposes of collective impairment assessment, to reflect their risk profile. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or should be considered past due. The carrying amounts of loans that have been classified as renegotiated retain this classification until maturity or derecognition.

(g) Financial instruments

Other than loans and advances to banks and customers, the Group classifies its financial instruments into the following categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred.

(i) Trading assets and trading liabilities

Financial instruments and short positions thereof which have been acquired or incurred principally for the purpose of selling or repurchasing in the near term, or are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking, are classified as held-for-trading. Trading liabilities also include customer deposits and certificates of deposit with embedded options or other derivatives, the market risk of which was managed in the trading book. Trading assets and liabilities are recognised initially at fair value with transaction costs taken to the income statement, and are subsequently remeasured at fair value. All subsequent gains and losses from changes in the fair value of these assets and liabilities, together with the related interest income and expense and dividends, are recognised in the income statement within "Trading income" as they arise. Upon disposal or repurchase, the difference between the net sale proceeds or the net payment and the carrying value is included in the income statement.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

(ii) Financial instruments designated at fair value

A financial instrument is classified in this category if it meets any one of the criteria set out below, and is so designated by management. The Group may designate financial instruments at fair value where the designation:

- eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities or recognising the gains and losses on them on different bases.
- applies to a group of financial assets, financial liabilities or both that is managed and its performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and where information about that group of financial instruments is provided internally on that basis to key management personnel. Under this criterion, certain liabilities under investment contracts and financial assets held to meet liabilities under insurance and investment contracts are the main classes of financial instrument so designated.
- The Group has documented risk management and investment strategies designed to manage such assets at fair value, taking into consideration the relationship of assets to liabilities in a way that mitigates market risks. Reports are provided to management on the fair value of the assets. Fair value measurement is also consistent with the regulatory reporting requirements under the appropriate regulations for these insurance operations.
- relates to financial instruments containing one or more embedded derivatives that significantly modify the cash flows resulting from those financial instruments.

Financial assets and financial liabilities so designated are recognised initially at fair value, with transaction costs taken directly to the income statement, and are subsequently remeasured at fair value. This designation, once made, is irrevocable in respect of the financial instruments to which it is made. Gains and losses from changes in the fair value of such assets and liabilities and dividends are recognised in the income statement as they arise, within "Net income from financial instruments designated at fair value". Gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with financial assets or financial liabilities designated at fair value are also included in "Net income from financial instruments designated at fair value".

(iii) Available-for-sale financial assets

Financial instruments intended to be held on a continuing basis are classified as available-for-sale, unless they are designated at fair value (see note 4(g)(ii)) or classified as held-to-maturity (see note 4(g)(iv)).

Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income and accumulated separately in equity in the "Available-for-sale investment reserve" until the financial assets are either sold or become impaired. When available-for-sale financial assets are sold, cumulative gains or losses which are previously recognised in other comprehensive income shall be reclassified from equity to the income statement as "Gains less losses from financial investments and fixed assets".

(iv) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has the positive intention and ability to hold until maturity. Held-to-maturity investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest rate method, less any impairment allowances.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(h) Derivative financial instruments

Derivative financial instruments ("derivatives") are recognised initially, and are subsequently remeasured, at fair value. Fair values of exchange-traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models.

Derivatives may be embedded in other financial instruments, for example, a convertible bond with an embedded conversion option. Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract; and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with changes therein recognised in the income statement.

Derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

The method of recognising the resulting fair value gains or losses depends on whether the derivative is held for trading, or is designated as a hedging instrument, and if so, the nature of the risk being hedged.

(i) Hedge accounting

The Group designates certain derivatives as either (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ("fair value hedge"); (ii) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ("cash flow hedge"). Hedge accounting is applied to derivatives designated as hedging instruments in fair value or cash flow hedge provided certain criteria are met.

At the inception of a hedging relationship, the Group documents the relationship between the hedging instruments and the hedged items, its risk management objective and its strategy for undertaking the hedge. The Group also requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments, primarily derivatives, that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items.

(i) Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement within "Trading income", along with changes in the fair value of the hedged asset, liability or group thereof that are attributable to the hedged risk.

If the hedging relationship no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the income statement based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised, in which case it is released to the income statement immediately.

(ii) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualified as cash flow hedge are recognised in other comprehensive income and accumulated separately in equity. Any gain or loss relating to an ineffective portion is recognised immediately in the income statement within "Trading income".

For cash flow hedge of a recognised asset or liability, the associated cumulative gain or loss is reclassified from equity to the income statement in the same periods during which the hedged cash flow affect profit and loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss at that time remains in equity until the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in other comprehensive income is immediately reclassified to the income statement.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(i) Hedge accounting (continued)

(iii) Hedge effectiveness testing

In order to qualify for hedge accounting, the Group carries out prospective effectiveness testing to demonstrate that it expects the hedge to be highly effective at the inception of the hedge and throughout its life. Actual effectiveness (retrospective effectiveness) is also demonstrated on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method the Group adopts for assessing hedge effectiveness will depend on its risk management strategy.

For fair value hedge relationships, the Group utilises the cumulative dollar offset method or regression as effectiveness testing methodology. For cash flow hedge relationships, the Group utilises the change in variable cash flow method or capacity test or the cumulative dollar offset method using the hypothetical derivative approach.

For prospective effectiveness, the hedging instrument is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness, the change in fair value or cash flows must offset each other in the range of 80 per cent to 125 per cent for the hedge to be deemed effective.

(iv) Derivatives that do not qualify for hedge accounting

All gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in the income statement. These gains and losses are reported in "Trading income", except where derivatives are managed in conjunction with financial instruments designated at fair value, in which case gains and losses are reported in "Net income from financial instruments designated at fair value".

(j) Sale and repurchase agreements

Where securities are sold subject to commitment to repurchase them at a pre-determined price, they remain on the balance sheet and a liability is recorded in respect of the consideration received in "Deposits from banks" where the counterparty is a bank, or in "Current, savings and other deposit accounts" where the counterparty is a non-bank. Conversely, securities purchased under analogous commitments to resell are not recognised on the balance sheet and the consideration paid is recorded in "Placings with and advances to banks and other financial institutions" where the counterparty is a bank, or in "Advance to customers" where the counterparty is a non-bank. The difference between the sale and repurchase price is treated as interest and recognised over the life of the agreement.

(k) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(l) Application of trade date accounting

Except for loans and advances and deposits, all financial assets, liabilities and instruments are accounted for on trade date basis.

(m) Derecognition of financial assets and liabilities

Financial assets are derecognised when the rights to receive cash flows from the assets have expired; or where the Group has transferred its contractual rights to receive the cash flows of the financial assets and has transferred substantially all the risks and rewards of ownership; or where control is not retained. Financial liabilities are derecognised when they are extinguished, i.e. when the obligation is discharged or cancelled or expires.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(n) Valuation of financial instruments

All financial instruments are recognised initially at fair value. In the normal course of business, the fair value of a financial instrument on initial recognition is normally the transaction price, i.e. the fair value of the consideration given or received. In certain circumstances, however, the fair value may be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Group recognises a trading gain or loss on inception of the financial instrument, being the difference between the transaction price and the fair value. When unobservable market data have a significant impact on the valuation of financial instruments, the entire initial difference in fair value indicated by the valuation model from the transaction price is not recognised immediately in the income statement but is recognised over the life of the transaction on an appropriate basis, or when the inputs become observable, or the transaction matures or is closed out, or when the Group enters into an offsetting transaction.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value are measured in accordance with the Group's valuation methodologies, which are described in Note 62.

(o) Subsidiaries

A subsidiary is a corporate entity in which the Group, directly or indirectly, holds more than half of the issued share capital or controls more than half of the voting power or controls the composition of the board of directors, or a non-corporate entity the Group otherwise controls, directly or indirectly, by way of having the power to govern its financial and operating policies so that the Group obtains benefits from these activities. A subsidiary is fully consolidated into the consolidated financial statements from the date that control commences until the date that control ceases. In the Bank's balance sheet, an investment in subsidiary is stated at cost less impairment allowances.

(p) Associates

An associate is an entity over which the Group or the Bank has the ability to significantly influence, but not control over its management, including participation in the financial and operating policy decision. An interest in an associate is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the associate's net assets. The consolidated income statement includes the Group's share of the post-acquisition, post tax results of the associate and any impairment losses for the year, whereas the Group's share of the post-acquisition post-tax items of the associate's other comprehensive income is recognised in the consolidated statement of comprehensive income.

Unrealised gains on transactions between the Group and its associate are eliminated to the extent of the Group's interest in the associate. Unrealised losses are also eliminated to the extent of the Group's interest in the associate unless the transaction provides evidence of an impairment of the asset transferred.

In the Bank's balance sheet, interest in associate is stated at cost less impairment allowances.

(q) Goodwill and intangible assets

(i) Goodwill arises on business combinations, including the acquisition of subsidiaries or associates when the cost of acquisition exceeds the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities acquired and is reported in the consolidated balance sheet. Goodwill on acquisitions of associates is included in "Interest in associates". Goodwill is allocated to cash-generating units for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. Goodwill is tested for impairment annually by comparing the recoverable amount from a cash-generating unit with the carrying value of its net assets, including attributable goodwill. The recoverable amount of an asset is the higher of, its fair value less cost to sell, and its value in use. Value in use is the present value of the expected future cash flows from a cash-generating unit. If the recoverable amount is less than the carrying value, an impairment loss is charged to the income statement. Goodwill is stated at cost less any accumulated impairment losses.

Any excess of the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of an acquired business over the cost to acquire is recognised immediately in the income statement.

At the date of disposal of a business, attributable goodwill is included in the Group's share of net assets in the calculation of the gain or loss on disposal.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(q) Goodwill and intangible assets (continued)

(ii) Intangible assets include the value of in-force long-term insurance business, acquired software licences and capitalised development costs of computer software programmes. The value of in-force long-term insurance business is stated at a valuation determined annually in consultation with actuaries using the methodology as described in note 4(ac). Computer software acquired is stated at cost less amortisation and impairment allowances. Amortisation of computer software is charged to the income statement over its useful life. Costs incurred in the development phase of a project to produce application software for internal use are capitalised and amortised over the software's estimated useful life, usually five years. A periodic review is performed on intangible assets to confirm that there has been no impairment.

(r) Investment property

Investment properties are land and/or buildings which are owned or held under a leasehold interest to earn rental income and/or for capital appreciation. Investment properties are stated in the balance sheet at fair value. Any gain or loss arising from a change in fair value is recognised in the income statement. Fair values are determined by independent professional valuers, primarily on the basis of capitalisation of net incomes with due allowance for outgoings and reversionary income potential. Property interests which are held under operating leases to earn rentals, or for capital appreciation or, both, are classified and accounted for as investment property on a property-by-property basis. Such property interests are accounted for as if they were held under finance leases (see note 4(u)).

(s) Premises, plant and equipment

(i) The following land and buildings held for own use are stated in the balance sheet at their revalued amount, being their fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses:

– leasehold land and buildings where the fair value of the land cannot be reliably separated from the value of the building at inception of the lease and the premises are not clearly held under an operating lease; and

– leasehold land and buildings where the value of the land can be reliably separated from the value of the building at inception of the lease and the term of the lease is not less than 50 years.

Revaluations are performed by professionally qualified valuers, on a market basis, with sufficient regularity to ensure that the net carrying amount does not differ materially from the fair value at the balance sheet date. Surpluses arising on revaluation are credited firstly to the income statement to the extent of any deficits arising on revaluation previously charged to the income statement in respect of the same land and buildings, and are thereafter taken to other comprehensive income and are accumulated separately in the "Premises revaluation reserve". Deficits arising on revaluation, are firstly set off against any previous revaluation surpluses included in the "Premises revaluation reserve" in respect of the same land and building, and are thereafter recognised in the income statement.

Depreciation is calculated to write-off the valuation of the land and building over their estimated useful lives as follows:

– freehold land is not depreciated;

– leasehold land is depreciated over the unexpired terms of the leases; and

– buildings and improvements thereto are depreciated at the greater of 2 per cent per annum on the straight-line basis or over the unexpired terms of the leases.

On revaluation of the property, depreciation accumulated during the year will be eliminated. Depreciation charged on revaluation surplus of the properties is transferred from "Premises revaluation reserve" to "Retained profits".

On disposal of the property, the profit and loss is calculated as the difference between the net sales proceeds and the net carrying amount and recognised in the income statement. Surpluses relating to the property disposed of included in the "Premises revaluation reserve" are transferred as movements in reserves to "Retained profits".

(ii) Furniture, plant and other equipment, is stated at cost less depreciation calculated on the straight-line basis to write off the assets over their estimated useful lives, which are generally between 3 and 10 years. On disposal, the profit and loss is calculated as the difference between the net sales proceeds and the net carrying amount.

Premises, plant and equipment are subject to review for impairment if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(t) Interest in leasehold land held for own use under operating lease

The Government of Hong Kong owns all the land in Hong Kong and permits its use under leasehold arrangements. Similar arrangements exist in mainland China. At inception of the lease, where the cost of land is known or can be reliably determined and the term of the lease is less than 50 years, the Group records its interest in leasehold land and land use rights separately as operating leases.

Where the cost of land is known or can be reliably determined and the term of the lease is not less than 50 years, the Group records its interest in leasehold land and land use rights as land and buildings held for own use.

Where the cost of the land is unknown or cannot be reliably determined, and the leasehold land and land use rights are not clearly held under an operating lease, they are accounted for as land and buildings held for own use.

(u) Finance and operating leases

Leases which transfer substantially all the risks and rewards of ownership to the lessees are classified as finance leases. Leases which do not transfer substantially all the risks and rewards of ownership to the lessees are classified as operating leases, with the exceptions of land and building held under a leasehold interest as set out in notes 4(r) & 4(s).

(i) Finance leases

Where the Group is a lessor under finance leases, an amount representing the net investment in the lease is included in the balance sheet as loans and advances to customers. Hire purchase contracts having the characteristics of a finance lease are accounted for in the same manner as finance leases. Impairment allowances are accounted for in accordance with the accounting policies set out in note 4(f).

Where the Group acquires the use of assets under finance leases, the amount representing the fair value of the leased asset, or, if lower, the present value of the minimum payments of such assets is included in fixed assets and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. Depreciation is provided at rates which write off the cost or valuation of the assets over the term of the relevant lease or, where it is likely the Group will obtain ownership of the asset, the life of the asset, as set out in note 4(s). Impairment allowances are accounted for in accordance with the accounting policy as set out in note 4(v). Finance charges implicit in the lease payments are charged to the income statement over the period of the leases so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period. Contingent rentals are written off as an expense of the accounting period in which they are incurred.

(ii) Operating leases

Where the Group leases out assets under operating leases, the assets are included in the balance sheet according to their nature and, where applicable. Rental revenue arising from operating lease is recognised in accordance with the Group's revenue recognition policies as set out in note 4(b)(ii).

(v) Impairment of assets

The carrying amount of the Group's assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, the carrying amount is reduced to the estimated recoverable amount by means of a charge to the income statement.

The accounting policies on impairment losses on loans and receivables and goodwill are set out in notes 4(f) and 4(q) respectively.

(i) Held-to-maturity investments

For held-to-maturity investments, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets) on an individual basis.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement. The reversal of impairment is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(v) Impairment of assets (continued)

(ii) Available-for-sale financial assets

At each balance sheet date, an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset or group of assets. Impairment losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the income statement, is reclassified from equity to the income statement.

Impairment losses on available-for-sale debt securities are recognised within "Loan impairment charges" in the income statement and impairment losses on available-for-sale equity securities are recognised within "Gains less losses from financial investments and fixed assets" in the income statement.

Once an impairment loss has been recognised on an available-for-sale financial asset, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the nature of the available-for-sale financial asset concerned:

- for an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in the income statement if, and only if there is objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income and accumulated separately in equity. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement to the extent of the increase in fair value; and

- for an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised in other comprehensive income and accumulated separately in equity. Impairment losses recognised on the equity security are not reversed through the income statement. Subsequent decreases in the fair value of the available-for-sale equity security are recognised in the income statement, only to the extent that further cumulative impairment losses have been incurred in relation to the acquisition cost of the equity security.

(iii) Other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following types of assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased:

- premises and equipment (other than properties carried at revalued amounts);

- pre-paid interests in leasehold land classified as "Interest in leasehold land held for own use under operating lease";

- investments in subsidiaries and associates; and

- intangible assets.

If any such indication exists, the asset's recoverable amount is estimated and impairment losses recognised.

Calculation of recoverable amount

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the assets. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(v) Impairment of assets (continued)

(iii) Other assets (continued)

Recognition of impairment losses

An impairment loss is recognised in the income statement whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

Reversals of impairment losses

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognised.

(w) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the income statement except to the extent that they relate to items recognised in other comprehensive income or directly in equity, in which case the relevant amounts of tax are recognised in other comprehensive income or directly in equity, respectively. Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset.

Current tax is the expected tax payable on the taxable profits for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities are settled on an individual taxable entity basis.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purpose and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available, against which deductible temporary differences can be utilised.

Deferred tax is calculated using the tax rates that are expected to apply in the periods in which the assets will be realised or the liabilities settled. Deferred tax assets and liabilities are not discounted. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when a legal right to offset exists in the entity.

The carrying amount of deferred tax assets/liabilities is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised.

(x) Employee benefits

(i) Salaries, annual bonuses, paid annual leave, leave passage and the cost to the Group of non-monetary benefits are accrued in the year in which the associated services are rendered by the employees. Provision is made in respect of paid leave entitlement accumulated during the year, which can be carried forward into future periods for compensated absence or payment in lieu if the employee leaves employment.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(x) Employee benefits (continued)

(ii) The Group provides retirement benefits for staff members and operates defined benefit and defined contribution schemes and participates in mandatory provident fund schemes in accordance with the relevant laws and regulations.

The retirement benefit costs of defined benefit schemes charged to the income statement are determined by calculating the current service cost, interest cost and expected return on scheme assets in accordance with a set of actuarial assumptions. Any actuarial gains and losses are fully recognised in shareholders' equity and presented in the statement of changes in equity in the period in which they arise.

The Group's net obligation in respect of defined benefit schemes is calculated separately for each scheme by estimating the amount of future benefit that employees have earned in return for their service in the current and prior years; that benefit is discounted to determine the present value, and the fair value of any scheme assets is deducted. The discount rate is the yield at the balance sheet date on high quality corporate bonds that have maturity dates approximating the terms of the Group's obligation. The calculation is performed by a qualified actuary using the Projected Unit Credit Method.

Where the calculation of the Group's net obligation results in a negative amount, the asset recognised is limited to the present value of any future refunds from the scheme or reductions in future contributions to the scheme less past service cost.

The retirement benefit costs of defined contribution schemes and mandatory provident fund schemes are the contributions made in accordance with the relative scheme rules and are charged to the income statement of the year.

(y) Share-based payments

The cost of share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted, and recognised as an expense on a straight-line basis over the vesting period, with a corresponding credit to the "Other reserves". The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately.

Fair value is determined by using market prices or appropriate valuation models, taking into account the terms and conditions upon which the equity instruments were granted. Market performance conditions are taken into account when estimating the fair value of equity instruments at the date of grant, so that an award is treated as vesting irrespective of whether the market performance condition is satisfied, provided all other conditions are satisfied.

Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

Where an award has been modified, as a minimum, the expense of the original award continues to be recognised as if it had not been modified. Where the effect of a modification is to increase the fair value of an award or increase the number of equity instruments, the incremental fair value of the award or incremental fair value of the extra equity instruments is recognised in addition to the expense of the original grant, measured at the date of modification, over the modified vesting period.

A cancellation that occurs during the vesting period is treated as an acceleration of vesting, and recognised immediately for the amount that would otherwise have been recognised for services over the vesting period.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(z) Translation of foreign currencies

Foreign currency transactions during the year are translated at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rates ruling at the balance sheet date. Exchange gains and losses are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

Exchange differences arising from the re-translation of opening foreign currency net investments and the related cost of hedging, if any, and exchange differences arising from re-translation of the result for the year from the average rate to the exchange rate ruling at the year-end, are recognised in other comprehensive income and accumulated separately in equity in the foreign exchange reserve. Exchange differences on a monetary item that is part of a net investment in a foreign operation are recognised in the income statement of separate subsidiary financial statements. In the consolidated financial statements, these exchange differences are recognised in other comprehensive income and accumulated separately in equity in the foreign exchange reserve.

(aa) Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation as a result of past events and a reliable estimate can be made as to the amount of the obligation.

(ab) Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of the loans or debt instruments.

Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). Financial guarantees are included within other liabilities.

(ac) Insurance contracts

Through its insurance subsidiaries, the Group issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which the Group accepts significant insurance risk from another party, by agreeing to compensate that party on the occurrence of a specified uncertain future event, is classified as an insurance contract. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant.

A contract issued by the Group that transfers financial risk, without significant insurance risk, is classified as an investment contract, and is accounted for as a financial instrument. The financial assets held by the Group for the purpose of meeting liabilities under insurance and investment contracts are classified and accounted for based on their classifications as set out in notes 4(d) to 4(i).

Insurance contracts are accounted for as follows:

Net earned insurance premiums

Premiums for life insurance are accounted for when receivable, except in unit-linked business where premiums are accounted for when liabilities are recognised.

Gross insurance premiums for general insurance business are accounted for in the period in which the amount is determined, which is generally the period in which the risk commences. The proportion of premiums written in the accounting year relating to the period of risk after the balance sheet date is carried forward as a provision for unearned premium and is calculated on a daily pro rata basis.

Reinsurance premiums, netted by the reinsurers' share of provision for unearned premiums, are accounted for in the same accounting year as the premiums for the direct insurance to which they relate.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(ac) Insurance contracts (continued)

Claims and reinsurance recoveries

Gross insurance claims for life insurance reflect the total cost of claims arising during the year, including policyholder cash dividend payment upon policy anniversary and payments of maturities, surrenders and death claims. The technical reserves for non-linked liabilities (long-term business provision) are calculated based on actuarial principles. The technical reserves for linked liabilities are at least the element of any surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices. Reinsurance recoveries are accounted for in the same period as the related claims.

Gross insurance claims for general insurance business include paid claims and movements in outstanding claims reserves. Full provision for outstanding claims is made for the estimated cost of all claims notified but not settled at the balance sheet date, and claims incurred but not reported by that date. Provision is also made for the estimated cost of servicing claims notified but not settled at the balance sheet date, reduced by estimates of salvage and subrogation recoveries, and to meet expenses on claims incurred but not reported. Reinsurance recoveries are assessed in a manner similar to the assessment of provision for outstanding claims.

Deferred acquisition costs

The deferred acquisition costs related to insurance contract, such as initial commission, are amortised over the period in which the related revenues are earned.

Present value of in-force long-term insurance business

A value is placed on insurance contracts that are classified as long-term insurance business and are in force at the balance sheet date is recognised as an asset.

The value of the in-force long-term insurance business, referred to as PVIF, is determined by discounting future earnings expected to emerge from business currently in force, using appropriate assumptions in assessing factors such as future mortality, lapse rates, levels of expenses and a risk discount rate that reflects the risk premium attributable to the respective long-term insurance business. The calculation of the PVIF asset was refined during the year by incorporating the explicit margins and allowances for certain risks and uncertainties in place of implicit adjustments to the discount rate. The valuation has also included explicit risk margins for non-economic risks in the projection assumptions, and explicit allowances for financial options and guarantees using stochastic methods. Risk discount rates are set on an active basis with reference to market risk free yields. Movements in the value of in-force long-term insurance business are included in other operating income on a pre-tax basis. The value of in-force long-term insurance business is reported under "Intangible assets" in the balance sheet.

(ad) Investment contracts

Customer liabilities under linked investment contracts are measured at fair value and reported under "Financial liabilities designated at fair value". The linked financial assets are measured at fair value and the movements in fair value are recognised in the income statement in "Net income from financial instruments designated at fair value". Deposits receivable and amounts withdrawn are accounted for as increases or decreases in the liability recorded in respect of investment contracts.

Investment management fee receivables are recognised in the income statement over the period of the provision of the investment management services.

(ae) Debt securities in issue and subordinated liabilities

Debt securities in issue and subordinated liabilities are measured at amortised cost using the effective interest rate method, and are reported under "Debt securities in issue" or "Subordinated liabilities", except for those issued for trading or designated at fair value, which are carried at fair value and reported under the "Trading liabilities" and "Financial liabilities designated at fair value" in the balance sheet.

(af) Assets held for sale

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use are classified as "Assets held for sale". Immediately before classification as Assets held for sale, the assets are remeasured in accordance with the Group's accounting policies set out elsewhere in note 4. Thereafter, generally the assets are measured at the lower of their carrying amount and fair value less cost to sell. Impairment losses on initial classification as Assets held for sale and subsequent gains or losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

4. PRINCIPAL ACCOUNTING POLICIES (continued)

(ag) Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are members of the same group. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities which are under the significant influence of related parties of the Group and post employment benefit scheme. Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Bank and its holding companies, directly or indirectly, including any directors (whether executive or otherwise) and Executive Committee members of the Bank and its holding companies.

(ah) Dividends

Dividends proposed or declared after the balance sheet date are disclosed as a separate component of shareholders' equity.

5. CHANGES IN ACCOUNTING POLICIES

The Group adopted a number of amendments to HKFRSs and interpretations which had insignificant or no effect on the consolidated financial statements. These are:

- Amendments to HKAS 32 "Financial Instruments: Presentation – Classification of Rights Issues";
- Amendment to Hong Kong (IFRIC) Interpretation 14 "HKAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction" – "Prepayments of a Minimum Funding Requirement";
- Hong Kong (IFRIC) Interpretation 19 "Extinguishing Financial Liabilities with Equity Instruments"; and
- Other amendments made under "Improvements to HKFRSs" in May 2010.

During the year, the Group adopted the following amendments to HKFRSs:

The Improvements to HKFRS 7 which the Group adopted are applied retrospectively and emphasise the interaction between quantitative and qualitative disclosures, and the nature and extent of risks associated with financial instruments. The new disclosures have been included in note 61(a)(ii) under "Financial Risk Management".

The Group also adopted the revised Hong Kong Accounting Standard 24, "Related Party Disclosures" ("the revised standard") which is effective for annual periods beginning on or after 1 January 2011 and with retrospective application. The revised standard clarifies the definition of a related party and upon adoption, transactions with associates of immediate and ultimate holding companies are identified as related party transactions with the Group. The prior year comparatives under "Associates" in note 60(a) have been adjusted accordingly:

(i) For the Group

Figures in HK$m	As reported	Adjustment	Restated
Interest income	11	37	48
Other operating income	1	5	6
Amounts due from:			
Placings with and advances to banks and other financial institutions	1,141	4,406	5,547

(ii) For the Bank

Figures in HK$m	As reported	Adjustment	Restated
Amounts due from:			
Placings with and advances to banks and other financial institutions	552	3,016	3,568

6. ACCOUNTING ESTIMATES AND JUDGEMENTS

Key sources of estimation uncertainty and critical judgements in applying the Group's accounting policies which have significant effect on the financial statements are set out below.

(a) Key sources of estimation uncertainty

(i) Impairment allowances on loans and advances

The Group periodically reviews its loan portfolios to assess whether impairment allowances exist. In determining whether impairment allowances should be recorded in the income statement, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the Group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(ii) Valuation of financial instruments

The Group's accounting policy for valuation of financial instruments is included in note 4(n) and is discussed further within note 62 "Fair value of financial instruments".

When fair values are determined by using valuation techniques which refer to observable market data because independent prices are not available, management will consider the following when applying a valuation model:

- the likelihood and expected timing of future cash flows on the instrument. These cash flows are usually governed by the terms of the instrument, although management judgement may be required when the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt;

- an appropriate discount rate for the instrument. Management uses all relevant market information in determining the appropriate spread over the risk-free/benchmark rate used by market participants for the particular instrument; and

- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivatives.

When valuing instruments by reference to comparable instruments, management takes into account the maturity, structure, liquidity, credit rating and other market factors of the instrument with which the position held is being compared. When valuing instruments on a model basis using the fair value of underlying components, management also considers the need for adjustments to take into account of factors such as bid-offer spread, credit profile, model limitation and any other factors market participants would consider in the valuation of that instrument. These adjustments are based on defined policies which are applied consistently across the Group.

When unobservable market data have a significant impact on the valuation of derivatives, the entire initial change in fair value indicated by the valuation model is recognised on one of the following bases: over the life of the transaction on an appropriate basis; in the income statement when the inputs become observable; or when the transaction matures or is closed out.

Financial instruments measured at fair value through profit or loss comprise of financial instruments held for trading and financial instruments designated at fair value. Changes in their fair value directly impact the Group's income statement in the period in which they occur.

A change in the fair value of a financial asset which is classified as "available-for-sale" is recorded directly in equity until the financial asset is sold, when the cumulative change in fair value is charged or credited to the income statement. When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is reclassified from equity to the income statement, reducing the Group's operating profit.

6. ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

(a) Key sources of estimation uncertainty (continued)

(iii) Insurance contracts

Classification

HKFRS 4 – Insurance Contracts ("HKFRS 4") requires the Group to determine whether an insurance contract that transfers both insurance risk and financial risk is classified as an insurance contract, or as a financial instrument under HKAS 39, or whether the insurance and non-insurance elements of the contract should be accounted for separately. This process involves judgement and estimation of the amounts of different types of risks that are transferred or assumed under a contract. The estimation of such risks often involves the use of assumptions about future events and is thus subject to a degree of uncertainty.

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

The value of PVIF, which is recorded as an intangible asset, depends upon assumptions regarding future events. These are described in more detail in note 41(a). The assumptions are reassessed at each reporting date and changes in the estimates which affect the value of PVIF are reflected in the income statement.

Insurance liabilities

The estimation of insurance claims liabilities involves selecting statistical models and making assumptions about future events which need to be frequently calibrated against experience and forecasts. The sensitivity of insurance liabilities to potential changes in key assumptions is set out in note 61(d).

(b) Critical accounting judgements in applying the Group's accounting policies

(i) Impairment of available-for-sale financial assets

For available-for-sale financial assets, a significant or prolonged decline in fair value below cost is considered to be objective evidence of impairment. Judgement is required when determining whether a decline in fair value has been significant or prolonged. In making this judgement, the historical data on market volatility as well as the price of the specific investment are taken into account. The Group also takes into account other factors, such as industry and sector performance and financial information regarding the issuer/investee.

(ii) Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity investments if the Group has the intention and ability to hold them until maturity. In evaluating whether the requirements to classify a financial asset as held-to-maturity are met, management makes significant judgements. Failure in correctly assessing the Group's intention and ability to hold specific investments until maturity may result in reclassification of the whole portfolio as available-for-sale.

(iii) Income taxes

Determining income tax provisions involves judgement on the future tax treatment of certain transactions. The Group carefully evaluates tax implications of transactions and tax provisions are set up accordingly. The tax treatment of such transactions is reconsidered periodically to take into account all changes in tax legislations.

7. POSSIBLE IMPACT OF AMENDMENTS AND NEW STANDARDS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31 DECEMBER 2011

The HKICPA has issued a number of amendments and new standards which are not yet effective for the year ended 31 December 2011 and which have not been adopted in the financial statements. Key changes are summarised as follows:

- Amendment to HKFRS 7 "Financial Instruments: Disclosures" issued in October 2010 which requires additional disclosures for risk exposures arising from transferred financial assets, will be effective for annual periods beginning on or after 1 July 2011, with early adoption permitted. No disclosures are required for prior periods.

- Amendment to HKAS 12 "Income Taxes" issued in December 2010 whereby deferred taxes on an investment property, carried under the fair value model in IAS 40, will be measured presuming that an investment property is recovered entirely through sale. The presumption is rebutted if the investment property is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale. The amendment will be effective for annual periods beginning on or after 1 January 2012 with early adoption permitted. The Group is currently assessing the impact of this new HKFRS and expected the balance of deferred tax liabilities on investment properties would be reduced.

7. POSSIBLE IMPACT OF AMENDMENTS AND NEW STANDARDS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31 DECEMBER 2011 (continued)

- Amendment to HKAS 1 "Presentation of financial statements" issued in July 2011 which requires grouping of items presented in other comprehensive income on the basis of whether they are potentially reclassifiable to profit or loss subsequently, will be effective for annual periods beginning on or after 1 July 2012, with early adoption permitted.

- HKAS 28 (2011) "Investments in associates and joint ventures", HKFRS 10 "Consolidated Financial Statements" ("HKFRS 10"), HKFRS 11 "Joint Arrangements" ("HKFRS 11") and HKFRS 12 "Disclosure of Interests in Other Entities" ("HKFRS 12") will be effective for annual periods beginning on or after 1 January 2013, with early adoption permitted.

  Under HKFRS 10, there will be one approach for determining consolidation for all entities, based on the concept of power, variability of returns and their linkage. This will replace the current approach which emphasises legal control or exposure to risks and rewards, depending on the nature of the entity. HKFRS 11 places more focus on rights and obligations than on legal form, and introduces the concept of a joint operation. It requires a joint venturer to recognise an investment and to account for that investment using the equity method in accordance with HKAS 28, unless the entity is exempted from applying the equity method as specified in that standard. HKFRS 12 includes the disclosure requirements for subsidiaries, joint arrangements and associates and introduces new requirements for unconsolidated structured entities.

  The Group is currently assessing the impact of these new HKFRSs but it is impracticable to quantify their effect as at the date of publication of these consolidated financial statements.

- HKFRS 13 "Fair Value Measurement" ("HKFRS 13") will be effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. HKFRS 13 is required to be applied prospectively from the beginning of the first annual period in which it is applied. The disclosure requirements of HKFRS 13 do not require comparative information to be provided for periods prior to initial application.

  HKFRS 13 establishes a single source of guidance for all fair value measurements required or permitted by HKFRSs. The standard clarifies the definition of fair value as an exit price, which is defined as a price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions, and enhances disclosures about fair value measurement.

  The Group is currently assessing the impact of this new HKFRS but it is impracticable to quantify its effect as at the date of publication of these consolidated financial statements.

- Amendments to HKAS 19 "Employee Benefits" ("HKAS 19 revised") issued in July 2011 will be effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. HKAS 19 revised must be applied retrospectively.

  The most significant amendment to HKAS 19 for the Group is the replacement of interest cost and expected return on plan assets by a finance cost component comprising the net interest on the net defined benefit liability or asset. This finance cost component is determined by applying the same discount rate used to measure the defined benefit obligation to the net defined benefit liability or asset. The difference between the actual return on plan assets and the return included in the finance cost component in the income statement will be presented in other comprehensive income. The effect of this change is to increase the pension expense by the difference between the current expected return on plan assets and the return calculated by applying the relevant discount rate.

  Based on an initial estimate of the impact of this particular amendment on the 2011 consolidated financial statements, the change would decrease pre-tax profit, with no effect on the pension liability. The effect on total operating expenses and pre-tax profit is not expected to be material. The effect at the date of adoption will depend on market interest rates, rates of return and the actual mix of scheme assets at that time.

7. POSSIBLE IMPACT OF AMENDMENTS AND NEW STANDARDS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31 DECEMBER 2011 (continued)

- Amendments to HKFRS 7 "Disclosures – Offsetting Financial Assets and Financial Liabilities" issued in December 2011 requires disclosures about the effect or potential effects of offsetting financial assets and financial liabilities and related arrangements on an entity's financial position. The amendments are effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. The amendments are required to be applied retrospectively.

- Amendments to HKAS 32 "Offsetting Financial Assets and Financial Liabilities" issued in December 2011 clarified the requirements for offsetting financial instruments and addressed inconsistencies in current practice when applying the offsetting criteria in HKAS 32 "Financial Instruments: Presentation". The amendments are effective for annual periods beginning on or after 1 January 2014 with early adoption permitted and are required to be applied retrospectively. The Group is currently assessing the impact of these clarifications but it is impracticable to quantify its effect as at the date of publication of these consolidated financial statements.

- HKFRS 9 "Financial Instruments" ("HKFRS 9") was issued in November 2009 and establishes new principles for the classification and measurement of financial assets. In December 2010, the HKICPA issued additions to HKFRS 9 dealing with financial liabilities. The main changes to the requirements of HKAS 39 are summarised below.

  All financial assets are classified into two measurement categories: amortised cost or fair value on the basis of both an entity's business model for managing groups of financial assets and the contractual cash flow characteristics of the individual assets. These two categories replace the four categories under the current HKAS 39 "Financial Instruments: Recognition and Measurement".

  Financial assets are measured at fair value through profit or loss, if they do not meet the criteria specified for measurement at amortised cost or if doing so significantly reduces or eliminates an accounting mismatch. An entity has the option to designate all subsequent changes in fair value of an equity instrument not held for trading at fair value through other comprehensive income with no recycling of gains or losses to the income statement. Dividend income would continue to be recognised in the income statement.

  Financial assets which contain embedded derivatives are to be classified in their entirety either at fair value or amortised cost depending on whether the contracts as a whole meet the relevant criteria under HKFRS 9.

  HKFRS 9 retains all the existing requirements for derecognition of financial instruments and most of the requirements for financial liabilities, except that for financial liabilities designated under the fair value option other than loan commitments and financial guarantee contracts, fair value changes attributable to changes in own credit risk are to be presented in the statement of other comprehensive income, and are not subsequently reclassified to income statement but may be transferred within equity.

  HKFRS 9 is mandatory for annual periods beginning on or after 1 January 2015 with earlier application permitted. In December 2011, the amendment to HKFRS 9 and HKFRS 7 issued by HKICPA provided relief from the requirement to restate prior period comparative information and required additional disclosures on transition from HKAS 39 to HKFRS 9. The Group is presently studying the implications of applying HKFRS 9 but it is impracticable to quantify its effect as at the date of publication of these consolidated financial statements.

8. INTEREST INCOME/INTEREST EXPENSE

(a) Interest income

	2011	2010
Interest income arising from:		
– financial assets that are not at fair value through profit and loss	**19,535**	16,228
– trading assets	**251**	197
– financial assets designated at fair value	**59**	82
	19,845	16,507
of which:		
– interest income from listed investments	**1,585**	1,436
– interest income from unlisted investments	**3,387**	3,072
– interest income from impaired financial assets	**18**	48

(b) Interest expense

	2011	2010
Interest expense arising from:		
– financial liabilities that are not at fair value through profit and loss	**3,010**	1,769
– trading liabilities	**1,099**	435
– financial liabilities designated at fair value	**–**	3
	4,109	2,207
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	**197**	63

9. NET FEE INCOME

	2011	2010
– stockbroking and related services	**1,285**	1,468
– retail investment funds	**905**	1,039
– structured investment products	**13**	19
– insurance agency	**242**	256
– account services	**371**	349
– private banking service fee	**129**	160
– remittances	**273**	259
– cards	**1,676**	1,462
– credit facilities	**253**	195
– trade services	**461**	452
– other	**315**	236
Fee income	**5,923**	5,895
Fee expense	**(1,087)**	(998)
	4,836	4,897
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	**1,967**	1,810
– fee income	**2,761**	2,452
– fee expense	**(794)**	(642)
Net fee income on trust and other fiduciary activities where the Group holds or invests on behalf of its customers	**685**	773
– fee income	**823**	973
– fee expense	**(138)**	(200)

10. TRADING INCOME

	2011	2010
Foreign exchange	**1,843**	1,768
(Losses)/gains from hedging activities:		
– fair value hedge		
– on hedging instruments	**(603)**	(261)
– on the hedged items attributable to the hedged risk	**538**	272
– cash flow hedge		
– net hedging income	**–**	–
Securities, derivatives and other trading activities	**18**	280
	1,796	2,059

11. NET (LOSS)/INCOME FROM FINANCIAL INSTRUMENTS DESIGNATED AT FAIR VALUE

	2011	2010
Net (loss)/income on assets designated at fair value which back insurance and investment contracts	(160)	297
Net change in fair value of other financial instruments designated at fair value	–	(15)
	(160)	282
of which dividend income from:		
– listed investments	16	3
– unlisted investments	1	1
	17	4

12. DIVIDEND INCOME

	2011	2010
Dividend income:		
– listed investments	4	2
– unlisted investments	13	12
	17	14

13. NET EARNED INSURANCE PREMIUMS

	Non-life insurance	Life insurance (non-linked)	Life insurance (linked)	Total
2011				
Gross written premiums	456	10,802	9	11,267
Movement in unearned premiums	(12)	–	–	(12)
Gross earned premiums	444	10,802	9	11,255
Gross written premiums ceded to reinsurers	(107)	(88)	–	(195)
Reinsurers' share of movement in unearned premiums	1	–	–	1
Reinsurers' share of gross earned premiums	(106)	(88)	–	(194)
Net earned insurance premiums	338	10,714	9	11,061
2010				
Gross written premiums	466	11,031	11	11,508
Movement in unearned premiums	(29)	–	–	(29)
Gross earned premiums	437	11,031	11	11,479
Gross written premiums ceded to reinsurers	(122)	(76)	–	(198)
Reinsurers' share of movement in unearned premiums	26	–	–	26
Reinsurers' share of gross earned premiums	(96)	(76)	–	(172)
Net earned insurance premiums	341	10,955	11	11,307

14. OTHER OPERATING INCOME

	2011	2010
Rental income from investment properties	**174**	155
Movement in present value of in-force long-term insurance business	**595**	1,126
Other	**152**	277
	921	1,558

15. NET INSURANCE CLAIMS INCURRED AND MOVEMENT IN POLICYHOLDERS' LIABILITIES

	Non-life insurance	Life insurance (non-linked)	Life insurance (linked)	Total
2011				
Claims, benefits and surrenders paid	**109**	**3,533**	**30**	**3,672**
Movement in provisions	**23**	**8,040**	**(41)**	**8,022**
Gross claims incurred and movement in policyholders' liabilities	**132**	**11,573**	**(11)**	**11,694**
Reinsurers' share of claims, benefits and surrenders paid	**(28)**	**(29)**	**–**	**(57)**
Reinsurers' share of movement in provisions	**(9)**	**(18)**	**–**	**(27)**
Reinsurers' share of claims incurred and movement in policyholders' liabilities	**(37)**	**(47)**	**–**	**(84)**
Net insurance claims incurred and movement in policyholders' liabilities	**95**	**11,526**	**(11)**	**11,610**
2010				
Claims, benefits and surrenders paid	113	2,402	24	2,539
Movement in provisions	21	10,085	4	10,110
Gross claims incurred and movement in policyholders' liabilities	134	12,487	28	12,649
Reinsurers' share of claims, benefits and surrenders paid	(26)	(22)	–	(48)
Reinsurers' share of movement in provisions	–	(14)	–	(14)
Reinsurers' share of claims incurred and movement in policyholders' liabilities	(26)	(36)	–	(62)
Net insurance claims incurred and movement in policyholders' liabilities	108	12,451	28	12,587

16. LOAN IMPAIRMENT CHARGES

	Group		Bank	
	2011	2010	**2011**	2010
Loan impairment charges (note 35(b)):				
– individually assessed	**(103)**	(186)	**(163)**	(97)
– collectively assessed	**(337)**	(204)	**(322)**	(185)
	(440)	(390)	**(485)**	(282)
of which:				
– new and additional	**(740)**	(609)	**(662)**	(475)
– releases	**222**	157	**112**	142
– recoveries	**78**	62	**65**	51
	(440)	(390)	**(485)**	(282)
Other credit risk provisions	**–**	–	**–**	–
	(440)	(390)	**(485)**	(282)

There was no impairment charge (2010: Nil) provided for available-for-sale debt securities by the Group and the Bank. There was also no impairment loss made in relation to held-to-maturity debt securities in 2011 (2010: Nil).

17. OPERATING EXPENSES

	2011	2010
Employee compensation and benefits:		
– salaries and other costs*	**3,566**	3,448
– retirement benefit costs		
– defined benefit scheme (note 58(a))	**230**	191
– defined contribution scheme (note 58(b))	**92**	78
	3,888	3,717
General and administrative expenses:		
– rental expenses	**497**	464
– other premises and equipment	**959**	902
– marketing and advertising expenses	**559**	470
– other operating expenses	**1,176**	1,081
	3,191	2,917
Depreciation of business premises and equipment (note 40(a))	**700**	619
Amortisation of intangible assets (note 41(c))	**119**	102
	7,898	7,355
* of which:		
share-based payments (note 59(e))	**88**	100
Cost efficiency ratio	**35.0%**	33.7%

Included in operating expenses are minimum lease payments under operating leases of HK$526 million (2010: HK$493 million).

18. THE EMOLUMENTS OF THE FIVE HIGHEST PAID INDIVIDUALS

(a) The aggregate emoluments

	2011	2010 (restated)
Salaries, allowances and benefits in kind	**20**	20
Retirement scheme contributions	**2**	2
Variable bonuses	**27**	26
	49	48

(b) The numbers of the five highest paid individuals whose emoluments fell within the following bands were:

	2011 Number of Individuals	2010 Number of Individuals (restated)
HK$		
5,000,001 – 5,500,000	**1**	2
5,500,001 – 6,000,000	**1**	–
6,500,001 – 7,000,000	**–**	1
7,000,001 – 7,500,000	**1**	1
8,000,001 – 8,500,000	**1**	–
22,000,001 – 22,500,000	**1**	–
23,000,001 – 23,500,000	**–**	1
	5	5

The basis of calculating the five highest paid individuals have been revised and details have been set out in note 19. The comparative figures for 2010 were restated to conform with current year presentation. The emoluments of the five highest paid individuals set out above include the emoluments of two (2010: two) Executive Directors and one Non-executive Director (2010: one). Their respective directors' emoluments are included in note 19.

19. DIRECTORS' EMOLUMENTS

The emoluments of the Directors of the Bank calculated in accordance with section 161 of the Hong Kong Companies Ordinance were:

				Variable bonus [5]			
	Fees '000	Salaries, allowances and benefits in kind '000	Pension and Pension contribution[4] '000	Cash[6] '000	Shares[6] '000	Total 2011 '000	Total 2010 '000 (restated)
Executive Directors							
Mrs Margaret Leung[2]	–	5,999	825	7,786	7,786	22,396	23,450
Mr Andrew H C Fung[2] (Appointed on 10 October 2011)	–	722	39	589	1,110[7]	2,460	–
Mr William W C Leung[2] (Resigned on 20 August 2011)	–	2,353	287	–	–	2,640	5,025
Non-Executive Directors							
Dr Raymond K F Ch'ien[3]	500	–	–	–	–	500	367
Dr John C C Chan[3]	430	–	–	–	–	430	340
Dr Marvin K T Cheung[3]	500	–	–	–	–	500	360
Ms L Y Chiang[3]	340	–	–	–	–	340	93
Mr Alexander A Flockhart[1] (Resignation took effect from the close of business on 31 December 2010)	–	–	–	–	–	–	280
Ms Anita Y M Fung[1] (Appointed on 1 November 2011)	56	–	–	–	–	56	–
Dr Fred Zuliu Hu[3] (Appointed on 30 May 2011)	227	–	–	–	–	227	–
Mr Jenkin Hui[3]	400	–	–	–	–	400	320
Ms Sarah C Legg[1] (Appointed on 14 February 2011)	312	–	–	–	–	312	–
Dr Eric K C Li[3]	600	–	–	–	–	600	400
Dr Vincent H S Lo	340	–	–	–	–	340	280
Mr Iain J Mackay[1] (Resignation took effect from the close of business on 31 December 2010)	–	–	–	–	–	–	280
Mr Mark S Mccombe[1] (Appointed on 14 February 2011 and resigned on 9 September 2011)	227	–	–	–	–	227	–
Mrs Dorothy K Y P Sit[2]	–	3,946	414	2,660	1,140	8,160	7,455
Mr Richard Y S Tang[3]	623	–	–	–	–	623	478
Mr Peter T S Wong[1]	340	–	–	–	–	340	280
Mr Michael W K Wu[3]	340	–	–	–	–	340	93
Past Directors	–	–	2,206	–	–	2,206	2,169
	5,235	13,020	3,771	11,035	10,036	43,097	41,670
2010 (restated)	3,571	13,469	3,786	10,879	9,965		

Notes :

(1) Fees receivable as a Director of Hang Seng Bank Limited were surrendered to The Hongkong and Shanghai Banking Corporation Limited in accordance with the HSBC Group's internal policy.

(2) Fee receivable as a Director of Hang Seng Bank Limited were waived by the Directors in 2011.

(3) Independent Non-Executive Director.

(4) The aggregate amount of pensions received by the past Directors of the Bank under the relevant pension schemes amounted to HK$2.2 million in 2011. The Bank made contributions during 2011 into the pension schemes of which the Bank's past Directors are among their members. The contributions serve to maintain the funding positions of these schemes in respect of liabilities to all scheme members, including but not limited to the past Directors. The amount of contribution attributable to any specific scheme member is not determinable.

(5) The amount of bonus comprises the cash and the estimated purchase cost of the award of HSBC Holdings Restricted Share and Performance Share which is measured according to the Group's accounting policies for share-based payment as set out in note 4(y). Prior to 2011, the accrued bonus amount in respect of the cash portion was based on the amount paid during the year while the shares portion was based on the amortised amount of purchase cost of the awarded shares. In order to align with the Basel Committee's paper on "Pillar 3 Disclosure requirements for remunerations" issued in July 2011, the amount of bonus disclosed in 2011 have been revised which represented the amount of cash and the purchase cost of shares on accrual basis in respect of the Directors' services rendered in the year. The comparative figures for the year 2010 were also restated to conform with current year presentation. The bonus comprises the deferred and non-deferred bonus, details of which are also set out in the section of "remuneration of senior management and key personnel" under "Corporate Governance and Other Information". The details are also set out in note 59.

(6) The bonus – cash portion payable to the above directors was on non-deferred basis except HK$4.67 million (2010: HK$4.64 million) payable to Mrs Margaret Leung which was on deferred basis. The bonus - share portion payable to the above directors was on deferred basis except HK$3.11 million (2010: HK$3.10 million) payable to Mrs Margaret Leung which was on non-deferred basis.

(7) The amount represented the share payable to Mr Andrew H C Fung in 2011 and have not been pro-rata from the date of being appointed as Director of the Bank.

20. AUDITORS' REMUNERATION

	Group		Bank	
	2011	2010	**2011**	2010
Statutory audit services	**13**	13	**8**	8
Non-statutory audit services and others	**7**	6	**6**	5
	20	19	**14**	13

21. GAINS LESS LOSSES FROM FINANCIAL INVESTMENTS AND FIXED ASSETS

	2011	2010
Net gains from disposal of available-for-sale equity securities:		
– reclassified from reserve	**25**	9
– net gains arising in the year	**17**	1
	42	10
Net gains from disposal of available-for-sale debt securities	**11**	95
Impairment of available-for-sale equity securities	**–**	–
Gain on disposal of assets held for sale	**–**	12
Losses on disposal of fixed assets	**(3)**	(5)
	50	112

There was no impairment losses or gains less losses on disposal of held-to-maturity debt securities, loans and receivables and financial liabilities measured at amortised cost for 2011 and 2010.

22. NET SURPLUS ON PROPERTY REVALUATION

	2011	2010
Surplus of revaluation on investment properties (note 39(a))	**982**	474
Surplus of revaluation on assets held for sale	**8**	10
Reversal of revaluation deficit on premises (note 40(a))	**2**	3
	992	487

23. TAX EXPENSE

(a) Taxation in the consolidated income statement represents:

	2011	2010
Current tax – provision for Hong Kong profits tax		
Tax for the year	**1,942**	1,967
Adjustment in respect of prior year	**(14)**	(19)
	1,928	1,948
Current tax – taxation outside Hong Kong		
Tax for the year	**76**	38
Deferred tax (note 49(b))		
Origination and reversal of temporary differences	**529**	442
Total tax expense	**2,533**	2,428

The current tax provision is based on the estimated assessable profit for 2011, 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 (2010: 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 year when the liability is settled or the asset is realised.

(b) Reconciliation between taxation charge and accounting profit at applicable tax rates:

	2011	2010
Profit before tax	**19,213**	17,345
Notional tax on profit before tax, calculated at Hong Kong tax rate of 16.5% (2010: 16.5%)	**3,170**	2,862
Tax effect of:		
– different tax rates in other countries/areas	**(290)**	(172)
– non-taxable income and non-deductible expenses	**(34)**	(41)
– share of results of associates	**(658)**	(439)
– others	**345**	218
Actual charge for taxation	**2,533**	2,428

24. PROFIT ATTRIBUTABLE TO SHAREHOLDERS

Of the profit attributable to shareholders, HK$14,145 million (2010: HK$10,914 million) has been dealt with in the financial statements of the Bank.

Reconciliation of the above amount to the Bank's profit for the year:

	2011	2010
Amount of consolidated profit attributable to shareholders dealt with in the Bank's financial statements	**14,145**	10,914
Dividends declared during the year by subsidiaries from retained profits	**82**	565
The Bank's profit for the year	**14,227**	11,479

25. EARNINGS PER SHARE

The calculation of earnings per share for 2011 is based on earnings of HK$16,680 million (HK$14,917 million in 2010) and on the weighted average number of ordinary shares in issue of 1,911,842,736 shares (unchanged from 2010).

26. DIVIDENDS PER SHARE

(a) Dividends attributable to the year:

	2011		2010	
	per share HK$	**HK$ million**	per share HK$	HK$ million
First interim	**1.10**	**2,103**	1.10	2,103
Second interim	**1.10**	**2,103**	1.10	2,103
Third interim	**1.10**	**2,103**	1.10	2,103
Fourth interim	**1.90**	**3,633**	1.90	3,633
	5.20	**9,942**	5.20	9,942

The fourth interim dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date.

(b) Dividends attributable to the previous year, approved and paid during the year:

	2011	2010
Fourth interim dividend in respect of the previous year, approved and paid during the year, of HK$1.90 per share (2010: HK$1.90 per share)	**3,633**	3,633

27. SEGMENTAL ANALYSIS

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

Retail Banking and Wealth Management provides banking (including deposits, credit cards, mortgages and other retail lending) and wealth management services (including private banking, investment and insurance) to personal customers. Commercial Banking manages middle market and smaller corporate relationships and specialises in trade-related financial services. Corporate Banking handles relationships with large corporate and institutional customers. Treasury engages in balance sheet management. Treasury also manages the funding and liquidity positions of the Group and other market risk positions arising from banking activities. "Other" mainly represents management of shareholders' funds and investments in premises, investment properties and equity shares.

(a) Segment result

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

27. SEGMENTAL ANALYSIS (continued)

(a) Segment result (continued)

	Retail Banking and Wealth Management	Commercial Banking	Corporate Banking	Treasury	Other	Total reportable segments	Inter-segment elimination	Total
2011								
Net interest income	8,150	3,400	1,998	2,108	80	15,736	–	15,736
Net fee income/(expense)	3,298	1,210	219	(34)	143	4,836	–	4,836
Trading income/(loss)	351	530	13	1,001	(99)	1,796	–	1,796
Net loss from financial instruments designated at fair value	(158)	(1)	–	(1)	–	(160)	–	(160)
Dividend income	–	7	–	–	10	17	–	17
Net earned insurance premiums	10,820	239	2	–	–	11,061	–	11,061
Other operating income/(loss)	719	18	(1)	–	679	1,415	(494)	921
Total operating income	23,180	5,403	2,231	3,074	813	34,701	(494)	34,207
Net insurance claims incurred and movement in policyholders' liabilities	(11,487)	(122)	(1)	–	–	(11,610)	–	(11,610)
Net operating income before loan impairment charges	11,693	5,281	2,230	3,074	813	23,091	(494)	22,597
Loan impairment (charges)/releases	(254)	(233)	46	1	–	(440)	–	(440)
Net operating income	11,439	5,048	2,276	3,075	813	22,651	(494)	22,157
Operating expenses*	(5,177)	(1,836)	(436)	(346)	(597)	(8,392)	494	(7,898)
Impairment loss on intangible assets	(75)	(3)	–	–	–	(78)	–	(78)
Operating profit	6,187	3,209	1,840	2,729	216	14,181	–	14,181
Gains less losses from financial investments and fixed assets	20	11	3	12	4	50	–	50
Net surplus on property revaluation	–	–	–	–	992	992	–	992
Share of profits from associates	416	1,811	–	1,486	277	3,990	–	3,990
Profit before tax	6,623	5,031	1,843	4,227	1,489	19,213	–	19,213
Share of profit before tax	34.5%	26.2%	9.6%	22.0%	7.7%	100.0%	–	100.0%
Operating profit excluding loan impairment charges	6,441	3,442	1,794	2,728	216	14,621	–	14,621
** Depreciation/amortisation included in operating expenses*	(155)	(31)	(5)	(5)	(623)	(819)	–	(819)
Total assets	274,294	185,350	143,734	329,295	42,772	975,445	–	975,445
Total liabilities	596,593	149,416	64,736	51,897	34,048	896,690	–	896,690
Interest in associates	2,115	8,185	–	6,441	2,666	19,407	–	19,407
Non-current assets incurred during the year	160	49	5	4	204	422	–	422

27. SEGMENTAL ANALYSIS (continued)

(a) Segment result (continued)

	Retail Banking and Wealth Management	Commercial Banking	Corporate Banking	Treasury	Other	Total reportable segments	Inter-segment elimination	Total
2010								
Net interest income	8,485	2,709	1,440	1,403	263	14,300	–	14,300
Net fee income/(expense)	3,423	1,209	188	(29)	106	4,897	–	4,897
Trading income/(loss)	630	334	11	1,162	(78)	2,059	–	2,059
Net income/(loss) from financial instruments designated at fair value	297	–	–	(1)	(14)	282	–	282
Dividend income	–	5	–	–	9	14	–	14
Net earned insurance premiums	11,059	246	2	–	–	11,307	–	11,307
Other operating income/(loss)	1,271	23	1	(1)	712	2,006	(448)	1,558
Total operating income	25,165	4,526	1,642	2,534	998	34,865	(448)	34,417
Net insurance claims incurred and movement in policyholders' liabilities	(12,436)	(152)	1	–	–	(12,587)	–	(12,587)
Net operating income before loan impairment charges	12,729	4,374	1,643	2,534	998	22,278	(448)	21,830
Loan impairment charges	(209)	(178)	(3)	–	–	(390)	–	(390)
Net operating income	12,520	4,196	1,640	2,534	998	21,888	(448)	21,440
Total operating expenses*	(4,864)	(1,703)	(379)	(327)	(530)	(7,803)	448	(7,355)
Operating profit	7,656	2,493	1,261	2,207	468	14,085	–	14,085
Gains less losses from financial investments and fixed assets	–	–	5	95	12	112	–	112
Net surplus on property revaluation	–	–	–	–	487	487	–	487
Share of profits from associates	216	1,255	–	1,059	131	2,661	–	2,661
Profit before tax	7,872	3,748	1,266	3,361	1,098	17,345	–	17,345
Share of profit before tax	45.4%	21.6%	7.3%	19.4%	6.3%	100.0%	–	100.0%
Operating profit excluding loan impairment charges	7,865	2,671	1,264	2,207	468	14,475	–	14,475
** Depreciation/amortisation included in total operating expenses*	(175)	(34)	(5)	(4)	(503)	(721)	–	(721)
Total assets	264,827	180,013	130,148	304,898	37,025	916,911	–	916,911
Total liabilities	581,118	141,518	50,862	39,268	34,133	846,899	–	846,899
Interest in associates	1,384	6,197	–	5,626	2,459	15,666	–	15,666
Non-current assets incurred during the year	128	39	5	4	739	915	–	915

27. SEGMENTAL ANALYSIS (continued)

(b) Geographic Information

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

	2011		2010	
		%		%
Total operating income				
– Hong Kong	31,106	91	32,124	93
– Americas	1,339	4	1,047	3
– Mainland and others	1,762	5	1,246	4
	34,207	100	34,417	100
Profit before tax				
– Hong Kong	13,629	71	13,722	79
– Americas	1,307	7	996	6
– Mainland and others	4,277	22	2,627	15
	19,213	100	17,345	100
Total assets				
– Hong Kong	789,988	81	752,206	82
– Americas	58,506	6	68,216	7
– Mainland and others	126,951	13	96,489	11
	975,445	100	916,911	100
Total liabilities				
– Hong Kong	818,966	91	786,304	93
– Americas	1,085	–	1,187	–
– Mainland and others	76,639	9	59,408	7
	896,690	100	846,899	100
Interest in associates				
– Hong Kong	1,198	6	989	6
– Americas	–	–	–	–
– Mainland and others	18,209	94	14,677	94
	19,407	100	15,666	100
Non-current assets*				
– Hong Kong	27,258	96	22,262	96
– Americas	–	–	–	–
– Mainland and others	1,001	4	944	4
	28,259	100	23,206	100
Contingent liabilities and commitments				
– Hong Kong	246,655	83	223,659	83
– Americas	–	–	–	–
– Mainland and others	50,076	17	44,589	17
	296,731	100	268,248	100

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

28. ANALYSIS OF ASSETS AND LIABILITIES BY REMAINING MATURITY

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

	Group								
	Repayable on demand	One month or less but not on demand	Over one month but within three months	Over three months but within one year	Over one year but within five years	Over five years	Trading	No contractual maturity	Total
2011									
Assets									
Cash and balances with banks and other financial institutions	39,533	–	–	–	–	–	–	–	39,533
Placings with and advances to banks and other financial institutions	9,089	47,699	43,686	5,639	–	1,629	–	–	107,742
Trading assets	–	–	–	–	–	–	64,171	–	64,171
Financial assets designated at fair value	–	140	82	116	3,615	49	–	4,094	8,096
Derivative financial instruments	–	7	13	72	87	–	4,531	–	4,710
Advances to customers	11,131	39,239	43,024	89,609	164,318	133,253	–	–	480,574
Financial investments:									
– available-for-sale investments	–	10,940	19,648	68,426	47,510	1,621	–	1,134	149,279
– held-to-maturity debt securities	–	668	1,083	2,529	21,736	33,895	–	–	59,911
Interest in associates	–	–	–	–	–	–	–	19,407	19,407
Investment properties	–	–	–	–	–	–	–	4,314	4,314
Premises, plant and equipment	–	–	–	–	–	–	–	17,983	17,983
Intangible assets	–	–	–	–	–	–	–	5,962	5,962
Other assets	5,185	3,231	3,234	1,616	124	19	–	354	13,763
	64,938	101,924	110,770	168,007	237,390	170,466	68,702	53,248	975,445
Liabilities									
Current, savings and other deposit accounts	503,537	93,809	69,086	32,401	1,024	–	–	–	699,857
Deposits from banks	2,072	8,941	2,374	617	–	–	–	–	14,004
Trading liabilities	–	–	–	–	–	–	59,712	–	59,712
Financial liabilities designated at fair value	1	–	–	–	–	433	–	–	434
Derivative financial instruments	–	22	4	65	1,046	203	3,508	–	4,848
Certificates of deposit and other debt securities in issue:									
– certificates of deposit in issue	–	1,596	–	1,475	6,213	–	–	–	9,284
Other liabilities	6,629	4,205	3,343	1,817	64	19	–	4,061	20,138
Liabilities to customers under insurance contracts	–	–	–	–	–	–	–	72,225	72,225
Current tax liabilities	–	–	–	305	–	–	–	–	305
Deferred tax liabilities	–	–	–	–	–	–	–	4,037	4,037
Subordinated liabilities	–	–	–	2,328	–	9,518	–	–	11,846
	512,239	108,573	74,807	39,008	8,347	10,173	63,220	80,323	896,690
of which:									
Certificates of deposit included in:									
– trading assets	–	–	–	–	–	–	432	–	432
– financial assets designated at fair value	–	–	–	–	1	–	–	–	1
– available-for-sale investments	–	2,650	1,538	926	853	–	–	39	6,006
– held-to-maturity debt securities	–	–	6	429	673	2,272	–	–	3,380
	–	2,650	1,544	1,355	1,527	2,272	432	39	9,819
Debt securities included in:									
– trading assets	–	–	–	–	–	–	63,226	–	63,226
– financial assets designated at fair value	–	140	82	116	3,613	49	–	(2)	3,998
– available-for-sale investments	–	8,290	18,110	67,500	46,657	1,621	–	836	143,014
– held-to-maturity debt securities	–	668	1,077	2,100	21,063	31,623	–	–	56,531
	–	9,098	19,269	69,716	71,333	33,293	63,226	834	266,769
Certificates of deposit in issue included in:									
– trading liabilities	–	–	–	–	–	–	2,641	–	2,641
– financial liabilities designated at fair value	–	–	–	–	–	–	–	–	–
– issue at amortised cost	–	1,596	–	1,475	6,213	–	–	–	9,284
	–	1,596	–	1,475	6,213	–	2,641	–	11,925

28. ANALYSIS OF ASSETS AND LIABILITIES BY REMAINING MATURITY (continued)

	Group								
	Repayable on demand	One month or less but not on demand	Over one month but within three months	Over three months but within one year	Over one year but within five years	Over five years	Trading	No contractual maturity	Total
2010									
Assets									
Cash and balances with banks and other financial institutions	44,411	–	–	–	–	–	–	–	44,411
Placings with and advances to banks and other financial institutions	4,730	51,706	48,475	5,185	–	468	–	–	110,564
Trading assets	–	–	–	–	–	–	26,055	–	26,055
Financial assets designated at fair value	–	50	7	384	3,951	48	–	2,674	7,114
Derivative financial instruments	–	20	74	113	288	16	5,082	–	5,593
Advances to customers	10,198	65,179	34,733	71,444	151,430	139,653	–	–	472,637
Financial investments:									
– available-for-sale investments	–	8,957	12,112	56,453	63,465	1,216	–	855	143,058
– held-to-maturity debt securities	–	226	521	2,936	21,101	31,517	–	–	56,301
Interest in associates	–	–	–	–	–	–	–	15,666	15,666
Investment properties	–	–	–	–	–	–	–	3,251	3,251
Premises, plant and equipment	–	–	–	–	–	–	–	14,561	14,561
Intangible assets	–	–	–	–	–	–	–	5,394	5,394
Other assets	4,980	2,765	2,390	1,708	74	18	–	371	12,306
	64,319	128,903	98,312	138,223	240,309	172,936	31,137	42,772	916,911
Liabilities									
Current, savings and other deposit accounts	536,363	78,218	37,862	29,611	1,574	–	–	–	683,628
Deposits from banks	6,387	7,688	1,394	–	117	–	–	–	15,586
Trading liabilities	–	–	–	–	–	–	42,581	–	42,581
Financial liabilities designated at fair value	2	–	–	–	–	455	–	–	457
Derivative financial instruments	–	–	–	99	819	56	3,709	–	4,683
Certificates of deposit and other debt securities in issue:									
– certificates of deposit in issue	–	96	447	112	2,440	–	–	–	3,095
Other liabilities	6,954	3,293	2,597	1,598	97	25	–	2,454	17,018
Liabilities to customers under insurance contracts	–	–	–	–	–	–	–	64,425	64,425
Current tax liabilities	–	–	–	344	–	–	–	–	344
Deferred tax liabilities	–	–	–	–	–	–	–	3,234	3,234
Subordinated liabilities	–	–	–	3,495	2,328	6,025	–	–	11,848
	549,706	89,295	42,300	35,259	7,375	6,561	46,290	70,113	846,899
of which:									
Certificates of deposit included in:									
– trading assets	–	–	–	–	–	–	18	–	18
– financial assets designated at fair value	–	–	–	–	–	–	–	–	–
– available-for-sale investments	–	120	700	1,813	1,246	–	–	43	3,922
– held-to-maturity debt securities	–	20	79	259	861	1,572	–	–	2,791
	–	140	779	2,072	2,107	1,572	18	43	6,731
Debt securities included in:									
– trading assets	–	–	–	–	–	–	25,305	–	25,305
– financial assets designated at fair value	–	50	7	384	3,951	48	–	–	4,440
– available-for-sale investments	–	8,837	11,412	54,640	62,219	1,216	–	486	138,810
– held-to-maturity debt securities	–	206	442	2,677	20,240	29,945	–	–	53,510
	–	9,093	11,861	57,701	86,410	31,209	25,305	486	222,065
Certificates of deposit in issue included in:									
– trading liabilities	–	–	–	–	–	–	26	–	26
– financial liabilities designated at fair value	–	–	–	–	–	–	–	–	–
– issue at amortised cost	–	96	447	112	2,440	–	–	–	3,095
	–	96	447	112	2,440	–	26	–	3,121

28. ANALYSIS OF ASSETS AND LIABILITIES BY REMAINING MATURITY (continued)

Bank

	Repayable on demand	One month or less but not on demand	Over one month but within three months	Over three months but within one year	Over one year but within five years	Over five years	Trading	No contractual maturity	Total
2011									
Assets									
Cash and balances with banks and other financial institutions	36,475	–	–	–	–	–	–	–	36,475
Placings with and advances to banks and other financial institutions	5,429	19,521	20,877	1,897	–	–	–	–	47,724
Trading assets	–	–	–	–	–	–	60,526	–	60,526
Financial assets designated at fair value	–	140	–	–	–	–	–	–	140
Derivative financial instruments	–	7	13	28	20	–	4,368	–	4,436
Advances to customers	11,156	33,675	33,991	78,447	144,295	124,065	–	–	425,629
Amounts due from subsidiaries	57,743	2,469	10,655	8,133	6,222	–	–	–	85,222
Financial investments:									
– available-for-sale investments	–	9,307	14,809	55,856	23,108	1,621	–	441	105,142
Investments in subsidiaries	–	–	–	–	–	–	–	14,434	14,434
Interest in associates	–	–	–	–	–	–	–	5,172	5,172
Investment properties	–	–	–	–	–	–	–	2,806	2,806
Premises, plant and equipment	–	–	–	–	–	–	–	13,249	13,249
Intangible assets	–	–	–	–	–	–	–	408	408
Other assets	4,433	2,820	1,470	365	50	–	–	44	9,182
	115,236	67,939	81,815	144,726	173,695	125,686	64,894	36,554	810,545
Liabilities									
Current, savings and other deposit accounts	489,880	90,583	60,669	19,425	455	–	–	–	661,012
Deposits from banks	2,065	7,007	2,300	617	–	–	–	–	11,989
Trading liabilities	–	–	–	–	–	–	36,077	–	36,077
Derivative financial instruments	–	22	–	27	530	203	3,320	–	4,102
Certificates of deposit and other debt securities in issue:									
– certificates of deposit in issue	–	1,596	–	1,475	6,213	–	–	–	9,284
Amounts due to subsidiaries	6,143	4,629	22	3	–	–	–	–	10,797
Other liabilities	6,019	4,214	1,936	847	8	19	–	3,917	16,960
Current tax liabilities	–	–	–	270	–	–	–	–	270
Deferred tax liabilities	–	–	–	–	–	–	–	1,801	1,801
Subordinated liabilities	–	–	–	2,328	–	9,518	–	–	11,846
	504,107	108,051	64,927	24,992	7,206	9,740	39,397	5,718	764,138
of which:									
Certificates of deposit included in:									
– trading assets	–	–	–	–	–	–	432	–	432
– financial assets designated at fair value	–	–	–	–	–	–	–	–	–
– available-for-sale investments	–	2,650	1,538	926	853	–	–	39	6,006
– held-to-maturity debt securities	–	–	–	–	–	–	–	–	–
	–	2,650	1,538	926	853	–	432	39	6,438
Debt securities included in:									
– trading assets	–	–	–	–	–	–	59,581	–	59,581
– financial assets designated at fair value	–	140	–	–	–	–	–	–	140
– available-for-sale investments	–	6,657	13,271	54,930	22,255	1,621	–	340	99,074
– held-to-maturity debt securities	–	–	–	–	–	–	–	–	–
	–	6,797	13,271	54,930	22,255	1,621	59,581	340	158,795
Certificates of deposit in issue included in:									
– trading liabilities	–	–	–	–	–	–	2,641	–	2,641
– financial liabilities designated at fair value	–	–	–	–	–	–	–	–	–
– issue at amortised cost	–	1,596	–	1,475	6,213	–	–	–	9,284
	–	1,596	–	1,475	6,213	–	2,641	–	11,925

28. ANALYSIS OF ASSETS AND LIABILITIES BY REMAINING MATURITY (continued)

	Bank								
	Repayable on demand	One month or less but not on demand	Over one month but within three months	Over three months but within one year	Over one year but within five years	Over five years	Trading	No contractual maturity	Total
2010									
Assets									
Cash and balances with banks and other financial institutions	41,062	–	–	–	–	–	–	–	41,062
Placings with and advances to banks and other financial institutions	2,120	16,999	28,875	4,137	–	–	–	–	52,131
Trading assets	–	–	–	–	–	–	25,232	–	25,232
Financial assets designated at fair value	–	–	–	–	148	–	–	–	148
Derivative financial instruments	–	19	72	92	55	16	4,772	–	5,026
Advances to customers	10,187	61,578	25,706	62,337	134,127	129,139	–	–	423,074
Amounts due from subsidiaries	66,716	1,577	13,028	6,494	5,630	–	–	–	93,445
Financial investments:									
– available-for-sale investments	–	7,321	6,918	47,381	39,857	1,047	–	582	103,106
Investments in subsidiaries	–	–	–	–	–	–	–	11,584	11,584
Interest in associates	–	–	–	–	–	–	–	5,172	5,172
Investment properties	–	–	–	–	–	–	–	2,100	2,100
Premises, plant and equipment	–	–	–	–	–	–	–	10,588	10,588
Intangible assets	–	–	–	–	–	–	–	442	442
Other assets	4,652	2,176	1,298	538	17	–	–	106	8,787
	124,737	89,670	75,897	120,979	179,834	130,202	30,004	30,574	781,897
Liabilities									
Current, savings and other deposit accounts	526,103	73,458	32,405	16,145	1,033	–	–	–	649,144
Deposits from banks	6,386	7,688	1,394	–	117	–	–	–	15,585
Trading liabilities	–	–	–	–	–	–	30,106	–	30,106
Derivative financial instruments	–	–	–	95	587	44	3,802	–	4,528
Certificates of deposit and other debt securities in issue:									
– certificates of deposit in issue	–	96	447	112	2,440	–	–	–	3,095
Amounts due to subsidiaries	4,222	4,337	338	2	–	–	–	–	8,899
Other liabilities	6,704	2,912	1,739	805	26	18	–	3,230	15,434
Current tax liabilities	–	–	–	320	–	–	–	–	320
Deferred tax liabilities	–	–	–	–	–	–	–	1,617	1,617
Subordinated liabilities	–	–	–	3,495	2,328	6,025	–	–	11,848
	543,415	88,491	36,323	20,974	6,531	6,087	33,908	4,847	740,576
of which:									
Certificates of deposit included in:									
– trading assets	–	–	–	–	–	–	18	–	18
– financial assets designated at fair value	–	–	–	–	–	–	–	–	–
– available-for-sale investments	–	120	75	1,444	1,246	–	–	43	2,928
– held-to-maturity debt securities	–	–	–	–	–	–	–	–	–
	–	120	75	1,444	1,246	–	18	43	2,946
Debt securities included in:									
– trading assets	–	–	–	–	–	–	24,482	–	24,482
– financial assets designated at fair value	–	–	–	–	148	–	–	–	148
– available-for-sale investments	–	7,201	6,843	45,937	38,611	1,047	–	418	100,057
– held-to-maturity debt securities	–	–	–	–	–	–	–	–	–
	–	7,201	6,843	45,937	38,759	1,047	24,482	418	124,687
Certificates of deposit in issue included in:									
– trading liabilities	–	–	–	–	–	–	26	–	26
– financial liabilities designated at fair value	–	–	–	–	–	–	–	–	–
– issue at amortised cost	–	96	447	112	2,440	–	–	–	3,095
	–	96	447	112	2,440	–	26	–	3,121

29. ACCOUNTING CLASSIFICATIONS

The tables below set out the Group's classification of financial assets and liabilities:

	Group						
	Trading	Designated at fair value	Available-for-sale/ hedging	Held-to-maturity	Loans and receivables	Other amortised cost	Total
2011							
Cash and balances with banks and other financial institutions	–	–	–	–	–	39,533	39,533
Placings with and advances to banks and other financial institutions	–	–	–	–	107,742	–	107,742
Derivative financial instruments	4,531	–	179	–	–	–	4,710
Advances to customers	–	–	–	–	480,574	–	480,574
Investment securities	63,665	8,096	149,279	59,911	–	–	280,951
Acceptances and endorsements	–	–	–	–	–	4,697	4,697
Other financial assets	506	–	–	–	–	8,638	9,144
Total financial assets	68,702	8,096	149,458	59,911	588,316	52,868	927,351
Non-financial assets							48,094
Total assets							975,445
Current, savings and other deposit accounts	30,923	–	–	–	–	699,857	730,780
Deposits from banks	–	–	–	–	–	14,004	14,004
Derivative financial instruments	3,505	3	1,340	–	–	–	4,848
Certificates of deposit and other debt securities in issue	3,183	–	–	–	–	9,284	12,467
Other financial liabilities	25,606	–	–	–	–	11,290	36,896
Subordinated liabilities	–	–	–	–	–	11,846	11,846
Liabilities to customers under investment contracts	–	434	–	–	–	–	434
Acceptances and endorsements	–	–	–	–	–	4,697	4,697
Total financial liabilities	63,217	437	1,340	–	–	750,978	815,972
Non-financial liabilities							80,718
Total liabilities							896,690

29. ACCOUNTING CLASSIFICATIONS (continued)

	Group						
	Trading	Designated at fair value	Available-for-sale/ hedging	Held-to-maturity	Loans and receivables	Other amortised cost	Total
2010							
Cash and balances with banks and other financial institutions	–	–	–	–	–	44,411	44,411
Placings with and advances to banks and other financial institutions	–	–	–	–	110,564	–	110,564
Derivative financial instruments	5,082	–	511	–	–	–	5,593
Advances to customers	–	–	–	–	472,637	–	472,637
Investment securities	25,331	7,114	143,058	56,301	–	–	231,804
Acceptances and endorsements	–	–	–	–	–	3,751	3,751
Other financial assets	724	–	–	–	–	7,881	8,605
Total financial assets	31,137	7,114	143,569	56,301	583,201	56,043	877,365
Non-financial assets							39,546
Total assets							916,911
Current, savings and other deposit accounts	20,852	–	–	–	–	683,628	704,480
Deposits from banks	–	–	–	–	–	15,586	15,586
Derivative financial instruments	3,697	12	974	–	–	–	4,683
Certificates of deposit and other debt securities in issue	2,738	–	–	–	–	3,095	5,833
Other financial liabilities	18,991	–	–	–	–	10,716	29,707
Subordinated liabilities	–	–	–	–	–	11,848	11,848
Liabilities to customers under investment contracts	–	457	–	–	–	–	457
Acceptances and endorsements	–	–	–	–	–	3,751	3,751
Total financial liabilities	46,278	469	974	–	–	728,624	776,345
Non-financial liabilities							70,554
Total liabilities							846,899

29. ACCOUNTING CLASSIFICATIONS (continued)

Bank

	Trading	Designated at fair value	Available-for-sale/ hedging	Held-to-maturity	Loans and receivables	Other amortised cost	Total
2011							
Cash and balances with banks and other financial institutions	–	–	–	–	–	36,475	36,475
Placings with and advances to banks and other financial institutions	–	–	–	–	47,724	–	47,724
Derivative financial instruments	4,368	–	68	–	–	–	4,436
Advances to customers	–	–	–	–	425,629	–	425,629
Investment securities	60,020	140	105,142	–	–	–	165,302
Amounts due from subsidiaries	–	–	–	–	–	85,222	85,222
Acceptances and endorsements	–	–	–	–	–	3,052	3,052
Other financial assets	506	–	–	–	–	5,971	6,477
Total financial assets	64,894	140	105,210	–	473,353	130,720	774,317
Non-financial assets							36,228
Total assets							810,545
Current, savings and other deposit accounts	7,288	–	–	–	–	661,012	668,300
Deposits from banks	–	–	–	–	–	11,989	11,989
Derivative financial instruments	3,317	3	782	–	–	–	4,102
Certificates of deposit and other debt securities in issue	3,183	–	–	–	–	9,284	12,467
Amounts due to subsidiaries	–	–	–	–	–	10,797	10,797
Other financial liabilities	25,606	–	–	–	–	10,845	36,451
Subordinated liabilities	–	–	–	–	–	11,846	11,846
Acceptances and endorsements	–	–	–	–	–	3,052	3,052
Total financial liabilities	39,394	3	782	–	–	718,825	759,004
Non-financial liabilities							5,134
Total liabilities							764,138

29. ACCOUNTING CLASSIFICATIONS (continued)

	Bank						
	Trading	Designated at fair value	Available-for-sale/ hedging	Held-to-maturity	Loans and receivables	Other amortised cost	Total
2010							
Cash and balances with banks and other financial institutions	–	–	–	–	–	41,062	41,062
Placings with and advances to banks and other financial institutions	–	–	–	–	52,131	–	52,131
Derivative financial instruments	4,772	–	254	–	–	–	5,026
Advances to customers	–	–	–	–	423,074	–	423,074
Investment securities	24,508	148	103,106	–	–	–	127,762
Amounts due from subsidiaries	–	–	–	–	–	93,445	93,445
Acceptances and endorsements	–	–	–	–	–	2,363	2,363
Other financial assets	724	–	–	–	–	6,026	6,750
Total financial assets	30,004	148	103,360	–	475,205	142,896	751,613
Non-financial assets							30,284
Total assets							781,897
Current, savings and other deposit accounts	8,377	–	–	–	–	649,144	657,521
Deposits from banks	–	–	–	–	–	15,585	15,585
Derivative financial instruments	3,793	9	726	–	–	–	4,528
Certificates of deposit and other debt securities in issue	2,738	–	–	–	–	3,095	5,833
Amounts due to subsidiaries	–	–	–	–	–	8,899	8,899
Other financial liabilities	18,991	–	–	–	–	10,672	29,663
Subordinated liabilities	–	–	–	–	–	11,848	11,848
Acceptances and endorsements	–	–	–	–	–	2,363	2,363
Total financial liabilities	33,899	9	726	–	–	701,606	736,240
Non-financial liabilities							4,336
Total liabilities							740,576

30. CASH AND BALANCES WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

	Group		Bank	
	2011	2010	**2011**	2010
Cash in hand	**9,491**	6,101	**9,247**	5,857
Balances with central banks	**7,102**	6,591	**5,027**	4,250
Balances with banks and other financial institutions	**22,940**	31,719	**22,201**	30,955
	39,533	44,411	**36,475**	41,062

31. PLACINGS WITH AND ADVANCES TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	Group		Bank	
	2011	2010	**2011**	2010
Placings with and advances to banks and other financial institutions maturing within one month	**56,787**	56,437	**24,950**	19,119
Placings with and advances to banks and other financial institutions maturing after one month but less than one year	**49,326**	53,659	**22,774**	33,012
Placings with and advances to banks and other financial institutions maturing after one year	**1,629**	468	**–**	–
	107,742	110,564	**47,724**	52,131

There were no overdue advances, impaired advances and rescheduled advances to banks and other financial institutions at 31 December 2011 by the Group and the Bank (2010: Nil).

32. TRADING ASSETS

	Group 2011	Group 2010	Bank 2011	Bank 2010
Treasury bills	**54,220**	20,204	**54,220**	20,204
Certificates of deposit	**432**	18	**432**	18
Other debt securities	**9,006**	5,101	**5,361**	4,278
Debt securities	**63,658**	25,323	**60,013**	24,500
Equity shares	**7**	8	**7**	8
Total trading securities	**63,665**	25,331	**60,020**	24,508
Other*	**506**	724	**506**	724
Total trading assets	**64,171**	26,055	**60,526**	25,232
Debt securities:				
– listed in Hong Kong	**4,550**	3,876	**4,550**	3,876
– listed outside Hong Kong	**717**	170	**717**	170
	5,267	4,046	**5,267**	4,046
– unlisted	**58,391**	21,277	**54,746**	20,454
	63,658	25,323	**60,013**	24,500
Equity shares:				
– listed in Hong Kong	**7**	8	**7**	8
– unlisted	**–**	–	**–**	–
	7	8	**7**	8
Total trading securities	**63,665**	25,331	**60,020**	24,508
Debt securities:				
Issued by public bodies:				
– central governments and central banks	**60,800**	24,905	**59,365**	24,129
– other public sector entities	**82**	101	**82**	101
	60,882	25,006	**59,447**	24,230
Issued by other bodies:				
– banks	**963**	149	**438**	102
– corporate entities	**1,813**	168	**128**	168
	2,776	317	**566**	270
	63,658	25,323	**60,013**	24,500
Equity shares:				
Issued by corporate entities	**7**	8	**7**	8
Total trading securities	**63,665**	25,331	**60,020**	24,508

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

33. FINANCIAL ASSETS DESIGNATED AT FAIR VALUE

	Group 2011	Group 2010	Bank 2011	Bank 2010
Certificates of deposit	**1**	–	**–**	–
Other debt securities	**3,998**	4,440	**140**	148
Debt securities	**3,999**	4,440	**140**	148
Equity shares	**473**	583	**–**	–
Investment funds	**3,624**	2,091	**–**	–
	8,096	7,114	**140**	148
Debt securities:				
– listed in Hong Kong	**15**	11	**–**	–
– listed outside Hong Kong	**182**	184	**140**	148
	197	195	**140**	148
– unlisted	**3,802**	4,245	**–**	–
	3,999	4,440	**140**	148
Equity shares:				
– listed in Hong Kong	**473**	583	**–**	–
Investment funds:				
– listed in Hong Kong	**23**	23	**–**	–
– listed outside Hong Kong	**150**	65	**–**	–
	173	88	**–**	–
– unlisted	**3,451**	2,003	**–**	–
	3,624	2,091	**–**	–
	8,096	7,114	**140**	148
Debt securities:				
Issued by public bodies:				
– central governments and central banks	**140**	148	**140**	148
– other public sector entities	**53**	105	**–**	–
	193	253	**140**	148
Issued by other bodies:				
– banks	**3,725**	4,113	**–**	–
– corporate entities	**81**	74	**–**	–
	3,806	4,187	**–**	–
	3,999	4,440	**140**	148
Equity shares:				
Issued by banks	**109**	69	**–**	–
Issued by public sector entities	**5**	15	**–**	–
Issued by corporate entities	**359**	499	**–**	–
	473	583	**–**	–
Investment funds:				
Issued by banks	**1,869**	2,004	**–**	–
Issued by corporate entities	**1,755**	87	**–**	–
	3,624	2,091	**–**	–
	8,096	7,114	**140**	148

34. DERIVATIVE FINANCIAL INSTRUMENTS

Derivatives are financial contracts whose values and characteristics are derived from underlying assets, exchange and interest rates, and indices. Derivative instruments are subject to both credit risk and market risk. The credit risk relating to a derivative contract is principally the replacement cost of the contract when it has a positive mark-to-market value and the estimated potential future change in value over the residual maturity of the contract. The nominal value of the contracts does not represent the amount of the Group's exposure to credit risk. All activities relating to derivatives are subject to the same credit approval and monitoring standards used to control credit risk for other transactions. Market risk from derivative positions is controlled individually and in combination with on-balance sheet market risk positions within the Group's market risk limits regime as described in note 61(c).

The Group transacts derivatives for three primary purposes: to create risk management solutions for clients, for proprietary trading purposes, and to manage and hedge its own risks. For accounting purposes, derivative financial instruments are held for trading, or financial instruments designated at fair value, or designated as either fair value hedge or cash flow hedge. The Group primarily traded over-the-counter derivatives and also participated in exchange traded derivatives.

Trading derivatives

Most of the Group's trading derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities in derivatives are entered into principally for the purpose of generating profits from short-term fluctuations in price or margin. Positions may be traded actively or be held over a period of time to benefit from expected changes in currency rates, interest rates, equity prices or other market parameters.

Derivatives classified as held for trading include non-qualifying hedging derivatives and ineffective hedging derivatives. Non-qualifying hedging derivatives are entered into for risk management purposes but do not meet the criteria for hedge accounting. These include derivatives managed in conjunction with financial instruments designated at fair value. Ineffective hedging derivatives were previously designated as hedges, but no longer meet the criteria for hedge accounting.

Hedging instruments

The Group uses derivatives (principally interest rate swaps) for hedging purposes in the management of its own asset and liability portfolios and structural positions. This enables the Group to optimise the cost of managing the balance sheet, and to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities.

(a) Fair value hedge

The Group's fair value hedge principally consists of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates.

34. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

(b) Cash flow hedge

The Group is exposed to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio for financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedge of forecast transactions.

Gains and losses are initially recognised in equity, in the cash flow hedging reserve, and are transferred to the income statement when the forecast cash flows affect the income statement. During the year to 31 December 2011, the amount of cash flow hedging reserve transferred to the income statement comprised HK$197 million (2010: HK$414 million) included in net interest income and nil balance included in net trading income (2010: Nil).

There was insignificant ineffectiveness recognised in the Group's income statement arising from cash flow hedge during the years of 2011 and 2010. During the years of 2011 and 2010, there were forecast transactions for which hedge accounting had previously been used but which were no longer expected to occur. In 2011, there was no gain recognised due to termination of such forecast transactions (2010: Nil).

The schedules of forecast principal balances on which the expected interest cash flows associated with derivatives that are cash flow hedge were as follows:

	Group		
	Three months or less	Over three months but within one year	Over one year but within five years
At 31 December 2011			
Cash inflows from assets	**48,385**	**34,920**	**9,681**
Cash outflows from liabilities	**–**	**–**	**–**
Net cash inflows	**48,385**	**34,920**	**9,681**
At 31 December 2010			
Cash inflows from assets	78,389	40,443	21,869
Cash outflows from liabilities	–	–	–
Net cash inflows	78,389	40,443	21,869

34. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

(c) The following table shows the nominal contract amounts and marked-to-market value of assets and liabilities by each class of derivatives.

	Group					
	2011			2010		
	Contract amounts	**Derivative assets**	**Derivative liabilities**	Contract amounts	Derivative assets	Derivative liabilities
Derivatives held for trading						
Exchange rate contracts:						
– spot and forward foreign exchange	**533,604**	**1,760**	**1,090**	495,913	2,471	1,802
– currency swaps	**4,827**	**82**	**76**	17,366	190	139
– currency options purchased	**81,173**	**401**	**–**	41,183	59	–
– currency options written	**86,786**	**–**	**415**	46,657	–	87
– other exchange rate contracts	**131**	**3**	**1**	101	1	3
	706,521	**2,246**	**1,582**	601,220	2,721	2,031
Interest rate contracts:						
– interest rate swaps	**267,229**	**2,042**	**1,590**	234,425	1,748	1,557
– interest rate options purchased	**–**	**–**	**–**	25	–	–
– interest rate options written	**–**	**–**	**–**	25	–	–
– other interest rate contracts	**8,547**	**1**	**–**	1,555	–	–
	275,776	**2,043**	**1,590**	236,030	1,748	1,557
Equity and other contracts:						
– equity swaps	**4,557**	**5**	**290**	5,980	32	99
– equity options purchased	**11,436**	**117**	**–**	5,503	168	–
– equity options written	**1,673**	**–**	**29**	1,731	–	8
– other equity contracts	**7**	**–**	**–**	8	–	–
– spot and forward contracts and others	**3,359**	**120**	**14**	3,669	413	2
	21,032	**242**	**333**	16,891	613	109
Total derivatives held for trading	**1,003,329**	**4,531**	**3,505**	854,141	5,082	3,697
Derivatives managed in conjunction with financial assets designated at fair value						
Exchange rate contracts:						
– spot and forward foreign exchange	**–**	**–**	**–**	769	–	3
Interest rate contracts:						
– interest rate swaps	**140**	**–**	**3**	140	–	9
	140	**–**	**3**	909	–	12
Cash flow hedge derivatives						
Interest rate contracts:						
– interest rate swaps	**48,385**	**66**	**21**	78,389	256	19
Fair value hedge derivatives						
Interest rate contracts:						
– interest rate swaps	**27,046**	**113**	**1,319**	27,122	255	955
Total derivatives	**1,078,900**	**4,710**	**4,848**	960,561	5,593	4,683

34. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

	Bank					
	2011			2010		
	Contract amounts	**Derivative assets**	**Derivative liabilities**	Contract amounts	Derivative assets	Derivative liabilities
Derivatives held for trading						
Exchange rate contracts:						
– spot and forward foreign exchange	**514,440**	**1,656**	**972**	496,363	2,379	1,880
– currency swaps	**4,827**	**82**	**76**	17,366	190	139
– currency options purchased	**81,342**	**401**	**–**	41,220	60	–
– currency options written	**86,918**	**–**	**560**	46,694	–	127
– other exchange rate contracts	**131**	**3**	**1**	101	1	3
	687,658	**2,142**	**1,609**	601,744	2,630	2,149
Interest rate contracts:						
– interest rate swaps	**217,264**	**1,791**	**1,371**	227,205	1,662	1,509
– interest rate options purchased	**–**	**–**	**–**	25	–	–
– interest rate options written	**–**	**–**	**–**	25	–	–
– other interest rate contracts	**8,547**	**1**	**–**	1,554	–	–
	225,811	**1,792**	**1,371**	228,809	1,662	1,509
Equity and other contracts:						
– equity swaps	**8,444**	**285**	**294**	7,997	59	125
– equity options purchased	**1,673**	**29**	**–**	1,732	8	–
– equity options written	**1,673**	**–**	**29**	1,731	–	8
– other equity contracts	**7**	**–**	**–**	8	–	–
– spot and forward contracts and others	**3,359**	**120**	**14**	3,695	413	2
	15,156	**434**	**337**	15,163	480	135
Total derivatives held for trading	**928,625**	**4,368**	**3,317**	845,716	4,772	3,793
Derivatives managed in conjunction with financial assets designated at fair value						
Interest rate contracts:						
– interest rate swaps	**140**	**–**	**3**	140	–	9
Cash flow hedge derivatives						
Interest rate contracts:						
– interest rate swaps	**48,385**	**66**	**21**	76,495	232	19
Fair value hedge derivatives						
Interest rate contracts:						
– interest rate swaps	**10,609**	**2**	**761**	14,976	22	707
Total derivatives	**987,759**	**4,436**	**4,102**	937,327	5,026	4,528

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

34. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

(d) Contract amounts, credit equivalent amounts and risk-weighted amounts

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

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

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

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

The Group uses the approaches approved by the Hong Kong Monetary Authority to calculate the capital adequacy ratio in accordance with the Capital Rules. The risk-weighted assets at 31 December 2011 and 2010 were calculated based on the advanced internal ratings-based approach.

	Group			Bank		
	Contract amounts	Credit equivalent amounts	Risk-weighted amounts	Contract amounts	Credit equivalent amounts	Risk-weighted amounts
2011						
Exchange rate contracts:						
– spot and forward foreign exchange	493,588	2,441	1,169	480,558	2,198	1,056
– currency swaps	4,827	155	17	4,827	155	16
– currency options purchased	87,005	2,316	1,749	87,083	2,317	1,749
– other exchange rate contracts	131	4	–	131	4	–
	585,551	4,916	2,935	572,599	4,674	2,821
Interest rate contracts:						
– interest rate swaps	342,801	2,624	950	276,398	2,099	757
– interest rate options purchased	–	–	–	–	–	–
	342,801	2,624	950	276,398	2,099	757
Equity and other contracts:						
– equity swaps	4,386	276	39	8,274	798	70
– equity options purchased	1,087	95	75	1,087	95	75
– others	–	–	–	–	–	–
	5,473	371	114	9,361	893	145

The total fair value of the derivatives at 31 December 2011 was HK$2,411 million (31 December 2010: HK$2,513 million) after taking into account the effect of valid bilateral netting agreement amounting to HK$1,664 million (31 December 2010: HK$2,174 million).

34. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

(d) Contract amounts, credit equivalent amounts and risk-weighted amounts (continued)

	Group			Bank		
	Contract amounts	Credit equivalent amounts	Risk-weighted amounts	Contract amounts	Credit equivalent amounts	Risk-weighted amounts
2010						
Exchange rate contracts:						
– spot and forward foreign exchange	431,732	2,738	1,417	428,192	2,599	1,337
– currency swaps	17,366	433	70	17,366	433	70
– currency options purchased	41,755	820	642	41,762	820	642
– other exchange rate contracts	101	5	–	101	5	–
	490,954	3,996	2,129	487,421	3,857	2,049
Interest rate contracts:						
– interest rate swaps	340,076	2,522	602	318,816	2,084	472
– interest rate options purchased	25	–	–	25	–	–
	340,101	2,522	602	318,841	2,084	472
Equity and other contracts:						
– equity swaps	5,980	391	65	7,997	525	72
– equity options purchased	1,732	112	72	1,732	112	72
– others	17	2	–	33	4	–
	7,729	505	137	9,762	641	144

35. ADVANCES TO CUSTOMERS

(a) Advances to customers

	Group		**Bank**	
	2011	2010	**2011**	2010
Gross advances to customers	**482,241**	474,473	**427,038**	424,506
Less: loan impairment allowances				
– individually assessed	**(896)**	(1,118)	**(789)**	(844)
– collectively assessed	**(771)**	(718)	**(620)**	(588)
	480,574	472,637	**425,629**	423,074

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

	Group		**Bank**	
	2011	2010	**2011**	2010
	%	%	**%**	%
Loan impairment allowances:				
– individually assessed	**0.19**	0.24	**0.18**	0.20
– collectively assessed	**0.16**	0.15	**0.15**	0.14
Total loan impairment allowances	**0.35**	0.39	**0.33**	0.34

35. ADVANCES TO CUSTOMERS (continued)

(b) Loan impairment allowances against advances to customers

	Group		
	Individually assessed	Collectively assessed	Total
2011			
At 1 January	**1,118**	**718**	**1,836**
Amounts written off	**(355)**	**(330)**	**(685)**
Recoveries of advances written off in previous years	**35**	**43**	**78**
New impairment allowances charged to income statement (note 16)	**359**	**381**	**740**
Impairment allowances released to income statement (note 16)	**(256)**	**(44)**	**(300)**
Unwinding of discount of loan impairment allowances recognised as "interest income"	**(10)**	**(3)**	**(13)**
Exchange	**5**	**6**	**11**
At 31 December	**896**	**771**	**1,667**
2010			
At 1 January	1,151	814	1,965
Amounts written off	(227)	(345)	(572)
Recoveries of advances written off in previous years	18	44	62
New impairment allowances charged to income statement (note 16)	296	313	609
Impairment allowances released to income statement (note 16)	(110)	(109)	(219)
Unwinding of discount of loan impairment allowances recognised as "interest income"	(16)	(3)	(19)
Exchange	6	4	10
At 31 December	1,118	718	1,836

	Bank		
	Individually assessed	Collectively assessed	Total
2011			
At 1 January	**844**	**588**	**1,432**
Amounts written off	**(235)**	**(330)**	**(565)**
Recoveries of advances written off in previous years	**22**	**43**	**65**
New impairment allowances charged to income statement (note 16)	**297**	**365**	**662**
Impairment allowances released to income statement (note 16)	**(134)**	**(43)**	**(177)**
Unwinding of discount of loan impairment allowances recognised as "interest income"	**(5)**	**(3)**	**(8)**
At 31 December	**789**	**620**	**1,409**
2010			
At 1 January	957	706	1,663
Amounts written off	(211)	(344)	(555)
Recoveries of advances written off in previous years	7	44	51
New impairment allowances charged to income statement (note 16)	162	313	475
Impairment allowances released to income statement (note 16)	(65)	(128)	(193)
Unwinding of discount of loan impairment allowances recognised as "interest income"	(6)	(3)	(9)
At 31 December	844	588	1,432

35. ADVANCES TO CUSTOMERS (continued)

(c) Impaired advances and allowances

	Group		Bank	
	2011	2010	**2011**	2010
Gross impaired advances	**1,584**	1,990	**1,404**	1,462
Individually assessed allowances	**(896)**	(1,118)	**(789)**	(844)
Net impaired advances	**688**	872	**615**	618
Individually assessed allowances as a percentage of gross impaired advances	**56.6%**	56.2%	**56.2%**	57.7%
Gross impaired advances as a percentage of gross advances to customers	**0.33%**	0.42%	**0.33%**	0.34%

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

	Group		Bank	
	2011	2010	**2011**	2010
Gross individually assessed impaired advances	**1,493**	1,886	**1,313**	1,358
Individually assessed allowances	**(896)**	(1,118)	**(789)**	(844)
	597	768	**524**	514
Gross individually assessed impaired advances as a percentage of gross advances to customers	**0.31%**	0.40%	**0.31%**	0.32%
Amount of collateral which has been taken into account in respect of individually assessed impaired advances to customers	**423**	682	**346**	464

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

35. ADVANCES TO CUSTOMERS (continued)

(d) Overdue advances

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

	Group		Bank	
		%		%
2011				
Gross advances to customers which have been overdue with respect to either principal or interest for periods of:				
– more than three months but not more than six months	**228**	**–**	**225**	**–**
– more than six months but not more than one year	**72**	**–**	**52**	**–**
– more than one year	**756**	**0.2**	**675**	**0.2**
	1,056	**0.2**	**952**	**0.2**
of which:				
– individually impaired allowances	**(822)**		**(743)**	
– covered portion of overdue loans and advances	**172**		**147**	
– uncovered portion of overdue loans and advances	**884**		**805**	
– current market value held against the covered portion of overdue loans and advances	**368**		**312**	
2010				
Gross advances to customers which have been overdue with respect to either principal or interest for periods of:				
– more than three months but not more than six months	137	–	126	–
– more than six months but not more than one year	89	–	88	–
– more than one year	1,147	0.3	904	0.3
	1,373	0.3	1,118	0.3
of which:				
– individually impaired allowances	(994)		(805)	
– covered portion of overdue loans and advances	354		291	
– uncovered portion of overdue loans and advances	1,019		827	
– current market value held against the covered portion of overdue loans and advances	586		514	

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

35. ADVANCES TO CUSTOMERS (continued)

(e) Rescheduled advances

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

	Group		Bank	
		%		%
2011	**180**	**–**	**90**	**–**
2010	194	–	95	–

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

Rescheduled advances to customers are stated net of any advances which have subsequently become overdue for more than three months and which are included in "Overdue advances" (note 35(d)).

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

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

Group

	Gross advances to customers	Individually impaired advances to customers	Overdue advances to customers	Individually assessed allowances	Collectively assessed allowances
At 31 December 2011					
Hong Kong	**404,889**	**1,315**	**929**	**779**	**603**
Rest of Asia-Pacific	**70,099**	**158**	**127**	**115**	**150**
Others	**7,253**	**20**	**–**	**2**	**18**
	482,241	**1,493**	**1,056**	**896**	**771**
At 31 December 2010					
Hong Kong	392,836	1,452	1,112	838	545
Rest of Asia-Pacific	76,308	345	257	234	162
Others	5,329	89	4	46	11
	474,473	1,886	1,373	1,118	718

Bank

	Gross advances to customers	Individually impaired advances to customers	Overdue advances to customers	Individually assessed allowances	Collectively assessed allowances
At 31 December 2011					
Hong Kong	**385,958**	**1,261**	**920**	**778**	**573**
Rest of Asia-Pacific	**38,089**	**32**	**32**	**9**	**43**
Others	**2,991**	**20**	**–**	**2**	**4**
	427,038	**1,313**	**952**	**789**	**620**
At 31 December 2010					
Hong Kong	374,776	1,308	1,094	831	528
Rest of Asia-Pacific	46,404	32	20	12	56
Others	3,326	18	4	1	4
	424,506	1,358	1,118	844	588

35. ADVANCES TO CUSTOMERS (continued)

(g) Gross advances to customers by industry sector

The analysis of gross advances to customers by industry sector based on categories and definitions used by the Hong Kong Monetary Authority is as follows:

	Group			
	2011		2010	
		% of gross advances covered by collateral		% of gross advances covered by collateral (restated)
Gross advances to customers for use in Hong Kong				
Industrial, commercial and financial sectors				
– property development	**27,090**	**50.0**	32,430	43.0
– property investment	**102,066**	**88.3**	100,023	83.0
– financial concerns	**2,648**	**24.7**	2,907	33.7
– stockbrokers	**1,227**	**5.9**	165	82.4
– wholesale and retail trade	**11,511**	**44.5**	11,339	43.5
– manufacturing	**16,274**	**30.4**	14,628	35.7
– transport and transport equipment	**6,309**	**64.0**	7,546	72.8
– recreational activities	**62**	**24.9**	532	99.5
– information technology	**899**	**2.0**	1,957	0.7
– other	**21,859**	**52.5**	20,177	61.8
	189,945	**68.4**	191,704	66.1
Individuals				
– advances for the purchase of flats under the Government Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	**14,405**	**99.7**	14,834	100.0
– advances for the purchase of other residential properties	**107,563**	**100.0**	112,394	100.0
– credit card advances	**18,547**	**–**	15,735	–
– other	**13,887**	**29.4**	13,776	30.9
	154,402	**81.5**	156,739	83.9
Total gross advances for use in Hong Kong	**344,347**	**74.3**	348,443	74.1
Trade finance	**49,552**	**27.8**	63,660	18.3
Gross advances for use outside Hong Kong	**88,342**	**25.8**	62,370	40.5
Gross advances to customers	**482,241**	**60.6**	474,473	62.2

35. ADVANCES TO CUSTOMERS (continued)

(g) Gross advances to customers by industry sector (continued)

	Bank			
	2011		2010	
		% of gross advances covered by collateral		% of gross advances covered by collateral (restated)
Gross advances to customers for use in Hong Kong				
Industrial, commercial and financial sectors				
– property development	27,090	50.0	32,430	43.0
– property investment	101,445	88.4	98,994	83.4
– financial concerns	2,648	24.7	2,907	33.7
– stockbrokers	1,227	5.9	165	82.4
– wholesale and retail trade	11,511	44.5	11,339	43.5
– manufacturing	16,274	30.4	14,626	35.7
– transport and transport equipment	5,887	61.4	6,711	69.7
– recreational activities	62	24.9	532	99.5
– information technology	899	2.0	1,957	0.7
– other	21,852	52.5	20,158	61.8
	188,895	68.4	189,819	66.1
Individuals				
– advances for the purchase of flats under the Government Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	6,950	99.3	5,695	100.0
– advances for the purchase of other residential properties	105,525	100.0	109,776	100.0
– credit card advances	18,547	–	15,735	–
– other	13,885	29.4	13,773	30.9
	144,907	80.3	144,979	82.6
Total gross advances for use in Hong Kong	333,802	73.5	334,798	73.2
Trade finance	49,552	27.8	63,660	18.3
Gross advances for use outside Hong Kong	43,684	8.4	26,048	7.4
Gross advances to customers	427,038	61.6	424,506	61.0

35. ADVANCES TO CUSTOMERS (continued)

(h) Net investments in finance leases

Advances to customers include net investments in equipment leased to customers under finance leases and hire purchase contracts having the characteristics of finance leases. The contracts usually run for an initial period of 5 to 20 years, with an option for acquiring by the lessee the leased asset at nominal value at the end of the lease period. The total minimum lease payments receivable and their present value at the year-end are as follows:

	Group		Bank	
	2011	2010	**2011**	2010
Finance leases	**1**	9	**1**	9
Hire purchase contracts	**4,102**	5,751	**3,679**	4,918
	4,103	5,760	**3,680**	4,927

	Group		
	Present value of minimum lease payments receivable	**Interest income relating to future periods**	**Total minimum lease payments receivable**
2011			
Amounts receivable:			
– within one year	**454**	**64**	**518**
– after one year but within five years	**1,027**	**198**	**1,225**
– after five years	**2,647**	**314**	**2,961**
	4,128	**576**	**4,704**
Loans impairment allowances	**(25)**		
Net investments in finance leases and hire purchase contracts	**4,103**		
2010			
Amounts receivable:			
– within one year	260	54	314
– after one year but within five years	1,026	166	1,192
– after five years	4,500	1,029	5,529
	5,786	1,249	7,035
Loans impairment allowances	(26)		
Net investments in finance leases and hire purchase contracts	5,760		

35. ADVANCES TO CUSTOMERS (continued)

(h) Net investments in finance leases (continued)

	Bank		
	Present value of minimum lease payments receivable	Interest income relating to future periods	Total minimum lease payments receivable
2011			
Amounts receivable:			
– within one year	**417**	**56**	**473**
– after one year but within five years	**893**	**171**	**1,064**
– after five years	**2,395**	**292**	**2,687**
	3,705	**519**	**4,224**
Loans impairment allowances	**(25)**		
Net investments in finance leases and hire purchase contracts	**3,680**		
2010			
Amounts receivable:			
– within one year	189	36	225
– after one year but within five years	766	111	877
– after five years	3,994	977	4,971
	4,949	1,124	6,073
Loans impairment allowances	(22)		
Net investments in finance leases and hire purchase contracts	4,927		

36. FINANCIAL INVESTMENTS

	Group		Bank	
	2011	2010	**2011**	2010
Financial investments:				
– which may be repledged or resold by counterparties	**156**	207	**156**	207
– which may not be repledged or resold or are not subject to repledge or resale by counterparties	**209,034**	199,152	**104,986**	102,899
	209,190	199,359	**105,142**	103,106
Held-to-maturity debt securities at amortised cost	**59,911**	56,301	**–**	–
Available-for-sale at fair value:				
– debt securities	**149,020**	142,732	**105,080**	102,985
– equity shares	**259**	326	**62**	121
	209,190	199,359	**105,142**	103,106
Treasury bills	**43,296**	18,010	**43,296**	17,225
Certificates of deposit	**9,386**	6,713	**6,006**	2,928
Other debt securities	**156,249**	174,310	**55,778**	82,832
Debt securities	**208,931**	199,033	**105,080**	102,985
Equity shares	**259**	326	**62**	121
	209,190	199,359	**105,142**	103,106

There was no overdue debt securities at 31 December 2011 (31 December 2010: Nil).

(a) Held-to-maturity debt securities

	Group		Bank	
	2011	2010	**2011**	2010
Listed in Hong Kong	**977**	997	**–**	–
Listed outside Hong Kong	**10,234**	9,822	**–**	–
	11,211	10,819	**–**	–
Unlisted	**48,700**	45,482	**–**	–
	59,911	56,301	**–**	–
Issued by public bodies:				
– central governments and central banks	**309**	272	**–**	–
– other public sector entities	**8,273**	7,563	**–**	–
	8,582	7,835	**–**	–
Issued by other bodies:				
– banks	**36,304**	36,225	**–**	–
– corporate entities	**15,025**	12,241	**–**	–
	51,329	48,466	**–**	–
	59,911	56,301	**–**	–
Fair value of held-to-maturity debt securities:				
– listed	**11,879**	11,189	**–**	–
– unlisted	**51,517**	47,138	**–**	–
	63,396	58,327	**–**	–

There was no held-to-maturity debt securities determined to be impaired at 31 December 2011 for the Group and the Bank (31 December 2010: Nil).

36. FINANCIAL INVESTMENTS (continued)

(b) Available-for-sale debt securities

	Group		Bank	
	2011	2010	**2011**	2010
Listed in Hong Kong	**20,164**	8,786	**20,158**	8,780
Listed outside Hong Kong	**29,793**	57,317	**16,901**	43,528
	49,957	66,103	**37,059**	52,308
Unlisted	**99,063**	76,629	**68,021**	50,677
	149,020	142,732	**105,080**	102,985
Issued by public bodies:				
– central governments and central banks	**78,350**	38,735	**63,537**	28,757
– other public sector entities	**17,748**	15,478	**9,307**	10,371
	96,098	54,213	**72,844**	39,128
Issued by other bodies:				
– banks	**48,947**	83,075	**28,402**	60,100
– corporate entities	**3,975**	5,444	**3,834**	3,757
	52,922	88,519	**32,236**	63,857
	149,020	142,732	**105,080**	102,985

At 31 December 2011 and 2010, there were no available-for-sale debt securities individually determined to be impaired on the basis that there was objective evidence of impairment in the value of the debt securities for the Group and the Bank.

(c) Available-for-sale equity shares

	Group		Bank	
	2011	2010	**2011**	2010
Listed in Hong Kong	**48**	47	**–**	–
Listed outside Hong Kong	**18**	64	**18**	64
	66	111	**18**	64
Unlisted	**193**	215	**44**	57
	259	326	**62**	121
Issued by corporate entities	**259**	326	**62**	121

There were no available-for-sale equity securities individually determined to be impaired during the year of 2011 and 2010 for the Group and the Bank.

37. INVESTMENTS IN SUBSIDIARIES

	Bank	
	2011	2010
Unlisted shares, at cost	**14,434**	11,584

The principal subsidiaries of the Bank are:

Name of company	Place of incorporation	Principal activities	Issued equity capital
Hang Seng Bank (China) Limited	People's Republic of China	Banking	RMB4,500,000,000
Hang Seng Finance Limited	Hong Kong SAR	Lending	HK$1,000,000,000
Hang Seng Credit Limited	Hong Kong SAR	Lending	HK$200,000,000
Hang Seng Bank (Bahamas) Limited	Bahamas	Banking	US$1,000,000
Hang Seng Finance (Bahamas) Limited	Bahamas	Finance	US$5,000
Hang Seng Bank (Trustee) Limited	Hong Kong SAR	Trustee service	HK$3,000,000
Hang Seng (Nominee) Limited	Hong Kong SAR	Nominee service	HK$100,000
Hang Seng Life Limited	Hong Kong SAR	Retirement benefits and life assurance	HK$970,000,000
Hang Seng Insurance Company Limited	Hong Kong SAR	Retirement benefits and life assurance	HK$5,226,184,570
Hang Seng General Insurance (Hong Kong) Company Limited	Hong Kong SAR	General insurance	HK$620,000,000
Hang Seng Asset Management Pte Ltd	Singapore	Fund management	SG$2,000,000
Hang Seng Investment Management Limited	Hong Kong SAR	Fund management	HK$10,000,000
Haseba Investment Company Limited	Hong Kong SAR	Investment holding	HK$6,000
Hang Seng Securities Limited	Hong Kong SAR	Stockbroking	HK$26,000,000
Yan Nin Development Company Limited	Hong Kong SAR	Investment holding	HK$100,000
Hang Seng Indexes Company Limited	Hong Kong SAR	Compilation and dissemination of the Hang Seng share index	HK$10,000
Hang Seng Real Estate Management Limited	Hong Kong SAR	Property management	HK$10,000
High Time Investments Limited	Hong Kong SAR	Investment holding	HK$2,250,010,000

All the above companies are wholly-owned subsidiaries and unlisted. All subsidiaries are held directly by the Bank except for Hang Seng Life Limited and Hang Seng Indexes Company Limited. The principal places of operation are the same as the places of incorporation.

Some principal subsidiaries are regulated banking and insurance entities and as such, are required to maintain certain minimum levels of capital and liquid assets to support their operations. The effect of these regulatory requirements is to limit the extent to which the subsidiaries may transfer funds to the Bank in the form of repayment of certain shareholder loans or cash dividends.

38. INTEREST IN ASSOCIATES

	Group		Bank	
	2011	2010	**2011**	2010
Unlisted investments, at cost	**–**	–	**912**	912
Listed investments, at cost	**–**	–	**4,260**	4,260
Share of net assets	**18,875**	15,119	**–**	–
Intangible asset	**57**	84	**–**	–
Goodwill	**475**	463	**–**	–
	19,407	15,666	**5,172**	5,172

The associates are:

Name of company	Place of incorporation and operation	Principal activity	Group's interest in equity capital	Issued equity capital
Unlisted				
Barrowgate Limited	Hong Kong SAR	Property investment	24.64%	HK$10,000
Yantai Bank Co., Ltd.	People's Republic of China	Banking	20.00%	RMB2,000,000,000
Listed				
Industrial Bank Co., Ltd.	People's Republic of China	Banking	12.80%	RMB5,992,000,000

Interest in associates included listed investment of HK$17,199 million (2010: HK$13,752 million). At the balance sheet date, the fair value of these investments, based on quoted market prices was HK$21,307 million (2010: HK$21,753 million).

In accordance with Hong Kong Accounting Standard 28 "Investments in Associates", an associate is an entity over which the investor has significant influence, including the power to participate in the financial and operating policy decisions without controlling the management of the investee. Usually a holding of less than 20 per cent is presumed not to have significant influence, unless such influence can be clearly demonstrated. The interests are recognised at cost and dividends accounted for as declared.

The interest in Barrowgate Limited is owned by a subsidiary of the Bank. The interest in Industrial Bank Co., Ltd. ("IB") and Yantai Bank Co., Ltd. ("Yantai Bank") are owned directly by the Bank.

The Group's interest in IB has been accounted for as an associate using the equity method as the Group has representation in both the Board and Executive Committee of IB, and the ability to participate in the decision making process.

For the year ended 31 December 2011, the financial results of IB and Yantai Bank were included in the financial statements based on financial statements drawn up to 30 September 2011, but taking into account any changes in the subsequent period from 1 October 2011 to 31 December 2011 that would materially affect the results. The Group has taken advantage of the provision contained in Hong Kong Accounting Standard 28 "Investments in Associates" whereby it is permitted to include the attributable share of associates' results based on accounts drawn up to a non-coterminous period end where the difference must be no greater than three months.

38. INTEREST IN ASSOCIATES (continued)

The following table shows the summarised financial information of the associates with the aggregated amounts in which the Group's interests have been accounted for:

	Assets	Liabilities	Equity	Revenue	Expenses	Revenue Less Expenses
2011						
100 per cent	**2,628,083**	**2,487,408**	**140,675**	**66,218**	**36,226**	**29,992**
The Group's effective interest	**340,228**	**321,353**	**18,875**	**8,713**	**4,723**	**3,990**
2010						
100 per cent	2,173,920	2,061,507	112,413	49,336	29,003	20,333
The Group's effective interest	281,332	266,213	15,119	6,462	3,801	2,661

There was no impairment loss on our interest in associates for the years ended 31 December 2011 and 2010.

39. INVESTMENT PROPERTIES

The Group's investment properties were revalued by DTZ Debenham Tie Leung Limited, an independent professional valuer, at 30 November 2011, and were updated for any material changes in the valuation as at 31 December 2011. The valuations were carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of the valuation for investment properties was open market value.

(a) Movement of investment properties

	Group		Bank	
	2011	2010	**2011**	2010
At 1 January	**3,251**	2,872	**2,100**	1,883
Surplus on revaluation credited to income statement (note 22)	**982**	474	**613**	291
Transfer from/(to) assets held for sale	**77**	(78)	**77**	(78)
Transfer from/(to) premises (note 40(a))	**4**	(17)	**16**	4
At 31 December	**4,314**	3,251	**2,806**	2,100

(b) Terms of lease

	Group		Bank	
	2011	2010	**2011**	2010
Leaseholds				
Held in Hong Kong:				
– long leases (over 50 years unexpired)	**1,495**	1,086	**776**	533
– medium leases (10 to 50 years unexpired)	**2,819**	2,165	**2,030**	1,567
Held outside Hong Kong:				
– medium leases (10 to 50 years unexpired)	**–**	–	**–**	–
	4,314	3,251	**2,806**	2,100

39. INVESTMENT PROPERTIES (continued)

(c) The Group leases out investment properties under operating leases. The leases typically run for an initial period of 2 years, and may contain an option to renew the lease after that date at which time all terms are renegotiated. None of the leases includes contingent rentals.

	Group		Bank	
	2011	2010	**2011**	2010
Direct operating expenses arising from investment properties	**24**	21	**16**	14
Direct operating expenses from investment properties that generated rental income	**22**	19	**15**	11

The Group's total future minimum lease payments receivable under non-cancellable operating leases are as follows:

	Group		Bank	
	2011	2010	**2011**	2010
Less than one year	**146**	120	**100**	72
Over one year but within five years	**71**	91	**52**	59
	217	211	**152**	131

40. PREMISES, PLANT AND EQUIPMENT

The Group's premises were revalued by DTZ Debenham Tie Leung Limited, an independent professional valuer, at 30 November 2011, and were updated for any material changes in the valuation as at 31 December 2011. The valuations were carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of the valuation of premises was open market value for existing use.

(a) Movement of premises, plant and equipment

	Group		
	Premises	**Plant and equipment**	**Total**
2011			
Cost or valuation:			
At 1 January	**13,899**	**3,502**	**17,401**
Exchange adjustments	**31**	**21**	**52**
Additions	**–**	**254**	**254**
Disposals	**–**	**(77)**	**(77)**
Elimination of accumulated depreciation on revalued premises	**(398)**	**–**	**(398)**
Surplus on revaluation:			
– credited to premises revaluation reserve	**3,729**	**–**	**3,729**
– credited to income statement (note 22)	**2**	**–**	**2**
Transfer from assets held for sale	**102**	**–**	**102**
Transfer to investment property (note 39(a))	**(4)**	**–**	**(4)**
Other	**16**	**(14)**	**2**
At 31 December	**17,377**	**3,686**	**21,063**
Accumulated depreciation:			
At 1 January	**(1)**	**(2,839)**	**(2,840)**
Exchange adjustments	**–**	**(12)**	**(12)**
Charge for the year (note 17)	**(404)**	**(296)**	**(700)**
Written off on disposal	**–**	**74**	**74**
Elimination of accumulated depreciation on revalued premises	**398**	**–**	**398**
At 31 December	**(7)**	**(3,073)**	**(3,080)**
Net book value at 31 December	**17,370**	**613**	**17,983**

40. PREMISES, PLANT AND EQUIPMENT (continued)

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

	Group		
	Premises	Plant and equipment	Total
2010			
Cost or valuation:			
At 1 January	11,638	3,387	15,025
Exchange adjustments	20	15	35
Additions	585	175	760
Disposals	–	(75)	(75)
Elimination of accumulated depreciation on revalued premises	(329)	–	(329)
Surplus on revaluation:			
– credited to premises revaluation reserve	2,102	–	2,102
– credited to income statement (note 22)	3	–	3
Transfer to assets held for sale	(137)	–	(137)
Transfer from investment property (note 39(a))	17	–	17
At 31 December	13,899	3,502	17,401
Accumulated depreciation:			
At 1 January	–	(2,611)	(2,611)
Exchange adjustments	–	(9)	(9)
Charge for the year (note 17)	(330)	(289)	(619)
Written off on disposal	–	70	70
Elimination of accumulated depreciation on revalued premises	329	–	329
At 31 December	(1)	(2,839)	(2,840)
Net book value at 31 December	13,898	663	14,561

40. PREMISES, PLANT AND EQUIPMENT (continued)

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

	Bank		
	Premises	Plant and equipment	Total
2011			
Cost or valuation:			
At 1 January	**10,107**	**3,054**	**13,161**
Additions	**–**	**178**	**178**
Disposals	**–**	**(71)**	**(71)**
Elimination of accumulated depreciation on revalued premises	**(305)**	**–**	**(305)**
Surplus on revaluation:			
– credited to premises revaluation reserve	**2,923**	**–**	**2,923**
– credited to income statement	**1**	**–**	**1**
Transfer from assets held for sale	**102**	**–**	**102**
Transfer to investment property (note 39(a))	**(16)**	**–**	**(16)**
At 31 December	**12,812**	**3,161**	**15,973**
Accumulated depreciation:			
At 1 January	**–**	**(2,573)**	**(2,573)**
Charge for the year	**(305)**	**(220)**	**(525)**
Written off on disposal	**–**	**69**	**69**
Elimination of accumulated depreciation on revalued premises	**305**	**–**	**305**
At 31 December	**–**	**(2,724)**	**(2,724)**
Net book value at 31 December	**12,812**	**437**	**13,249**

	Bank		
	Premises	Plant and equipment	Total
2010			
Cost or valuation:			
At 1 January	8,837	3,006	11,843
Additions	–	114	114
Disposals	–	(66)	(66)
Elimination of accumulated depreciation on revalued premises	(259)	–	(259)
Surplus on revaluation:			
– credited to premises revaluation reserve	1,667	–	1,667
– credited to income statement	3	–	3
Transfer to assets held for sale	(137)	–	(137)
Transfer to investment property (note 39(a))	(4)	–	(4)
At 31 December	10,107	3,054	13,161
Accumulated depreciation:			
At 1 January	–	(2,409)	(2,409)
Charge for the year	(259)	(226)	(485)
Written off on disposal	–	62	62
Elimination of accumulated depreciation on revalued premises	259	–	259
At 31 December	–	(2,573)	(2,573)
Net book value at 31 December	10,107	481	10,588

40. PREMISES, PLANT AND EQUIPMENT (continued)

(b) Terms of lease

The net book value of premises comprises:

	Group		Bank	
	2011	2010	**2011**	2010
Leaseholds				
Held in Hong Kong:				
– long leases (over 50 years unexpired)	**1,615**	1,031	**1,226**	759
– medium leases (10 to 50 years unexpired)	**14,963**	12,098	**11,584**	9,311
– short leases (under 10 years unexpired)	**–**	36	**–**	36
Held outside Hong Kong:				
– long leases (over 50 years unexpired)	**8**	8	**–**	–
– medium leases (10 to 50 years unexpired)	**784**	725	**2**	1
	17,370	13,898	**12,812**	10,107

(c) The carrying amount of all premises which have been stated in the balance sheet would have been as follows had they been stated at cost less accumulated depreciation:

	Group		Bank	
	2011	2010	**2011**	2010
Cost less accumulated depreciation at 31 December	**3,023**	2,923	**1,300**	1,209

41. INTANGIBLE ASSETS

	Group		Bank	
	2011	2010	**2011**	2010
Present value of in-force long-term insurance business	**5,188**	4,593	**–**	–
Internally developed software	**399**	429	**398**	428
Acquired software	**46**	43	**10**	14
Goodwill	**329**	329	**–**	–
	5,962	5,394	**408**	442

(a) Movement of present value of in-force long-term insurance business

	Group	
	2011	2010
At 1 January	**4,593**	3,466
Addition from current year new business	**1,062**	803
Movement from in-force business	**(467)**	324
At 31 December	**5,188**	4,593

41. INTANGIBLE ASSETS (continued)

(a) Movement of present value of in-force long-term insurance business (continued)

The key assumptions used in the computation of present value of in-force long-term insurance business ("PVIF") are as follows:

	2011	2010
Risk discount rate	**8.3%**	11.0%
Expenses inflation	**3.0%**	3.0%
Average lapse rate:		
– 1st year	**3.4%**	3.4%
– 2nd year onwards	**0.8%**	1.3%

The sensitivity of PVIF valuation to changes in individual assumptions at the balance sheet dates is shown in note 61(d).

(b) Goodwill

	Group		**Bank**	
	2011	2010	**2011**	2010
At 1 January and at 31 December	**329**	329	**–**	–

Goodwill arising from acquisition of the remaining 50 per cent of Hang Seng Life Limited from HSBC Insurance (Asia-Pacific) Holdings Limited amounted to HK$329 million is allocated to cash-generating units of Personal Financial Services (Life Insurance) - Hang Seng Insurance Company Limited ("HSIC") for the purpose of impairment testing.

During 2011, there was no impairment of goodwill (2010: Nil). Impairment testing in respect of goodwill is performed annually by comparing the recoverable amount of cash generating unit based on appraisal value with the carrying amount of its net assets, including attributable goodwill.

The appraisal value comprises HSIC's net assets (other than value of business acquired and goodwill) as at 31 December 2011, the present value of in-force long-term insurance business and the expected value of future business. The present value of the in-force long-term insurance business is determined by discounting future earnings expected from the current business, taking into account factors such as future mortality, lapse rates, levels of expenses and risk discount rate. The above details are shown in notes 41(a) and 61(d).

(c) Movement of internally developed application software and acquired software

	Group		**Bank**	
	2011	2010	**2011**	2010
Cost:				
At 1 January	**817**	666	**776**	641
Additions	**168**	155	**155**	140
Disposals	**(10)**	(5)	**(10)**	(5)
Exchange and others	**3**	1	**–**	–
At 31 December	**978**	817	**921**	776
Accumulated amortisation:				
At 1 January	**(345)**	(247)	**(334)**	(242)
Charge for the year (note 17)	**(119)**	(102)	**(111)**	(96)
Written off on disposals	**10**	5	**10**	4
Impairment	**(78)**	–	**(78)**	–
Exchange and others	**(1)**	(1)	**–**	–
At 31 December	**(533)**	(345)	**(513)**	(334)
Net book value at 31 December	**445**	472	**408**	442

During 2011, there was impairment on internally developed application software and acquired software of HK$78 million (2010: Nil).

42. OTHER ASSETS

	Group		Bank	
	2011	2010	**2011**	2010
Items in the course of collection from other banks	**4,513**	4,673	**4,513**	4,673
Prepayments and accrued income	**2,844**	2,259	**950**	835
Assets held for sale*				
– repossessed assets	**3**	12	**–**	7
– other assets held for sale	**35**	206	**35**	206
Acceptances and endorsements	**4,697**	3,751	**3,052**	2,363
Retirement benefit assets	**34**	95	**34**	95
Other accounts	**1,637**	1,310	**598**	608
	13,763	12,306	**9,182**	8,787

* There was no accumulated loss recognised directly in equity relating to assets held for sale for 2011 and 2010.

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

43. CURRENT, SAVINGS AND OTHER DEPOSIT ACCOUNTS

	Group		Bank	
	2011	2010	**2011**	2010
Current, savings and other deposit accounts:				
– as stated in balance sheet	**699,857**	683,628	**661,012**	649,144
– structured deposits reported as trading liabilities (note 44)	**30,923**	20,852	**7,288**	8,377
	730,780	704,480	**668,300**	657,521
By type:				
– demand and current accounts	**57,977**	59,116	**57,975**	59,104
– savings accounts	**431,863**	466,158	**421,003**	456,818
– time and other deposits	**240,940**	179,206	**189,322**	141,599
	730,780	704,480	**668,300**	657,521

44. TRADING LIABILITIES

	Group		Bank	
	2011	2010	**2011**	2010
Structured certificates of deposit in issue (note 46)	**2,641**	26	**2,641**	26
Other debt securities in issue (note 46)	**542**	2,712	**542**	2,712
Structured deposits (note 43)	**30,923**	20,852	**7,288**	8,377
Short positions in securities and others	**25,606**	18,991	**25,606**	18,991
	59,712	42,581	**36,077**	30,106

45. FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE

	Group		Bank	
	2011	2010	**2011**	2010
Liabilities to customers under investment contracts	**434**	457	**–**	–

46. CERTIFICATES OF DEPOSIT AND OTHER DEBT SECURITIES IN ISSUE

	Group		Bank	
	2011	2010	**2011**	2010
Certificates of deposit and other debt securities in issue:				
– as stated in balance sheet	**9,284**	3,095	**9,284**	3,095
– structured certificates of deposit in issue reported as trading liabilities (note 44)	**2,641**	26	**2,641**	26
– other structured debt securities in issue reported as trading liabilities (note 44)	**542**	2,712	**542**	2,712
	12,467	5,833	**12,467**	5,833
By type:				
– certificates of deposit in issue	**11,925**	3,121	**11,925**	3,121
– other debt securities in issue	**542**	2,712	**542**	2,712
	12,467	5,833	**12,467**	5,833

47. OTHER LIABILITIES

	Group		Bank	
	2011	2010	**2011**	2010
Items in the course of transmission to other banks	**7,027**	7,208	**6,977**	7,208
Accruals	**2,956**	2,385	**1,980**	1,783
Acceptances and endorsements	**4,697**	3,751	**3,052**	2,363
Retirement benefit liabilities	**3,260**	1,718	**3,260**	1,718
Other	**2,198**	1,956	**1,691**	2,362
	20,138	17,018	**16,960**	15,434

48. LIABILITIES TO CUSTOMERS UNDER INSURANCE CONTRACTS

	Group					
	2011			2010		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
Non-life insurance						
Unearned premiums	245	(77)	168	227	(75)	152
Notified claims	183	(27)	156	160	(18)	142
Claims incurred but not reported	37	(8)	29	41	(9)	32
Other	54	(1)	53	49	(1)	48
	519	(113)	406	477	(103)	374
Policyholders' liabilities						
Life (non-linked)	71,523	(42)	71,481	63,722	(35)	63,687
Life (linked)	183	–	183	226	–	226
	71,706	(42)	71,664	63,948	(35)	63,913
	72,225	(155)	72,070	64,425	(138)	64,287

Amounts recoverable from reinsurance of liabilities under insurance contracts issued are included in the consolidated balance sheet in "Other assets".

The movement of liabilities under insurance contracts was as follows:

(a) Non-life insurance

	Group		
	Gross	Reinsurance	Net
2011			
Unearned premiums			
At 1 January	227	(75)	152
Gross written premiums	456	(107)	349
Gross earned premiums	(444)	106	(338)
Exchange and other movements	6	(1)	5
At 31 December	245	(77)	168
Notified and incurred but not reported claims			
At 1 January			
– notified claims	160	(18)	142
– claims incurred but not reported	41	(9)	32
	201	(27)	174
Claims paid	(109)	28	(81)
Claims incurred	132	(37)	95
	23	(9)	14
Exchange and other movements	(4)	1	(3)
At 31 December			
– notified claims	183	(27)	156
– claims incurred but not reported	37	(8)	29
	220	(35)	185
Other	54	(1)	53
	519	(113)	406

48. LIABILITIES TO CUSTOMERS UNDER INSURANCE CONTRACTS (continued)

(a) Non-life insurance (continued)

	Group		
	Gross	Reinsurance	Net
2010			
Unearned premiums			
At 1 January	192	(52)	140
Gross written premiums	466	(122)	344
Gross earned premiums	(437)	96	(341)
Exchange and other movements	6	3	9
At 31 December	227	(75)	152
Notified and incurred but not reported claims			
At 1 January			
– notified claims	146	(19)	127
– claims incurred but not reported	43	(8)	35
	189	(27)	162
Claims paid	(113)	26	(87)
Claims incurred	134	(26)	108
	21	–	21
Exchange and other movements	(9)	–	(9)
At 31 December			
– notified claims	160	(18)	142
– claims incurred but not reported	41	(9)	32
	201	(27)	174
Other	49	(1)	48
	477	(103)	374

48. LIABILITIES TO CUSTOMERS UNDER INSURANCE CONTRACTS (continued)

(b) Policyholders' liabilities

	Group		
	Gross	**Reinsurance**	**Net**
2011			
Life (non-linked)			
At 1 January	**63,722**	**(35)**	**63,687**
Benefits paid	**(3,533)**	**29**	**(3,504)**
Claims incurred and movement in policyholders' liabilities	**11,573**	**(47)**	**11,526**
Exchange and other movements	**(239)**	**11**	**(228)**
At 31 December	**71,523**	**(42)**	**71,481**
Life (linked)			
At 1 January	**226**	**–**	**226**
Benefits paid	**(30)**	**–**	**(30)**
Claims incurred and movement in policyholders' liabilities	**(11)**	**–**	**(11)**
Exchange and other movements	**(2)**	**–**	**(2)**
At 31 December	**183**	**–**	**183**
	71,706	**(42)**	**71,664**

	Group		
	Gross	Reinsurance	Net
2010			
Life (non-linked)			
At 1 January	53,588	(19)	53,569
Benefits paid	(2,402)	22	(2,380)
Claims incurred and movement in policyholders' liabilities	12,487	(36)	12,451
Exchange and other movements	49	(2)	47
At 31 December	63,722	(35)	63,687
Life (linked)			
At 1 January	224	–	224
Benefits paid	(24)	–	(24)
Claims incurred and movement in policyholders' liabilities	28	–	28
Exchange and other movements	(2)	–	(2)
At 31 December	226	–	226
	63,948	(35)	63,913

49. CURRENT TAX AND DEFERRED TAX

(a) Current tax and deferred tax are represented in the balance sheet:

	Group		Bank	
	2011	2010	**2011**	2010
Current taxation recoverable (included in "Other assets")	**13**	12	**–**	–
Current tax liabilities:				
Provision for Hong Kong profits tax	**293**	337	**260**	316
Provision for taxation outside Hong Kong	**12**	7	**10**	4
	305	344	**270**	320
Deferred tax liabilities	**4,037**	3,234	**1,801**	1,617
	4,342	3,578	**2,071**	1,937

(b) Deferred tax assets and liabilities recognised

The major components of deferred tax (assets)/liabilities recognised in the balance sheet and the movements during the year are as follows:

	Group						
	Depreciation allowances in excess of related depreciation	**Revaluation of properties**	**Loan impairment allowances**	**Fair value adjustments for available-for-sale financial assets**	**Cash flow hedge**	**Other**	**Total**
2011							
At 1 January	**106**	**2,348**	**(85)**	**28**	**14**	**823**	**3,234**
(Credited)/charged to income statement (note 23(a))	**(13)**	**111**	**(3)**	**–**	**–**	**434**	**529**
Charged/(credited) to reserves	**–**	**610**	**–**	**(59)**	**(13)**	**(264)**	**274**
At 31 December	**93**	**3,069**	**(88)**	**(31)**	**1**	**993**	**4,037**
2010							
At 1 January	119	1,964	(99)	5	35	420	2,444
(Credited)/charged to income statement (note 23(a))	(13)	40	14	–	–	401	442
Charged/(credited) to reserves	–	344	–	23	(21)	2	348
At 31 December	106	2,348	(85)	28	14	823	3,234

49. CURRENT TAX AND DEFERRED TAX (continued)

(b) Deferred tax assets and liabilities recognised (continued)

Bank

	Depreciation allowances in excess of related depreciation	Revaluation of properties	Loan impairment allowances	Fair value adjustments for available-for-sale financial assets	Cash flow hedge	Other	Total
2011							
At 1 January	**101**	**1,868**	**(84)**	**25**	**14**	**(307)**	**1,617**
(Credited)/charged to income statement	**(9)**	**59**	**(3)**	**–**	**–**	**(8)**	**39**
Charged/(credited) to reserves	**–**	**482**	**–**	**(59)**	**(13)**	**(265)**	**145**
At 31 December	**92**	**2,409**	**(87)**	**(34)**	**1**	**(580)**	**1,801**
2010							
At 1 January	118	1,578	(98)	4	35	(294)	1,343
(Credited)/charged to income statement	(17)	16	14	–	–	(15)	(2)
Charged/(credited) to reserves	–	274	–	21	(21)	2	276
At 31 December	101	1,868	(84)	25	14	(307)	1,617

(c) Deferred tax assets not recognised

At the end of the balance sheet dates, the Group has not recognised deferred tax assets in respect of tax losses and revaluation loss on debt securities of subsidiaries amounting to HK$64 million (2010: HK$70 million) which are considered unlikely to be utilised. Of this amount, HK$30 million (2010: HK$40 million) has no expiry date and HK$34 million (2010: HK$30 million) is scheduled to expire within five years.

(d) Deferred tax liabilities not recognised

There were no deferred tax liabilities not recognised in 2011 (2010: Nil).

50. SUBORDINATED LIABILITIES

Nominal value	Description	Group 2011	Group 2010	Bank 2011	Bank 2010
Amount owed to third parties					
US$450 million	Callable floating rate subordinated notes due July 2016 [1]	**–**	3,495	**–**	3,495
US$300 million	Callable floating rate subordinated notes due July 2017 [2]	**2,328**	2,328	**2,328**	2,328
Amount owed to HSBC Group undertakings					
US$775 million	Floating rate subordinated loan debt due December 2020	**6,022**	6,025	**6,022**	6,025
US$450 million	Floating rate subordinated loan debt due July 2021 [1]	**3,496**	–	**3,496**	–
		11,846	11,848	**11,846**	11,848
Representing:					
– measured at amortised cost		**11,846**	11,848	**11,846**	11,848

The above subordinated notes (excluding the subordinated loan debt due December 2020 and July 2021) carries a one-time call option exercisable by the Group on a day falling five years plus one day after the relevant date of issue/drawdown.

(1) The Bank exercised its option to redeem these subordinated notes at par of US$450 million and replenished them with a new issue of US$450 million subordinated loan debt in July 2011.

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

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

51. SHARE CAPITAL

Authorised:

The authorised share capital of the Bank is HK$11,000 million (2010: HK$11,000 million) divided into 2,200 million shares (2010: 2,200 million shares) of HK$5 each.

	2011	2010
Issued and fully paid:		
1,911,842,736 shares (2010: 1,911,842,736 shares) of HK$5 each	**9,559**	9,559

During the year, the Bank made no repurchase of its own shares (2010: Nil).

52. RESERVES

The reconciliation between the opening and closing balances of each component of the Group's consolidated equity is set out in the consolidated statement of changes in equity.

The Bank and its banking subsidiaries operate under regulatory jurisdictions which require the maintenance of minimum capital adequacy ratios and which could therefore potentially restrict the amount of realised profits which can be distributed to shareholders.

Regulatory reserve

To satisfy the provisions of the Hong Kong Banking Ordinance and local regulatory requirements for prudential supervision purposes, the Group has earmarked a "regulatory reserve" from retained profits. Movements in the reserve are made directly through retained earnings. As at 31 December 2011, the effect of this requirement is to restrict the amount of reserves which can be distributed by the Group and the Bank to shareholders by HK$4,226 million (2010: HK$1,654 million) and HK$3,896 million (2010: HK$1,535 million) respectively.

Retained profits

Retained profits are the cumulative net earnings of the Group that have not been paid out as dividends, but retained to be reinvested in the business.

Premises revaluation reserve

The premises revaluation reserve represents the difference between the current fair value of the premises and its original depreciated cost.

The premises revaluation reserve included HK$22 million in relation to a premise classified as assets held for sale, included in "Other assets" in the consolidated balance sheet at 31 December 2011 (31 December 2010: HK$117 million).

Cash flow hedging reserve

The cash flow hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions.

Available-for-sale investment reserve

The available-for-sale investment reserve includes the cumulative net change in the fair value of available-for-sale investments other than impairments which have been recognised in the income statement.

Capital redemption reserve

Capital redemption reserve represents the difference between the capital payment and the nominal value of the redeemed share capital.

Other reserves

Other reserves mainly comprise foreign exchange reserve and share-based payment reserve. The foreign exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations. The share-based payment reserve is used to record the corresponding amount of share options granted by ultimate holding company to the Group's employees and other cost of share-based payment arrangement. Other reserves also included the gain on dilution of investment in an associate of HK$1,465 million transferred from retained profits.

52. RESERVES (continued)

Details of the changes in the Bank's individual components of equity between the beginning and the end of the year are set out below:

	Bank	
	2011	2010
Retained profits (including proposed dividends)	**26,451**	23,270
Premises revaluation reserve	**9,871**	7,654
Cash flow hedging reserve	**6**	72
Available-for-sale investment reserve:		
– on debt securities	**(174)**	109
– on equity securities	**10**	34
Capital redemption reserve	**99**	99
Other reserves	**585**	524
Total reserves (including proposed dividends)	**36,848**	31,762
Retained profits (including proposed dividends)		
At beginning of the year	**23,270**	21,527
Dividends to shareholders:		
– dividends approved in respect of the previous year	**(3,633)**	(3,633)
– dividends declared in respect of the current year	**(6,309)**	(6,309)
Transfer	**224**	185
Total comprehensive income for the year	**12,899**	11,500
	26,451	23,270
Premises revaluation reserve		
At beginning of the year	**7,654**	6,447
Transfer	**(224)**	(185)
Total comprehensive income for the year	**2,441**	1,392
	9,871	7,654
Cash flow hedging reserve		
At beginning of the year	**72**	180
Total comprehensive income for the year	**(66)**	(108)
	6	72
Available-for-sale investment reserve		
At beginning of the year	**143**	(1)
Total comprehensive income for the year	**(307)**	144
	(164)	143
Capital redemption reserve		
At beginning of the year	**99**	99
Total comprehensive income for the year	**–**	–
	99	99
Other reserve		
At beginning of the year	**524**	459
Costs of share-based payment arrangements	**61**	64
Total comprehensive income for the year	**–**	1
	585	524
Total reserves (including proposed dividends)	**36,848**	31,762

At 31 December 2011, the aggregate amount of reserves available for distribution to equity shareholders of the Bank as calculated under the provision of section 79B of the Hong Kong Companies Ordinance amounted to HK$20,642 million (2010: HK$20,556 million). After considering regulatory capital requirement and business development needs, an amount of HK$3,633 million has been declared as the proposed fourth interim dividends in respect of the financial year ended 31 December 2011 (2010: HK$3,633 million). The difference between the aggregate distributable reserves of HK$20,642 million and the Bank's retained profit of HK$26,451 million as reported above mainly represents the exclusion of unrealised revaluation gain on investment properties and the regulatory reserve of the Bank.

53. RECONCILIATION OF CASH FLOW STATEMENT

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

	2011	2010
Operating profit	**14,181**	14,085
Net interest income	**(15,736)**	(14,300)
Dividend income	**(17)**	(14)
Loan impairment charges	**440**	390
Impairment loss of intangible assets	**78**	–
Depreciation	**700**	619
Amortisation of intangible assets	**119**	102
Amortisation of available-for-sale investments	**(24)**	80
Amortisation of held-to-maturity debt securities	**5**	5
Advances written off net of recoveries	**(607)**	(510)
Interest received	**18,403**	15,219
Interest paid	**(4,439)**	(2,301)
Operating profit before changes in working capital	**13,103**	13,375
Change in treasury bills and certificates of deposit with original maturity more than three months	**(24,344)**	32,409
Change in placings with and advances to banks maturing after one month	**4,801**	(26,155)
Change in trading assets	**(34,947)**	24,451
Change in financial assets designated at fair value	**150**	501
Change in derivative financial instruments	**1,048**	(111)
Change in advances to customers	**(13,419)**	(127,906)
Change in other assets	**(7,715)**	(15,680)
Change in financial liabilities designated at fair value	**–**	(2)
Change in current, savings and other deposit accounts	**16,229**	47,259
Change in deposits from banks	**(1,582)**	10,716
Change in trading liabilities	**17,131**	4,190
Change in certificates of deposit and other debt securities in issue	**6,189**	1,269
Change in other liabilities	**10,659**	15,448
Elimination of exchange differences and other non-cash items	**(4,836)**	(8,158)
Cash used in operating activities	**(17,533)**	(28,394)
Taxation paid	**(2,044)**	(1,704)
Net cash outflow from operating activities	**(19,577)**	(30,098)

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

	2011	2010
Cash and balances with banks and other financial institutions	**39,533**	44,411
Placings with and advances to banks and other financial institutions maturing within one month	**54,049**	53,457
Treasury bills	**23,738**	20,692
Certificates of deposit	**3,149**	–
	120,469	118,560

The balances of cash and cash equivalents included cash balances with central banks and financial institutions that are subject to exchange control and regulatory restrictions, amounting to HK$20,004 million at 31 December 2011 (31 December 2010: HK$13,331 million).

54. CONTINGENT LIABILITIES AND COMMITMENTS

(a) Off-balance sheet contingent liabilities and commitments

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

For the purposes of these financial statements, acceptances and endorsements are recognised on the balance sheet in "Other assets" and "Other liabilities" in accordance with HKAS 39. For the purpose of the Banking (Capital) Rules ("the Capital Rules"), acceptances and endorsements are included in the capital adequacy calculation as if they were contingencies. The contract amount of acceptances and endorsements included in the below tables for the Group and the Bank were HK$4,697 million (2010: HK$3,751 million) and HK$3,052 million (2010: HK2,363 million) respectively.

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

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

The risk-weighted assets at balance sheet dates were calculated based on the "Advanced internal ratings-based approach".

	Group			Bank		
	Contract amounts	Credit equivalent amounts	Risk-weighted amounts	Contract amounts	Credit equivalent amounts	Risk-weighted amounts
2011						
Direct credit substitutes	5,438	5,308	3,426	3,704	3,574	1,692
Transaction-related contingencies	1,220	138	72	1,178	135	72
Trade-related contingencies	9,807	979	532	7,933	791	394
Forward asset purchases	35	35	35	35	35	35
Undrawn formal standby facilities, credit lines and other commitments to lend:						
– not unconditionally cancellable*	31,311	15,081	5,384	31,262	14,243	5,334
– unconditionally cancellable	232,469	76,890	23,420	196,627	70,777	18,524
	280,280	98,431	32,869	240,739	89,555	26,051

54. CONTINGENT LIABILITIES AND COMMITMENTS (continued)

(a) Off-balance sheet contingent liabilities and commitments (continued)

	Group			Bank		
	Contract amounts	Credit equivalent amounts	Risk-weighted amounts	Contract amounts	Credit equivalent amounts	Risk-weighted amounts
2010						
Direct credit substitutes	4,365	4,220	3,231	3,263	3,118	2,129
Transaction-related contingencies	455	337	168	351	300	134
Trade-related contingencies	10,593	3,516	2,008	8,935	2,737	1,530
Forward asset purchases	51	51	51	51	51	51
Undrawn formal standby facilities, credit lines and other commitments to lend:						
– not unconditionally cancellable*	38,273	17,788	7,479	34,363	15,191	5,767
– unconditionally cancellable	198,724	66,852	20,649	170,333	60,379	15,042
	252,461	92,764	33,586	217,296	81,776	24,653

* The contract amount for undrawn formal standby facilities, credit lines and other commitments to lend with original maturity of "not more than one year" and "more than one year" as at 31 December 2011 were HK$11,487 million and HK$19,824 million respectively (31 December 2010: HK$13,264 million and HK$25,009 million).

(b) Contingencies

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

55. ASSETS PLEDGED AS SECURITY FOR LIABILITIES

At 31 December 2011, liabilities of the Group and the Bank which were secured by the deposit of assets, including assets subject to sale and repurchase arrangements for the Group and the Bank amounted to HK$25,569 million (Group and Bank at 31 December 2010: HK$18,971 million). The amounts of assets pledged to secure these liabilities by the Group and the Bank amounted to HK$25,881 million (Group and Bank at 31 December 2010: HK$19,270 million) and mainly comprised items included in "Trading assets" and "Financial investments".

These transactions are conducted under terms that are usual and customary to standard lending activities.

56. CAPITAL COMMITMENTS

	Group		Bank	
	2011	2010	**2011**	2010
Expenditure authorised and contracted for	**117**	162	**100**	121
Expenditure authorised but not contracted for	**–**	–	**–**	–

57. LEASE COMMITMENTS

The Group leases certain properties and equipment under operating leases. The leases typically run for an initial period of one to five years and may include an option to renew the lease when all terms are renegotiated. None of these leases includes contingent rentals.

The total future minimum lease payments payable under non-cancellable operating leases are as follows:

	Group		Bank	
	2011	2010	**2011**	2010
Within one year	**512**	454	**377**	338
Between one and five years	**647**	717	**517**	611
Over five years	**11**	14	**–**	–
	1,170	1,185	**894**	949

58. EMPLOYEE RETIREMENT BENEFITS

(a) Defined benefit schemes

The Group operates three defined benefit schemes, the Hang Seng Bank Limited Defined Benefit Scheme ("HSBDBS"), which is the principal scheme which covers about 40 per cent of the Group's employees, and two other schemes, the Hang Seng Bank Limited Pension Scheme ("HSBPS") and the Hang Seng Bank Limited Non-contributory Terminal Benefits Scheme ("HSBNTBS"). HSBDBS was closed to new entrants with effect from 1 April 1999, and HSBPS and HSBNTBS were closed to new entrants with effect from 31 December 1986.

These schemes are funded defined benefit schemes and are administered by trustees with assets held separately from those of the Group. The latest annual actuarial valuations at 31 December 2011 were performed by T Ching, fellow of the Society of Actuaries of the United States of America, of HSBC Insurance (Asia) Limited, a fellow subsidiary company of the Bank, using the Projected Unit Credit Method. The amounts recognised in the balance sheet at year-end and retirement benefits costs recognised in the income statement for the year in respect of these defined benefit schemes are set out below.

(i) The amounts recognised in the balance sheet are as follows:

	Group and Bank		
	HSBDBS	**HSBPS**	**HSBNTBS**
2011			
Present value of funded obligations (note 58(a)(iii))	**(7,066)**	**(201)**	**(1)**
Fair value of scheme assets (note 58(a)(iv))	**3,806**	**204**	**32**
Net (liabilities)/assets recognised in the balance sheet (note 58(a)(v))	**(3,260)**	**3**	**31**
Reported as "Assets"	**–**	**3**	**31**
Reported as "Liabilities"	**(3,260)**	**–**	**–**
	(3,260)	**3**	**31**
Obligations covered by scheme assets (%)	**54**	**101**	**3,200**
2010			
Present value of funded obligations (note 58(a)(iii))	(5,710)	(157)	(2)
Fair value of scheme assets (note 58(a)(iv))	3,992	222	32
Net (liabilities)/assets recognised in the balance sheet (note 58(a)(v))	(1,718)	65	30
Reported as "Assets"	–	65	30
Reported as "Liabilities"	(1,718)	–	–
	(1,718)	65	30
Obligations covered by scheme assets (%)	70	141	1,600

The Occupational Retirement Schemes Ordinance (Cap.426 of the laws of Hong Kong) ("the Ordinance") requires that registered retirement benefit schemes shall at all time be fully funded to meet its aggregate vested liability (i.e. on a wind-up basis) in accordance with the recommendations contained in an actuarial certificate supplied under the Ordinance. Any shortfall must be made up within the specified time under the Ordinance. Any deficits to meet the aggregate past service liability (i.e. on an on-going basis) can however be eliminated over a period of time in accordance with the funding recommendations of an actuary.

On an on-going basis, the actuarial value of the principal scheme assets of HSBDBS represented 87 per cent (2010: 97 per cent) of the benefits accrued to scheme members, after allowing for expected future increases in salaries, and the resulting deficit amounted to HK$594 million (deficit in 2010: HK$109 million). On a wind-up basis, the actuarial value of the scheme assets represented 92 per cent (2010: 102 per cent) of the members' vested benefits, based on salaries at that date, and the resulting deficit amounted to HK$316 million (surplus in 2010: HK$71 million).

58. EMPLOYEE RETIREMENT BENEFITS (continued)

(a) Defined benefit schemes (continued)

(ii) The composition of the scheme assets are as follows:

	Group and Bank		
	HSBDBS	HSBPS	HSBNTBS
2011			
Equity	**1,324**	**14**	**–**
Bonds	**2,307**	**170**	**–**
Ordinary shares issued by ultimate holding company	**35**	**–**	**–**
Other	**140**	**20**	**32**
	3,806	**204**	**32**
2010			
Equity	1,297	29	–
Bonds	2,570	170	–
Ordinary shares issued by ultimate holding company	45	–	–
Other	80	23	32
	3,992	222	32

(iii) Change in the present value of scheme obligations

	Group and Bank		
	HSBDBS	HSBPS	HSBNTBS
2011			
At 1 January	**5,710**	**157**	**2**
Current service cost	**265**	**–**	**–**
Interest cost	**160**	**5**	**–**
Actuarial losses/(gains)	**1,217**	**54**	**(1)**
Benefits paid	**(286)**	**(15)**	**–**
At 31 December	**7,066**	**201**	**1**
2010			
At 1 January	5,557	170	2
Current service cost	267	–	–
Interest cost	141	4	–
Actuarial losses/(gains)	51	(3)	1
Benefits paid	(306)	(14)	(1)
At 31 December	5,710	157	2

58. EMPLOYEE RETIREMENT BENEFITS (continued)

(a) Defined benefit schemes (continued)

(iv) Change in the fair value of scheme assets

	Group and Bank		
	HSBDBS	HSBPS	HSBNTBS
2011			
At 1 January	**3,992**	**222**	**32**
Contributions by the Bank	**227**	**–**	**–**
Expected return on scheme assets	**190**	**9**	**1**
Experience losses	**(317)**	**(12)**	**(1)**
Benefits paid	**(286)**	**(15)**	**–**
At 31 December	**3,806**	**204**	**32**
2010			
At 1 January	3,845	225	33
Contributions by the Bank	183	–	–
Expected return on scheme assets	212	8	1
Experience gains/(losses)	58	3	(1)
Benefits paid	(306)	(14)	(1)
At 31 December	3,992	222	32

The Group and the Bank expect to make HK$416 million of contributions to defined benefit schemes during the following year (2010: HK$231 million).

(v) Movements in the net (liabilities)/assets recognised in the balance sheet are as follows:

	Group and Bank		
	HSBDBS	HSBPS	HSBNTBS
2011			
At 1 January	**(1,718)**	**65**	**30**
Contributions by the Bank	**227**	**–**	**–**
Net (expense)/income recognised in the income statement (note 58(a)(vi))	**(235)**	**4**	**1**
Net actuarial losses	**(1,534)**	**(66)**	**–**
At 31 December	**(3,260)**	**3**	**31**
Experience (losses)/gains on scheme liabilities	**(91)**	**(6)**	**1**
Experience losses on scheme assets	**(317)**	**(12)**	**(1)**
Losses from change in actuarial assumptions	**(1,126)**	**(48)**	**–**
Net actuarial losses	**(1,534)**	**(66)**	**–**
2010			
At 1 January	(1,712)	55	31
Contributions by the Bank	183	–	–
Net (expense)/income recognised in the income statement (note 58(a)(vi))	(196)	4	1
Net actuarial gains/(losses)	7	6	(2)
At 31 December	(1,718)	65	30
Experience losses on scheme liabilities	(14)	(1)	(1)
Experience gains/(losses) on scheme assets	58	3	(1)
(Losses)/gains from change in actuarial assumptions	(37)	4	–
Net actuarial gains/(losses)	7	6	(2)

58. EMPLOYEE RETIREMENT BENEFITS (continued)

(a) Defined benefit schemes (continued)

(vi) Amounts recognised in the income statement are as follows:

	Group and Bank		
	HSBDBS	HSBPS	HSBNTBS
2011			
Current service cost	**(265)**	**–**	**–**
Interest cost	**(160)**	**(5)**	**–**
Expected return on scheme assets	**190**	**9**	**1**
Net (expense)/income for the year (note 17)	**(235)**	**4**	**1**
Actual return on scheme assets	**(127)**	**(3)**	**–**
2010			
Current service cost	(267)	–	–
Interest cost	(141)	(4)	–
Expected return on scheme assets	212	8	1
Net (expense)/income for the year (note 17)	(196)	4	1
Actual return on scheme assets	270	11	–

The net actuarial losses recognised in the Group's retained profit during 2011 in respect of defined benefit schemes were HK$1,336 million (net actuarial gains of HK$9 million during 2010). The total cumulative amount of actuarial losses recognised in the retained profit was HK$3,238 million (2010: the cumulative amount of actuarial losses was HK$1,902 million). The total effect of the limit on schemes surpluses in 2011 and 2010 in respect of defined benefit schemes was nil.

(vii) The principal actuarial assumptions used as at 31 December (expressed as weighted averages) are as follows:

	Group and Bank		
	HSBDBS %	HSBPS %	HSBNTBS %
2011			
Discount rate	**1.5**	**1.5**	**1.5**
Expected rate of return on scheme assets	**4.5**	**4.0**	**1.8**
Expected rate of salary increases	**5.0**	**5.0**	**5.0**
Expected rate of pension increases	**–**	**1.5**	**–**
2010	%	%	%
Discount rate	2.9	2.9	2.9
Expected rate of return on scheme assets	4.5	4.0	2.5
Expected rate of salary increases	5.0	5.0	5.0
Expected rate of pension increases	–	1.0	–

The expected rate of return on scheme assets represents the best estimate of long-term future asset returns, which takes into account historical market returns plus additional factors such as the current rate of inflation and interest rates.

58. EMPLOYEE RETIREMENT BENEFITS (continued)

(a) Defined benefit schemes (continued)

(viii) Amounts for the current and previous years

	Group and Bank				
	2011	2010	2009	2008	2007
Defined benefit obligations	**7,268**	5,869	5,729	7,183	5,913
Plan assets	**4,042**	4,246	4,103	3,681	5,388
Net deficits	**(3,226)**	(1,623)	(1,626)	(3,502)	(525)
Experience (losses)/gains on scheme liabilities	**(96)**	(16)	293	260	(212)
Experience (losses)/gains on scheme assets	**(330)**	60	348	(1,989)	416
(Losses)/gains from change in actuarial assumptions	**(1,174)**	(33)	1,236	(1,287)	(1,711)

(b) Defined contribution schemes

The principal defined contribution scheme for Group employees joining on or after 1 April 1999 is the HSBC Group Hong Kong Local Staff Defined Contribution Scheme. The Group also operates three other defined contribution schemes, the Hang Seng Bank Provident Fund Scheme which was closed to new entrants since 31 December 1986, the Hang Seng Insurance Company Limited Employees' Provident Fund and the Hang Seng Bank (Bahamas) Limited Defined Contribution Scheme for employees of the respective subsidiaries. The Bank and relevant Group entities also participated in mandatory provident fund schemes ("MPF schemes") registered under the Hong Kong Mandatory Provident Fund Ordinance, which are also defined contribution schemes.

Contributions made in accordance with the relevant scheme rules to these defined contribution schemes (including MPF schemes) are charged to the income statement as below:

	2011	2010
Amounts charged to the income statement (note 17)	**92**	78

Under the schemes, the Group's contributions are reduced by contributions forfeited by those employees who leave the schemes prior to the contributions vesting fully. There was no forfeited contributions utilised during the year or available at the year-end to reduce future contributions (2010: Nil).

59. SHARE-BASED PAYMENTS

The Group participated in various share compensation plans operated by the HSBC Group for acquiring of HSBC Holdings plc shares. They are the Savings-Related Share Option Plan, Executive/Group Share Option Plan and Restricted Share/Performance Share/Achievement Share Awards. These are to be settled by the delivery of shares of HSBC Holdings plc.

Share Awards Plans

Award	Policy	Purpose
Restricted Share Awards	– Vesting of awards based on continued employment within the Group of between one and five years from the date of award – Shares awarded without corporate performance conditions – Certain shares awarded subject to a retention requirement until cessation of employment	– Rewards employee performance, potential and retention requirements – To aid recruitment – Part-deferral of annual bonuses
Performance Share Awards	– Vesting of awards based on three independent performance measures (relative corporate performance condition, economic profit and growth in earnings per share) – Performance conditions are measured over a three year period and reviewed annually – Awards are forfeited to the extent the performance conditions have not been met	– Recognise individual performance and potential
Achievement Share Awards	– Additional awards made throughout the three-year vesting period – Original award together with the additional share awards are released after three years of continued employment within the Group – Shares awarded without corporate performance conditions	– Rewards eligible employees for their performance – High performing and/or senior and middle managers are normally eligible to receive achievement shares during their annual pay review

Share Option Plans

Plans	Policy	Purpose
Savings-Related Share Option Plan	– Exercisable within three months following the first anniversary of the commencement of a one-year savings contract or within six months following either the third or fifth anniversaries of the commencement of three-year or five-year contracts, respectively – The exercise price is set at a 20% (2010: 20%) discount to the market value immediately preceding the date of invitation	– Eligible employees save up to £250 per month (or its equivalent in Hong Kong dollars), with the option to use the savings to acquire shares
Executive Share Option Scheme ("ESOS") and Group Share Option Plan ("GSOP")	– Vesting of awards based on achievement of certain corporate performance condition targets – Exercisable between third and tenth anniversaries of the date of grant – Plan ceased in 2004	– Long-term incentive plan between 2000 and 2004 during which certain employees were awarded share options

59. SHARE-BASED PAYMENTS (continued)

(a) Savings-Related Share Option Plan

The number of options, weighted average exercise price, and the weighted average remaining contractual life for options outstanding at the date of balance sheet, are as follows:

(i) Option scheme with exercise price set in pounds sterling

	2011		2010	
	Weighted average exercise price £	**Number ('000)**	Weighted average exercise price £	Number ('000)
Outstanding at 1 January	**–**	**–**	5.82	29
Exercised in the year	**–**	**–**	5.82	(23)
Lapsed in the year	**–**	**–**	5.82	(6)
Outstanding at 31 December	**–**	**–**	–	–
Exercisable at 31 December	**–**	**–**	–	–

There was no share options exercised during the year. The weighted average share price at the date of exercise for share options exercised during the year of 2010 was £6.53.

There was no option outstanding at the end of the year 2011 and 2010.

(ii) Option scheme with exercise price set in Hong Kong dollars

	2011		2010	
	Weighted average exercise price HK$	**Number ('000)**	Weighted average exercise price HK$	Number ('000)
Outstanding at 1 January	**41.18**	**11,292**	38.30	12,193
Granted in the year	**63.99**	**1,493**	62.97	1,561
Exercised in the year	**62.20**	**(772)**	37.98	(1,749)
Lapsed in the year	**41.18**	**(1,127)**	38.30	(713)
Outstanding at 31 December	**41.31**	**10,886**	41.18	11,292
Exercisable at 31 December	**–**	**–**	–	–

The weighted average share price at the date of exercise for share options exercised during the year was HK$69.24 (2010: HK$79.38).

The options outstanding at the year end of 2011 had an exercise price in the range of HK$37.88 to HK$94.51 (2010: HK$37.88 to HK$94.51), and a weighted average remaining contractual life of 1.95 years (2010: 2.82 years).

The weighted average fair value of options granted during 2011 was HK$15.54 (2010: HK$18.80).

59. SHARE-BASED PAYMENTS (continued)

(b) Executive/Group Share Option Plan

The number of options, weighted average exercise price, and the weighted average remaining contractual life for options outstanding at balance sheet date, are as follows:

	2011		2010	
	Weighted average exercise price £	Number ('000)	Weighted average exercise price £	Number ('000)
Outstanding at 1 January	**7.10**	**2,251**	7.04	2,652
Exercised in the year	**6.02**	**(19)**	6.40	(145)
Lapsed in the year	**7.10**	**(561)**	7.04	(256)
Outstanding at 31 December	**6.95**	**1,671**	7.10	2,251

The weighted average share price at the date of exercise for share options exercised during the year was £6.60 (2010: £6.76).

The options outstanding at the year end of 2011 had an exercise price in the range of £6.02 to £7.32 (2010: £6.02 to £7.59), and a weighted average remaining contractual life of 1.61 years (2010: 2.15 years).

(c) Calculation of fair value

The recognition of compensation cost of share option is based on the fair value of the options on grant date. The calculation of the fair value of HSBC share option is centrally managed by HSBC Holdings plc. Fair values of share options, measured at the date of grant of the options are calculated using a binomial lattice model methodology that is based on the underlying assumptions of the Black-Scholes model. Expected dividends are incorporated into the valuation model for share options and awards where applicable. The expected life of options depends on the behaviour of option holders, which is incorporated into the option model consistent with historic observable data. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used.

The significant weighted average assumptions used to estimate the fair value of the options granted during the year were as follows:

	1-year Savings-Related Share Option Plan	3-year Savings-Related Share Option Plan	5-year Savings-Related Share Option Plan
2011			
Risk-free interest rate (%)	**0.8**	**1.7**	**2.5**
Expected life (years)	**1**	**3**	**5**
Expected volatility (%)	**25**	**25**	**25**
Share price at grant date (HK$)	**82.90**	**82.90**	**82.90**
2010			
Risk-free interest rate (%)	0.7	1.9	2.9
Expected life (years)	1	3	5
Expected volatility (%)	30	30	30
Share price at grant date (HK$)	82.05	82.05	82.05

The risk-free rate was determined from the UK gilts yield curve for Savings-Related Share Option Plan. Expected life is not a single input parameter but a function of various behavioural assumptions. Expected volatility is estimated by considering both historic average share price volatility and implied volatility derived from traded options over HSBC shares of similar maturity to those of the employee options. Expected dividend yield was based on historic levels of dividend growth.

59. SHARE-BASED PAYMENTS (continued)

(d) Restricted Share Awards/Performance Share Awards/Achievement Share Awards

	2011 Number ('000)	2010 Number ('000)
Outstanding at 1 January	**803**	957
Additions during the year	**19**	28
Released in the year	**(522)**	(182)
Outstanding at 31 December	**300**	803

The closing price of the HSBC Holdings plc share at 31 December 2011 was £4.91 (2010: £6.51).

The weighted average remaining vesting period as at 31 December 2011 was 0.94 years (2010: 1.21 years).

(e) Income statement charge

	2011	2010
Share awards plans	**26**	30
Share option plans	**62**	70
	88	100
Equity-settled share-based payments*	**86**	100
Cash-settled share-based payments	**2**	–
	88	100

* This charge, which was computed from the fair values of the share-based payment transaction when contracted, arose under employee share awards made in accordance with the Group's reward structures.

60. MATERIAL RELATED-PARTY TRANSACTIONS

(a) Immediate holding company and its subsidiaries, fellow subsidiary companies, subsidiaries and associates

In 2011, the Group entered into transactions with its immediate holding company and its subsidiaries and fellow subsidiary companies in the ordinary course of its interbank activities including lending activities, acceptance and placement of interbank deposits, correspondent banking transactions, off-balance sheet transactions and the provision of other banking and financial services. The activities were on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

The Group used the IT service of, and shared an automated teller machine network with, its immediate holding company. The Group also shared certain IT projects with and used certain processing services of fellow subsidiaries on a cost recovery basis. The Group maintained a staff retirement benefit scheme for which a fellow subsidiary company acts as insurer and administrator. A fellow subsidiary company was appointed as fund manager to manage the Group's investment portfolios. The Bank acted as agent for the marketing of Mandatory Provident Fund products and the distribution of retail investment funds for two fellow subsidiary companies.

There was an arrangement whereby a fellow subsidiary provided certain management services, being services related to risk management, back office processing and administration, development and pricing of selected products, information technology and business recovery, financial control and actuarial services, to Hang Seng Insurance Company Limited. The fees on these transactions are determined on an arm's length basis.

60. MATERIAL RELATED-PARTY TRANSACTIONS (continued)

(a) Immediate holding company and its subsidiaries, fellow subsidiary companies, subsidiaries and associates (continued)

The aggregate amount of income and expenses arising from these transactions during the year, the balances of amounts due to and from the relevant related parties, and the total contract sum of off-balance sheet transactions at the year-end are as follows:

	Group					
	Immediate holding company and its subsidiaries		Fellow subsidiaries		Associates	
	2011	2010	**2011**	2010	**2011**	2010 (restated)
Interest income	**72**	84	**2**	–	**116**	48
Interest expense	**(191)**	(39)	**(2)**	(3)	**1**	–
Other operating income	**123**	104	**(3)**	–	**8**	6
Operating expenses*	**(743)**	(740)	**(522)**	(442)	**(18)**	(14)
Amounts due from:						
Cash and balances with banks and other financial institutions	**1,220**	463	**4,140**	2,081	**–**	5
Placings with and advances to banks and other financial institutions	**3,412**	8,915	**–**	–	**6,898**	5,547
Financial assets designated at fair value	**114**	123	**3,425**	3,418	**–**	–
Derivative financial instruments	**253**	586	**31**	19	**–**	–
Advances to customers	**–**	–	**–**	–	**233**	233
Financial investments	**243**	334	**–**	–	**–**	–
Other assets	**53**	64	**–**	–	**4**	3
	5,295	10,485	**7,596**	5,518	**7,135**	5,788
Amounts due to:						
Current, savings and other deposit accounts	**126**	332	**–**	–	**110**	68
Deposits from banks	**829**	2,484	**–**	8	**610**	117
Derivative financial instruments	**581**	494	**66**	59	**–**	–
Other liabilities	**373**	326	**62**	67	**–**	–
Subordinated liabilities	**9,518**	6,025	**–**	–	**–**	–
	11,427	9,661	**128**	134	**720**	185
Derivative contracts:						
Contract amount	**69,104**	75,230	**20,647**	15,780	**–**	–
Guarantees:						
Guarantees issued	**–**	2	**–**	–	**116**	116
Committed facilities:						
Committed facilities from	**–**	826	**–**	–	**–**	–
Committed facilities to	**–**	–	**–**	–	**–**	–

* 2011 Operating expenses included payment of HK$140 million (2010: HK$97 million) of software costs which were capitalised as intangible assets in the balance sheet of the Group.

60. MATERIAL RELATED-PARTY TRANSACTIONS (continued)

(a) Immediate holding company and its subsidiaries, fellow subsidiary companies, subsidiaries and associates (continued)

	Bank							
	Immediate holding company and its subsidiaries		Fellow subsidiaries		Subsidiaries		Associates	
	2011	2010	**2011**	2010	**2011**	2010	**2011**	2010 (restated)
Amounts due from:								
Cash and balances with banks and other financial institutions	**1,140**	390	**4,062**	2,018	**–**	–	**–**	–
Placings with and advances to banks and other financial institutions	**–**	4,683	**–**	–	**–**	–	**5,309**	3,568
Financial assets designated at fair value	**–**	–	**–**	–	**–**	–	**–**	–
Derivative financial instruments	**184**	418	**31**	19	**373**	88	**–**	–
Advances to customers	**–**	–	**–**	–	**–**	–	**–**	–
Amounts due from subsidiaries	**–**	–	**–**	–	**85,222**	93,445	**–**	–
Financial investments	**–**	–	**–**	–	**–**	–	**–**	–
Other assets	**35**	18	**–**	–	**–**	–	**4**	3
	1,359	5,509	**4,093**	2,037	**85,595**	93,533	**5,313**	3,571
Amounts due to:								
Current, savings and other deposit accounts	**52**	233	**–**	–	**–**	–	**110**	68
Deposits from banks	**822**	2,484	**–**	8	**–**	–	**117**	117
Derivative financial instruments	**315**	334	**66**	59	**211**	298	**–**	–
Subordinated liabilities	**9,518**	6,025	**–**	–	**–**	–	**–**	–
Amounts due to subsidiaries	**–**	–	**–**	–	**10,797**	8,899	**–**	–
Other liabilities	**223**	276	**61**	65	**–**	–	**–**	–
	10,930	9,352	**127**	132	**11,008**	9,197	**227**	185
Derivative contracts:								
Contract amount	**40,354**	57,371	**20,647**	15,780	**25,874**	33,333	**–**	–
Guarantees:								
Guarantees issued	**–**	2	**–**	–	**565**	559	**116**	116
Guarantees received	**–**	–	**–**	–	**165**	159	**–**	–
Committed facilities:								
Committed facilities from	**–**	–	**–**	–	**–**	–	**–**	–
Committed facilities to	**–**	–	**–**	–	**1,500**	2,332	**–**	–

60. MATERIAL RELATED-PARTY TRANSACTIONS (continued)

(b) Key management personnel remuneration

Remuneration for key management personnel, including amounts paid to the Bank's directors as disclosed in note 19 and highest paid employees as disclosed in note 18, is as follows:

	Group		Bank	
	2011	2010 (restated)	**2011**	2010 (restated)
Salaries, allowances and benefits in kind	**37**	30	**37**	30
Retirement scheme contributions	**5**	5	**5**	5
Variable bonuses	**31**	30	**31**	30
	73	65	**73**	65

(c) Material transactions with key management personnel

During the year, the Group provided credit facilities to and accepted deposits from key management personnel of the Bank and its holding companies, their close family members and companies controlled or significantly influenced by them. The credit facilities extended and deposit taken were provided in the ordinary course of business and on substantially the same terms as for comparable transactions with persons of a similar standing or, where applicable, with other employees.

Material transactions conducted with key management personnel of the Bank and its holding companies and parties related to them are as follows:

	Group		Bank	
	2011	2010 (restated)	**2011**	2010 (restated)
Interest received	**192**	173	**192**	173
Interest paid	**8**	4	**8**	4
Fees and exchange income received	**15**	18	**15**	18
Loans and advances	**10,857**	12,156	**10,210**	11,363
Deposits	**2,784**	2,906	**2,703**	2,906
Undrawn commitments	**1,844**	1,969	**1,412**	1,670
Maximum aggregate amount of loans and advances during the year	**13,714**	14,542	**12,736**	13,401

The Group adheres to section 83 of the Hong Kong Banking Ordinance regarding lending to related parties; this includes unsecured lending to key management personnel, their relatives and companies that may be directly or indirectly influenced or controlled by such individuals.

No impairment losses have been recorded against balances outstanding during the year with key management personnel, and there is no specific impairment allowances on balances with key management personnel at the year-end.

60. MATERIAL RELATED-PARTY TRANSACTIONS (continued)

(d) Loans to officers

Loans to officers of the Bank disclosed pursuant to section 161B of the Hong Kong Companies Ordinance are as follows:

	Group		Bank	
	2011	2010 (restated)	**2011**	2010 (restated)
Aggregate amount of relevant transactions outstanding at 31 December	**20**	8	**20**	8
Maximum aggregate amount of relevant transactions during the year	**28**	17	**28**	17

(e) Associates

Information relating to associates and transactions with associates can be found in notes 38 and 60(a).

The Group maintains a shareholders' loan to an associate. The shareholders' loan is unsecured, interest free and with no fixed term of repayment. The balance at 31 December 2011 was HK$233 million (2010: HK$233 million).

The Bank has been assisting Industrial Bank Co., Ltd. in managing and growing the credit card business.

The Bank has entered into Technical Support Agreement with Yantai Bank Co., Ltd. ("Yantai Bank") to provide technical support and assistance in relation to various banking operations and businesses of Yantai Bank.

(f) Ultimate holding company

The Group participates in various share option and share plans operated by HSBC Holdings plc whereby share options or shares of HSBC Holdings plc are granted to employees of the Group. As disclosed in note 59, the Group recognises an expense in respect of these share options and share awards. The cost borne by the ultimate holding company in respect of these share options and share awards is treated as a capital contribution and is recorded under "Other reserves". The balance of this reserve as at 31 December 2011 amounted to HK$571 million comprising HK$576 million relating to share option schemes and negative reserve amounted to HK$5 million relating to share award schemes (2010: HK$510 million comprising HK$514 million relating to share option schemes and negative reserve amounted to HK$4 million relating to share award schemes).

(g) Employee retirement benefits

At 31 December 2011, defined benefit scheme assets amounted to HK$1,152 million (2010: HK$1,269 million) were under management by fellow subsidiary companies. The amount of management fee paid to these companies amounted to HK$5 million (2010: HK$5 million).

61. FINANCIAL RISK MANAGEMENT

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

The Group's risk management policy is designed to identify and analyse risks, to set appropriate risk limits and to monitor these risks and limits continually by means of reliable and up-to-date management information systems. The Group's risk management policies and major control limits are approved by the Board of Directors and they are monitored and reviewed regularly by various management committees, including the Executive Committee, Audit Committee, Asset and Liability Management Committee ("ALCO") and Risk Management Committee ("RMC").

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

(a) Credit risk

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

The Credit Risk Management ("CRM") function headed by the Chief Credit Officer who reported to Chief Risk Officer is mandated to provide centralised management of credit risk through:

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

Impaired loan management and recovery

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

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

Risk rating framework

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

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

Collateral and other credit enhancements

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

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

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

- in the commercial real estate sector, charges over the properties being financed.

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

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

Settlement risk

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

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

Concentration of credit risk

Concentration of credit risk exists when changes in geographic, economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is material in relation to the Group's total exposures. The Group's portfolio of financial instrument is diversified along geographic, industry and product sectors. Analysis of geographical concentration of the Group's assets is disclosed in note 27 to the financial statements and credit risk concentration of respective financial assets is disclosed in notes 32, 33, 35 and 36.

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

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

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

	Group		Bank	
	2011	2010	**2011**	2010
Cash and balances with banks and other financial institutions	**39,533**	44,411	**36,475**	41,062
Placings with and advances to banks and other financial institutions	**107,742**	110,564	**47,724**	52,131
Trading assets	**64,164**	26,047	**60,519**	25,224
Financial assets designated at fair value	**3,999**	4,440	**140**	148
Derivative financial instruments	**4,710**	5,593	**4,436**	5,026
Advances to customers	**480,574**	472,637	**425,629**	423,074
Financial investments	**208,931**	199,033	**105,080**	102,985
Amounts due from subsidiaries	**–**	–	**85,222**	93,445
Other assets	**13,442**	11,754	**9,066**	8,419
Financial guarantees and other credit related contingent liabilities	**11,694**	11,392	**9,764**	9,916
Loan commitments and other credit related commitments	**354,837**	347,019	**316,338**	314,108
	1,289,626	1,232,890	**1,100,393**	1,075,538

(ii) Collateral and other credit enhancements

Loans and advances

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

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

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(ii) Collateral and other credit enhancements (continued)

Personal lending

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

Residential mortgages

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

Residential mortgages loans and advances

	2011	2010
Uncollateralised	**–**	–
Fully collateralised		
– Less than 25% LTV	**19,790**	18,472
– 25% to 50% LTV	**72,383**	64,035
– 51% to 75% LTV	**49,482**	65,794
– 76% to 90% LTV	**4,058**	6,055
– 91% to 100% LTV	**863**	759
	146,576	155,115
Partially collateralised loans and advances		
– Greater than 100% LTV	**1**	2
Total residential mortgages	**146,577**	155,117
Value of specific collateral held for partially collateralised loans and advances	**1**	2

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

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

Other personal lending

The remainder of our personal lending consists primarily of motor vehicle finance, credit cards, instalment loan, overdraft or revolving loan. Motor vehicle lending is generally collateralised by the motor vehicle financed. Credit cards are generally unsecured. Instalment loan, overdraft and revolving loan could be partially secured by cash or marketable securities.

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(ii) Collateral and other credit enhancements (continued)

Corporate and commercial and financial (non-bank) lending

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

Commercial real estate

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

Commercial real estate loans and advances

	2011	2010
Rated – CRR/EL 1 to 7		
Uncollateralised	**8,713**	5,926
Fully collateralised	**46,718**	40,992
Partially collateralised	**3,879**	2,509
Value of specific collateral held for partially collateralised loans and advances	**2,929**	2,093
Rated – CRR/EL 8 to 10		
Uncollateralised	**–**	–
Fully collateralised	**7**	3
Partially collateralised	**–**	–
Value of specific collateral held for partially collateralised loans and advances	**–**	–

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

The value of collateral is determined through a combination of professional valuations, physical inspections or house price indices. The collateral valuation will exclude any adjustments for obtaining and selling the collateral.

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

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

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

	2011	2010
Rated – CRR/EL 8 to 10		
Uncollateralised	**1,169**	1,241
Fully collateralised	**520**	822
Partially collateralised	**147**	215
Value of specific collateral held for partially collateralised loans and advances	**75**	106

The collateral used in the assessment of the above relates primarily to charges held over business assets in the commercial and industrial sector and charges over marketable financial instruments in the financial sector.

The value of collateral is determined through a combination of professional valuations, physical inspections or house price indices. The collateral valuation will exclude any adjustments with respect of obtaining and selling the collateral.

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(ii) Collateral and other credit enhancements (continued)

Loans and advances to banks

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

Loans and advances to banks

	2011	2010
Uncollateralised	**107,742**	110,564
Fully collateralised	**–**	–
Partially collateralised	**–**	–
Value of specific collateral held for partially collateralised loans and advances	**–**	–

Derivatives

The International Swaps and Derivatives Association ("ISDA") Master Agreement is our preferred agreement for documenting derivatives activity. It provides the contractual framework within which dealing activity across a full range of OTC products is conducted, and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or another pre-agreed termination event occurs. It is common, and our preferred practice, for the parties to execute a Credit Support Annex ("CSA") in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between the parties to mitigate the counterparty risk inherent in outstanding positions. The majority of our CSAs are with financial institutional clients.

Other

The table below describes other types of collateral held, other credit enhancements employed and methods used to mitigate credit risk arising from financial assets presented in the maximum exposure to credit risk table on page 200.

Cash and balances with banks and other financial institutions	Generally no collateral or other credit enhancements held.
Items in the course of collection from other banks	Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt of cash, securities or equities. Daily settlement limits are established for counterparties to cover the aggregate of our transactions with each one on any single day. We generally mitigate settlement risk on many transactions, particularly those involving securities and equities, by settling through assured payment systems or on a delivery-versus-payment basis.
Trading assets, Financial assets designated at fair value, Financial investments	Debt securities, treasury and other eligible bills consist of government, bank or other financial institution issued securities for which either government guarantees are held or no collateral is held.
Other assets	Generally no collateral or other credit enhancements held.
Advances to customers, Financial guarantees and similar contracts, Loan commitment and other credit related commitments	Depending on the customer's standing and the type of products, facilities may be secured or unsecured. The general types of collaterals and other credit enhancements are highlighted in page 199.

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(iii) Credit quality

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

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

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

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

Quality classification definitions:

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

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

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

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

The Group's policy in respect of impairment on loans and advances and debt securities is set out in note 4 on the financial statements. Analysis of impairment allowances as at 31 December 2011 and the movement of such allowances during the year are disclosed in note 35.

Granular risk rating scales:

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

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

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(iii) Credit quality (continued)

Distribution of financial instruments by credit quality

	Group						
	Neither past due nor impaired						
	Strong	Medium*	Sub-standard	Past due not impaired	Impaired	Impairment allowances	Total
2011							
Items in the course of collection from other banks	4,319	194	–	–	–	–	4,513
Trading assets:							
– treasury and eligible bills	54,220	–	–	–	–	–	54,220
– debt securities	9,418	20	–	–	–	–	9,438
– loans and advances to banks	–	501	–	–	–	–	501
– loans and advances to customers	5	–	–	–	–	–	5
	63,643	521	–	–	–	–	64,164
Financial assets designated at fair value:							
– treasury and eligible bills	–	–	–	–	–	–	–
– debt securities	3,962	37	–	–	–	–	3,999
– loans and advances to banks	–	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–	–
	3,962	37	–	–	–	–	3,999
Derivatives	3,094	1,555	61	–	–	–	4,710
Loans and advances held at amortised cost:							
– loans and advances to banks	124,140	13,644	–	–	–	–	137,784
– loans and advances to customers	280,312	194,278	2,842	3,225	1,584	(1,667)	480,574
	404,452	207,922	2,842	3,225	1,584	(1,667)	618,358
Financial investments:							
– treasury and similar bills	43,296	–	–	–	–	–	43,296
– debt securities	157,242	8,393	–	–	–	–	165,635
	200,538	8,393	–	–	–	–	208,931
Other assets:							
– acceptances and endorsements	1,512	2,988	197	–	–	–	4,697
– other	2,168	2,016	6	42	–	–	4,232
	3,680	5,004	203	42	–	–	8,929

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(iii) Credit quality (continued)

	Group						
	Neither past due nor impaired						
	Strong	Medium*	Sub-standard	Past due not impaired	Impaired	Impairment allowances	Total
2010							
Items in the course of collection from other banks	4,589	84	–	–	–	–	4,673
Trading assets:							
– treasury and eligible bills	20,204	–	–	–	–	–	20,204
– debt securities	5,063	56	–	–	–	–	5,119
– loans and advances to banks	700	–	–	–	–	–	700
– loans and advances to customers	24	–	–	–	–	–	24
	25,991	56	–	–	–	–	26,047
Financial assets designated at fair value:							
– treasury and eligible bills	–	–	–	–	–	–	–
– debt securities	4,438	2	–	–	–	–	4,440
– loans and advances to banks	–	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–	–
	4,438	2	–	–	–	–	4,440
Derivatives	4,235	1,284	74	–	–	–	5,593
Loans and advances held at amortised cost:							
– loans and advances to banks	135,797	13,077	–	–	–	–	148,874
– loans and advances to customers	271,974	194,139	2,990	3,380	1,990	(1,836)	472,637
	407,771	207,216	2,990	3,380	1,990	(1,836)	621,511
Financial investments:							
– treasury and similar bills	18,010	–	–	–	–	–	18,010
– debt securities	175,887	5,136	–	–	–	–	181,023
	193,897	5,136	–	–	–	–	199,033
Other assets:							
– acceptances and endorsements	1,034	2,688	29	–	–	–	3,751
– other	1,752	1,538	5	35	–	–	3,330
	2,786	4,226	34	35	–	–	7,081

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(iii) Credit quality (continued)

	Bank						
	Neither past due nor impaired						
	Strong	Medium*	Sub-standard	Past due not impaired	Impaired	Impairment allowances	Total
2011							
Items in the course of collection from other banks	4,319	194	–	–	–	–	4,513
Trading assets:							
– treasury and eligible bills	54,220	–	–	–	–	–	54,220
– debt securities	5,773	20	–	–	–	–	5,793
– loans and advances to banks	–	501	–	–	–	–	501
– loans and advances to customers	5	–	–	–	–	–	5
	59,998	521	–	–	–	–	60,519
Financial assets designated at fair value:							
– treasury and eligible bills	–	–	–	–	–	–	–
– debt securities	140	–	–	–	–	–	140
– loans and advances to banks	–	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–	–
	140	–	–	–	–	–	140
Derivatives	2,978	1,420	38	–	–	–	4,436
Loans and advances held at amortised cost:							
– loans and advances to banks	68,279	6,673	–	–	–	–	74,952
– loans and advances to customers	257,965	163,570	1,577	2,522	1,404	(1,409)	425,629
	326,244	170,243	1,577	2,522	1,404	(1,409)	500,581
Financial investments:							
– treasury and similar bills	43,296	–	–	–	–	–	43,296
– debt securities	59,860	1,924	–	–	–	–	61,784
	103,156	1,924	–	–	–	–	105,080
Other assets:							
– acceptances and endorsements	867	2,157	28	–	–	–	3,052
– other	674	823	2	2	–	–	1,501
	1,541	2,980	30	2	–	–	4,553

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(iii) Credit quality (continued)

Bank

	Neither past due nor impaired						
	Strong	Medium*	Sub-standard	Past due not impaired	Impaired	Impairment allowances	Total
2010							
Items in the course of collection from other banks	4,589	84	–	–	–	–	4,673
Trading assets:							
– treasury and eligible bills	20,204	–	–	–	–	–	20,204
– debt securities	4,240	56	–	–	–	–	4,296
– loans and advances to banks	700	–	–	–	–	–	700
– loans and advances to customers	24	–	–	–	–	–	24
	25,168	56	–	–	–	–	25,224
Financial assets designated at fair value:							
– treasury and eligible bills	–	–	–	–	–	–	–
– debt securities	148	–	–	–	–	–	148
– loans and advances to banks	–	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–	–
	148	–	–	–	–	–	148
Derivatives	3,744	1,220	62	–	–	–	5,026
Loans and advances held at amortised cost:							
– loans and advances to banks	80,171	7,165	–	–	–	–	87,336
– loans and advances to customers	247,256	171,341	1,984	2,463	1,462	(1,432)	423,074
	327,427	178,506	1,984	2,463	1,462	(1,432)	510,410
Financial investments:							
– treasury and similar bills	17,225	–	–	–	–	–	17,225
– debt securities	83,325	2,435	–	–	–	–	85,760
	100,550	2,435	–	–	–	–	102,985
Other assets:							
– acceptances and endorsements	681	1,666	16	–	–	–	2,363
– other	607	775	–	1	–	–	1,383
	1,288	2,441	16	1	–	–	3,746

* Includes HK$5,198 million (2010: HK$1,623 million) and HK$780 million (2010: HK$283 million) of debt securities that have been classified as BBB- to BBB+ for the Group and the Bank respectively in 2011, based on Standard and Poor's ratings or their equivalent to the respective issues of the financial securities. If major rating agencies have different ratings for the same debt securities, the securities are reported against the lower rating. In the absence of such issue ratings, the ratings designated for the issuers are reported.

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(iii) Credit quality (continued)

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

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

	Group					
	Up to 29 days	30- 59 days	60- 89 days	90- 180 days	Over 180 days	Total
2011						
Items in the course of collection from other banks	–	–	–	–	–	–
Trading assets:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Financial assets designated at fair value:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Derivatives	–	–	–	–	–	–
Loans and advances held at amortised cost:						
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers#	2,768	394	63	–	–	3,225
	2,768	394	63	–	–	3,225
Financial investments:						
– treasury and similar bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
	–	–	–	–	–	–
Other assets:						
– acceptances and endorsements	–	–	–	–	–	–
– other	27	8	3	2	2	42
	27	8	3	2	2	42

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(iii) Credit quality (continued)

	Group					
	Up to 29 days	30- 59 days	60- 89 days	90- 180 days	Over 180 days	Total
2010						
Items in the course of collection from other banks	–	–	–	–	–	–
Trading assets:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Financial assets designated at fair value:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Derivatives	–	–	–	–	–	–
Loans and advances held at amortised cost:						
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers#	2,892	419	51	13	5	3,380
	2,892	419	51	13	5	3,380
Financial investments:						
– treasury and similar bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
	–	–	–	–	–	–
Other assets:						
– acceptances and endorsements	–	–	–	–	–	–
– other	17	5	2	5	6	35
	17	5	2	5	6	35

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(iii) Credit quality (continued)

	Bank					
	Up to 29 days	30-59 days	60-89 days	90-180 days	Over 180 days	Total
2011						
Items in the course of collection from other banks	–	–	–	–	–	–
Trading assets:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Financial assets designated at fair value:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Derivatives	–	–	–	–	–	–
Loans and advances held at amortised cost:						
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers#	2,219	256	47	–	–	2,522
	2,219	256	47	–	–	2,522
Financial investments:						
– treasury and similar bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
	–	–	–	–	–	–
Other assets:						
– acceptances and endorsements	–	–	–	–	–	–
– other	1	1	–	–	–	2
	1	1	–	–	–	2

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(iii) Credit quality (continued)

	Bank					
	Up to 29 days	30-59 days	60-89 days	90-180 days	Over 180 days	Total
2010						
Items in the course of collection from other banks	–	–	–	–	–	–
Trading assets:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Financial assets designated at fair value:						
– treasury and eligible bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers	–	–	–	–	–	–
	–	–	–	–	–	–
Derivatives	–	–	–	–	–	–
Loans and advances held at amortised cost:						
– loans and advances to banks	–	–	–	–	–	–
– loans and advances to customers#	2,173	236	39	13	2	2,463
	2,173	236	39	13	2	2,463
Financial investments:						
– treasury and similar bills	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–
	–	–	–	–	–	–
Other assets:						
– acceptances and endorsements	–	–	–	–	–	–
– other	1	–	–	–	–	1
	1	–	–	–	–	1

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

Impaired loans and advances

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

The Group's policy for recognising and measuring impairment allowances on both individually assessed advances and those which are collectively assessed on a portfolio basis is described in note 4(f) to the financial statements.

Analysis of impairment allowances at 31 December 2011 and the movement of such allowances during the year are disclosed in note 35.

61. FINANCIAL RISK MANAGEMENT (continued)

(a) Credit risk (continued)

(iv) Collateral and other credit enhancements obtained

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

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

	Group		Bank	
	2011	2010	**2011**	2010
Nature of assets:				
Residential properties	**3**	12	**–**	7
Commercial and industrial properties	**–**	–	**–**	–
Other	**–**	–	**–**	–
	3	12	**–**	7

(b) Liquidity risk

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

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

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

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

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

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

61. FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

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

	Group	
	2011	2010
The Bank and its subsidiaries designated by the Hong Kong Monetary Authority	**33.6%**	38.1%

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

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

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

61. FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

	Group					
	Repayable on demand	Three months or less but not on demand	Over three months but within one year	Over one year but within five years	Over five years	Total
At 31 December 2011						
Current, savings and other deposit accounts	**503,663**	**163,776**	**33,036**	**1,119**	**–**	**701,594**
Deposits from banks	**2,072**	**11,320**	**618**	**–**	**–**	**14,010**
Financial liabilities designated at fair value	**1**	**–**	**–**	**–**	**433**	**434**
Trading liabilities	**59,712**	**–**	**–**	**–**	**–**	**59,712**
Derivative financial instruments	**3,508**	**156**	**320**	**904**	**79**	**4,967**
Certificates of deposit and other debt securities in issue	**–**	**1,633**	**1,535**	**6,280**	**–**	**9,448**
Other financial liabilities	**6,319**	**7,071**	**1,800**	**62**	**19**	**15,271**
Subordinated liabilities	**–**	**94**	**2,511**	**939**	**10,497**	**14,041**
	575,275	**184,050**	**39,820**	**9,304**	**11,028**	**819,477**
Commitments	**240,159**	**42,488**	**1,823**	**982**	**–**	**285,452**
Financial guarantee contracts	**5,325**	**51**	**1**	**–**	**–**	**5,377**
	245,484	**42,539**	**1,824**	**982**	**–**	**290,829**
At 31 December 2010						
Current, savings and other deposit accounts	536,442	116,288	29,956	1,660	–	684,346
Deposits from banks	6,387	9,084	–	117	–	15,588
Financial liabilities designated at fair value	2	–	–	–	455	457
Trading liabilities	42,581	–	–	–	–	42,581
Derivative financial instruments	3,709	104	400	616	(18)	4,811
Certificates of deposit and other debt securities in issue	–	553	135	2,489	–	3,177
Other financial liabilities	6,719	5,643	1,499	70	25	13,956
Subordinated liabilities	–	54	3,609	2,843	6,655	13,161
	595,840	131,726	35,599	7,795	7,117	778,077
Commitments	222,111	37,081	179	575	–	259,946
Financial guarantee contracts	4,094	–	2	–	–	4,096
	226,205	37,081	181	575	–	264,042

61. FINANCIAL RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

	Bank					
	Repayable on demand	Three months or less but not on demand	Over three months but within one year	Over one year but within five years	Over five years	Total
At 31 December 2011						
Current, savings and other deposit accounts	**489,952**	**151,649**	**19,671**	**500**	**–**	**661,772**
Deposits from banks	**2,065**	**9,311**	**618**	**–**	**–**	**11,994**
Financial liabilities designated at fair value	**–**	**–**	**–**	**–**	**–**	**–**
Trading liabilities	**36,077**	**–**	**–**	**–**	**–**	**36,077**
Derivative financial instruments	**3,319**	**102**	**177**	**488**	**79**	**4,165**
Certificates of deposit and other debt securities in issue	**–**	**1,633**	**1,535**	**6,280**	**–**	**9,448**
Amounts due to subsidiaries	**6,143**	**4,651**	**3**	**–**	**–**	**10,797**
Other financial liabilities	**5,917**	**5,890**	**971**	**8**	**19**	**12,805**
Subordinated liabilities	**–**	**94**	**2,511**	**939**	**10,497**	**14,041**
	543,473	**173,330**	**25,486**	**8,215**	**10,595**	**761,099**
Commitments	**216,941**	**29,772**	**79**	**1**	**–**	**246,793**
Financial guarantee contracts	**3,654**	**51**	**1**	**–**	**–**	**3,706**
	220,595	**29,823**	**80**	**1**	**–**	**250,499**
At 31 December 2010						
Current, savings and other deposit accounts	526,177	105,993	16,276	1,106	–	649,552
Deposits from banks	6,386	9,084	–	117	–	15,587
Financial liabilities designated at fair value	–	–	–	–	–	–
Trading liabilities	30,106	–	–	–	–	30,106
Derivative financial instruments	3,803	91	280	381	(21)	4,534
Certificates of deposit and other debt securities in issue	–	553	135	2,489	–	3,177
Amounts due to subsidiaries	4,222	4,675	2	–	–	8,899
Other financial liabilities	6,596	4,514	770	1	910	12,791
Subordinated liabilities	–	54	3,609	2,843	6,655	13,161
	577,290	124,964	21,072	6,937	7,544	737,807
Commitments	190,235	36,455	75	1	–	226,766
Financial guarantee contracts	2,992	–	2	–	–	2,994
	193,227	36,455	77	1	–	229,760

The Basel Committee on Banking Supervision has issued the final rules in two documents "A global regulatory framework for more resilient banks and banking systems" and "International framework for liquidity risk measurement, standards and monitoring" in December 2010, widely referred to as Basel III rules, on the areas of capital and liquidity. The Hong Kong Monetary Authority has then issued a consultation paper in January 2012 on the implementation of Basel III Liquidity Standards in Hong Kong. Under the consultation paper, a new minimum standard, the Liquidity Coverage Ratio, will be developed to promote the short-term resilience of banks to potential liquidity disruptions. A Net Stable Funding Ratio will also be introduced to promote the longer term resilience of banks. These will be phased in 2015 and 2018 respectively after the observation periods.

61. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk

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

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

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

Value at risk ("VAR")

One of the principal tools used by the Group to monitor and limit market risk exposure is VAR.

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

VAR is calculated daily. The Group validates the accuracy of its VAR models by back-testing the actual daily profit and loss results which include both end of day market movements and intra-day trading outcomes, adjusted to remove non-modelled items such as fees and commissions, against the corresponding VAR numbers. Statistically, the Group would expect to see losses in excess of VAR only one per cent of the time over a 1-year period. The actual number of excesses over this period can therefore be used to gauge how well the models are performing.

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

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

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

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

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

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

61. FINANCIAL RISK MANAGEMENT (continued)

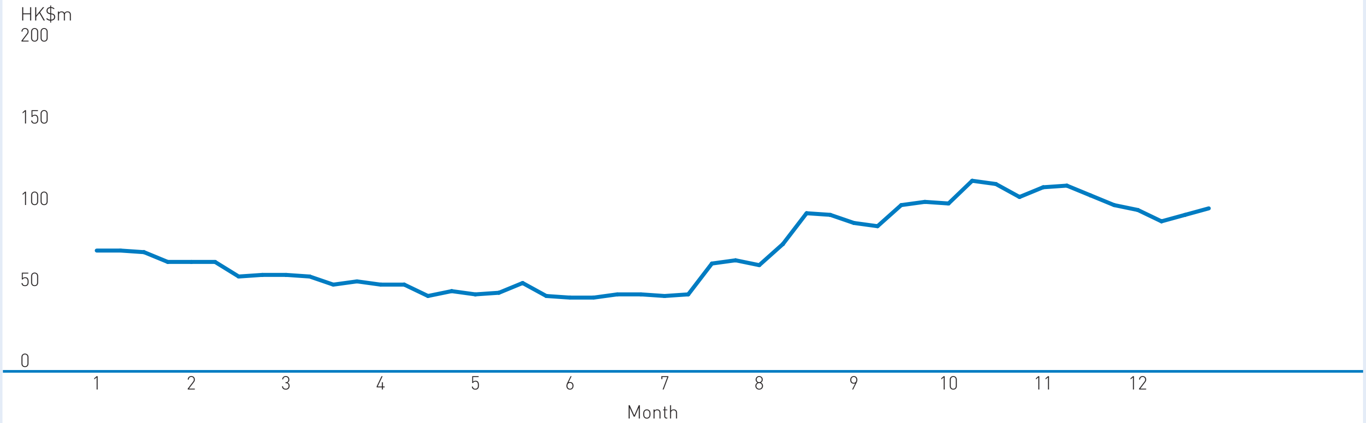
(c) Market risk (continued)

The Group's VAR, both trading and non-trading, for total positions of all interest rate risk and foreign exchange risk positions and on individual risk portfolios during 2011 and 2010 are shown in the table below.

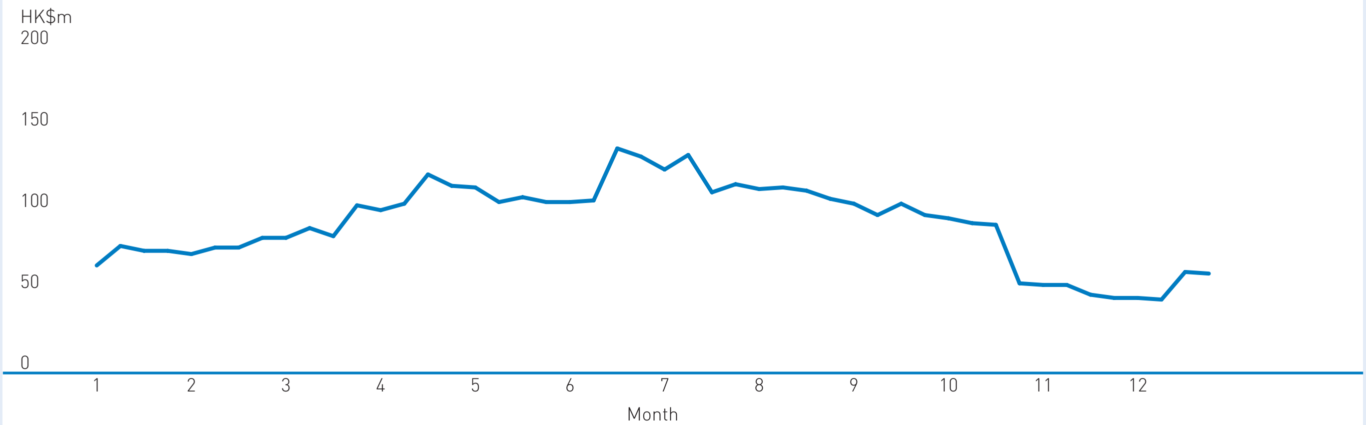
	At 31 December 2011	**Minimum during the year**	**Maximum during the year**	**Average for the year**
Total VAR	**91**	**37**	**110**	**66**
Total trading VAR	**10**	**5**	**18**	**10**
VAR for foreign exchange risk (trading)	**5**	**2**	**9**	**6**
VAR for interest rate risk:				
– trading	**10**	**3**	**16**	**8**
– non-trading	**27**	**15**	**30**	**21**

	At 31 December 2010	Minimum during the year	Maximum during the year	Average for the year
Total VAR	69	53	149	99
Total trading VAR	9	5	25	10
VAR for foreign exchange risk (trading)	5	1	10	3
VAR for interest rate risk:				
– trading	6	5	23	10
– non-trading	18	17	100	62

TOTAL VALUE AT RISK FOR 2011



TOTAL VALUE AT RISK FOR 2010



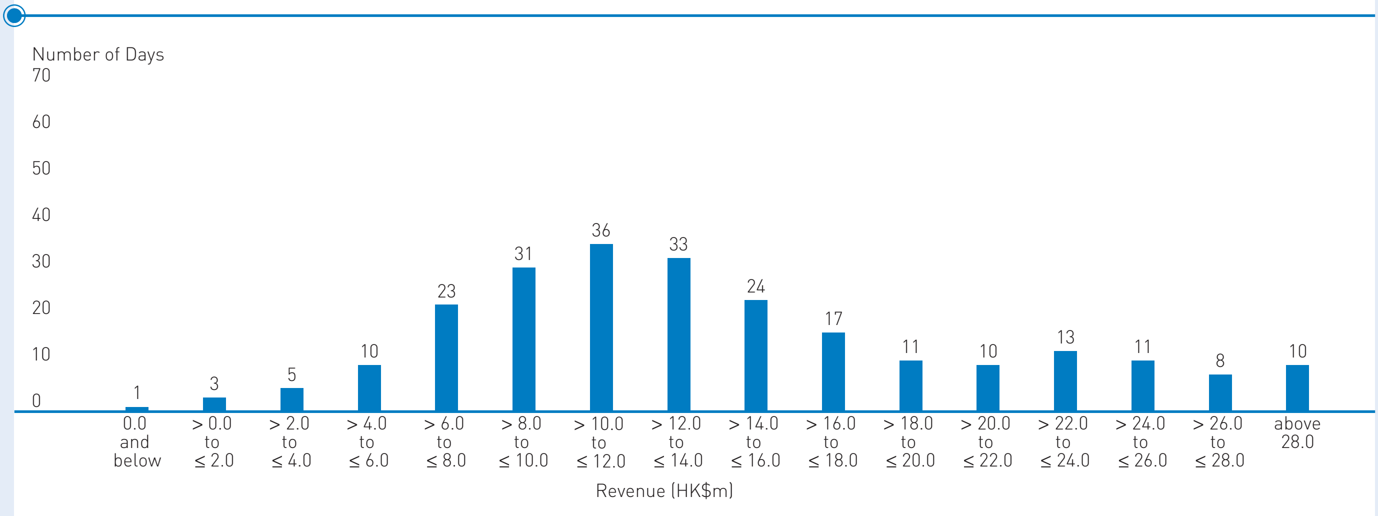
61. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

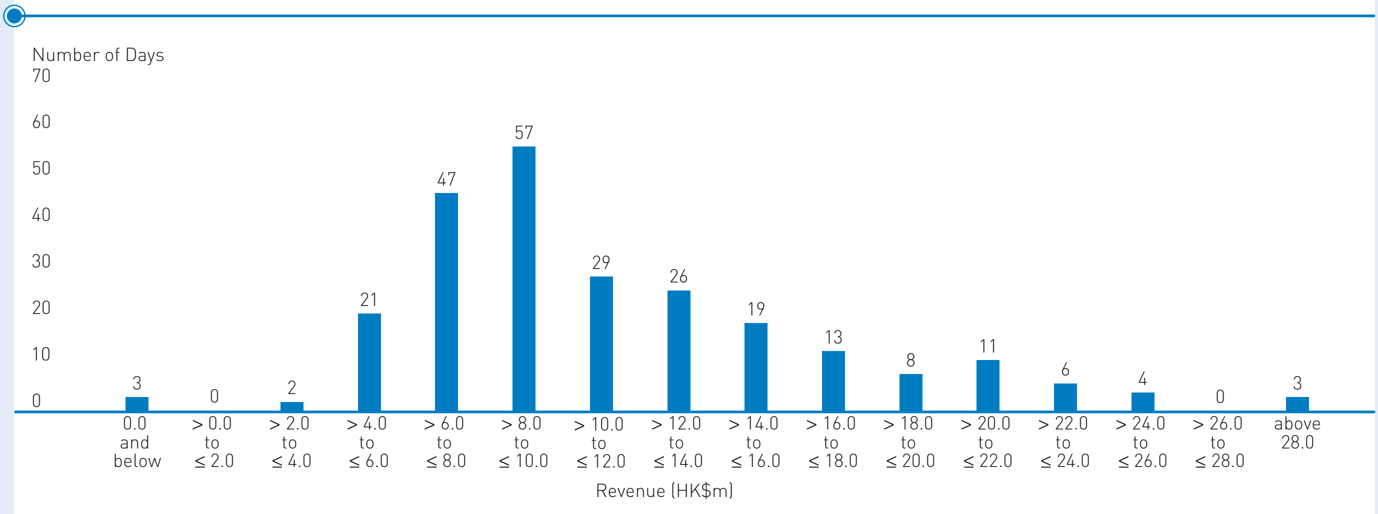
The average daily revenue earned from market risk-related treasury activities in 2011, including non-trading book net interest income and funding related to trading positions, was HK$14 million (2010: HK$11 million). The standard deviation of these daily revenues was HK$7 million, compared with HK$6 million for 2010.

An analysis of the frequency distribution of daily revenue shows that out of 246 trading days in 2011, losses were recorded on 1 day (2010: 3 days) and the maximum daily loss was HK$6 million (2010: HK$35 million). The most frequent result was a daily revenue of between HK$6 million and HK$18 million, with 164 occurrences (2010: 191 occurrences). The highest daily revenue was HK$41 million (2010: HK$32 million).

DAILY DISTRIBUTION OF MARKET RISK REVENUE FOR 2011



DAILY DISTRIBUTION OF MARKET RISK REVENUE FOR 2010



61. FINANCIAL RISK MANAGEMENT (continued)

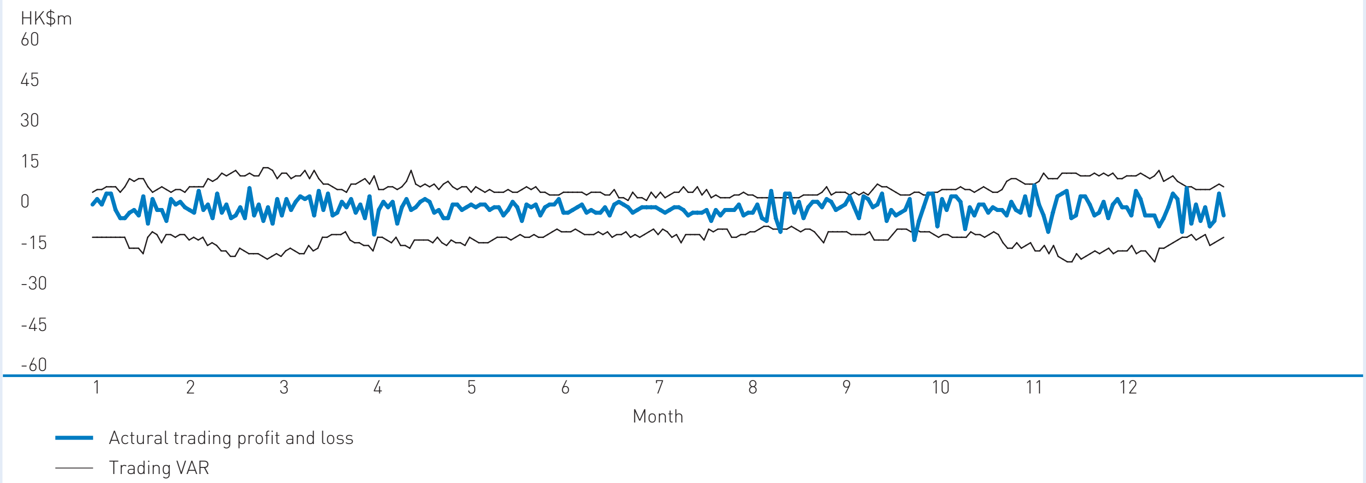
(c) Market risk (continued)

Back-testing of the Trading VAR model for interest rate and foreign exchange uses cleaned profits and losses from trading operations and compares these to total trading VAR, foreign exchange and interest rate level VAR on a daily basis.

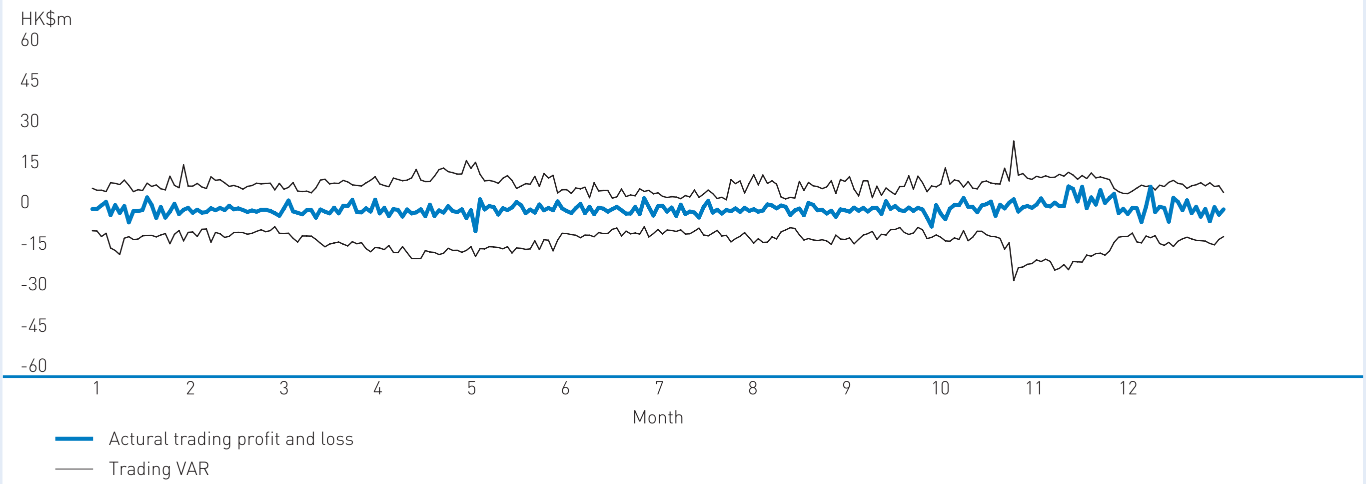
The trading VAR model back-testing with actual profit and loss involves tracking the trading VAR with the next day actual profit and loss. It will be regarded as a loss side exception if actual loss exceeds loss side trading VAR.

A comparison of the Group trading VAR with the actual profits and losses related to trading positions during 2011 and 2010 are shown in the table below.

A COMPARISON OF TRADING VAR WITH ACTUAL TRADING PROFIT AND LOSS FOR 2011



A COMPARISON OF TRADING VAR WITH ACTUAL TRADING PROFIT AND LOSS FOR 2010



61. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

Interest rate exposure

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

Trading

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

Non-trading

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

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

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

Net interest income

A principal part of the Group's management of interest rate risk in non-trading portfolios is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). The Group aims, through its management of market risk in non-trading portfolios, to mitigate the impact of prospective interest rate movements which could reduce future net interest income, whilst balancing the cost of such hedging activities on the current net revenue stream.

The table below sets out the impact on future net interest income of a 100 basis points parallel fall or rise in all-in yield curves at the beginning of year from 1 January 2012 and 25 basis points parallel fall or rise in all-in yield curves at the beginning of each quarter during the 12 month period from 1 January 2012.

Assuming no management actions, such a series of incremental parallel rises in all-in yield curves would increase planned net interest income for the year to 31 December 2012 by HK$1,477 million for 100 basis points case and by HK$972 million for 25 basis points case, while such a series of incremental parallel falls in all-in yield curves would decrease planned net interest income by HK$2,049 million for 100 basis points case and by HK$1,507 million for 25 basis points case. These figures incorporate the impact of any option features in the underlying exposures and takes into account the change in pricing of retail products relative to change in market interest rates.

61. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

Projected Net Interest Income

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

	100bp parallel increase	100bp parallel decrease	25bp increase at the beginning of each quarter	25bp decrease at the beginning of each quarter
Change in 2012 projected net interest income				
– HKD	**867**	**(1,466)**	**646**	**(1,216)**
– US$	**426**	**(386)**	**272**	**(271)**
– other	**184**	**(197)**	**54**	**(20)**
Total	**1,477**	**(2,049)**	**972**	**(1,507)**
Change in 2011 projected net interest income				
– HKD	861	(1,113)	562	(963)
– US$	309	(447)	113	(262)
– other	133	(146)	87	(55)
Total	1,303	(1,706)	762	(1,280)

The interest rate sensitivities set out in the table above are illustrative only and are based on simplified scenarios. The figures represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and the Group's current interest rate risk profile. This effect, however, does not incorporate actions that would be taken by Treasury or in the business units to mitigate the impact of this interest rate risk. In reality, Treasury seeks proactively to change the interest rate risk profile to minimise losses and optimise net revenues. The projections above also assume that interest rates of all maturities move by the same amount and, therefore, do not reflect the potential impact on net interest income of some rates changing while others remain unchanged. The projections also make other simplifying assumptions, including that all positions run to maturity.

It can be seen from the above that projecting the movement in net interest income from prospective changes in interest rates is a complex interaction of structural and managed exposures. In a rising rate environment, the most critical exposures are those managed within Treasury.

61. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

Sensitivity of reserves

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

	At 31 December 2011	Maximum impact	Minimum impact
+ 100 basis points parallel move in all-in yield curves	**(973)**	**(1,047)**	**(827)**
As a percentage of shareholders' funds at 31 December 2011 (%)	**(1.2)**	**(1.3)**	**(1.0)**
– 100 basis points parallel move in all-in yield curves	**256**	**292**	**246**
As a percentage of shareholders' funds at 31 December 2011 (%)	**0.3**	**0.4**	**0.3**

	At 31 December 2010	Maximum impact	Minimum impact
+ 100 basis points parallel move in all-in yield curves	(803)	(1,173)	(803)
As a percentage of shareholders' funds at 31 December 2010 (%)	(1.1)	(1.7)	(1.1)
– 100 basis points parallel move in all-in yield curves	264	303	174
As a percentage of shareholders' funds at 31 December 2010 (%)	0.4	0.4	0.2

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

Foreign exchange exposure

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

At 31 December 2011, the US dollar ("US$"), Chinese renminbi ("RMB") and Euro ("EUR") were the currencies in which the Group had non-structural foreign currency positions that were not less than 10 per cent of the total net position in all foreign currencies. The Group also had a RMB structural foreign currency position, which was not less than 10 percent of the total net structural position in all foreign currencies.

61. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

Foreign exchange exposure (continued)

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

Group

	US$	RMB	GBP	JPY	EUR	CAD	CHF	AUD	NZD	GOL	Other foreign currencies	Total foreign currencies
2011												
Non-structural position												
Spot assets	**149,152**	**123,061**	**12,922**	**32,344**	**9,119**	**13,405**	**117**	**46,562**	**7,576**	**4,341**	**941**	**399,540**
Spot liabilities	**(128,778)**	**(124,005)**	**(15,234)**	**(1,930)**	**(11,097)**	**(16,447)**	**(601)**	**(48,899)**	**(10,897)**	**(4,524)**	**(1,397)**	**(363,809)**
Forward purchases	**265,328**	**87,981**	**4,121**	**4,122**	**4,699**	**3,358**	**1,089**	**9,464**	**5,134**	**2,248**	**1,393**	**388,937**
Forward sales	**(284,172)**	**(85,934)**	**(1,783)**	**(34,510)**	**(3,061)**	**(313)**	**(635)**	**(7,265)**	**(1,829)**	**(2,014)**	**(956)**	**(422,472)**
Net options position	**147**	**(124)**	**–**	**2**	**(24)**	**–**	**–**	**20**	**(18)**	**–**	**–**	**3**
Net long/(short) non-structural position	**1,677**	**979**	**26**	**28**	**(364)**	**3**	**(30)**	**(118)**	**(34)**	**51**	**(19)**	**2,199**
Structural position	**206**	**24,850**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**305**	**25,361**
2010												
Non-structural position												
Spot assets	246,638	93,067	13,026	8,985	11,068	13,933	191	43,643	9,017	2,169	974	442,711
Spot liabilities	(155,377)	(88,666)	(15,470)	(1,912)	(12,393)	(14,882)	(549)	(41,953)	(11,658)	(3,404)	(3,034)	(349,298)
Forward purchases	228,982	72,661	7,130	8,932	3,735	2,431	1,347	8,340	3,909	2,919	3,423	343,809
Forward sales	(319,494)	(77,799)	(4,810)	(16,151)	(2,497)	(1,449)	(964)	(9,885)	(1,341)	(1,559)	(1,359)	(437,308)
Net options position	133	(41)	–	(5)	(55)	(7)	–	(71)	60	–	–	14
Net long/(short) non-structural position	882	(778)	(124)	(151)	(142)	26	25	74	(13)	125	4	(72)
Structural position	206	20,124	–	–	–	–	–	–	–	–	238	20,568

Bank

	US$	RMB	GBP	JPY	EUR	CAD	CHF	AUD	NZD	GOL	Other foreign currencies	Total foreign currencies
2011												
Non-structural position												
Spot assets	**132,455**	**43,164**	**7,105**	**32,303**	**6,489**	**7,071**	**76**	**24,082**	**3,901**	**4,341**	**917**	**261,904**
Spot liabilities	**(118,352)**	**(43,874)**	**(9,329)**	**(1,893)**	**(8,300)**	**(9,932)**	**(561)**	**(23,528)**	**(7,050)**	**(4,524)**	**(1,372)**	**(228,715)**
Forward purchases	**244,899**	**71,773**	**4,048**	**4,093**	**4,561**	**3,175**	**1,089**	**6,511**	**4,954**	**2,248**	**1,393**	**348,744**
Forward sales	**(258,679)**	**(69,425)**	**(1,735)**	**(34,475)**	**(3,020)**	**(313)**	**(635)**	**(7,265)**	**(1,829)**	**(2,014)**	**(956)**	**(380,346)**
Net options position	**147**	**(124)**	**-**	**2**	**(24)**	**-**	**-**	**20**	**(18)**	**-**	**-**	**3**
Net long/(short) non-structural position	**470**	**1,514**	**89**	**30**	**(294)**	**1**	**(31)**	**(180)**	**(42)**	**51**	**(18)**	**1,590**
Structural position	**206**	**24,850**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**305**	**25,361**
2010												
Non-structural position												
Spot assets	203,809	41,067	7,591	8,883	8,411	7,568	129	23,618	5,993	2,169	864	310,102
Spot liabilities	(117,702)	(36,296)	(10,022)	(1,840)	(9,529)	(8,463)	(504)	(20,171)	(8,544)	(3,404)	(2,924)	(219,399)
Forward purchases	205,281	59,923	7,130	8,695	3,550	2,377	1,347	6,433	3,813	2,919	3,423	304,891
Forward sales	(292,023)	(64,330)	(4,762)	(15,805)	(2,467)	(1,449)	(948)	(9,782)	(1,341)	(1,559)	(1,359)	(395,825)
Net options position	133	(41)	–	(5)	(55)	(7)	–	(71)	60	–	–	14
Net long/(short) non-structural position	(502)	323	(63)	(72)	(90)	26	24	27	(19)	125	4	(217)
Structural position	206	20,124	–	–	–	–	–	–	–	–	238	20,568

The above US Dollars foreign currency exposure included certain US Dollars currency loans with embedded US Dollars forward contract granted to customers under the bank negotiation with the underlying documentary credit denominated in RMB currency amounted to HK$19,128 millions at 31 December 2011 (31 December 2010: HK$30,575 millions).

61. FINANCIAL RISK MANAGEMENT (continued)

(c) Market risk (continued)

Equities exposure

The Group's equities exposures in 2011 and 2010 are mainly in long-term equity investments which are reported as "Financial investments" set out in note 36. Equities held for trading purpose are included under "Trading assets" set out in note 32. These are subject to trading limit and risk management control procedures and other market risk regime.

(d) Insurance risk

Risk management objectives and policies for management of insurance risk

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

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

The Group manages its insurance risk through underwriting limits, approval procedures for transactions that involve new products or that exceed set limits, risk diversification, pricing guidelines, reinsurance and monitoring of emerging issues.

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

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

Asset/liability management

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

The Group establishes target asset portfolios for each major insurance product category according to specific product requirements and local regulatory requirement. The investment strategy and asset allocations consider yield, duration, sensitivity, market risk, volatility, liquidity, asset concentration, foreign exchange and credit quality. The estimates and assumptions used in determining the approximate amounts and timing of payments to or on behalf of policyholders for insurance liabilities are regularly re-evaluated. Many of these estimates and assumptions are inherently subjective and could impact the Group's ability to achieve its asset/liability management goals and objectives.

61. FINANCIAL RISK MANAGEMENT (continued)

(d) Insurance risk (continued)

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

Balance sheet of insurance subsidiaries by type of contract

	Life linked contracts[1]	Life non-linked contracts[2]	Non-life insurance[3]	Other assets[4]	Total[5]
2011					
Financial assets:					
– financial assets designated at fair value	**192**	**7,764**	**–**	**–**	**7,956**
– derivatives	**–**	**94**	**–**	**–**	**94**
– financial investments	**–**	**56,714**	**–**	**3,831**	**60,545**
– other financial assets	**114**	**5,919**	**459**	**1,039**	**7,531**
Total financial assets	**306**	**70,491**	**459**	**4,870**	**76,126**
Reinsurance assets	**–**	**42**	**113**	**14**	**169**
Present value of in-force long-term insurance contracts	**–**	**–**	**–**	**5,188**	**5,188**
Other assets	**–**	**783**	**12**	**2,104**	**2,899**
Total assets	**306**	**71,316**	**584**	**12,176**	**84,382**
Liabilities under investment contracts designated at fair value	**120**	**314**	**–**	**–**	**434**
Liabilities under insurance contracts	**183**	**71,523**	**519**	**–**	**72,225**
Deferred tax	**–**	**–**	**–**	**856**	**856**
Other liabilities	**–**	**–**	**21**	**145**	**166**
Total liabilities	**303**	**71,837**	**540**	**1,001**	**73,681**
Shareholders' equity	**–**	**–**	**–**	**10,701**	**10,701**
Total liabilities and shareholders' equity	**303**	**71,837**	**540**	**11,702**	**84,382**
2010					
Financial assets:					
– financial assets designated at fair value	237	6,586	–	142	6,965
– derivatives	–	161	–	–	161
– financial investments	–	53,591	–	3,339	56,930
– other financial assets	125	3,270	421	657	4,473
Total financial assets	362	63,608	421	4,138	68,529
Reinsurance assets	–	35	103	21	159
Present value of in-force long-term insurance contracts	–	–	–	4,593	4,593
Other assets	–	729	11	706	1,446
Total assets	362	64,372	535	9,458	74,727
Liabilities under investment contracts designated at fair value	136	321	–	–	457
Liabilities under insurance contracts	226	63,722	477	–	64,425
Deferred tax	–	–	–	733	733
Other liabilities	–	–	19	125	144
Total liabilities	362	64,043	496	858	65,759
Shareholders' equity	–	–	–	8,968	8,968
Total liabilities and shareholders' equity	362	64,043	496	9,826	74,727

1 Comprises life linked insurance contracts and linked investment contracts

2 Comprises life non-linked insurance contracts and non-linked investment contracts

3 Comprises non-life insurance contracts

4 Comprises shareholder assets

5 Total assets of life insurance subsidaries at 31 December 2011 amounted to HK$82,718 million (31 December 2010: HK$73,205 million). Total assets of non-life insurance subsidaries at 31 December 2011 amounted to HK$1,664 million (31 December 2010: HK$1,522 million).

61. FINANCIAL RISK MANAGEMENT (continued)

(d) Insurance risk (continued)

Underwriting strategy

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

Reinsurance strategy

The Group reinsures a portion of the insurance risks it underwrites in order to control its exposures to losses and protect capital resources. These reinsurance agreements transfer part of the risk and limit the exposure from each life insured. The amount of each risk retained depends on the Group's evaluation of the specific risk, subject in certain circumstances, to maximum limits based on characteristics of coverage. Under the terms of the reinsurance agreements, the reinsurer agrees to reimburse the ceded amount in the event the claim is paid. However, the Group remains liable to its policyholders with respect to ceded insurance if any reinsurer fails to meet the obligations it assumes. The Group buys a combination of proportionate and non-proportionate reinsurance to reduce the retained sum assured so that it falls within specified insurance risk appetite. The Group uses non-affiliated reinsurers to control its exposure to losses resulting from certain catastrophes.

Nature of risks covered

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

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

The basic feature of long-term non-linked insurance business is to provide guaranteed death benefit determined at the time of policy issue. For non-linked insurance products with a savings element, guaranteed surrender benefit, guaranteed maturity benefit are usually provided. Discretionary participating features allow policyholders to participate in the profits of the life fund by means of annual bonus. The Group has complete contractual discretion on the bonuses declared. In practice the Group considers policyholders' reasonable expectations when setting bonus levels. It is the Group's intention to maintain a smooth dividend scale based on the long-term rate of return. Annual reviews are performed to confirm whether the current dividend scale is supportable taken into account the overall experience on investments, claims, operating expenses and lapses.

(ii) Long-term insurance contracts – linked products

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

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

The Group underwrites retirement fund business which gives rise to contracts that are classified as investment contracts. Under each retirement scheme, employers and employees are given a choice of funds to place their contributions, on which the Group provides an investment return guarantees for some specific funds. The guarantee risks are managed through investment in good quality fixed rate bonds. Investment strategy is set with the objective of providing return that is sufficient to meet at least the minimum guarantee.

(iv) Long-term Investment contracts – linked products

The Group underwrites retirement fund business which gives rise to contracts that are classified as investment contracts. Under each retirement scheme, employers and employees are given a choice of funds to place their contributions, on which the Group does not bear investment risk for most of the funds. Although scheme members bear the market risk on the funds, the Group must manage the scheme members' exposure to market risk in a manner consistent with any parameters set out in the policy documents.

(v) Non-life insurance contracts

The Group assumes the risk of loss from persons and organisations that are directly subject to the risk. Such risk may relate to property, liability, life, accident, health, financial or other perils that may arise from an insurable event. The Group manages the risks through underwriting limits, approval procedures for transactions that involve new products or that exceed set authority limits, risk diversification, underwriting guidelines, reinsurance and centralised management of reinsurance and monitoring of emerging issues. The Group also assesses and monitors insurance risk exposures both for individual types of risks insured and overall risks.

61. FINANCIAL RISK MANAGEMENT (continued)

(d) Insurance risk (continued)

Concentration of insurance risks

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

The Group is subject to concentration risk arising from accidents relating to common carriers, epidemics, earthquakes and other natural disasters that affect the properties, physical conditions and lives of the policyholders insured by the Group. To mitigate these risks, excess of loss and catastrophe reinsurance arrangements have been made by the Group.

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

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

Life business tends to be longer-term in nature than non-life business and frequently involves an element of savings and investment in the contract. An analysis of life insurance liabilities are therefore the best available overall measure of insurance exposure, because provisions for life contracts are typically set by reference to expected future cash outflows relating to the underlying policies. Details of the analysis of life insurance liabilities are disclosed in note 48. By contrast for analysis of non-life insurance risk, written premiums represent the best available measure of risk exposure as shown in the following table.

Analysis of non-life insurance risk – net written insurance premiums

	2011	2010
Accident and health	**101**	102
Fire and other damage	**126**	126
Motor	**25**	23
Liability	**54**	45
Marine, aviation and transport	**22**	21
Other (non-life)	**21**	27
	349	344

Financial risks

The Group's insurance businesses are exposed to a range of financial risks, including market risk, credit risk and liquidity risk. Each of these financial risks is described below, together with a summary of the ways in which the Group manages these risks arising from underwriting insurance business.

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

61. FINANCIAL RISK MANAGEMENT (continued)

(d) Insurance risk (continued)

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

Financial assets held by insurance operations

	Group				
	Life linked contracts	**Life non-linked contracts**	**Non-life insurance**	**Other assets**	**Total**
2011					
Financial assets designated at fair value:					
– debt securities	**–**	**3,859**	**–**	**–**	**3,859**
– equity securities	**192**	**3,905**	**–**	**–**	**4,097**
	192	**7,764**	**–**	**–**	**7,956**
Financial investments					
Held-to-maturity:					
– debt securities	**–**	**56,714**	**–**	**3,197**	**59,911**
	–	**56,714**	**–**	**3,197**	**59,911**
Available-for-sale:					
– debt securities	**–**	**–**	**–**	**619**	**619**
– equity securities	**–**	**–**	**–**	**15**	**15**
	–	**–**	**–**	**634**	**634**
Derivatives	**–**	**94**	**–**	**–**	**94**
Other financial assets	**114**	**5,919**	**459**	**1,039**	**7,531**
	306	**70,491**	**459**	**4,870**	**76,126**

	Group				
	Life linked contracts	Life non-linked contracts	Non-life insurance	Other assets	Total
2010					
Financial assets designated at fair value:					
– debt securities	–	4,150	–	142	4,292
– equity securities	237	2,436	–	–	2,673
	237	6,586	–	142	6,965
Financial investments					
Held-to-maturity:					
– debt securities	–	53,591	–	2,710	56,301
	–	53,591	–	2,710	56,301
Available-for-sale:					
– debt securities	–	–	–	616	616
– equity securities	–	–	–	13	13
	–	–	–	629	629
Derivatives	–	161	–	–	161
Other financial assets	125	3,270	421	657	4,473
	362	63,608	421	4,138	68,529

61. FINANCIAL RISK MANAGEMENT (continued)

(d) Insurance risk (continued)

The table demonstrates that for linked contracts, the Group typically designates assets at fair value. For non-linked contracts, the classification of the assets is driven by the nature of the underlying contract. The assets held to support life linked liabilities represented 0.4% of the total financial assets of the Group's insurance manufacturing subsidiaries at the end of 2011 (2010: 0.5%). The table also shows that approximately 84.6% of financial assets was invested in debt securities at 31 December 2011 (2010: 89.3%) with 5.4% (2010: 3.9%) invested in equity securities.

Market risk

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

Interest rate risk

The insurance subsidiaries of the Group's exposure to interest rate risk arises mainly from its debt securities holdings. The held-to-maturity debt securities accounts for a significant portion of the debt securities holding which is managed to match expected liability payments. The Group monitors this exposure through periodic reviews of its asset and liability positions. Estimates of cash flows, as well as the impact of interest rate fluctuations relating to the investment portfolio and insurance reserves, are modelled and reviewed regularly. The overall objective of these strategies is to limit the net changes in the value of assets and liabilities arising from interest rate movements.

For participating products, interest rate risk related to non-linked policies can also be mitigated through sharing of risk with policyholders under the discretionary participation feature.

An immediate and permanent movement in interest yield curves as at 31 December 2011 in all territories in which the Group's insurance subsidiaries operate would have the following impact on the profit for the year and net assets at that date:

	2011		2010	
	Impact on profit for the year	**Impact on net assets**	Impact on profit for the year	Impact on net assets
+ 100 basis points shift in yield curves	**517**	**508**	239	229
– 100 basis points shift in yield curves	**(335)**	**(326)**	(161)	(151)

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

Equity risk

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

61. FINANCIAL RISK MANAGEMENT (continued)

(d) Insurance risk (continued)

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

	2011		2010	
	Impact on profit for the year	**Impact on net assets**	Impact on profit for the year	Impact on net assets
10 per cent increase in equity prices	**277**	**277**	205	205
10 per cent decrease in equity prices	**(396)**	**(396)**	(205)	(205)

These equity sensitivities are illustrative only and employ simplified scenarios. It should be noted that the effects may not be linear and therefore the results cannot be extrapolated. They do not allow for the effect of management actions which may mitigate the equity price decline, nor for any resultant changes, such as in policyholder behaviour, that might accompany such a fall.

Foreign currency risk

Substantial amounts of the assets and liabilities are denominated in two main currencies, United States dollar and Hong Kong dollar. The Group adopts a policy of predominately matching the assets with liabilities in the same currency, effectively reducing the foreign currency exchange rate exposure. Limits are set to ensure that the net foreign currency exposure is kept to an acceptable level. The Group uses forward exchange contracts to manage its foreign currency risk.

Credit risk

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

61. FINANCIAL RISK MANAGEMENT (continued)

(d) Insurance risk (continued)

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

	Neither past due nor impaired						
	Strong	Medium	Sub-standard	Past due not impaired	Impaired	Impairment allowances	Total
2011							
Supporting liabilities under non-linked insurance and investment contracts							
Financial assets designated at fair value:							
– treasury and other eligible bills	–	–	–	–	–	–	–
– debt securities	3,822	37	–	–	–	–	3,859
	3,822	37	–	–	–	–	3,859
Financial investments:							
– treasury and other similar bills	–	–	–	–	–	–	–
– debt securities	52,081	4,632	–	–	–	–	56,713
	52,081	4,632	–	–	–	–	56,713
Supporting shareholders funds							
Financial assets designated at fair value:							
– treasury and other eligible bills	–	–	–	–	–	–	–
– debt securities	–	–	–	–	–	–	–
	–	–	–	–	–	–	–
Financial investments:							
– treasury and other similar bills	–	–	–	–	–	–	–
– debt securities	3,633	184	–	–	–	–	3,817
	3,633	184	–	–	–	–	3,817
Total							
Financial assets designated at fair value:							
– treasury and other eligible bills	–	–	–	–	–	–	–
– debt securities	3,822	37	–	–	–	–	3,859
	3,822	37	–	–	–	–	3,859
Financial investments:							
– treasury and other similar bills	–	–	–	–	–	–	–
– debt securities	55,714	4,816	–	–	–	–	60,530
	55,714	4,816	–	–	–	–	60,530

61. FINANCIAL RISK MANAGEMENT (continued)

(d) Insurance risk (continued)

	Neither past due nor impaired						
	Strong	Medium	Sub-standard	Past due not impaired	Impaired	Impairment allowances	Total
2010							
Supporting liabilities under non-linked insurance and investment contracts							
Financial assets designated at fair value:							
– treasury and other eligible bills	–	–	–	–	–	–	–
– debt securities	4,148	2	–	–	–	–	4,150
	4,148	2	–	–	–	–	4,150
Financial investments:							
– treasury and other similar bills	–	–	–	–	–	–	–
– debt securities	52,271	1,320	–	–	–	–	53,591
	52,271	1,320	–	–	–	–	53,591
Supporting shareholders funds							
Financial assets designated at fair value:							
– treasury and other eligible bills	–	–	–	–	–	–	–
– debt securities	142	–	–	–	–	–	142
	142	–	–	–	–	–	142
Financial investments:							
– treasury and other similar bills	–	–	–	–	–	–	–
– debt securities	3,282	44	–	–	–	–	3,326
	3,282	44	–	–	–	–	3,326
Total							
Financial assets designated at fair value:							
– treasury and other eligible bills	–	–	–	–	–	–	–
– debt securities	4,290	2	–	–	–	–	4,292
	4,290	2	–	–	–	–	4,292
Financial investments:							
– treasury and other similar bills	–	–	–	–	–	–	–
– debt securities	55,553	1,364	–	–	–	–	56,917
	55,553	1,364	–	–	–	–	56,917

61. FINANCIAL RISK MANAGEMENT (continued)

(d) Insurance risk (continued)

The Group also has insurance and other receivable amounts subject to credit risk. The most significant of these are reinsurance recoveries. To mitigate the risk of the counterparties not paying the amounts due, the Group has established certain business and financial guidelines for reinsurer approval, incorporating ratings by major agencies and considering currently available market information. The Group also periodically reviews the financial stability of reinsurers and the settlement trend of amount due from reinsurers. The split of liabilities ceded to reinsurers and outstanding reinsurance recoveries was as follows:

Reinsurers' share of liabilities under insurance contracts

	Neither past due nor impaired						
	Strong	Medium	Sub-standard	Past due not impaired	Impaired	Impairment allowances	Total
2011							
Linked insurance contracts	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Non-linked insurance contracts	**110**	**45**	**–**	**–**	**–**	**–**	**155**
Total	**110**	**45**	**–**	**–**	**–**	**–**	**155**
Reinsurance Debtors	**7**	**1**	**–**	**6**	**–**	**–**	**14**
2010							
Linked insurance contracts	–	–	–	–	–	–	–
Non-linked insurance contracts	108	30	–	–	–	–	138
Total	108	30	–	–	–	–	138
Reinsurance Debtors	7	3	–	11	–	–	21

Liquidity risk

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

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

Expected maturity of insurance contract liabilities

	Expected cash flows (undiscounted)				
	Within 1 year	Over 1 year but within 5 years	Over 5 years but within 15 years	Over 15 years	Total
2011					
Non-life insurance	**291**	**206**	**43**	**–**	**540**
Life insurance (non-linked)	**3,592**	**33,943**	**67,507**	**42,430**	**147,472**
Life insurance (linked)	**112**	**50**	**126**	**833**	**1,121**
	3,995	**34,199**	**67,676**	**43,263**	**149,133**
2010					
Non-life insurance	266	187	43	–	496
Life insurance (non-linked)	5,281	29,418	61,674	35,696	132,069
Life insurance (linked)	27	177	149	892	1,245
	5,574	29,782	61,866	36,588	133,810

61. FINANCIAL RISK MANAGEMENT (continued)

(d) Insurance risk (continued)

Remaining contractual maturity of investment contract liabilities

	Liabilities under investment contracts by insurance underwriting subsidiaries			
	Linked investment contracts	Non-linked investment contracts	Investment contracts with DPF	Total
2011				
Remaining contractual maturity:				
– due within 1 year	**1**	**–**	**–**	**1**
– due over 1 year but within 5 years	**–**	**–**	**–**	**–**
– due over 5 years but within 10 years	**–**	**–**	**–**	**–**
– due over 10 years	**–**	**–**	**–**	**–**
– undated	**119**	**314**	**–**	**433**
	120	**314**	**–**	**434**
2010				
Remaining contractual maturity:				
– due within 1 year	2	–	–	2
– due over 1 year but within 5 years	–	–	–	–
– due over 5 years but within 10 years	–	–	–	–
– due over 10 years	–	–	–	–
– undated	134	321	–	455
	136	321	–	457

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

The Group's life insurance business is accounted for using the embedded value approach, which, inter alia, provides a comprehensive framework for the evaluation of insurance and related risks. The value of the PVIF asset at 31 December 2011 was HK$5,188 million (31 December 2010: HK$4,593 million). The present value of the shareholders' interest in the profits expected to emerge from the book of in-force policies at balance sheet dates can be stress-tested to assess the sensitivity of the value of life business to adverse movement of different risk factors.

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

	2011	2010
+ 100 basis points shift in risk-free rate	**619**	635
– 100 basis points shift in risk-free rate	**(401)**	(494)

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

61. FINANCIAL RISK MANAGEMENT (continued)

(d) Insurance risk (continued)

Non-economic assumptions

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

	Impact on 2011 results		Impact on 2010 results	
	Profit for the year	**Net assets**	Profit for the year	Net assets
20 per cent increase in claims costs	**(9)**	**(9)**	(12)	(12)
20 per cent decrease in claims costs	**9**	**9**	12	12
10 per cent increase in mortality and/or morbidity rates	**(65)**	**(65)**	(27)	(27)
10 per cent decrease in mortality and/or morbidity rates	**64**	**64**	27	27
50 per cent increase in lapse rates	**259**	**259**	520	520
50 per cent decrease in lapse rates	**(243)**	**(243)**	(531)	(531)
10 per cent increase in expense rates	**(76)**	**(76)**	(40)	(40)
10 per cent decrease in expense rates	**76**	**76**	40	40

(e) Operational risk

Operational risk is the risk of loss arising through fraud, unauthorised activities, error, omission, inefficiency, system failure or from external events. It is inherent to every business organisation and covers a wide spectrum of issues.

The Group manages its operational risk through a controls-based environment in which the processes and controls are documented, authorisation is independent and transactions are reconciled and monitored. This is supported by periodic independent review of the internal control systems by internal audit, and by monitoring external operational risk events, which ensure that the Group stays in line with industry best practice and takes account of lessons learned from publicised operational failures within the financial services industry.

The Group has codified its operational risk management process by issuing a high level standard, supplemented by more detailed formal guidance. This explains how the Group manages operational risk by identifying, assessing, monitoring, controlling and mitigating the risk, rectifying operational risk events, and implementing any additional procedures required for compliance with local regulatory requirements. The standard covers the following:

- operational risk management responsibility is assigned to senior management within the business operation;
- information systems are used to record the identification and assessment of operational risks and to generate appropriate, regular management reporting;
- assessments are undertaken of the operational risks facing each business and the risks inherent in its processes, activities and products. Risk assessment incorporates a regular review of identified risks to monitor significant changes;
- operational risk loss data is collected and reported to senior management. Aggregate operational risk losses are recorded and details of incidents above a materiality threshold are reported to the Group's Audit Committee; and
- risk mitigation, including insurance is considered where this is cost-effective.

61. FINANCIAL RISK MANAGEMENT (continued)

(e) Operational risk (continued)

The Group maintains and tests contingency facilities to support operations in the event of disasters.

Additional reviews and tests are conducted in the event that any Group's office is affected by a business disruption event, to incorporate lessons learned in the operational recovery from those circumstances. Plans have been prepared for the continued operation of the Group's business, with reduced staffing levels, should a flu pandemic occur.

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

(f) Capital management

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

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

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

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

Externally imposed capital requirements:

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

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

61. FINANCIAL RISK MANAGEMENT (continued)

(f) Capital management (continued)

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

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

For credit risk, with the Hong Kong Monetary Authority approval, the Group has adopted the advanced internal ratings-based approach for the majority of its non-securitisation business with effect from 1 January 2009, with the remainder on standardised approach.

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

For market risk, the Group is required to use a variety of approaches to calculate its market risk capital requirement, including the internal model approach and the standardised approach for different risk categories.

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

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

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

The Basel Committee on Banking Supervision has issued the final rules in two documents "A global regulatory framework for more resilient banks and banking systems" and "International framework for liquidity risk measurement, standards and monitoring" in December 2010, widely referred to as Basel III rules, on the areas of capital and liquidity. The Hong Kong Monetary Authority has then issued a consultation paper in January 2012 on the implementation of Basel III capital standards in Hong Kong. The paper set out, amongst other things, the requirements relating the revised definitions of capital. The revised definitions are proposed to take effect from 2013, with phase-in arrangement from 2013 to 2019 for many items.

62. FAIR VALUE OF FINANCIAL INSTRUMENTS

(a) Determination of fair value

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Financial instruments measured at fair value on an ongoing basis include trading assets and liabilities, instruments designated at fair value, derivatives, and financial investments classified as available-for-sale (including treasury and other eligible bills, debt securities, and equity securities).

Control framework

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

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

Determination of fair value of financial instruments carried at fair value

Fair values are determined according to the following hierarchy:

(i) Level 1: Quoted market price

Financial instruments with quoted prices for identical instruments in active markets.

(ii) Level 2: Valuation technique using observable inputs

Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

(iii) Level 3: Valuation technique with significant non-observable inputs

Financial instruments valued using models where one or more significant inputs are not observable.

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

Furthermore, the assessment of hierarchy level is based on the lowest level of input that is significant to the fair value of the financial instrument. Consequently, the level of uncertainty in the determination of the unobservable inputs will generally give rise to valuation uncertainty that is less than the fair value itself.

In certain circumstances, the Group applies the fair value option to its own debt in issue. Where available, the fair value will be based upon quoted prices in an active market for the specific instrument concerned. Where unavailable, the fair value will either be based upon quoted prices in an inactive market for the specific instrument concerned, or estimated by comparison with quoted prices in an active market for similar instruments. The fair value of these instruments therefore includes the effect of own credit spread. Gains and losses arising from changes in the credit spread of liabilities issued by Group reverse over the contractual life of the debt.

62. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

(a) Determination of fair value (continued)

Structured notes issued and certain other hybrid instrument liabilities are included within trading liabilities and are marked at fair value. The credit spread applied to these instruments is derived from the spreads at which the Group issues structured notes. Gains and losses arising from changes in the credit spread of liabilities issued by the Group reverse over the contractual life of the debt, provided that the debt is not repaid at a premium or a discount.

All net positions in non-derivative financial instruments, and all derivative portfolios, are valued at bid or offer prices as appropriate. Long positions are marked at bid prices; short positions are marked at offer prices.

The fair values of large holdings of non-derivative financial instruments are based on a multiple of the value of a single instrument, and do not include block adjustments for the size of the holding.

The valuation models used where quoted market prices are not available incorporate certain assumptions that the Group anticipates would be used by a market participant to establish fair value. Where the Group believes that there are additional considerations not included within the valuation model, adjustments may be adopted outside the model.

Examples of such adjustments are:

– Credit risk adjustment: an adjustment to reflect the credit worthiness of over-the-counter ("OTC") derivative counterparties.

– Market data/model uncertainty: an adjustment to reflect uncertainties in fair values based on uncertain market data inputs (e.g. as a result of illiquidity) or in areas where the choice of valuation model is particularly subjective.

– Inception profit ("day 1 P&L reserves"): for financial instruments valued at inception, on the basis of one or more significant unobservable inputs, the difference between transaction price and model value (as adjusted) at inception is not recognised in the consolidated income statement, but is deferred and included as part of the fair value.

  Transaction costs are not included in the fair value calculation. Trade origination costs such as brokerage fees and post-trade costs are included in operating expenses. The future costs of administering the OTC derivative portfolio are also not included in fair value, but are expensed as incurred.

– Debt securities, Treasury and eligible bills, and Equities

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

– Derivatives

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

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

62. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

(a) Determination of fair value (continued)

Analysis of fair value determination

The following table provides an analysis of the basis for valuing financial assets and financial liabilities measured at fair value in the consolidated financial statements:

	Group					
	Valuation techniques					
	quoted market price Level 1	using observable inputs Level 2	with significant non-observable inputs Level 3	Third party total	Amounts with HSBC entities*	Total
2011						
Assets						
Trading assets	**59,866**	**4,305**	**–**	**64,171**	**–**	**64,171**
Financial assets designated at fair value	**758**	**3,165**	**634**	**4,557**	**3,539**	**8,096**
Derivative financial instruments	**541**	**3,814**	**71**	**4,426**	**284**	**4,710**
Available-for-sale financial investments	**59,411**	**89,718**	**150**	**149,279**	**–**	**149,279**
Liabilities						
Trading liabilities	**25,605**	**33,584**	**523**	**59,712**	**–**	**59,712**
Financial liabilities designated at fair value	**–**	**434**	**–**	**434**	**–**	**434**
Derivative financial instruments	**48**	**4,153**	**–**	**4,201**	**647**	**4,848**
2010						
Assets						
Trading assets	24,840	1,215	–	26,055	–	26,055
Financial assets designated at fair value	818	2,245	510	3,573	3,541	7,114
Derivative financial instruments	721	4,161	106	4,988	605	5,593
Available-for-sale financial investments	25,207	117,568	283	143,058	–	143,058
Liabilities						
Trading liabilities	18,991	23,037	553	42,581	–	42,581
Financial liabilities designated at fair value	–	457	–	457	–	457
Derivative financial instruments	96	4,034	–	4,130	553	4,683

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

There were no material movements between Level 1 and Level 2 during the year.

62. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

(a) Determination of fair value (continued)

	Bank					
	Valuation techniques					
	quoted market price Level 1	using observable inputs Level 2	with significant non-observable inputs Level 3	Third party total	Amounts with HSBC entities*	Total
2011						
Assets						
Trading assets	**59,866**	**660**	**–**	**60,526**	**–**	**60,526**
Financial assets designated at fair value	**–**	**140**	**–**	**140**	**–**	**140**
Derivative financial instruments	**539**	**3,308**	**–**	**3,847**	**589**	**4,436**
Available-for-sale financial investments	**59,168**	**45,930**	**44**	**105,142**	**–**	**105,142**
Liabilities						
Trading liabilities	**25,605**	**10,051**	**421**	**36,077**	**–**	**36,077**
Financial liabilities designated at fair value	**–**	**–**	**–**	**–**	**–**	**–**
Derivative financial instruments	**42**	**3,468**	**–**	**3,510**	**592**	**4,102**
2011						
Assets						
Trading assets	24,840	392	–	25,232	–	25,232
Financial assets designated at fair value	–	148	–	148	–	148
Derivative financial instruments	717	3,784	–	4,501	525	5,026
Available-for-sale financial investments	24,176	78,894	36	103,106	–	103,106
Liabilities						
Trading liabilities	18,991	10,831	284	30,106	–	30,106
Financial liabilities designated at fair value	–	–	–	–	–	–
Derivative financial instruments	95	3,742	–	3,837	691	4,528

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

There were no material movements between Level 1 and Level 2 during the year.

62. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

(a) Determination of fair value (continued)

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy

The following table provides a reconciliation of the movement between opening and closing balances of Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs:

	Group						
	Assets				Liabilities		
	Available-for-sale	Held for trading	Designated at fair value through profit or loss	Derivatives	Held for trading	Designated at fair value through profit or loss	Derivatives
At 1 January 2011	283	–	510	106	553	–	–
Total gains or losses recognised in profit and loss	–	–	(1)	(154)	(5)	–	–
Total gains or losses recognised in other comprehensive income	9	–	–	–	–	–	–
Purchases	–	–	355	–	–	–	–
Issues/deposit taking	–	–	–	–	933	–	–
Sales	–	–	(63)	–	–	–	–
Settlements	–	–	(22)	119	(935)	–	–
Transfers out	(142)	–	(150)	–	(160)	–	–
Transfers in	–	–	5	–	122	–	–
Exchange adjustments	–	–	–	–	15	–	–
At 31 December 2011	150	–	634	71	523	–	–
Total gains or losses recognised in profit or loss relating to those assets and liabilities held at the balance sheet date	13	–	2	(154)	5	–	–

62. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

(a) Determination of fair value (continued)

	Group						
	Assets				Liabilities		
	Available-for-sale	Held for trading	Designated at fair value through profit or loss	Derivatives	Held for trading	Designated at fair value through profit or loss	Derivatives
At 1 January 2010	448	–	696	–	756	–	–
Total gains or losses recognised in profit and loss	(1)	–	47	14	14	–	–
Total gains or losses recognised in other comprehensive income	12	–	–	–	–	–	–
Purchases	20	–	165	–	–	–	–
Issues/deposit taking	–	–	–	–	1,528	–	–
Sales	–	–	(21)	–	–	–	–
Settlements	(9)	–	(80)	92	(2,110)	–	–
Transfers out	(397)	–	(425)	–	(685)	–	–
Transfers in	210	–	128	–	1,044	–	–
Exchange adjustments	–	–	–	–	6	–	–
At 31 December 2010	283	–	510	106	553	–	–
Total gains or losses recognised in profit or loss relating to those assets and liabilities held at the balance sheet date	16	–	52	13	8	–	–

62. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

(a) Determination of fair value (continued)

	Bank						
	Assets				Liabilities		
	Available-for-sale	Held for trading	Designated at fair value through profit or loss	Derivatives	Held for trading	Designated at fair value through profit or loss	Derivatives
At 1 January 2011	36	–	–	–	284	–	–
Total gains or losses recognised in profit and loss	–	–	–	–	–	–	–
Total gains or losses recognised in other comprehensive income	8	–	–	–	–	–	–
Purchases	–	–	–	–	–	–	–
Issues/deposit taking	–	–	–	–	721	–	–
Sales	–	–	–	–	–	–	–
Settlements	–	–	–	–	(584)	–	–
Transfers out	–	–	–	–	–	–	–
Transfers in	–	–	–	–	–	–	–
Exchange adjustments	–	–	–	–	–	–	–
At 31 December 2011	44	–	–	–	421	–	–
Total gains or losses recognised in profit or loss relating to those assets and liabilities held at the balance sheet date	6	–	–	–	–	–	–

62. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

(a) Determination of fair value (continued)

	Bank						
	Assets				Liabilities		
	Available-for-sale	Held for trading	Designated at fair value through profit or loss	Derivatives	Held for trading	Designated at fair value through profit or loss	Derivatives
At 1 January 2010	33	–	–	–	602	–	–
Total gains or losses recognised in profit and loss	–	–	–	–	11	–	–
Total gains or losses recognised in other comprehensive income	3	–	–	–	–	–	–
Purchases	–	–	–	–	–	–	–
Issues/deposit taking	–	–	–	–	1,018	–	–
Sales	–	–	–	–	–	–	–
Settlements	–	–	–	–	(1,662)	–	–
Transfers out	–	–	–	–	(685)	–	–
Transfers in	–	–	–	–	1,000	–	–
Exchange adjustments	–	–	–	–	–	–	–
At 31 December 2010	36	–	–	–	284	–	–
Total gains or losses recognised in profit or loss relating to those assets and liabilities held at the balance sheet date	5	–	–	–	9	–	–

For available-for-sale securities and financial assets designated at fair value, the transfers into and out of Level 3 were due to change in valuation observability of certain debt securities during the year.

For held-for-trading liabilities, transfers into and out of Level 3 were primarily due to change in observability of equity correlation during the year.

For assets and liabilities classified as held for trading, realised and unrealised gains and losses are presented in the income statement under "Trading income".

Fair value changes on assets designated at fair value are presented in the income statement under "Net income/(loss) from financial instruments designated at fair value".

Realised gains and losses from available-for-sale securities are presented under "Gains less losses from financial investments and fixed assets" in the income statement while unrealised gains and losses are presented in "Fair value changes taken to/(from) equity" within "Available-for-sale investment reserve" in other comprehensive income.

62. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

(a) Determination of fair value (continued)

Effects of changes in significant non-observable assumptions to reasonably possible alternatives

As discussed above, the fair value of financial instruments are, in certain circumstances, measured using valuation models that incorporate assumptions that are not supported 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 fair values to reasonably possible alternative assumptions.

Group

	Reflected in income statement		Reflected in other comprehensive income	
	favourable changes	unfavourable changes	favourable changes	unfavourable changes
2011				
Derivatives/trading assets/trading liabilities	**8**	**(8)**	**–**	**–**
Financial assets/liabilities designated at fair value	**63**	**(63)**	**–**	**–**
Available-for-sale financial investments	**–**	**–**	**15**	**(15)**
2010				
Derivatives/trading assets/trading liabilities	1	(1)	–	–
Financial assets/liabilities designated at fair value	51	(51)	–	–
Available-for-sale financial investments	–	–	28	(28)

Bank

	Reflected in income statement		Reflected in other comprehensive income	
	favourable changes	unfavourable changes	favourable changes	unfavourable changes
2011				
Derivatives/trading assets/trading liabilities	**–**	**–**	**–**	**–**
Financial assets/liabilities designated at fair value	**–**	**–**	**–**	**–**
Available-for-sale financial investments	**–**	**–**	**4**	**(4)**
2010				
Derivatives/trading assets/trading liabilities	–	–	–	–
Financial assets/liabilities designated at fair value	–	–	–	–
Available-for-sale financial investments	–	–	4	(4)

62. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

(a) Determination of fair value (continued)

Changes in fair value recorded in the income statement

The following table details changes in fair values recognised in the income statement during the year, where the fair value is estimated using valuation techniques that incorporate significant assumptions that are not supported by prices from observable current market transactions in the same instrument, and are not based on observable market data:

- the table details the total change in fair value of these instruments; it does not isolate that component of the change that is attributable to the non-observable component;
- instruments valued with significant non-observable inputs are frequently dynamically hedged with instruments valued using observable inputs; the table does not include any changes in fair value of these hedges.

	Group		Bank	
	2011	2010	**2011**	2010
Recorded in the income statement:				
Derivatives/trading assets/trading liabilities	**(159)**	28	**–**	11
Financial assets/liabilities designated at fair value	**(1)**	47	**–**	–

Fair value of financial instruments not carried at fair value

The fair values of financial instruments that are not recognised at fair value on the balance sheet are calculated as described below.

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

The following types of financial instruments are measured at amortised cost unless they are held for trading or designated at fair value through profit or loss. Where assets or liabilities are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the assets or liabilities so hedged includes a fair value adjustment for the hedged risk only. Fair values at the date of balance sheet of the assets and liabilities set out below are estimated for the purpose of disclosure as follows:

(i) Loans and advances to customers

The fair value of advances to customers is estimated using discounted cash flow models, using an estimate of the discount rate that a market participant would use in valuing instruments with similar maturity, repricing and credit risk characteristics.

The fair value of a loan portfolio reflects both loan impairments at the date of balance sheet and estimates of market participants' expectations of credit losses over the life of the loans.

62. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

(a) Determination of fair value (continued)

(ii) Financial investments

The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that take into consideration either the prices of, or future earnings streams of, equivalent quoted securities.

(iii) Deposits and customer accounts

The fair value of deposits and customers account is estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of deposits repayable on demand is assumed to be the amount payable on demand at the balance sheet date.

(iv) Debt securities in issue and subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments.

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. In many cases, it would not be possible to realise immediately the estimated fair values given the size of the portfolios measured. Accordingly, these fair values do not represent the value of these financial instruments to the Group as a going concern.

For all classes of financial instruments, fair value represents the product of the value of a single instrument, multiplied by the number of instruments held. No block discount or premium adjustments are made.

The fair values of intangible assets, such as values placed on portfolios of core deposits, credit card and customer relationships, are not included above because they are not financial instruments.

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

Assets

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

Liabilities

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

The methods and significant assumptions applied in determining the fair value of financial instruments are set out in note 4(n).

62. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

(b) Fair value

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

	Group			
	2011		2010	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial Assets				
Placings with and advances to banks and other financial institutions	**107,742**	**107,707**	110,564	110,570
Advances to customers	**480,574**	**468,563**	472,637	474,045
Held-to-maturity debt securities	**59,911**	**63,396**	56,301	58,327
Financial Liabilities				
Current, savings and other deposit accounts	**699,857**	**699,939**	683,628	683,732
Deposits from banks	**14,004**	**14,004**	15,586	15,586
Certificates of deposit and other debt securities in issue	**9,284**	**9,294**	3,095	3,104
Subordinated liabilities	**11,846**	**13,424**	11,848	12,761

	Bank			
	2011		2010	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial Assets				
Placings with and advances to banks and other financial institutions	**47,724**	**47,724**	52,131	52,136
Advances to customers	**425,629**	**413,629**	423,074	424,514
Financial Liabilities				
Current, savings and other deposit accounts	**661,012**	**661,093**	649,144	649,249
Deposits from banks	**11,989**	**11,989**	15,585	15,585
Certificates of deposit and other debt securities in issue	**9,284**	**9,294**	3,095	3,104
Subordinated liabilities	**11,846**	**13,424**	11,848	12,761

63. COMPARATIVE FIGURES

As a result of the adoption of the HKAS 24 (Revised) "Related Party Disclosures", certain comparative figures have been adjusted to conform with the current year's presentation and to provide comparative amounts in respect of items disclosed for the first time in 2011.

64. 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.

65. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board of Directors on 27 February 2012.