恒生銀行
HANG SENG BANK

INTERIM REPORT

CONTENTS

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

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

RESULTS IN BRIEF

	30 June 2021	*30 June 2020*
For the half-year ended	**HK$m**	HK$m
Net operating income before change in expected credit losses and other credit impairment charges	**17,326**	19,187
Operating profit	**10,223**	11,134
Operating profit excluding change in expected credit losses and other credit impairment charges	**10,562**	12,894
Profit before tax	**10,298**	10,619
Profit attributable to shareholders	**8,767**	9,143
	%	%
Return on average ordinary shareholders' equity	**9.9**	10.7
Cost efficiency ratio	**39.0**	32.8
	HK$	HK$
Earnings per share	**4.44**	4.64
Dividends per share	**2.20**	1.90

	At 30 June 2021	*At 31 December 2020*
At period-end	**HK$m**	HK$m
Shareholders' equity	**183,677**	183,100
Total assets	**1,800,215**	1,759,787
	%	%
Capital ratios		
– Common Equity Tier 1 ('CET1') Capital Ratio	**15.8**	16.8
– Tier 1 Capital Ratio	**17.4**	18.5
– Total Capital Ratio	**18.9**	20.0
Liquidity ratios		
– Liquidity coverage ratio	**217.0**	230.4
– Net stable funding ratio	**146.6**	152.9

The first six months of 2021 have been a period of transition. Supportive fiscal and monetary policies from governments and central banks and the wider implementation of effective measures to control the spread of COVID-19 have returned a degree of stability to international markets. Economies around the world, including those of Hong Kong and mainland China, are showing signs of recovery as more companies refocus energy directed at managing the acute effects of the pandemic back towards the pursuit of long-term business objectives. That said, the situation remains fragile. Economic recovery to this point has been uneven and incomplete, with sectors hardest hit by the pandemic continuing to be relatively weak.

In the Hang Seng context, our agile business structure facilitated an effective response to the upturn in market activity during the first half of 2021, resulting in good year-on-year growth in non-interest income. However, the continued decline in market interest rates remained a significant challenge. Further downward pressure on the net interest margin affected our ability to grow net interest income, despite increased balance sheet volumes.

The overall impact on the bottom line was a 4% decline in profit attributable to shareholders to HK$8,767m. Earnings per share were HK$4.44 per share. Return on average ordinary shareholders' equity was 9.9%. Return on average total assets was 1.0%.

As a business with a long-term vision and strategy for sustainable growth, progress and success are measured by more than financial figures.

Our previous investments in digital services and technology have played a major role in delivering successful banking solutions for customers, particularly amid the height of the pandemic. With more clients experiencing the convenience and speed of online and mobile banking, we continued to grow our digital capabilities during the first half to offer customers even greater flexibility and choice in how and when they manage their financial needs.

We established new and closer alliances with strategic partners who share our ambition to open up new opportunities for our customers and to facilitate the success of local start-ups and entrepreneurs. We rolled out innovative new wealth management products and services to help individuals and businesses plan more effectively for the future.

Our people have continued to excel in anticipating and meeting the banking needs of customers in an environment of rapidly evolving service expectations.

The Directors have declared a second interim dividend of HK$1.10 per share. This brings the total distribution for the first half of 2021 to HK$2.20 per share, compared with HK$1.90 per share for the first half of 2020.

Economic Outlook

The sustainability of global economic recovery is heavily dependent on a complex matrix of factors, not least the ability of the international community to contain the emergence and spread of new COVID-19 variants. Despite the expansion of vaccine programmes and ongoing economic policy support, many uncertainties are still in play and it will likely be some time before we see a sustained return to pre-pandemic levels of economic activity and market confidence.

In Hong Kong, increased demand for exports from major trading partners and government policy measures are the major factors underpinning the recent recovery. GDP rose by 7.9% year-on-year in the first quarter of 2021, the first expansion after six consecutive quarters of contraction. Domestic consumption, however, is lagging behind, and key sectors of the economy such as consumption and tourism-related industries are still very much feeling the effects of the pandemic. This is reflected in the job shortfall in the labour market, which remains significant in comparison with the pre-recession level. Assuming the worst of the downside risks are avoided, Hong Kong's economy will likely experience continued growth in the upcoming quarters, but regaining its previous balance will take longer to achieve. We expect Hong Kong's economy to achieve GDP growth of about 7.3% in 2021.

Trade, production and investment continue to be the primary engines of the Mainland's economic recovery. The government is continuing with major initiatives to boost domestic consumption, which remains restrained, as part of its 'dual circulation strategy', but rebalancing the mix of economic drivers will take time. As such, the government is likely to maintain a proactive fiscal policy, with the People's Bank of China providing support by ensuring the availability of adequate credit and liquidity. We expect the Mainland economy to achieve high single-digit GDP growth for the year.

Hong Kong Roots, Greater Bay Area Expertise

As this is my first results announcement as Chairman of Hang Seng's Board of Directors, I wish to take this opportunity to express my deep gratitude to my predecessor, Raymond Ch'ien. His leadership and sage guidance over the years has significantly strengthened Hang Seng's position as a progressive, customer-centric bank that continually demonstrates market leadership across all areas of its business and as a responsible and compassionate corporate citizen.

I also wish to sincerely thank the members of the Board and the senior management team for their invaluable support, as well as staff across the Bank for being adaptable, determined and passionate in taking care of our customers' needs under challenging conditions. By working together as one team, I am confident we will build on Raymond's strong legacy to grow Hang Seng in ways that continue to give us a strong sense of purpose and pride.

The past 18 months have underscored the need to ensure our business continues to have the resilience and agility necessary to respond smoothly and successfully to unexpected changes in market conditions and to play an active part in contributing to solutions that support the well-being and prosperity of our community.

One important way in which we are achieving this is through our environmental, social and governance (ESG) commitments. Guided by our ESG Steering Committee, we have established ambitious targets, which include becoming carbon neutral in our operations by 2030. We aim to lead the way in driving ESG performance in Hong Kong's banking industry as we contribute to a bright future for Hong Kong and the Greater Bay Area.

Our deep local roots and international perspective contribute to the long-term development of the markets we serve in many different ways. As the leading compiler of indexes focused on the Hong Kong and mainland China markets, our wholly owned subsidiary Hang Seng Indexes Company is building bridges with the global finance and investment community through the development of innovative indexes around new-economy and ESG themes focused on the Greater China region.

There will be more challenges ahead, but we have a clear business purpose and a robust set of values to guide us. We will continue to focus on improving outcomes for customers, building a more sustainable society, and opening up exciting new opportunities for our business and our diverse range of stakeholders.

Irene Lee
Chairman
2 August 2021

Economic and investment activity trends that began to emerge in the second half of 2020 carried forward into the first half of this year.

We leveraged our strong wealth management capabilities to achieve good growth in our retail investment business. On the commercial side, reviving export demand and other signs of recovery in the international economy facilitated new lending activity as we continued to build close customer relationships. We also accelerated efforts to develop new business segments and opportunities in green finance to further diversify our revenue base.

The success of these actions is reflected in the 24% year-on-year growth in our non-interest income. Our ability to move swiftly in fluid market conditions reflects the agility and resilience of our business model and the fruits of investing in technology and in enhancing the service experience.

However, the further lowering of interest rates and a decline in HIBOR compared with the first half of 2020 proved a significant challenge for our year-on-year performance, despite balance sheet growth. Overall, with the macroeconomic conditions putting pressure on the net interest margin, and net interest income down, we recorded a 4% drop in attributable profit to HK$8,767m.

Nevertheless, if we compare our performance to the second half of 2020, in which external market conditions were more comparable to the first half of this year, our attributable profit is up by 16%. This demonstrates the good business momentum we are generating and shows we are on the right track in driving our long-term business strategy and achieving sustainable growth.

Investment in technology remains a priority and has enabled us to stay ahead in the digital space as more customers discover the benefits of online and mobile banking. In the first six months of this year, we rolled out more than 270 new or enriched digital features to enhance customer experiences. These include functions such as the new 'My Investment' portfolio overview and market insights service for personal mobile banking customers that are helping to drive growth in digital banking usage. Year-on-year, the ratio of active personal banking mobile users increased to 75% and mobile app log-ons rose by 45%.

The greater convenience and speed of new solutions such as remote account opening and cross-boundary account management are helping us to win new business.

We were the first bank to introduce the use of Hong Kong's 'iAM Smart' app for identity verification at all our branches.

Our omni-channel 'branch of the future' model means shorter waiting times and improved efficiency for customers, enhancing Hang Seng's 'best-in-class' service with a human touch.

We are also developing more services that add real value in enriching customers' lifestyles. Our newly launched wellness app Olive, provided in partnership with two leading local healthcare experts, is helping customers to stay 'fit for the future' in all aspects of their lives. Our commercial business is assisting SMEs and other companies to get 'future fit' through an acceleration of our green financing activities.

As part of our 'beyond banking' service proposition, we are also working to connect local companies with new markets. Our new strategic alliance with Cyberport is designed to help innovators and start-ups benefit from opportunities that are emerging in the Greater Bay Area (GBA) through tailor-made financing solutions and fintech collaboration.

Our customer-centric and innovative services, particularly in the digital sphere, continued to garner industry recognition. *The Asset* named our personal banking mobile app as the best in Hong Kong for the second consecutive year, and acknowledged our efforts to support business customers with two Best Payment and Collection Solution awards. We were also identified as the Best Bank for SMEs in Hong Kong by *Asiamoney*.

Our SimplyFund in-app investment service, which won a Best Financial Asset/Market Trading Service award from *The Asian Banker*, provides young and novice investors with an easy-to-use and low-cost channel for beginning their wealth management journey.

Our growing appeal among younger segments is reflected in the year-on-year increase in our number of customers aged from 18 to 30. We will continue to launch new services that meet the specific banking needs and preferences of this important group of customers.

Financial Overview

Net operating income before change in expected credit losses and other credit impairment charges was HK$17,326m, down 10% year-on-year, but up by 3% compared with the second half of 2020.

Net interest income dropped by 20% year-on-year to HK$11,883m, with the impact of the unfavourable interest rate environment outweighing increased volumes from balance sheet growth and a 5% rise in average interest-earning assets. Year-on-year, the net interest margin fell by 45 basis points, to 1.51%, due mainly to balance sheet repricing. Compared with the second half of 2020, net interest margin was broadly in line. Net interest income was down by 2%, reflecting fewer calendar days in the first half of the year compared with the second half.

Non-interest income was HK$5,443m, up by 24% and 14% compared with the first and second halves of last year respectively.

Net fee income rose by 17% to HK$3,709m. Our swift response to the resurgence in financial markets activity drove strong growth in fee income from retail investment funds and stockbroking and related services. As social-distancing restrictions relaxed, we capitalised on improving retail consumption sentiment with lifestyle-focused spending offers to record a 10% increase in our card business income. Similarly, an upturn in commercial investment sentiment drove growth in corporate lending activities, leading to a 14% rise in credit facilities fees.

Net income from financial instruments measured at fair value through profit or loss recorded a gain of HK$2,685m, compared with a loss in the same period last year.

Net trading income and net income from financial instruments designated at fair value through profit or loss together fell by HK$373m, or 30%, due mainly to lower income from foreign exchange activities and debt securities trading.

Net income from assets and liabilities of insurance businesses measured at fair value through profit or loss recorded a gain of HK$1,821m as compared with a loss of HK$1,284m in same period last year, reflecting favourable equity market movements in the first half of 2021. To the extent that these investment returns were attributable to policyholders, there was an offsetting effect in 'net insurance claims and benefits paid and movement in liabilities to policyholders' and 'movement in present value of in-force long-term insurance business' under 'other operating income'.

Net insurance premium income fell by 5%, reflecting lower renewal business despite higher new business sales.

Other operating income fell by 81%, mainly reflecting the offsetting effect in relation to investment returns on our insurance portfolio as mentioned above.

Change in expected credit losses and other credit impairment charges (ECL) decreased by HK$1,421m, or 81%, to HK$339m. The overall ECL balance remained stable.

As at the end of June, gross impaired loans and advances as a percentage of gross loans and advances to customers was 0.69%, up nine basis points on the end of last year. However, a large portion of these impaired loans are secured by tangible collaterals. We are comfortable with our current level of provisions and will remain vigilant in our monitoring of market conditions.

Year-on-year, operating expenses increased by HK$461m, or 7%, to HK$6,754m. This increase mainly reflects further investments in technology to keep pace with changing customer expectations, as well as increased marketing expenses to capture opportunities arising from the upturn in investment and commercial business activity. Compared with the second half of 2020, operating expenses decreased by HK$158m, or 2%.

Our cost efficiency ratio was 39.0%.

Operating profit was down by 8% at HK$10,223m. Compared with the second half of 2020, operating profit was up by 14%.

With gradual recovery in the commercial property market during the first half, the investment property revaluation recorded a net surplus of HK$39m, compared with a net deficit of HK$428m in the same period last year.

Profit before tax fell by 3% to HK$10,298m.

Attributable profit fell by 4% to HK$8,767m. Earnings per share were down by 4% at HK$4.44 per share.

Compared with the second half of 2020, profit before tax was up by 17% and attributable profit rose by 16%.

Our capital base remains strong. At 30 June 2021, our common equity tier 1 capital ratio was 15.8%, our tier 1 capital ratio was 17.4%, and our total capital ratio was 18.9%, compared with 16.8%, 18.5% and 20.0% respectively at the end of 2020.

Towards a More Sustainable Future

Contributing to a more sustainable future is a core value for Hang Seng and major strategic focus of our long-term growth strategy. We are more deeply embedding environmental, social and governance (ESG) considerations into our services, operations and disclosures. In particular, we are accelerating our actions to strengthen our climate risk management capabilities and increase our contribution to tackling the major global challenge of climate change.

We have set demanding targets to improve our own performance, such as committing to be carbon neutral by 2030. And we are providing customers with more services that facilitate the transition to a low-carbon future.

With a new team focusing exclusively on green financing solutions for business customers, we have already approved about HK$6.6bn in green loans in the first half of this year and will further intensify our activity in this burgeoning new area of business. In addition, between January this year when our Global Markets' Repo Trading team began accepting green bonds as collateral and the end of June, the volume of such collateral has grown rapidly.

We are also continuing to strengthen the ESG focus of our wealth management portfolio of products. Two of our investment funds won a total of five awards in sustainability categories in *BENCHMARK*'s 2020 Funds of the Year Awards.

One Bank, A World of Opportunity

The global economy is showing tentative signs of recovery. The rollout of vaccine programmes and continuing policy support from governments and central banks around the world are bringing some calming effects to the business community and financial markets have become more active.

However, uncertainties ranging from new COVID-19 variants to geopolitical tensions still pose significant risks to economic recovery. The current low interest rate environment is likely to persist, which will continue to challenge our efforts to grow net interest income.

In fast-moving market conditions, we will continue to be guided by our values. Our strengths, reputation and progressive approach make us well positioned to fulfil our ambition of becoming the preferred banking and financial services partner for customers in Hong Kong and the GBA.

Through new customer-centric service innovations and accelerated efforts to tap the potential of new industry sectors, we will further grow our base of non-fund income revenue streams. We will leverage our digital advantage to offer customers a seamless financial services experience across channels and across boundaries.

The entire Hang Seng team is striving to create new opportunities and improve outcomes for our customers and our business. I wish to thank my colleagues for their continued hard work in a challenging operating environment. Their collaborative spirit has ensured the smooth delivery of quality services to our customers and will continue to contribute to the long-term well-being and prosperity of our customers, our community and the Bank.

Margaret Kwan
Executive Director, Acting Chief Executive and Head of Wealth and Personal Banking
2 August 2021

FINANCIAL PERFORMANCE

Income Analysis

Summary of financial performance

Figures in HK$m	***Half-year ended 30 June 2021***	*Half-year ended 30 June 2020*
Total operating income	**25,633**	27,259
Operating expenses	**6,754**	6,293
Operating profit	**10,223**	11,134
Profit before tax	**10,298**	10,619
Profit attributable to shareholders	**8,767**	9,143
Earnings per share (in HK$)	**4.44**	4.64

In the first half of 2021 ('1H 21'), downward pressure on global economy continued amid the ongoing COVID-19 pandemic. The continuous decline in market interest rates was the primary cause of the fall in the Group's revenue as compared with the first half of 2020 ('1H 20'). The Group leveraged its strong wealth management capabilities to increase fee-based income and achieved strong growth in its wealth management business income. This helped offset some of the negative impact on profitability caused by the prevailing low interest rate environment. Change in expected credit losses and other credit impairment charges ('ECL') fell substantially, reflecting an improved economic outlook.

Compared with the second half of 2020 ('2H 20'), the Group achieved a double-digit increase in both profit attributable to shareholders and operating profit, with broad-based improvement in key income and expenses lines other than the decrease in net interest income which was due mainly to more calendar days in 2H 20 compared with 1H 21. This reflects the Group's effective actions to achieve solid business momentum amid the challenges of the continuing effects of the COVID-19 pandemic and the still fragile economic conditions in 1H 21.

The Group's **profit attributable to shareholders** for 1H 21 was HK$8,767m, down by 4% when compared with 1H 20. **Profit before tax** fell by 3% to HK$10,298m. **Net operating income before change in expected credit losses and other credit impairment charges** was HK$17,326m, down 10%, reflecting the net effect of the decrease in net interest income and the increase in non-interest income. Net interest income was 20% lower due to narrower margins with the continued decline in global interest rates. Wealth management business income was a key source of income, growing by 44%, on the back of increases in income from securities broking-related services and retail investment fund sales, as well as in insurance business-related income due largely to better investment returns. Operating expenses went up by 7% when compared with 1H 20. ECL decreased significantly by 81% to HK$339m, reflecting an improvement in the forward-looking economic outlook. **Operating profit** dropped by 8% to HK$10,223m. Investment property revaluation reported a revaluation surplus of HK$39m compared with a revaluation deficit of HK$428m for 1H 20.

Net interest income decreased by HK$2,909m, or 20%, to HK$11,883m, with increased volumes from balance sheet growth more than offset by the narrowing of the net interest margin in the low interest rate environment. Net interest margin was down by 45 basis points to 1.51%, due mainly to balance sheet repricing. Net interest spread declined by 35 basis points to 1.43% and contribution from net-free funds dropped by 10 basis points to 0.08%. The global low interest rate environment is likely to be prolonged, which will continue to exert pressure on the Group's net interest income and net interest margin.

Figures in HK$m	***Half-year ended 30 June 2021***	*Half-year ended 30 June 2020*
Net interest income/(expense) arising from:		
– financial assets and liabilities that are not at fair value through profit and loss	**12,343**	15,168
– trading assets and liabilities	**57**	119
– financial instruments designated and otherwise mandatorily measured at fair value through profit or loss	**(517)**	(495)
	11,883	14,792
Average interest-earning assets	**1,587,529**	1,515,614
Net interest spread	**1.43%**	1.78%
Net interest margin	**1.51%**	1.96%

Average interest-earning assets grew by HK$72bn, or 5%, to HK$1,588bn, mainly driven by growth in average financial investments. The Markets Treasury team continued to proactively defend the interest margin and investment yield by seeking out good market opportunities, taking action to diversify investment holdings, and actively managing the portfolio while upholding prudent risk management standards. However, this was more than offset by the compressed deposit spread, despite the shift of funds from time deposits to low-cost current and savings deposits, arising from the progressive interest rate reductions during the period. The low interest rate environment also led to a reduction in contribution from net-free funds.

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

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

Figures in HK$m	***Half-year ended 30 June 2021***	*Half-year ended 30 June 2020*
Net interest income and expense reported as 'Net interest income'		
– Interest income	**13,945**	20,020
– Interest expense	**(1,606)**	(4,874)
– Net interest income	**12,339**	15,146
Net interest income and expense reported as 'Net income from financial instruments measured at fair value through profit or loss'	**(456)**	(354)
Average interest-earning assets	**1,550,173**	1,476,660
Net interest spread	**1.54%**	1.88%
Net interest margin	**1.61%**	2.06%

Net fee income increased by HK$534m, or 17%, to HK$3,709m. In the uncertain investment environment, the Bank's comprehensive portfolio of wealth management products and the convenient service channels facilitated strong growth in income from retail investment funds and securities broking and related services which rose by 38% and 25% respectively. Amid improved retail consumption sentiment, card business income rose by 10%, due mainly to higher card spending and merchant sales. Credit facilities fees were up by 14% due to higher new corporate lending activities. Fee income from insurance-related business and remittances fell by 17% and 13% respectively.

Net income/(loss) from financial instruments measured at fair value through profit or loss recorded a gain of HK$2,685m, compared with a loss of HK$52m in the same period last year.

Net trading income and net income from financial instruments designated at fair value through profit or loss together fell by HK$373m, or 30%, to HK$864m, driven largely by the decrease in income from foreign exchange activities and debt securities trading.

Net income from assets and liabilities of insurance businesses measured at fair value through profit or loss recorded a gain of HK$1,821m, compared with a loss of HK$1,284m in the same period last year. Investment returns on financial assets supporting insurance liabilities contracts improved substantially, reflecting the favourable market movements in 1H 21, compared with unfavourable market movements in 1H 20. To the extent that these investment returns were attributable to policyholders, there was an offsetting effect reported under 'net insurance claims and benefits paid and movement in liabilities to policyholders' and 'movement in present value of in-force long-term insurance business ('PVIF')' under 'other operating income'.

Analysis of income from wealth management business

Figures in HK$m	***Half-year ended 30 June 2021***	*Half-year ended 30 June 2020*
Investment services income[1]:		
– retail investment funds	**897**	650
– structured investment products	**241**	218
– securities broking and related services	**1,205**	960
– margin trading and others	**38**	42
	2,381	1,870
Insurance income:		
– life insurance:		
– net interest income and fee income	**2,115**	2,042
– investment returns on life insurance funds (including share of associate's profits/(losses), net surplus/(deficit) on property revaluation backing insurance contracts and change in expected credit losses and other credit impairment charges)	**1,814**	(1,705)
– net insurance premium income	**6,798**	7,171
– net insurance claims and benefits paid and movement in liabilities to policyholders	**(8,307)**	(8,072)
– movement in present value of in-force long-term insurance business	**131**	2,106
	2,551	1,542
– general insurance and others	**158**	125
	2,709	1,667
	5,090	3,537

1 *Income from retail investment funds and securities broking and related services are net of fee expenses. Income from structured investment products includes income reported under net fee income on the sales of third-party structured investment products. It also includes profits generated from the selling of structured investment products in issue, reported under net income from financial instruments measured at fair value through profit or loss.*

Wealth management business income increased by 44% when compared with same period last year.

Net interest income and fee income from life insurance business rose by 4%, in line with the growth in the insurance investment fund portfolio. Investment returns on the insurance portfolio recorded a gain of HK$1,814m for 1H 21, compared with a loss of HK$1,705m for 1H 20, driven mainly by favourable equity market movements in 1H 21 as compared with unfavourable equity market movements in 1H 20. To the extent that these investment returns were attributable to policyholders, there was an offsetting effect in 'net insurance claims and benefits paid and movement in liabilities to policyholders' and 'movement in PVIF' under 'other operating income'.

Net insurance premium income fell by 5%, reflecting lower renewal business partly offset by higher new business sales. In the challenging operating environment, the Group continued to enrich its comprehensive range of tax and retirement planning products and healthcare solutions to suit different customer needs, and expanded distribution through digital and broker channels. Hang Seng Olive, a new mobile health and wellness app launched in 1H 21, provides a diverse array of online health and wellness services such as a clinic, e-booking service, and virtual health consultations, and convenient access to a wide variety of insurance solutions.

Net insurance claims and benefits paid and movement in liabilities to policyholders increased by 3%, reflecting higher investment returns attributable to policyholders from the favourable equity market performance in 1H 21 and higher new business sales.

The movement in present value of in-force long-term insurance business reported under 'other operating income' decreased by 94%, mainly due to a significant positive adjustment to present value of in-force long-term insurance business in 1H 20 to account for the sharing of unfavourable investment returns attributable to policyholders. The movement in PVIF in 1H 21 period reflected the negative adjustment to PVIF to account for the sharing of favourable investment returns attributable to policyholders as partly offset by higher new business sales.

General insurance income was up by 26% compared with 1H 20.

Other operating income dropped by 81% as a result of the change in the movement in PVIF.

Change in expected credit losses and other credit impairment charges decreased by HK$1,421m, or 81%, to HK$339m, largely recorded in the stage 1 and stage 2 exposures (unimpaired credit portfolios), reflecting an improvement in the economic outlook as compared with 1H 20. In 1H 21, ECL for stage 1 and stage 2 portfolios registered a net decrease of HK$1,250m when compared with 1H 20, reflecting an improved economic outlook, as compared with the significant build-up of stage 1 and stage 2 allowances in 1H 20 due to the deteriorating economic outlook at the onset of the COVID-19 outbreak. Wealth and Personal Banking ('WPB') accounted for HK$339m of the reduction, with the remaining HK$911m coming from Commercial Banking ('CMB') and Global Banking and Markets ('GBM').

The Bank regularly reviews its forward economic guidance to reflect changes in the economic outlook and other factors that may influence the credit environment. While there is some expectation that the full-year ECL charge for 2021 may be lower than that in 2020, a high degree of economic uncertainty remains and therefore additional scenario analysis and post model-adjustments will be applied to take such uncertainties into account in managing the Bank's ECL.

Change in ECL for stage 3 and purchased or originated credit-impaired exposures (impaired credit exposures) decreased by HK$171m when compared with 1H 20, largely in retail portfolios. WPB recorded a HK$175m decrease, due mainly to lower charges on credit card and personal loan portfolios. There was a HK$4m increase related to CMB customers.

Gross impaired loans and advances were up by HK$1,287m, or 22%, to HK$7,011m against 2020 year-end. Several impaired corporate loans through the Group's Mainland banking subsidiary and Hong Kong office were downgraded during the period as a result of the challenging economic and credit environment. Taking into account the collaterals and the ECL allowances provided, the Group considers that the current provision level is adequate. Gross impaired loans and advances as a percentage of gross loans and advances to customers stood at 0.69% as at 30 June 2021, compared with 0.32% at 30 June 2020 and 0.60% at the end of December 2020. Overall credit quality remained robust.

The Group remains vigilant and will continue to closely monitor the market situation. Regular reviews on credit portfolios and sectors are carried out to help identify and mitigate any potential risks.

Operating expenses increased by HK$461m, or 7%, to HK$6,754m, reflecting an increase in investments, mainly IT-related costs to enhance our digital capabilities, staff costs, depreciation and amortisation of intangible assets. Notwithstanding the Group's continued investment into transformational digital initiatives for future business growth, careful cost disciplines resulted in a 2% decline in operating expenses when compared with 2H 20.

Staff costs were up by 2%, mainly due to increase in accrual of performance-related pay partly offset by the reduction in salaries resulting from lower headcount.

Depreciation charges remained flat. Amortisation of intangible assets increased by 60%, reflecting higher capitalised IT system development costs.

General and administrative expenses were up by 16%, largely in IT costs and marketing and advertising expenses.

Full-time equivalent staff numbers by region	***At 30 June 2021***	*At 30 June 2020*
Hong Kong and others	**8,028**	8,429
Mainland	**1,676**	1,714
	9,704	10,143

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
Cost efficiency ratio	**39.0%**	32.8%

The cost efficiency ratio increased by 6.2 percentage points to 39.0%, due mainly to the impact of lower revenue resulting from decreased net interest income and the increase in operating expenses.

Following the gradual recovery of the property market in 1H 21, **net surplus/(deficit) on property revaluation** recorded a net surplus of HK$39m, compared with a net deficit of HK$428m in 1H 20. **Share of profits/(losses) of associates** recorded a profit of HK$36m, compared with a loss of HK$87m for 1H 20, largely reflecting the significantly reduced revaluation loss of a property investment company.

First half of 2021 ('1H 21') compared with second half of 2020 ('2H 20')

The effects of the COVID-19 pandemic continued to dominate operating conditions in 1H 21. Despite the uncertain environment, the Group maintained broad-based business momentum and made good progress with its customer-centric strategy for growth, achieving increases in revenue and profit to return respectable results for 1H 21 compared with 2H 20. Key positive drivers included the increase in non-fund income, primarily in wealth management business income. ECL charges were comparatively lower in 1H 21 as a result of the improvement in the economic outlook. Investment property revaluation returned to a surplus compared with a deficit for 2H 20. These favourable factors were partly offset by lower net interest income, due mainly to more calendar days in 2H 20.

Profit attributable to shareholders grew by HK$1,223m, or 16%, when compared with 2H 20, driven by strong growth in non-interest income, reduction in ECL charges and improvement in investment property revaluation. **Operating profit** grew by HK$1,232m, or 14%. **Net operating income before change in expected credit losses and other credit impairment charges** was up by HK$445m, or 3%.

Net interest income decreased by HK$231m, or 2%. Excluding the calendar day change effect, net interest income remained flat, benefitting from stable net interest margin notwithstanding the declining low interest rate environment. Average interest-earning assets remained intact while net interest margin fell by 1 basis points to 1.51%, reflecting the flow-through of falling interest rates and compressed deposit spreads. There was also a reduction in contribution from net-free funds due to the low interest rate environment and the significant drop in HIBOR during 1H 21.

The Group continued to pursue a balanced growth strategy. Non-interest income grew by HK$676m, or 14%, representing 31% of net operating income before change in expected credit losses and other credit impairment charges, compared with 28% for 2H 20. Actions to further diversify revenue and strengthen customer relationships drove a 16% increase in net fee income to HK$3,709m. The Group capitalised on improved investor sentiment to achieve a 37% increase in retail investment funds income. Credit facilities fee income increased by 94%. Income from insurance businesses grew by 4%, attributable to the success of our active portfolio management following the partial rebound of financial markets since 2H 20.

Operating expenses decreased by HK$158m, or 2%, driven mainly by lower marketing and advertising costs and consultancy fees, the impact of which outweighed the increase in performance-related pay and salaries. The Group will continue to actively manage operating expenses to facilitate the ongoing direction of resources towards further optimising its digital capabilities.

ECL charges decreased by HK$639m, or 65%, largely due to reduced impairment charges under stage 3 impaired credit exposures. Stage 1 and 2 ECL charges remained flat following the improvement in economic outlook since 2H 20. Stage 3 ECL charges decreased by HK$653m, or 49% to HK$685m, reflecting lower ECL charges provided on downgrade of Commercial Banking customers taking collaterals into account, and lower ECL charges on credit cards and personal lending.

Net surplus/(deficit) on property revaluation recorded a revaluation surplus of HK$39m, compared with a revaluation deficit of HK$208m in 2H 20. **Share of profits/(losses) of associates** increased by HK$24m when compared with 2H 20.

Segmental Analysis

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

Figures in HK$m	***Wealth and Personal Banking***	***Commercial Banking***	***Global Banking and Markets***	***Other***	***Total***
Half-year ended 30 June 2021					
Profit/(loss) before tax	**5,577**	**2,780**	**2,177**	**(236)**	**10,298**
Share of profit/(loss) before tax	**54.2%**	**27.0%**	**21.1%**	**(2.3)%**	**100.0%**
Half-year ended 30 June 2020 (restated)					
Profit/(loss) before tax	5,489	3,208	2,643	(721)	10,619
Share of profit/(loss) before tax	51.7%	30.2%	24.9%	(6.8)%	100.0%

Wealth and Personal Banking ('WPB') recorded a 4% year-on-year decrease in net operating income before change in expected credit losses and other credit impairment charges to HK$9,895m compared with 1H 20. Operating profit dropped by 1% to HK$5,541m and profit before tax increased by 2% to HK$5,577m.

Operating profit increased by HK$521m, or 10%, and profit before tax grew by HK$544m, or 11%, compared with 2H 20, due mainly to growth in non-interest income and lower operating expenses.

Despite the average balances of both deposits and loans growing by 4% compared with 1H 20, the persistent downward trend in market interest rates resulted in a 20% drop in net interest income to HK$6,531m.

Leveraging strengthened sales management strategies, advanced data analytics and continuous uplift of digital banking capabilities, as well as actions to make customer journeys more convenient, non-interest income increased by 57% to HK$3,364m and wealth management business revenue grew by 51%.

We continued to invest in our digital infrastructure to support the changing banking behaviours of our customers. The ratio of active mobile users increased to 75%, mobile app log-ons rose by 45% and the total number of e-Banking and digital transactions grew by 62% year-on-year. We added new online products and services to enrich our suite of customer centric solutions, with delivery of 170 new digital features and enhancements in 1H 21. These features included seamless mobile payment and transfer experience; an easier card application journey and application status tracking; and a new 'My Investment' function in our mobile app, which provides an 'all-in-one' view of a customer's investment holdings and performance, timely market insights, and customised journeys for different levels of investment experience.

Our digital products and services continued to win industry recognition during 1H 21, including awards for our mobile banking app and wealth management innovations from organisations such as *The Asian Banker* and *The Asset*. We made good progress with further developing our open banking ecosystem to integrate our services more closely with the everyday lifestyle needs of our customers.

Total investment services income recorded year-on-year growth of 31%. We achieved strong securities business growth, facilitated by our Invest Express Stock Trading app that makes it easy and convenient for customers to capture good market opportunities. In fluid market conditions, we leveraged our all-weather portfolio of wealth management products and strengthened analytical capabilities to develop personalised wealth solutions for our customers, and offer the right products and services at the right time. New investments in our digital platform to uplift our online investment capabilities helped us achieve a 55% year-on-year increase in the number of our digital investment customers.

Insurance income rose by 75%, reflecting our astute management of the life insurance investment portfolio as financial markets became more active. Our distribution business achieved satisfactory growth, with our revamped analytics approach to strengthen sales capability helping to drive a 12% year-on-year increase in annualised premiums. We also launched our Olive Wellness app, which offers customers a one-stop health and wellness platform, backed by partnerships with CUHK Medical Centre Limited and Quality HealthCare Medical Services Limited.

Leveraging greater activity in the property sector, our extensive network of outlets and our close engagement with property agencies and mortgage brokers, we captured new business in both primary and secondary property markets and achieved a 38% year-on-year increase in new mortgage drawdowns. This helped facilitate 6% growth in our mortgage balances in Hong Kong. Our customer-centric end-to-end services drove new mortgage business and we continued to rank among the top three in Hong Kong for new mortgage registration.

Amid improved retail consumption sentiment, we were able to sustain our card market position through effective product and marketing initiatives. To serve the priorities of our customers, we continued to focus our initiatives towards everyday spending and e-commerce, in order to capture more business amid the improvement in discretionary spending. Our enJoy card's partnership with Dairy Farm's 'yuu' rewards programme has been well-received, with growth in the number of cardholders and spending, and has further strengthened our proposition to serve the lifestyle needs of our cardholders. We expanded our Cash Dollars ecosystem and solicited new partnerships to strengthen lifestyle benefits and offers for our cardholders. Year-on-year, card spending grew by 10%.

We continued to invest in upgrading our branch infrastructure to provide customer centric and fintech-enabled services. We were the first bank to begin accepting Hong Kong's 'iAM Smart' mobile app, which gives individuals a convenient alternative to presenting their physical Hong Kong ID card, for identity verification purposes across our branch network for enquiries and application services. We also leveraged the use of digital tablets for enquiries and account services, as well as for helping customers enhance their digital banking literacy, to save on waiting times and reduce our use of paper.

Driven by our customer-centric approach, we used our stronger analytics capabilities and robust contact management platform to deepen and broaden relationships with existing customers and reach out more effectively to new ones. Year-on-year, we achieved a 14% increase in the Signature customer base and grew our Prestige and Preferred Banking customer base by 13%.

Commercial Banking ('CMB') recorded a 18% year-on-year decrease in net operating income before change in expected credit losses and other credit impairment charges to HK$4,612m. Operating profit and profit before tax dropped by 13% to HK$2,780m.

Operating profit and profit before tax grew by HK$933m, or 51%, compared with 2H 20, due mainly to the reduction in ECL charges as a result of the improvement in the forward economic outlook and growth in non-interest income.

Supported by the successful acquisition of new operating accounts, our average deposits balance rose by 11%. However, net interest income from deposits was significantly affected by the low interest rate environment, resulting in a 23% decline to HK$3,495m.

Non-interest income grew by 2% to HK$1,117m, driven mainly by our active participation in syndicated loans, which also resulted in ranking second in terms of number of deals in the League Table for Hong Kong Mandated Arrangers for 1H 21. We also grew trade-related fee income by 5%.

We continued to support small and medium-sized enterprises ('SMEs') by providing fast and convenient banking services that are tailored towards their specific needs. We further extended our Remote Account Opening service scope from sole proprietors and one-person limited companies to include limited companies with up to five connected parties. With the introduction of an 'e-Sign' function, customers can now open an account remotely without the need to visit a Business Banking Centre.

Our new account proposition, 'Biz Virtual+', provides start-up companies with a wide range of digital commercial banking services that make it easier to get a new enterprise off the ground and for local entrepreneurs to focus on their core business at a low operating cost. Biz Virtual+ accounts can be opened in as few as three working days.

Our dedicated green financing team is helping customers to improve their environmental performance and start transitioning to a lower-carbon future. The Bank's new Greenness Assessment programme makes it easier for customers to apply for green bilateral and syndicated loan facilities.

A strategic alliance with Hong Kong Cyberport Management Company Limited was formed to assist Hong Kong entrepreneurs to scale up their operations and capture business opportunities in the Greater Bay Area, cultivate innovators, further the development of smart banking, explore corporate venture capital, and provide more banking services with cross-boundary financial features.

We continued to transform banking services through the expansion and enrichment of our digital platforms. Various enhancements were made to Hang Seng Business Mobile Banking, including the addition of biometric authentication to facilitate customer login and the launch of an Inward Payment Tracker function that enables customers to check the status of inward payments in real-time.

Our revamped flagship Business Banking Centre at our headquarters building provides customers with a spacious and relaxing environment in which to meet their banking needs, offering the speed and convenience of digital services through our Digital Bar and the personal attention and specialist advice of our experienced team.

In the uncertain economic environment, we continued to be vigilant in managing asset quality and proactively manage our credit risk. Our overall credit quality remained resilient.

We received various industry awards during 1H 21, including 'Best Payments and Collections Solution, Industry: E-commerce', 'Best Liquidity and Investments Solution, Industry: Chemicals' and 'Best in Treasury and Working Capital – SME's Hong Kong' in *The Asset's* Triple A Treasury, Trade and Risk Management Awards 2021. Our strong proposition for SMEs was recognised with a 'Best Bank for SMEs, Hong Kong' award from *Asiamoney* and a 'Best SME's Partner Award' from The Hong Kong General Chamber of Small and Medium Business.

Global Banking and Markets ('GBM') recorded a 20% year-on-year decrease in net operating income before change in expected credit losses and other credit impairment charges to HK$2,705m and an 18% decrease in operating profit and profit before tax to HK$2,177m.

Operating profit and profit before tax decreased by HK$150m, or 6%, compared with 2H 20, due mainly to higher net release of ECL in 2H 20.

Global Banking ('GB') recorded a 1% year-on-year drop in net operating income before change in expected credit losses and other credit impairment charges to HK$1,361m. Operating profit and profit before tax both rose by 16% to HK$1,152 m.

Net interest income fell by 6% to HK$1,151m.

New digital cash management solutions, including QR code collection, enabled us to build new and stronger operating account relationships. Customers also appreciated our award-winning corporate API solution for enhancing the efficiency of collections and payments. These developments helped us to grow average current and saving deposits by 68% and achieve robust growth in deposit interest income.

Our stagging loan business performed well. However, the continuing compression of credit spreads and the uncertain economic conditions continued to challenge growth. The average loans balance remained broadly in line with a year earlier but net interest income from lending dropped by 11%.

Non-interest income grew by 30% to HK$210m, driven mainly by strong growth in fee income from credit facilities and syndicated loan activities.

Leveraging our strong customer relationships, we made solid progress with further diversifying our income streams, particularly through the activities of our Debt Capital Markets Origination team, which completed several breakthrough deals involving dim-sum and green bonds in the first six months of the year.

Global Markets ('GM') reported a 32% decrease in net operating income before change in expected credit losses and other credit impairment charges to HK$1,344m. Operating profit and profit before tax both decreased by 38% to HK$1,025m.

Net interest income decreased by 27% to HK$878m, due mainly to the flattened yield curve and tightened credit spreads caused by the prevailing low interest rate environment. The Global Markets Treasury team continued to proactively defend the interest margin and investment yield by exploring market opportunities and actively managing and diversifying our portfolio while continuing to uphold prudent risk management standards.

Non-interest income decreased by 41% to HK$466m. Decreased volatility in the G7 foreign exchange market, together with the low interest rate environment, resulted in a decline in non-fund income from sales and trading activities. Nevertheless, we recorded a 15% year-on-year increase in corporate foreign exchange turnover as signs that the worst of the pandemic might be coming to an end which encouraged corporate clients become more active. Against the backdrop of low interest rates, we explored revenue diversification opportunities by uplifting our product capabilities and captured good opportunities in the foreign exchange markets. Year-on-year, we more than doubled our Hong Kong dollar and renminbi trading revenue.

Our Repo Trading business continued to build good momentum. Our Repo Trading team has achieved significant growth in volumes year-on-year, and has continued to expand its network of financial institution/non-bank financial institution counterparts. To support the Bank's sustainable financing initiatives, the team began accepting green bonds as collateral earlier this year. Between January and the end of June this year, the collateral volume of green bonds has grown rapidly.

We continued with initiatives to deepen the penetration of GM products among WPB, CMB and GB customers.

The stronger market sentiment and higher turnover in Hong Kong stock market during 1H 21 drove an increase in customer demand for equity-related products. We recorded a 33% year-on-year rise in income from equity-linked products and an 18% increase in turnover.

Balance Sheet Analysis

Assets

Total assets increased by HK$40bn, or 2%, to HK$1,800bn compared with 2020 year-end, with the Group maintaining good business momentum and advancing its strategy of enhancing profitability through sustainable growth.

Cash and balances at central banks increased by HK$1bn, or 9%, to HK$12bn. Trading assets were down by HK$5bn, or 13%, to HK$32bn, mainly in Hong Kong Exchange Fund Bills.

Customer loans and advances (net of ECL allowances) were HK$1,013bn, up by HK$69bn, or 7%, from the end of 2020. In response to the continued challenges encountered by the Hong Kong business community on the back of the COVID-19 outbreak, certain relief measures were introduced by the Hong Kong government to support local businesses and the community. The Group actively supported these measures and launched additional initiatives to support retail and corporate customers. Loans for use in Hong Kong grew by 6%. Lending to industrial, commercial and financial sectors increased by 9%, primarily reflecting growth in the stockbrokers' sector on finance granted to stockbroking companies relating to several initial public offerings ('IPO') at the end of June 2021. Lending to property development and investment sectors were broadly in line with 2020 year-end. There was increased lending to financial concerns, transport and transport equipment, and 'others' sectors, partly offset by a decline in lending to the wholesale and retail trade sector. Lending to individuals grew by 3%. With the more active property market, residential mortgage lending grew by 3%. Credit card advances and other loans to individuals grew by 3% and 1% respectively. Trade finance lending regained momentum and recorded strong growth of 53% against 2020 year-end, reflecting Commercial Banking's achievement in expanding trade finance business by maintaining close relationships with its business partners. Loans for use outside Hong Kong grew by 4%, reflecting increased lending by the Group's Mainland banking subsidiary and loans for use outside Hong Kong granted by the Hong Kong office. Excluding the impact of IPO stagging finance at the end of June 2021, customer loans and advances (net of ECL allowances) rose by 4%.

Financial investments decreased by HK$55bn, or 10%, to HK$499bn, reflecting the partial redeployment of the commercial surplus to support loan growth.

Liabilities and equity

Customer deposits, including certificates of deposit and other debt securities in issue, increased by HK$1bn, or 0.1%, to HK$1,305bn against the end of 2020. Current and savings deposits increased, but there was a drop in time deposits. To diversify its sources of funding, the Group issued more certificates of deposit in 1H 21. At 30 June 2021, the advances-to-deposits ratio was 77.6%, compared with 72.4% at 31 December 2020. Excluding IPO stagging finance at the end of June 2021, the advances-to-deposits ratio was 75.1%.

Figures in HK$m	***At 30 June 2021***	*At 31 December 2020*
Customer loans and advances (net of ECL allowances)	**1,013,463**	944,774
Customer deposits, including certificates of deposit and other debt securities in issue	**1,305,256**	1,304,083
Advances-to-deposits ratio	**77.6%**	72.4%

At 30 June 2021, shareholders' equity increased by HK$1bn, or 0.3% compared with 2020 year-end, to HK$184bn. Retained profits were up by HK$2bn, or 1%, reflecting profit accumulation after the appropriation of dividends paid during the period. Financial assets at fair value through other comprehensive income reserves were down by HK$1bn, or 31%, mainly reflecting the fair value movement of the Group's investments in financial assets measured at fair value.

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

Risk Management

Principal risks and uncertainties

The Group continuously monitors and identifies risks. Our principal risks are credit risk, liquidity and funding risk, market risk, resilience risk, regulatory compliance risk, financial crime risk, model risk and insurance risk. The description of principal risks and a summary of our current policies and practices regarding the management of risk is set out in the 'Risk' section of the Annual Report 2020.

We have maintained a consistent approach to risk management throughout our history, helping to ensure we protect customers' funds, lend responsibly and support economies.

Banks continued to play an expanded role in supporting society and customers during the first half of 2021 due to the unprecedented global economic events caused by the Coronavirus Disease ('COVID-19') pandemic. Many of our customers' business models and income were impacted by the global economic downturn, requiring them to take significant levels of support from both governments and banks.

Throughout the pandemic, we have continued to support our customers and adapted our operational processes. We have maintained high levels of services as our people, processes and systems responded to the required changes.

Key developments in the first half of 2021

There were no material changes to the policies and practices for the management of risk, as described in the Annual Report 2020. However, where required, appropriate exceptional handling approaches were exercised in response to COVID-19 developments.

We have been actively managing the risks resulting from the COVID-19 outbreak and its impact on our customers and operations during the first half of 2021 as well as other key risks described in this section.

We have set up a dedicated climate risk team to support our climate change strategy, to respond to regulatory expectations and to embed responsibilities for climate risk management within our businesses and functions. An independent consultant has been engaged to conduct a gap analysis of the Bank's climate risk framework against market's best practice and regulatory requirements. A road map is being drawn up to drive the climate risk related agenda forward. We have also rolled out customer transition risk questionnaires in the first quarter of 2021 and continue to get prepared for regulatory requirements relating to stress testing and other climate risk related regulations.

We remain committed to investing in the reliability and resilience of our IT systems and critical services that support all parts of our business. We do so to protect our customers, affiliates and counterparties, and to help ensure that we minimise any disruption to services that could result in reputational and regulatory consequences. We continue to operate in a challenging environment in which cyber threats are prevalent and invest in business and technical controls to defend against these threats.

In the first half of 2021, we enhanced our risk management in the following areas:

- We continued to simplify our approach to non-financial risk management, with the implementation of more effective oversight and better end-to-end identification and management of non-financial risks.

- We continued to improve the effectiveness of our financial crime controls with a specific targeted update of our fraud controls. We completed a refresh of our financial crime policies, ensuring they remain up-to-date and address changing and emerging risk, as well as meeting our regulatory obligations.

Areas of Special Interest

During the first half of 2021, a number of areas were identified and considered as part of our top and emerging risks because of the effect they may have on the Group. We place particular focus in this section on geopolitical and macroeconomic risk, risks related to COVID-19 and Interbank Offered Rate ('IBOR') transition.

Geopolitical and macroeconomic risk

Our operations and portfolios are exposed to risks associated with US-China tension, social unrest and COVID-19, which could lead to disruption of our operations, physical risk to our staff and/or physical damage to our assets.

The COVID-19 outbreak, including its perceived origins and responses, has also heightened existing US-China tensions, which could have potential ramifications for the Group and its customers. The US-China tensions may affect the Group by creating regulatory, reputational and market risks.

The US-China relationship in particular remains complex, with divisions over a number of issues. The US has imposed a range of sanctions and trade restrictions on Chinese individuals and companies, including on those individuals and companies that the US considers to be involved in human rights violations, the erosion of Hong Kong's autonomy, technology and telecommunications deemed to pose national security risks to the US, etc.

The Hong Kong Autonomy Act passed by the US authorises the imposition of 'secondary sanctions' against non-US financial institutions found to be knowingly engaged in significant transactions with certain individuals and entities subject to US sanctions for engaging in certain activities that undermine Hong Kong's autonomy. In addition, the US has imposed restrictions on US persons' ability to purchase or sell certain publicly traded securities linked to a number of prominent Chinese companies.

The US has increasingly instituted sanctions with its traditional allies including the EU, UK and Canada, primarily in response to allegations of human rights violations in Xinjiang.

In response, China announced a number of its own sanctions and trade restrictions that target or provide authority to target foreign individuals and companies, which have been primarily imposed against certain public officials associated with the implementation of foreign sanctions against China. More generally, China has promulgated new laws that provide a legal framework for further imposing such sanctions, prohibit implementing or complying with foreign sanctions against China and create private rights of action in Chinese courts for damages caused by third parties implementing foreign sanctions or other discriminatory measures. To date, no financial institution has been targeted for action under these measures. However, it should be noted that the scope and application of the recent Chinese laws remain uncertain. These and any future measures and countermeasures that may be taken by the US, China and other governments may affect the Group, its customers, and the markets in which we operate.

China's expanding data privacy and cybersecurity laws could pose potential challenges to intra-Group data sharing, especially within the Greater Bay Area ('GBA'). These developments could increase financial institutions' compliance burdens in respect of cross-border transfers of personal information. In Hong Kong, there is also an increasing focus by regulators on the use of big data and artificial intelligence. Use of personal data through digital platforms for GBA initiatives may need to take into account these evolving data privacy and cybersecurity obligations.

Most developed markets, including Hong Kong, are expected to recover from the COVID-19 crisis. However, permanent business closures and job losses in some sectors may prevent several developed markets from achieving pre-crisis activity levels in the near term.

We continually monitor the geopolitical developments and actively manage our credit portfolio through thematic reviews, internal stress tests, etc. We will continue to support our customers and manage risk and exposures as appropriate.

Risks related to COVID-19

The COVID-19 outbreak and its effect on the global economy have impacted our customers. The outbreak necessitated governments to respond at unprecedented levels to protect public health, and to support local economies and livelihoods. It affected countries and territories at different times and to varying degrees. Various government support measures and restrictions in response have added challenges, given the rapid pace of change and significant operational demands. The speed at which countries and territories are able to return to pre-COVID-19 levels of economic activity will vary based on the extent of continuing government support offered, infection rates and the ability to roll out vaccines. Renewed outbreaks emphasise the ongoing threat of COVID-19, as seen in India during the first half of 2021 following the outbreak of new variants of the virus, and may again result in renewed tightening of government restrictions following recent relaxations.

Government restrictions imposed around the world to limit the spread of COVID-19 resulted in a sharp contraction in global economic activity during 2020. At the same time, governments also took steps designed to soften the extent of the damage to investment, trade and labour markets. Gradual recovery in economic activity in Hong Kong is expected in 2021 in light of the stabilised COVID-19 situation, but it also relies on the willingness and ability of households and businesses to return towards pre-crisis spending levels.

Hong Kong Government has deployed extensive measures to support households and corporates. Measures implemented by Government have included income support to households and funding support to businesses. Some of these measures are being extended.

Apart from Government relief measures, we have initiated market-specific measures to support our personal and business customers through these challenging times, including principal moratorium, payment holidays, the waiver of certain fees and charges, etc. for businesses facing market uncertainty and short-term cash flow issue and for individuals facing salary reduction. These measures have been well received and we remain responsive to our customers' changing needs.

The rapid introduction and varying nature of the Government support schemes introduced throughout the COVID-19 pandemic has led to increased operational risks, including complex conduct considerations, increased reputational risk and increased risk of fraud. These risks are likely to be heightened further as and when those Government support schemes are unwound.

The impact of the pandemic on the long-term prospects of businesses in the most vulnerable sectors of the economy such as retail, hospitality and commercial real estate remains uncertain and may lead to significant Expected Credit Loss ('ECL') charges on specific exposures, which may not be fully captured in ECL estimates. In addition, in times of stress, fraudulent activity is often more prevalent, leading to potentially significant ECL charges or operational losses.

As economic conditions improve, and government support measures come to an end, there is a risk that the outputs of HKFRS 9 models may have a tendency to fail to accurately predict loan losses. Model outputs and management adjustments are closely monitored and independently reviewed for reliability and appropriateness prior to inclusion in the financial results.

As a result of COVID-19 outbreak, business continuity plans have been implemented, with no significant impacts to service delivery. Exceptional handling to ensure the continuity of critical customer services are being documented through governance.

Despite the ongoing economic recovery, significant uncertainties remain in assessing the duration and impact of the COVID-19 outbreak, including whether any subsequent outbreaks result in a reimposition of government restrictions. There is a risk that economy activity remains below pre-pandemic levels for a prolonged period. We continue to monitor the situation closely, and given the novel or prolonged nature of the outbreak, additional mitigating actions may be required.

IBOR transition

Interbank offered rates ('IBORs') are used to set interest rates on hundreds of trillions of US dollars of different types of financial transactions and are used extensively for valuation purposes, risk measurement and performance benchmarking.

The UK's Financial Conduct Authority ('FCA') announced in July 2017 that it would no longer continue to persuade or require panel banks to submit rates for the London interbank offered rate ('LIBOR') after 2021. In addition, the 2016 EU Benchmark Regulation, which aims to ensure the accuracy, robustness and integrity of interest rate benchmarks, has resulted in other regulatory bodies reassessing their national benchmarks. As a result, industry-led national working groups are discussing the mechanisms for an orderly transition of five LIBOR currencies, four Asia-Pacific benchmarks that reference US dollar LIBOR, and the Singapore interbank offered rate ('SIBOR') to their chosen replacement rates.

Furthermore, the FCA and the administrator of LIBOR, the Intercontinental Exchange Benchmark Administrator ('IBA'), announced on 5 March 2021 that publication of 24 of the 35 main LIBOR currency interest rate benchmark settings would cease at the end of 2021. Additionally, the FCA and IBA confirmed that the publication of the most widely used US dollar LIBOR settings will be extended until 30 June 2023, and that consultation will occur for continuing three sterling and three Japanese yen settings under a 'synthetic' calculation methodology. As a result, the Group's transition programme continued its efforts to provide risk-free rate ('RFR') and alternative rate products and is currently focused on actively transitioning clients away from those contracts that reference IBORs demising at the end of 2021.

Provision of alternative rate and RFR product capabilities

During 2020 and the first half of 2021, all of our businesses developed and implemented system and operational capabilities for the majority of RFR products and alternative rates, with only a limited number of non-standard or lower priority products requiring completion in the second half of 2021 or 2022. Our product readiness and increased market liquidity will enable new transactions to be undertaken in RFR and alternative rate products.

However, given the extension of the publication of US dollar LIBOR for the most widely used settings and the low take-up of RFR products in Asia-Pacific, the market activity for the Secured Overnight Financing Rate ('SOFR'), the Tokyo Overnight Average ('TONA') rate and other demising rate replacements continue to develop at a slow pace. We are currently monitoring other industry developments, including related to term SOFR and the Tokyo Term Risk Free Rate ('TORF'), and are supporting market initiatives to increase the volume of activity in the RFR derivative markets. We will also continue to develop additional products for our clients and in support of transition from US dollar LIBOR and other demising rates.

Transition legacy contracts

For benchmarks demising in 2021, we plan to transition all viable legacy IBOR contracts in advance of the end of the year, or earlier where this is in line with RFR working group guidelines. However, we remain dependent on our clients' decisions and the market to meet these targets. In support of our plans, we had commenced customer outreach for these contracts in the first half of 2021, but this continues due to low liquidity and market readiness in respective markets. We approached clients in a structured manner, based on product and market readiness for replacement rates and client prioritisation, with our transition progress being tracked using internal targets. In prioritising our client engagement, we also took into account our clients' adherence to the fallback provisions for derivatives within the ISDA protocol, implemented in January 2021, and loan contractual fallback language within legacy loan contracts. We placed greater emphasis on engaging with our clients who do not have adequate fallback provisions and products for which replacement rates may not be appropriate or need to be agreed, under the current fallback language.

Following our transition discussions with clients, we will be led by their decisions on timing and their level of readiness to transition. We are tracking client decisions to adequately plan for operational activities that need to occur in the second half of 2021. However, given the continued impact of COVID-19 on our customers and the market, there is a risk that our clients are not operationally ready to transition their IBOR contracts. This could potentially result in delays to transition, with the transition activities being further concentrated into the latter part of 2021, increasing the regulatory compliance, legal, resilience and operational risks.

Transition legacy contracts *(continued)*

While operational risks could be increased, contractual repapering and rebooking activities will be managed accordingly through bilateral and bulk transition processes. However, we may need to rely on some jurisdictional legislative solutions to allow for a smooth transition of all contracts, such as the proposed 'synthetic'-based methodology under UK law. Adequate contract continuity provisions will be critical to the successful implementation of such solutions.

Our transition efforts are one of the ways the Group manages its IBOR derivatives and loan exposures maturing beyond 2021.

For the derivatives exposures, new sterling LIBOR transactions for linear derivatives are only undertaken for risk management purposes since the first quarter 2021 cessation milestone. Second quarter industry milestones for cessation of sterling non-linear derivatives have been adhered to and this is expected to result in a further reduction in exposure.

For the Group's loan book, all loan contracts referencing 2021 demising IBORs that require refinancing are being offered on a RFR or alternative rates basis. The Group has adhered to the first quarter cessation milestone for issuance of new sterling LIBOR loans, and continues to support and engage its clients in transitioning to a suitable RFR or alternative rate product, prior to the relevant IBOR cessation date. For syndicated loans, we are actively engaging with agents and participants, as appropriate, but will be reliant on all syndicate members to transition.

Financial instruments impacted by IBOR reform

	Financial instruments yet to transition to alternative benchmarks, by main benchmark			
	USD LIBOR	GBP LIBOR	JPY LIBOR	SIBOR
At 30 June 2021	*(HK$m)*	*(HK$m)*	*(HK$m)*	*(HK$m)*
Non-derivative financial assets[1]	**29,785**	**12,345**	**33**	**–**
Non-derivative financial liabilities	**3,106**	**–**	**–**	**–**
Derivative notional contract amount	**69,763**	**1,353**	**–**	**–**
At 31 December 2020				
Non-derivative financial assets[1]	44,268	11,008	55	205
Non-derivative financial liabilities	3,101	–	–	–
Derivative notional contract amount	113,010	761	–	–

1 *Gross carrying amount excluding allowances for expected credit losses.*

The amounts in the above table relate to the Group's main operating entities where the Group has material exposures impacted by IBOR reform. The amounts provide an indication of the extent of the Group's exposure to the IBOR benchmarks that are due to be replaced. Amounts are in respect of financial instruments that:

- contractually reference an interest rate benchmark that is planned to transition to an alternative benchmark;
- have a contractual maturity date beyond the date by which the reference interest rate benchmark is expected to cease; and
- are recognised on the Group's consolidated balance sheet.

In March 2021, the administrator of LIBOR, IBA, announced that the publication date of most US dollar LIBOR tenors is extended from 31 December 2021 to 30 June 2023. Publication of one-week and two-month tenors will cease after 31 December 2021. This change reduce the amounts presented at 30 June 2021 in the above table as some financial instruments included at 31 December 2020 will reach their contractual maturity date prior to the extended publication dates. Comparative data have not been re-presented.

(a) Credit Risk

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

There were no material changes to the policies and practices for the management of credit risk in the first half of 2021.

A summary of our current policies and practices for the management of credit risk is set out in 'Credit risk management' on pages 60 to 62 of the Annual Report 2020.

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

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

	At 30 June 2021	*At 31 December 2020*
Cash and balances at central banks	**12,283**	11,226
Trading assets	**32,252**	37,072
Derivative financial instruments	**12,985**	17,181
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	**1,071**	1,284
Reverse repurchase agreements – non-trading	**14,733**	13,360
Placings with and advances to banks	**61,791**	44,357
Loans and advances to customers	**1,013,463**	944,774
Financial investments	**493,522**	547,669
Other assets	**43,598**	29,449
Financial guarantees and other credit related contingent liabilities[1]	**20,694**	19,773
Loan commitments and other credit related commitments	**567,627**	556,503
	2,274,019	2,222,648

1 *Performance and other guarantees were included.*

(a) Credit Risk *(continued)*

Summary of credit risk

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

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

	At 30 June 2021		At 31 December 2020	
	Gross carrying/ nominal amount	**Allowances for ECL[1]**	Gross carrying/ nominal amount	Allowances for ECL[1]
Loans and advances to customers at amortised cost	**1,018,595**	**(5,132)**	949,954	(5,180)
Placings with and advances to banks at amortised cost	**61,792**	**(1)**	44,357	–
Other financial assets measured at amortised costs:	**213,951**	**(266)**	188,872	(187)
– cash and balances at central banks	**12,283**	**–**	11,226	–
– reverse repurchase agreements – non-trading	**14,733**	**–**	13,360	–
– financial investments	**143,538**	**(257)**	134,997	(173)
– other assets[2]	**43,397**	**(9)**	29,289	(14)
Total gross carrying amount on balance sheet	**1,294,338**	**(5,399)**	1,183,183	(5,367)
Loans and other credit related commitments[3]	**356,320**	**(115)**	356,776	(163)
Financial guarantee and similar contracts	**2,226**	**(6)**	3,024	(18)
Total nominal amount off balance sheet[4]	**358,546**	**(121)**	359,800	(181)
Total	**1,652,884**	**(5,520)**	1,542,983	(5,548)

	Fair value	**Memorandum Allowances for ECL**	Fair value	Memorandum Allowances for ECL
Debt instruments measured at Fair Value through Other Comprehensive Income ('FVOCI')[5]	**350,241**	**(7)**	412,845	(9)

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

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

3 *Included forward forward deposit placed of HK$1,366m (2020: nil).*

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

5 *Debt instruments measured at FVOCI continue to be measured at fair value with the allowances for ECL as a memorandum item. Change in ECL is recognised in 'Change in expected credit losses and other credit impairment charges' in Condensed Consolidated Income Statement.*

(a) Credit Risk *(continued)*

The following table provides an overview of the Group's credit risk by stage and industry, and the associated ECL coverage. The financial assets recorded in each stage have the following characteristics:

Stage 1: These financial assets are unimpaired and without significant increase in credit risk on which a 12-month allowance for ECL is recognised.

Stage 2: A significant increase in credit risk has been experienced on these financial assets since initial recognition for which a lifetime ECL is recognised.

Stage 3: There is objective evidence of impairment and the financial assets are therefore considered to be in default or otherwise credit-impaired on which a lifetime ECL is recognised.

POCI: Financial assets that are purchased or originated at a deep discount are seen to reflect the incurred credit losses on which a lifetime ECL is recognised.

Summary of credit risk (excluding debt instruments measured at FVOCI) by stage distribution and ECL coverage

	Gross carrying/nominal amount[1]					*Allowances for ECL*					*ECL coverage %*				
	Stage 1	*Stage 2*	*Stage 3*	*POCI*[2]	*Total*	*Stage 1*	*Stage 2*	*Stage 3*	*POCI*	*Total*	*Stage 1*	*Stage 2*	*Stage 3*	*POCI*	*Total*
Loans and advances to customers at amortised cost:	840,801	170,783	7,010	1	1,018,595	(754)	(2,000)	(2,378)	–	(5,132)	0.09%	1.17%	33.92%	0.00%	0.50%
– personal	336,834	25,224	983	–	363,041	(216)	(929)	(220)	–	(1,365)	0.06%	3.68%	22.38%	N/A	0.38%
– corporate and commercial	449,894	141,398	5,886	1	597,179	(498)	(1,065)	(2,123)	–	(3,686)	0.11%	0.75%	36.07%	0.00%	0.62%
– non-bank financial institutions	54,073	4,161	141	–	58,375	(40)	(6)	(35)	–	(81)	0.07%	0.14%	24.82%	N/A	0.14%
Placings with and advances to banks at amortised cost	61,585	207	–	–	61,792	(1)	–	–	–	(1)	0.00%	0.00%	N/A	N/A	0.00%
Other financial assets measured at amortised cost	208,956	4,995	–	–	213,951	(202)	(64)	–	–	(266)	0.10%	1.28%	N/A	N/A	0.12%
Loans and other credit-related commitments	348,435	7,885	–	–	356,320	(55)	(60)	–	–	(115)	0.02%	0.76%	N/A	N/A	0.03%
– personal	244,782	–	–	–	244,782	–	–	–	–	–	0.00%	N/A	N/A	N/A	0.00%
– corporate and commercial	91,608	7,425	–	–	99,033	(53)	(59)	–	–	(112)	0.06%	0.79%	N/A	N/A	0.11%
– non-bank financial institutions	12,045	460	–	–	12,505	(2)	(1)	–	–	(3)	0.02%	0.22%	N/A	N/A	0.02%
Financial guarantee and similar contracts:	1,818	408	–	–	2,226	(4)	(2)	–	–	(6)	0.22%	0.49%	N/A	N/A	0.27%
– personal	8	–	–	–	8	–	–	–	–	–	0.00%	N/A	N/A	N/A	0.00%
– corporate and commercial	1,810	408	–	–	2,218	(4)	(2)	–	–	(6)	0.22%	0.49%	N/A	N/A	0.27%
– non-bank financial institutions	–	–	–	–	–	–	–	–	–	–	N/A	N/A	N/A	N/A	N/A
At 30 June 2021	1,461,595	184,278	7,010	1	1,652,884	(1,016)	(2,126)	(2,378)	–	(5,520)	0.07%	1.15%	33.92%	0.00%	0.33%

1 *Represents the maximum amount at risk should the contracts be fully drawn upon and clients default.*

2 *Purchased or originated credit-impaired ('POCI').*

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

Summary of credit risk (excluding debt instruments measured at FVOCI) by stage distribution and ECL coverage *(continued)*

	Gross carrying/nominal amount[1]					*Allowances for ECL*					*ECL coverage %*				
	Stage 1	*Stage 2*	*Stage 3*	*POCI*[2]	*Total*	*Stage 1*	*Stage 2*	*Stage 3*	*POCI*	*Total*	*Stage 1*	*Stage 2*	*Stage 3*	*POCI*	*Total*
Loans and advances to customers at amortised cost:	814,146	130,084	5,723	1	949,954	(1,315)	(1,821)	(2,044)	–	(5,180)	0.16%	1.40%	35.72%	0.00%	0.55%
– personal	339,299	12,282	984	–	352,565	(557)	(748)	(220)	–	(1,525)	0.16%	6.09%	22.36%	N/A	0.43%
– corporate and commercial	455,414	115,640	4,579	1	575,634	(695)	(1,065)	(1,782)	–	(3,542)	0.15%	0.92%	38.92%	0.00%	0.62%
– non-bank financial institutions	19,433	2,162	160	–	21,755	(63)	(8)	(42)	–	(113)	0.32%	0.37%	26.25%	N/A	0.52%
Placings with and advances to banks at amortised cost	43,919	438	–	–	44,357	–	–	–	–	–	0.00%	0.00%	N/A	N/A	0.00%
Other financial assets measured at amortised cost	184,344	4,528	–	–	188,872	(133)	(54)	–	–	(187)	0.07%	1.19%	N/A	N/A	0.10%
Loans and other credit-related commitments	352,241	4,535	–	–	356,776	(90)	(73)	–	–	(163)	0.03%	1.61%	N/A	N/A	0.05%
– personal	241,420	–	–	–	241,420	–	–	–	–	–	0.00%	N/A	N/A	N/A	0.00%
– corporate and commercial	98,795	4,535	–	–	103,330	(87)	(73)	–	–	(160)	0.09%	1.61%	N/A	N/A	0.15%
– non-bank financial institutions	12,026	–	–	–	12,026	(3)	–	–	–	(3)	0.02%	N/A	N/A	N/A	0.02%
Financial guarantee and similar contracts:	2,702	322	–	–	3,024	(16)	(2)	–	–	(18)	0.59%	0.62%	N/A	N/A	0.60%
– personal	7	–	–	–	7	–	–	–	–	–	0.00%	N/A	N/A	N/A	0.00%
– corporate and commercial	2,695	322	–	–	3,017	(16)	(2)	–	–	(18)	0.59%	0.62%	N/A	N/A	0.60%
– non-bank financial institutions	–	–	–	–	–	–	–	–	–	–	N/A	N/A	N/A	N/A	N/A
At 31 December 2020	1,397,352	139,907	5,723	1	1,542,983	(1,554)	(1,950)	(2,044)	–	(5,548)	0.11%	1.39%	35.72%	0.00%	0.36%

1 *Represents the maximum amount at risk should the contracts be fully drawn upon and clients default.*

2 *Purchased or originated credit-impaired ('POCI').*

(a) Credit Risk *(continued)*

Measurement uncertainty and sensitivity analysis of ECL estimates

The recognition and measurement of ECL involves the use of significant judgement and estimation. We form multiple economic scenarios based on economic forecasts, apply these assumptions to credit risk models to estimate future credit losses, and probability-weight the results to determine an unbiased ECL estimate.

Methodology

Four economic scenarios have been used to capture the exceptional nature of the current economic environment and to articulate management's view of the range of potential outcomes. Scenarios produced to calculate ECL are aligned to the Group's top and emerging risks. Three of these scenarios are drawn from consensus forecasts and distributional estimates. The Central scenario is deemed the 'most likely' scenario, and usually attracts the largest probability weighting, while the outer scenarios represent the tails of the distribution, which are less likely to occur. The Central scenario is created using the average of a panel of external forecasters, while consensus Upside and Downside scenarios are created with reference to distributions for select markets that capture forecasters' views of the entire range of outcomes. Management has chosen to use an additional scenario to represent its view of severe downside risks. The use of an additional scenario is in line with the Group's forward economic guidance methodology and has been regularly used over the course of 2021. Management may include additional scenarios if it feels that the consensus scenarios do not adequately capture the top and emerging risks. Unlike the consensus scenarios, these additional scenarios are driven by narrative assumptions, could be country-specific and may result in shocks that drive economic activity permanently away from trend.

Description of consensus economic scenarios

The economic assumptions presented in this section have been formed internally with reference to external forecasts specifically for the purpose of calculating ECL.

Global economic growth is experiencing a recovery in 2021, following an unprecedented contraction in 2020. Restrictions to mobility have started to ease across our key markets, aided in some cases by the successful roll-out of vaccination programmes. Data from vaccinated groups suggests vaccines provide a high level of immunity against the COVID-19 virus despite the emergence of more transmissible variants. To date, vaccinations have shown their effectiveness in lowering hospitalisations and deaths. A rapid roll-out of vaccination programmes has been a key factor enabling economies to reopen and some resumption of travel. The emergence of new variants that reduce the efficacy of vaccines remains a risk.

Economic forecasts are subject to a high degree of uncertainty in the current environment. While risks to the economic outlook are dominated by the progression and management of the pandemic and vaccine roll-out, geopolitical risks also present downside threats. These risks include continued differences between the US and China over a range of issues and dampened business sentiment in Hong Kong.

Four global scenarios have been used for the purpose of calculating ECL at 30 June 2021. These are the consensus Central scenario, the consensus Upside scenario, the consensus Downside scenario and an additional Downside scenario. The scenarios used to calculate ECL in the Interim Report 2021 are described below.

(a) Credit Risk *(continued)*

The consensus Central scenario

Following a severe and unprecedented drop in global economic activity in 2020, the Central scenario used by us features a sharp recovery in 2021, followed by a subsequent normalisation of growth. The V-shape in activity over the course of 2020 and 2021 reflects the impact of the pandemic on economies, with restrictions to mobility and reduction in activity imposed by governments, resulting in a strong contraction in 2020 while an increase in mobility and resumption in activity in 2021 signalling a recovery.

The Central scenario further assumes that the stringent restrictions on activity, employed across Hong Kong and China in 2020 and the first half of 2021 will not be repeated. This will allow economic activity to first rebound and then revert to more normal long-run trend rates of growth. Minimal long-term damage to economic prospects is expected. Cross-region differences in the speed and scale of recovery across the forecast horizon, reflect timing differences in the progression of the COVID-19 outbreak, different speeds of roll-out of vaccination programmes, national level differences in restrictions imposed and the scale of support measures.

Hong Kong GDP is expected to grow by 5.2% in 2021 in the Central scenario. The average rate of Hong Kong GDP growth is expected to be 2.6% over the forecast period of 3Q 2021 – 2Q 2026, which is higher than the average growth rate over the five-year period prior to the onset of the pandemic.

The unique circumstances surrounding the current fall in economic activity make it difficult to compare current prospects for global economic activity with previous recessions. However, we note that the depth of the contraction in economic activity and the subsequent recovery are both expected to be sharper than experienced during the last global economic downturn of 2008– 2009 across our key markets.

Across the key markets, we expect:

- Economic growth is expected to increase sharply in 2021 as governments ease restrictions to mobility, encouraging consumers and firms to spend and invest. GDP is expected to grow across all our major markets in 2021. Country specific measures aimed at supporting labour markets as economies re-open will affect the rate at which unemployment will decline.

- Inflation is expected to rise in 2021 in line with the economic recovery, before gradually converging back to government targets over the forecast period.

- Fiscal deficits are expected to reduce gradually over the course of the projection period from their peak in 2020, following a period where government in key market, provided extensive support to households and corporates. Sovereign indebtedness is expected to remain at high level.

- The West Texas Intermediate oil price is forecast to average US$58 per barrel over the projection period.

The Central scenario was first created with forecasts available in May 2021, and subsequently updated in June 2021 to reflect significant changes to forecasts. Probability weights assigned to the Central scenario reflect both the higher level of uncertainty in the current global economic environment and relative differences across markets. Weights assigned to the Central scenario vary from 70% to 80%.

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

The consensus Central scenario *(continued)*

The following table describes key macroeconomic variables and the probabilities assigned in the consensus Central scenario.

Central scenario (3Q 2021 – 2Q 2026)

	Hong Kong *%*	***Mainland China*** *%*
GDP growth		
Annual average growth rate: 2021	5.2	8.5
Annual average growth rate: 2022	3.2	5.5
Annual average growth rate: 2023	2.7	5.3
5-year average	2.6	5.0
Unemployment rate		
Annual average: 2021	6.2	3.9
Annual average: 2022	4.6	3.8
Annual average: 2023	3.9	3.8
5-year average	4.0	3.8
House Price Growth		
Annual average growth rate: 2021	2.6	4.3
Annual average growth rate: 2022	3.9	6.0
Annual average growth rate: 2023	2.5	5.4
5-year average	2.9	4.9
Probability	70	80

Note: The annual average growth rate refers to full year average. The 5-year average is computed by using time period from 3Q 2021 to 2Q 2026.

The consensus Upside scenario

Compared with the consensus Central scenario, the consensus Upside scenario features a faster recovery in economic activity during the first two years before converging to long-run trends.

The scenario is consistent with a number of key upside risk themes. These include the orderly and rapid global abatement of COVID-19 via successful containment and prompt deployment of vaccines; de-escalation of tensions between the US and China; de-escalation of political tensions in Hong Kong; and continued support from fiscal and monetary policy.

The following table describes key macroeconomic variables and the probabilities assigned in the consensus Upside scenario.

Consensus Upside scenario best outcome

	Hong Kong *%*	***Mainland China*** *%*
GDP growth rate	10.0 (2Q22)	13.5 (2Q22)
Unemployment rate	3.2 (2Q23)	3.6 (3Q22)
House price growth	8.9 (4Q21)	13.9 (2Q22)
Probability	5	10

Note: Extreme point in the consensus Upside is 'best outcome' in the scenario, for example the highest GDP growth and the lowest unemployment rate, in the first two years of the scenario.

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

The consensus Downside scenario

In the consensus Downside scenario, economic recovery is considerably weaker compared with the Central scenario. GDP growth remains weak, unemployment rates stay elevated and asset and commodity prices fall before gradually recovering towards their long-run trends.

The scenario is consistent with the key downside risks articulated above. Further outbreaks of COVID-19, coupled with delays in vaccination programmes, lead to longer-lasting restrictions on economic activity in this scenario. Other global risks also increase and drive increased risk-aversion in asset markets.

The following table describes key macroeconomic variables and the probabilities assigned in the consensus Downside scenario.

Consensus Downside scenario worst outcome

	Hong Kong *%*	***Mainland China*** *%*
GDP growth rate	(6.0) (1Q22)	(0.7) (4Q21)
Unemployment rate	7.1 (3Q21)	4.1 (4Q21)
House price growth	(8.0) (2Q22)	0.8 (2Q22)
Probability	20	8

Note: Extreme point in the consensus Downside is 'worst outcome' in the scenario, for example the lowest GDP growth and the highest unemployment rate, in the first two years of the scenario.

Additional Downside scenario

An additional Downside scenario that features a global recession has been created to reflect management's view of severe risks. In this scenario, infections rise over the second half of 2021 with setbacks to vaccine programmes such that it takes until the end of 2022 for the pandemic to come to an end. The scenario also assumes governments are unable to significantly increase fiscal and monetary programmes, which results in abrupt corrections in labour and asset markets.

The following table describes key macroeconomic variables and the probabilities assigned in the Additional Downside scenario.

Additional Downside scenario worst outcome

	Hong Kong *%*	***Mainland China*** *%*
GDP growth rate	(10.6) (1Q22)	(7.4) (2Q22)
Unemployment rate	7.1 (3Q21)	5.7 (1Q23)
House price growth	(17.0) (2Q22)	(20.7) (2Q22)
Probability	5	2

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

Additional Downside scenario worst outcome *(continued)*

In considering economic uncertainty and assigning probabilities to scenarios, management has considered both global and country-specific factors. This has led management to assigning scenario probabilities that are tailored to its view of uncertainty in individual markets. To inform its view, management has considered trends in the progression of the virus in individual countries, the expected reach and efficacy of vaccine roll-outs over the course of 2021, the size and effectiveness of future government support schemes and the connectivity with other countries. Management has also been guided by the actual response to the COVID-19 outbreak and by the economic experience across countries in 2020. China's visible success at containing the virus and its repeated rapid response to localised outbreaks, coupled with government support programmes and clear signs of economic recovery, have led management to conclude that the economic outlook for mainland China is the least volatile out of all our top markets. The Central scenario for mainland China has an 80% probability while a total of 10% has been assigned to the two Downside scenarios. In Hong Kong, the combination of recurrent outbreaks in the past, and the evidence of vaccine hesitancy which has delayed the original target of reaching herd immunity by the end of the third quarter this year, in addition to the other risks outlined above, have led management to assign 25% weight to the two Downside scenarios.

Critical accounting estimates and judgements

The calculation of ECL under HKFRS 9 involves significant judgements, assumptions and estimates, as set out in the Annual Report 2020 under 'Critical accounting estimates and judgements'. The level of estimation uncertainty and judgement has remained high since 31 December 2020 as a result of the economic effects of the COVID-19 pandemic, including significant judgements relating to:

- the selection and weighting of economic scenarios, given rapidly changing economic conditions in an unprecedented manner, uncertainty as to the effect of government support measures designed to alleviate adverse economic impacts, and a wide distribution of economic forecasts. There is judgement in making assumptions about the length of time and severity of the economic effects of the pandemic and the shape of recovery;

- estimating the economic effects of those scenarios on ECL, when the volatility of economic changes associated with the pandemic are outside the observable historical trends that can be reflected in the models. Modelled assumptions and linkages between economic factors and credit losses may underestimate or overestimate ECL in these conditions, including the effect of real estate prices on modelled ECL outcomes; and

- the identification of customers experiencing significant increases in credit risk and credit impairment, where judgements are made about the extent to which government support programmes have deferred or mitigated the risk of defaults, and the effects once support levels are reduced, particularly in relation to lending in high-risk and vulnerable sectors. Where customers have accepted payment deferrals and other reliefs designed to address short-term liquidity issues, or have extended those deferrals, judgements include the extent to which they are able to meet their financial obligations on returning to their original terms. The use of segmentation techniques for indicators of significant increases in credit risk involves significant estimation uncertainty.

How economic scenarios are reflected in ECL

The methodologies for the application of forward economic guidance into the calculation of ECL for wholesale and retail loans and portfolios is set out in pages 70 to 71 of the Annual Report 2020. These models are based largely on historical observations and correlations with default rates.

We continue to observe volatility in macroeconomic variables as a result of the COVID-19 pandemic, together with significant governmental support programmes, forbearance and payment holidays, have impacted model performance and historical correlations between macroeconomic variables and defaults. As economic forecasts begin to improve, the level and speed of economic recovery remains outside the range of historical experience used to calibrate the models, and the timing of defaults has considerably shifted from the modelled assumptions. Management judgements have been used to overcome the limitation in the model generated outcome, increasing the ECL.

(a) Credit Risk *(continued)*

How economic scenarios are reflected in ECL *(continued)*

Management judgemental adjustments arise when data and model limitations are addressed in the short term using in-model and post-model adjustments. This includes refining model inputs and outputs and using post-model adjustments based on management judgement and higher level quantitative analysis for impacts that are difficult to model.

Management judgmental adjustments

In the context of HKFRS 9, management judgmental adjustments are typically short-term increases or decreases to the ECL at either a customer or portfolio level to account for late breaking events, model deficiencies and other assessments applied following management review and challenge.

At 30 June 2021, management judgements were applied to reflect credit risk dynamics not captured by our models. The drivers of the management judgmental adjustments continue to evolve with the economic environment. We have internal governance in place to monitor management judgmental adjustments regularly and, where possible, to reduce the reliance on these through model recalibration or redevelopment, as appropriate.

Wider-ranging model changes will take time to develop and need observable loss data on which models can be developed. Models will be revisited over time once the longer-term impacts of the COVID-19 outbreak are observed. Therefore, we continue to anticipate significant management judgmental adjustments for the foreseeable future.

Some management judgmental adjustments could cease once macroeconomic forecasts have stabilised and move within the range of historical experience, portfolio impacts due to unwinding of government schemes become visible and the uncertainty due to COVID-19 reduces.

Management judgmental adjustments made in estimating the reported ECL at 30 June 2021 are set out in the following table. The table includes adjustments in relation to data and model limitations resulting from the pandemic, and as a result of the regular process of model development and implementation. It shows the adjustments applicable to the scenario-weighted ECL numbers.

Management judgmental adjustments to ECL at 30 June 2021:

	Retail	***Wholesale***	***Total***
Net post-model additions in ECL (HK$m)			
Low risk counterparties and economies (banks, sovereigns and government entities)	158	–	158
Corporate lending adjustments	–	716	716
Retail model default suppression adjustment	–	–	–
Macroeconomic-related adjustments	315	–	315
Other lending adjustments	20	49	69
Total	493	765	1,258

The adjustments relating to low credit-risk exposures of HK$158m (31 December 2020: HK$44m) were mainly to highly rated banks and sovereigns, where modelled credit factors did not fully reflect the underlying fundamentals of these entities.

Adjustments to corporate exposures principally reflected the outcome of management judgements for high-risk and vulnerable sectors through corporate lending adjustment in our key markets, supported by credit experts' input, quantitative analyses and benchmarks. Considerations included potential default suppression in some sectors due to continued government intervention and late-breaking idiosyncratic developments. The corporate lending adjustments were HK$716m at 30 June 2021 (31 December 2020: HK$608m).

In the retail portfolio, management judgement adjustments mainly relate to default suppression, macroeconomic conditions and customer support programmes.

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

Management judgmental adjustments *(continued)*

The retail model default suppression adjustment was removed (31 December 2020: HK$503m) during the period given the improvement in macroeconomic forecast and the unwinding in a number of markets as customer relief and government support concludes. Retail models are reliant on the assumption that as macroeconomic conditions deteriorate, defaults will crystallise. We will monitor the continuation of customer relief and government support programmes that have stabilised macroeconomic conditions and therefore suppressed retail model defaults.

Other macroeconomic-related adjustments for retail of HK$315m (31 December 2020: HK$198m) were applied to reflect credit experts' input, quantitative analyses and benchmarks on increased levels of risk. These were applied in consideration of the volatility between the improved macroeconomic forecasts and the level of uncertainty in relation to the COVID-19 outbreak which has increased during the period.

Other lending adjustments were applied reflecting customer support programmes or other adjustments. The other lending adjustments in retail were HK$20m at 30 June 2021 (31 December 2020: HK$21m) while wholesale were HK$49m at 30 June 2021 (31 December 2020: HK$78m).

Economic scenarios sensitivity analysis of ECL estimates

Management considered the sensitivity of the ECL outcome against the economic forecasts as part of the ECL governance process by recalculating the ECL under each scenario described above for selected portfolios, applying a 100% weighting to each scenario in turn. The weighting is reflected in both the determination of a significant increase in credit risk and the measurement of the resulting ECL.

The ECL calculated for the Upside and Downside scenarios should not be taken to represent the upper and lower limits of possible actual ECL outcomes. The impact of defaults that might occur in future under different economic scenarios is captured by recalculating ECL for loans in stages 1 and 2 at the balance sheet date. The population of stage 3 loans (in default) at the balance sheet date is unchanged in these sensitivity calculations. Stage 3 ECL would only be sensitive to changes in forecasts of future economic conditions if the loss given default of a particular portfolio was sensitive to these changes.

There is a particularly high degree of estimation uncertainty in numbers representing tail risk scenarios when assigned a 100% weighting. For wholesale credit risk exposures, the sensitivity analysis excludes ECL and financial instruments related to defaulted obligors because the measurement of ECL is relatively more sensitive to credit factors specific to the obligor than future economic scenarios. Therefore, it is impracticable to separate the effect of macroeconomic factors in individual assessments.

For retail credit risk exposures, the sensitivity analysis includes ECL for loans and advances to customers related to defaulted obligors. This is because the retail ECL for secured mortgage portfolios including loans in all stages is sensitive to macroeconomic variables.

Wholesale and Retail sensitivity

The wholesale and retail sensitivity analysis is stated inclusive of management judgmental adjustments, as appropriate to each scenario. The results tables exclude portfolios held by the insurance business and small portfolios, and as such cannot be directly compared to personal and wholesale lending presented in other credit risk tables. Additionally, in both the wholesale and retail analysis, the comparative period results for additional/alternative Downside scenarios are also not directly comparable with the current period, because they reflect different risk profiles relative to the consensus scenarios for the period end.

(a) Credit Risk *(continued)*

Wholesale analysis

HKFRS 9 ECL sensitivity to future economic conditions[1]

	Hong Kong	***Mainland China***
ECL of financial instruments subject to significant measurement uncertainty at 30 June 2021 (HK$m)[2]		
Reported ECL	1,517	240
Central scenario ECL	1,277	214
Upside scenario ECL	696	50
Downside scenario ECL	2,051	438
Additional Downside scenario ECL	3,528	3,368

1 *ECL sensitivities exclude portfolios utilising less complex modelling approaches.*

2 *ECL sensitivity includes off-balance sheet financial instruments that are subject to significant measurement uncertainty.*

At 30 June 2021, the additional downside scenario reflects the most significant level of ECL sensitivity in Hong Kong and mainland China due to the combination of potential for deterioration of the credit quality on those markets and level of exposure.

ECL sensitivities demonstrated a decrease from year ended 2020, primarily due to the improvement of economic forecasts under all scenarios. The higher ECL sensitivities can all be observed for the additional downside scenario, which represents a prolonged recovery period and sharper impact, comparative to other scenarios.

Retail analysis

HKFRS 9 ECL sensitivity to future economic conditions[1]

	Hong Kong	***Mainland China***
ECL of loans and advances to customers at 30 June 2021 (HK$m)[2]		
Reported ECL	1,270	57
Central scenario ECL	1,193	56
Upside scenario ECL	1,070	55
Downside scenario ECL	1,449	57
Additional Downside scenario ECL	1,969	78

1 *ECL sensitivities exclude portfolios utilising less complex modelling approaches.*

2 *ECL sensitivity includes only on-balance sheet financial instruments to which HKFRS 9 impairment requirements are applied.*

At 30 June 2021, the most significant level of ECL sensitivity was observed in Hong Kong. Mortgages reflected the lowest level of ECL sensitivity in Hong Kong as collateral values remain resilient. Hong Kong mortgages had low level of reported ECL due to the credit quality of the portfolio, and so presented sensitivity was negligible. Credit cards and other unsecured lending are more sensitive to economic forecasts, which have reflected improvement during the first half of 2021.

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

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers, including loan commitments and financial guarantees

	Non credit – impaired				*Credit – impaired*				*Total*	
	Stage 1		*Stage 2*		*Stage 3*		*POCI*[1]			
	Gross carrying/ nominal amount	*Allowances for ECL*	*Gross carrying/ nominal amount*	*Allowances for ECL*	*Gross carrying/ nominal amount*	*Allowances for ECL*	*Gross carrying/ nominal amount*	*Allowances for ECL*	*Gross carrying/ nominal amount*	*Allowances for ECL*
At 1 January 2021	**1,213,008**	**(1,421)**	**135,379**	**(1,896)**	**5,723**	**(2,044)**	**1**	**–**	**1,354,111**	**(5,361)**
Transfers of financial instruments:										
– transfers from Stage 1 to Stage 2	(99,604)	255	99,604	(255)	–	–	–	–	–	–
– transfers from Stage 2 to Stage 1	30,021	(260)	(30,021)	260	–	–	–	–	–	–
– transfers to Stage 3	(155)	5	(1,544)	131	1,699	(136)	–	–	–	–
– transfers from Stage 3	7	(1)	23	(1)	(30)	2	–	–	–	–
Net remeasurement of ECL arising from transfer of stage	–	120	–	(669)	–	(9)	–	–	–	(558)
New financial assets originated and purchased	175,035	(96)	2,231	(33)	103	(35)	–	–	177,369	(164)
Assets derecognised (including final repayments)	(94,000)	45	(11,899)	133	(213)	90	–	–	(106,112)	268
Changes to risk parameters – further lending/(repayments)	25,262	166	(14,555)	100	134	54	–	–	10,841	320
Changes in risk parameters – credit quality	–	373	–	168	–	(719)	–	–	–	(178)
Assets written off	–	–	–	–	(419)	419	–	–	(419)	419
Foreign exchange and others	1,699	–	65	–	13	–	–	–	1,777	–
At 30 June 2021	**1,251,273**	**(814)**	**179,283**	**(2,062)**	**7,010**	**(2,378)**	**1**	**–**	**1,437,567**	**(5,254)**

	Total
Change in ECL in income statement (charge)/ release for the period	(312)
Add: Recoveries	78
Add/(less): Others	(1)
Total ECL (charge)/release for the period	**(235)**

(a) Credit Risk *(continued)*

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers, including loan commitments and financial guarantees *(continued)*

	At 30 June 2021		For the half-year ended 30 June 2021
	Gross carrying/ nominal amount	Allowances for ECL	ECL (charge)/ release
Placings with and advances to banks and loans and advances to customers, including loan commitments and financial guarantees	1,437,567	(5,254)	(235)
Other financial assets measured at amortised cost	213,951	(266)	(104)
Forward forward deposit placed	1,366	–	–
Summary of financial instruments to which the impairment requirements in HKFRS 9 are applied	1,652,884	(5,520)	(339)
Debt instruments measured at FVOCI[2]	349,685	(7)	–
Performance and other guarantees	18,479	(5)	–
Total allowances for ECL/total consolidated income statement ECL charge for the period	2,021,048	(5,532)	(339)

1 *Purchased or originated credit-impaired ('POCI') represented distressed restructuring.*

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

3 *The financial information included in this table forms part of the Condensed Consolidated Financial Statements which have been reviewed by PricewaterhouseCoopers.*

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

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers, including loan commitments and financial guarantees *(continued)*

	Non credit – impaired				*Credit – impaired*				*Total*	
	Stage 1		*Stage 2*		*Stage 3*		*POCI*[1]			
	Gross carrying/ nominal amount	*Allowances for ECL*	*Gross carrying/ nominal amount*	*Allowances for ECL*	*Gross carrying/ nominal amount*	*Allowances for ECL*	*Gross carrying/ nominal amount*	*Allowances for ECL*	*Gross carrying/ nominal amount*	*Allowances for ECL*
At 1 January 2020	1,243,623	(1,014)	118,301	(1,838)	2,073	(814)	–	–	1,363,997	(3,666)
Transfers of financial instruments:										
– transfers from Stage 1 to Stage 2	(71,117)	118	71,117	(118)	–	–	–	–	–	–
– transfers from Stage 2 to Stage 1	33,455	(480)	(33,455)	480	–	–	–	–	–	–
– transfers to Stage 3	(1,607)	2	(1,443)	52	3,050	(54)	–	–	–	–
– transfers from Stage 3	–	–	31	–	(31)	–	–	–	–	–
Net remeasurement of ECL arising from transfer of stage	–	219	–	(101)	–	(3)	–	–	–	115
New financial assets originated and purchased	186,164	(342)	7,988	(177)	563	(329)	2	–	194,717	(848)
Assets derecognised (including final repayments)	(111,033)	74	(21,136)	253	(357)	109	–	–	(132,526)	436
Changes to risk parameters – further lending/(repayments)	(73,811)	117	(6,336)	135	1,463	(399)	(1)	–	(78,685)	(147)
Changes in risk parameters – credit quality	–	(255)	–	(1,610)	–	(1,645)	–	–	–	(3,510)
Changes to model used for ECL calculation	–	140	–	1,028	–	–	–	–	–	1,168
Assets written off	–	–	–	–	(1,091)	1,091	–	–	(1,091)	1,091
Foreign exchange and others	7,334	–	312	–	53	–	–	–	7,699	–
At 31 December 2020	1,213,008	(1,421)	135,379	(1,896)	5,723	(2,044)	1	–	1,354,111	(5,361)

	Total
Change in ECL in income statement (charge)/ release for the year	(2,786)
Add: Recoveries	104
Add/(less): Others	43
Total ECL (charge)/release for the year	(2,639)

	At 31 December 2020		*For the year ended 31 December 2020*
	Gross carrying/ nominal amount	*Allowances for ECL*	*ECL (charge)/ release*
Placings with and advances to banks and loans and advances to customers, including loan commitments and financial guarantees	1,354,111	(5,361)	(2,639)
Other financial assets measured at amortised cost	188,872	(187)	(99)
Forward forward deposit placed	–	–	–
Summary of financial instruments to which the impairment requirements in HKFRS 9 are applied	1,542,983	(5,548)	(2,738)
Debt instruments measured at FVOCI[2]	411,423	(9)	2
Performance and other guarantees	16,774	(7)	(2)
Total allowances for ECL/total consolidated income statement ECL charge for the year	1,971,180	(5,564)	(2,738)

1 *Purchased or originated credit-impaired ('POCI') represented distressed restructuring.*

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

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

The five credit quality classifications defined in the table below each encompass a range of granular internal credit rating grades assigned to wholesale and retail lending businesses and the external ratings attributed by external agencies to debt securities, as shown in the table below. Under HKFRS 9 retail lending credit quality is based on a 12-month point-in-time ('PIT') probability-weighted PD. The credit quality classifications for wholesale lending are unchanged and are based on internal credit risk ratings.

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

1 *Customer risk rating ('CRR').*

2 *12-month point-in-time ('PIT') probability-weighted probability of default ('PD').*

Quality classification definitions

- *Strong exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss.*
- *Good exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk.*
- *Satisfactory exposures require closer monitoring and demonstrate an average-to-fair capacity to meet financial commitments, with moderate default risk.*
- *Sub-standard exposures require varying degrees of special attention and default risk is of greater concern.*
- *Credit-impaired exposures have been assessed as described on note 2 (j) on the Consolidated Financial Statements in Annual Report 2020.*

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

Credit quality of financial instruments

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

	Gross carrying/notional amount							
	Strong	*Good*	*Satisfactory*	*Sub-standard*	*Credit-impaired*	*Total*	*Allowances for ECL*	*Net*
Loans and advances to customers at amortised cost	445,669	230,130	326,378	9,407	7,011	1,018,595	(5,132)	1,013,463
– stage 1	433,313	202,467	204,447	574	–	840,801	(754)	840,047
– stage 2	12,356	27,663	121,931	8,833	–	170,783	(2,000)	168,783
– stage 3	–	–	–	–	7,010	7,010	(2,378)	4,632
– POCI	–	–	–	–	1	1	–	1
Placings with and advances to banks at amortised cost	61,515	275	2	–	–	61,792	(1)	61,791
– stage 1	61,474	109	2	–	–	61,585	(1)	61,584
– stage 2	41	166	–	–	–	207	–	207
– stage 3	–	–	–	–	–	–	–	–
– POCI	–	–	–	–	–	–	–	–
Other financial assets measured at amortised cost	169,011	36,810	8,123	7	–	213,951	(266)	213,685
– stage 1	166,830	35,516	6,610	–	–	208,956	(202)	208,754
– stage 2	2,181	1,294	1,513	7	–	4,995	(64)	4,931
– stage 3	–	–	–	–	–	–	–	–
– POCI	–	–	–	–	–	–	–	–
Loan and other credit-related commitments[2]	273,916	45,109	36,910	385	–	356,320	(115)	356,205
– stage 1	273,835	43,127	31,232	241	–	348,435	(55)	348,380
– stage 2	81	1,982	5,678	144	–	7,885	(60)	7,825
– stage 3	–	–	–	–	–	–	–	–
– POCI	–	–	–	–	–	–	–	–
Financial guarantees and similar contracts[2]	36	1,052	1,128	10	–	2,226	(6)	2,220
– stage 1	27	929	861	1	–	1,818	(4)	1,814
– stage 2	9	123	267	9	–	408	(2)	406
– stage 3	–	–	–	–	–	–	–	–
– POCI	–	–	–	–	–	–	–	–
At 30 June 2021	950,147	313,376	372,541	9,809	7,011	1,652,884	(5,520)	1,647,364
Debt instruments at FVOCI[1]								
– stage 1	349,452	233	–	–	–	349,685	(7)	349,678
– stage 2	–	–	–	–	–	–	–	–
– stage 3	–	–	–	–	–	–	–	–
– POCI	–	–	–	–	–	–	–	–
At 30 June 2021	349,452	233	–	–	–	349,685	(7)	349,678

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

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

3 *The financial information included in this table forms part of the Condensed Consolidated Financial Statements which have been reviewed by PricewaterhouseCoopers.*

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

Credit quality of financial instruments *(continued)*

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

	Gross carrying/notional amount							
	Strong	*Good*	*Satisfactory*	*Sub-standard*	*Credit-impaired*	*Total*	*Allowances for ECL*	*Net*
Loans and advances to customers at amortised cost	434,281	215,848	281,689	12,412	5,724	949,954	(5,180)	944,774
– stage 1	430,162	189,437	193,739	808	–	814,146	(1,315)	812,831
– stage 2	4,119	26,411	87,950	11,604	–	130,084	(1,821)	128,263
– stage 3	–	–	–	–	5,723	5,723	(2,044)	3,679
– POCI	–	–	–	–	1	1	–	1
Placings with and advances to banks at amortised cost	44,044	311	2	–	–	44,357	–	44,357
– stage 1	43,854	65	–	–	–	43,919	–	43,919
– stage 2	190	246	2	–	–	438	–	438
– stage 3	–	–	–	–	–	–	–	–
– POCI	–	–	–	–	–	–	–	–
Other financial assets measured at amortised cost	145,561	32,019	11,280	12	–	188,872	(187)	188,685
– stage 1	143,610	31,506	9,227	1	–	184,344	(133)	184,211
– stage 2	1,951	513	2,053	11	–	4,528	(54)	4,474
– stage 3	–	–	–	–	–	–	–	–
– POCI	–	–	–	–	–	–	–	–
Loan and other credit-related commitments[2]	269,830	54,036	32,823	87	–	356,776	(163)	356,613
– stage 1	269,810	51,989	30,372	70	–	352,241	(90)	352,151
– stage 2	20	2,047	2,451	17	–	4,535	(73)	4,462
– stage 3	–	–	–	–	–	–	–	–
– POCI	–	–	–	–	–	–	–	–
Financial guarantees and similar contracts[2]	99	1,325	1,590	10	–	3,024	(18)	3,006
– stage 1	97	1,264	1,337	4	–	2,702	(16)	2,686
– stage 2	2	61	253	6	–	322	(2)	320
– stage 3	–	–	–	–	–	–	–	–
– POCI	–	–	–	–	–	–	–	–
At 31 December 2020	893,815	303,539	327,384	12,521	5,724	1,542,983	(5,548)	1,537,435
Debt instruments at FVOCI[1]								
– stage 1	411,036	387	–	–	–	411,423	(9)	411,414
– stage 2	–	–	–	–	–	–	–	–
– stage 3	–	–	–	–	–	–	–	–
– POCI	–	–	–	–	–	–	–	–
At 31 December 2020	411,036	387	–	–	–	411,423	(9)	411,414

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

2 *Figures do not include commitments and financial guarantee contracts not subject to impairment requirements under HKFRS 9. As such, the amounts do not agree with the figures shown in note 45 of the Consolidated Financial Statements in Annual Report 2020.*

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

Customer relief programmes

In response to the COVID-19 pandemic, governments around the world have introduced a number of support measures for both personal and wholesale customers. The Group has also continued to provide additional temporary relief measures to aid customers who were impacted by the coronavirus in Hong Kong, China and Macau in 2021. The following table presents the number of customers and drawn loan values of customers under these schemes and additional relief measures implemented by the Group at 30 June 2021.

		At 30 June 2021
Personal lending		
Number of customers granted mortgages payment holidays	Thousands	**0.3**
Drawn loan value of customers granted mortgage payment holidays	HK$m	**764**
Total mortgages	HK$m	**291,111**
Payment holidays as a proportion of total mortgages	%	**0.3**
Number of customers granted other personal lending payment holidays	Thousands	**0.2**
Drawn loan value of customers granted other personal lending payment holidays	HK$m	**376**
Total other personal lending	HK$m	**71,930**
Payment holidays as a proportion of total other personal lending	%	**0.5**
Wholesale lending		
Number of customers under customer relief schemes	Thousands	**0.2**
Drawn loan value of customers under customer relief schemes	HK$m	**9,764**
Total wholesale loans and advances to customers	HK$m	**655,554**
Customer relief as a proportion of total wholesale loans and advances to customers	%	**1.5**
Total customer relief as a proportion of total loans and advances to customers	%	**1.1**

Customer relief schemes in Hong Kong

Wholesale

Given the continued challenges encountered by the Hong Kong business community on the back of the COVID-19 outbreak, the Bank has continued to provide certain temporary relief measures in 2021 to support our corporate clients. The overarching premise of these initiatives was to support the immediate cash flow and liquidity of our customers, without increasing the overall quantum of exposure/risk appetite to these clients. Eligible customers were required to meet a set of credit criteria agreed with Risk.

The prescribed eligibility criteria (which include parameters for CRR, favorable past due history and no Worry-Watch-Monitor classification etc.) are to ensure that these measures are extended only to the 'good book', clients are not already showing any signs of stress and that these arrangements are more proactive and flexible approaches to commercial restructuring as opposed to forbearance/renegotiated loans/distressed restructuring.

(a) Credit Risk *(continued)*

Customer relief schemes in Hong Kong *(continued)*

Wholesale *(continued)*

The relief measures are as follows:

- The Bank continued to support the Pre-approved Principal Payment Holiday Scheme ('PPPHS') initiated by the Hong Kong Monetary Authority ('HKMA') since its launch in May 2020, and has granted up to 90-day tenor extension for trade facilities or/and up to 6-month principal payment holiday for other loans to eligible corporates respectively in February and May 2021. Eligible corporates covers corporates with turnover not exceeding HK$800m and satisfied other prescribed criteria;

- To further alleviate the cash flow pressure of small and medium-sized enterprises, the Special 100% Loan Guarantee under the SME Financing Guarantee Scheme ('SFGS100') has been further enhanced in March 2021, the maximum loan amount has been raised to HK$6m and maximum loan tenor has been increased to 8 years.

Retail

The HKMA in early February 2020 encouraged Authorised Institutions to adopt a sympathetic stance in dealing with customers facing financial stress due to the COVID-19 and, to the extent prudent risk management principles permit, consider requests from these borrowers for temporary relief arrangements favorably. The Bank introduced a suite of comprehensive relief measures to ease the financial burden and short term cash flow pressures on personal customers created by the spread of COVID-19. This exemplifies the Bank's commitment to support the local community during these tough times.

The relief measures are as follows:

- Deferred Mortgage Principal Repayment Plan is generally in 6 months and further extension of 6 months is allowed upon request (total up to 12 months). Eligible customers only need to repay interest during the period and the plan is offered to existing mortgage loan customers who have a good repayment record in the past 6 months and also covers Government Home Ownership Scheme ('GHOS')/Tenants Purchase Scheme ('TPS');

- HKSAR Government has launched the Personal Loan Guarantee Scheme ('PLGS') in April 2021. The guarantee loan covers a maximum tenor of 6 years and maximum loan size of HK$80k and optional 12 months payment holidays to customers who are unemployed after January 2020 due to COVID-19. Interest rate is set at 1% APR & interest will be rebated to customers after loan pay-off. The title of the loan will transfer to the Hong Kong Mortgage Corporation ('HKMCI'), a quasi-government agency.

(b) Liquidity and funding risk

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

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

There is no material change to the policies and practices for the management of liquidity and funding risk in the first half of 2021.

A summary of the Group's current policies and practices for the management of liquidity and funding risk is set out in 'Liquidity and funding risk' section on pages 89 to 93 of the Annual Report 2020.

Liquidity information

The Group is required to calculate its Liquidity Coverage Ratio ('LCR') and Net Stable Funding Ratio ('NSFR') on a consolidated basis in accordance with rule 11 (1) of The Banking (Liquidity) Rules ('BLR') and to maintain both LCR and NSFR of not less than 100%.

The average LCRs for the reportable periods are as follows:

	Quarter ended 30 June 2021	***Quarter ended 31 March 2021***	*Quarter ended 30 June 2020*	*Quarter ended 31 March 2020*
Average LCR	**214.4%**	**204.0%**	198.0%	181.6%

The liquidity position of the Group remained strong for the first half of 2021. The average LCR were 214.4% and 204.0% for the quarters ended 30 June and 31 March 2021 respectively, compared with 198.0% and 181.6% for the quarters ended 30 June and 31 March 2020 respectively.

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

	Weighted amount (average value) at quarter ended			
	30 June 2021	***31 March 2021***	*30 June 2020*	*31 March 2020*
Level 1 assets	**355,092**	**377,648**	315,876	297,826
Level 2A assets	**15,464**	**14,301**	15,415	15,056
Level 2B assets	**3,073**	**2,169**	1,795	1,224
Total weighted amount of HQLA	**373,629**	**394,118**	333,086	314,106

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

	Quarter ended 30 June 2021	***Quarter ended 31 March 2021***	*Quarter ended 30 June 2020*	*Quarter ended 31 March 2020*
NSFR	**146.6%**	**150.5%**	151.0%	146.0%

The funding position of the Group remained strong for the first half of 2021. The period end NSFR were 146.6% and 150.5% for the quarters ended 30 June and 31 March 2021 respectively, compared with 151.0% and 146.0% for the quarters ended 30 June and 31 March 2020 respectively.

(b) Liquidity and funding risk (continued)

Sources of funding

Our primary sources of funding are customer deposits. We issue wholesale securities to supplement our customer deposits and change the currency mix or maturity profile of our liabilities.

Additional contractual obligations

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

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

(c) Market risk

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

A summary of the Group's current policies and practices for the management of market risk is set out in 'Market Risk' section on pages 94 to 101 of the Annual Report 2020.

Market risk in the first half of 2021

There were no material changes to the Group's policies and practices for the management of market risk in the first half of 2021.

Financial markets remained resilient during the first half of 2021, against the backdrop of loose financial conditions, continued fiscal support and acceleration in the rollout of COVID-19 vaccination programmes to the general population. As the reopening of major economies progressed in the first quarter of 2021, rising concerns of inflationary pressures and expectations that the Fed could raise interest rates earlier than previously anticipated led to a temporary increase in long-term government bond yields and a pause in the stock market rally. During the second quarter of 2021, while the path of monetary policies remain uncertain, central banks continued to provide liquidity, remaining cautious and highlighting the potentially transitory nature of higher inflation. This provided continued support to risk assets valuations and led to interest rates retracing from the March highs, while volatilities remained subdued. In June 2021, major equity markets reached new record highs and credit markets remained strong, with credit spreads benchmarks for investment-grade and high-yield debt close to pre-pandemic levels.

The Group continued to manage market risk prudently in the first half of 2021. Sensitivity exposures and VaR mostly remained within appetite as the business pursued its core market-making activity in support of our customers. Market risk was managed using a complementary set of risk measures and limits, including stress and scenario analysis.

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

Trading portfolios

VaR of the trading portfolios

Trading VaR predominantly resides within Global Markets. Interest rate risks were the main drivers of trading VaR. The VaR for trading activity at 30 June 2021 was lower than that at 30 June 2020, mainly driven by foreign exchange trading portfolio.

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

Trading

	At 30 June 2021	***Minimum during the first half of 2021***	***Maximum during the first half of 2021***	***Average for the first half of 2021***
VaR				
Trading	**33**	**33**	**55**	**44**
Foreign exchange trading	**19**	**17**	**25**	**22**
Interest rate trading	**32**	**27**	**50**	**36**
Portfolio diversification	**(18)**	**–**	**–**	**(14)**
Stressed VaR				
Trading	**247**	**176**	**372**	**248**
Foreign exchange trading	**57**	**57**	**135**	**87**
Interest rate trading	**280**	**144**	**430**	**252**
Portfolio diversification	**(90)**	**–**	**–**	**(91)**

	At 30 June 2020	*Minimum during the first half of 2020*	*Maximum during the first half of 2020*	*Average for the first half of 2020*
VaR				
Trading	38	29	58	42
Foreign exchange trading	25	21	35	26
Interest rate trading	28	19	45	31
Portfolio diversification	(15)	–	–	(15)
Stressed VaR				
Trading	136	84	216	135
Foreign exchange trading	96	36	99	55
Interest rate trading	92	89	247	141
Portfolio diversification	(52)	–	–	(61)

Non-trading portfolios

Interest Rate Risk in the Banking Book is the risk of an adverse impact to earnings or capital due to changes in market interest rates that affect the Bank's banking book positions. The risk arises from timing mismatches in the re-pricing of non-traded assets and liabilities and is the potential adverse impact of changes in interest rates on earnings and capital.

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

(c) Market risk *(continued)*

Non-trading portfolios *(continued)*

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

Foreign exchange exposures

The Group's structural foreign exchange exposure, monitored using sensitivity analysis, represents the Group's foreign currency investments in subsidiaries, branches and associates, and the fair value of the Group's long-term foreign currency equity investments, the functional currencies of which are currencies other than the HK dollar. An entity's functional currency is normally that of the primary economic environment in which the entity operates. The Group's structural foreign exchange exposures are managed by the Group's ALCO with the primary objective of ensuring, where practical, that the Group's and the Bank's capital ratios are largely protected from the effect of changes in exchange rates.

Exchange differences on structural exposures are recognised in 'Other comprehensive income'.

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

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

Equities exposures

The Group's equities exposures are reported as 'Financial assets designated and otherwise mandatorily measured at fair value through profit or loss', 'Financial investments' and 'Trading assets' in the condensed consolidated financial statements. These are subject to trading limit and risk management control procedures and other market risk regime.

(d) Insurance manufacturing operation risk

Overview

Insurance risk is the risk that, over time, the cost of insurance policies written, including claims and benefits, may exceed the total amount of premiums and investment income received. The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, as well as lapses and surrender rates.

The majority of the risk in our insurance business derives from manufacturing activities and can be categorised as financial risk and insurance risk. Financial risks include market risk, credit risk and liquidity risk. Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to our insurance subsidiary, Hang Seng Insurance Company Limited ('HSIC').

A summary of our policies and practices regarding the risk management of insurance operation, our insurance model and the main contracts we manufacture is provided on pages 105 to 114 of the Annual Report 2020.

There have been no material changes to the policies and practices for the management of risks arising in our insurance operation described in the Annual Report 2020.

Insurance manufacturing operation risk profile in the first half of 2021

The risk profile of our insurance manufacturing businesses is measured using an economic capital ('EC') approach. Assets and liabilities are measured on a market value basis, and a capital requirement is defined to ensure that there is a less than one in 200 chance of insolvency over a one-year time horizon, given the risks to which the businesses are exposed to. The methodology for the economic capital calculation is largely aligned to the pan-European Solvency II insurance capital regulations. A key risk appetite metric is the economic coverage ratio, which is calculated by dividing the economic net asset value by the economic capital requirement.

Our insurance subsidiary, HSIC, manages the economic capital coverage ratio against its appetite and tolerance as approved by its Board.

(d) Insurance manufacturing operation risk *(continued)*

Insurance manufacturing operation risk profile in the first half of 2021 *(continued)*

The following table shows the composition of assets and liabilities by type of contract

Balance sheet of insurance manufacturing operation by type of contract

	Linked contracts[1]	*Non-linked contracts*[1]	*Other assets and liabilities*[2]	*Total*
30 June 2021				
Financial assets:				
– financial assets designated and otherwise mandatorily measured at fair value through profit or loss	201	25,505	–	25,706
– derivative financial instruments	–	478	–	478
– financial investments	–	125,540	6,055	131,595
– other financial assets	16	7,731	1,259	9,006
Total financial assets	217	159,254	7,314	166,785
Reinsurance assets	–	6,099	–	6,099
Present value of in-force long-term insurance contracts	–	–	22,682	22,682
Other assets	–	6,101	1,327	7,428
Total assets	217	171,454	31,323	202,994
Liabilities under investment contracts designated at fair value	133	276	–	409
Liabilities under insurance contracts	73	148,402	–	148,475
Deferred tax	–	8	3,786	3,794
Other liabilities	–	–	16,865	16,865
Total liabilities	206	148,686	20,651	169,543
Shareholders' equity	–	–	33,451	33,451
Total liabilities and shareholders' equity	206	148,686	54,102	202,994

(d) *Insurance manufacturing operation risk* *(continued)*

Insurance manufacturing operation risk profile in the first half of 2021 *(continued)*

Balance sheet of insurance manufacturing operation by type of contract *(continued)*

	Linked contracts[1]	*Non-linked contracts*[1]	*Other assets and liabilities*[2]	*Total*
31 December 2020				
Financial assets:				
– financial assets designated and otherwise mandatorily measured at fair value through profit or loss	199	20,419	–	20,618
– derivative financial instruments	–	439	–	439
– financial investments	–	116,983	6,177	123,160
– other financial assets	39	8,122	263	8,424
Total financial assets	238	145,963	6,440	152,641
Reinsurance assets	–	5,714	–	5,714
Present value of in-force long-term insurance contracts	–	–	22,551	22,551
Other assets	–	6,203	1,313	7,516
Total assets	238	157,880	30,304	188,422
Liabilities under investment contracts designated at fair value	137	282	–	419
Liabilities under insurance contracts	69	142,611	–	142,680
Deferred tax	–	9	3,776	3,785
Other liabilities	–	–	9,742	9,742
Total liabilities	206	142,902	13,518	156,626
Shareholders' equity	–	–	31,796	31,796
Total liabilities and shareholders' equity	206	142,902	45,314	188,422

1 *Comprises life insurance contracts and investment contracts*

2 *Comprises shareholder assets and liabilities*

Market risk (insurance)

Description and exposure

Market risk is the risk of changes in market factors affecting capital or profit. Market factors include interest rates, equity and other growth assets prices and foreign exchange rates.

Our exposure varies depending on the type of contract issued. Our most significant life insurance products are contracts with discretionary participating features ('DPF') issued in Hong Kong. These products typically include some form of capital guarantee or guaranteed return on the sums invested by the policyholders, to which discretionary bonuses are added if allowed by the overall performance of the funds. These funds are primarily invested in bonds, with a proportion allocated to other asset classes to provide customers with the potential for enhanced returns.

DPF products expose the Group to the risk of variation in asset returns, which will impact our participation in the investment performance. In addition, in some scenarios the asset returns can become insufficient to cover the financial guarantees to the policyholders, in which case the shortfall has to be met by the Group. Reserves are held against the cost of such guarantees, calculated by stochastic modelling.

Where local rules require, these reserves are held as part of liabilities under insurance contracts. Any remainder is accounted for as a deduction from the present value of in-force ('PVIF') long-term insurance business on the relevant product.

(d) Insurance manufacturing operation risk *(continued)*

Market risk (insurance) *(continued)*

Description and exposure (continued)

For unit-linked contracts, market risk is substantially borne by the policyholders, but some market risk exposure typically remains as fees earned are related to the market value of the linked assets.

The following table illustrates the effects of selected interest rate, equity price and foreign exchange rate scenarios on our profit for the period and the total shareholders' equity of our insurance manufacturing operation.

	30 June 2021	31 December 2020
	Impact on profit after tax and shareholders' equity	*Impact on profit after tax and shareholders' equity*
+ 100 basis points shift in yield curves	**(690)**	(750)
– 100 basis points shift in yield curves	**720**	787
10 per cent increase in equity prices	**517**	442
10 per cent decrease in equity prices	**(515)**	(468)
10% increase in USD exchange rate compared to all currencies	**(392)**	126
10% decrease in USD exchange rate compared to all currencies	**392**	(126)

Where appropriate, the effects of the sensitivity tests on profit after tax and total equity incorporate the impact of the stress on the PVIF. The relationship between the profit and total equity and the risk factors is non-linear and nonsymmetrical, therefore the results disclosed should not be extrapolated to measure sensitivities to different levels of stress. The sensitivities reflect the established risk sharing mechanism with policyholders for discretionary participating products, and are stated before allowance for management actions which may mitigate the effect of changes in the market environment. The sensitivities presented do not allow for adverse changes in policyholder behaviour that may arise in response to changes in market rates.

(e) Resilience risk

Resilience risk is the risk that we are unable to provide critical services to our customers, affiliates and counterparties, as a result of sustained and significant operational disruption.

Sustained and significant operational disruption means events that affect:

– the stability of the financial system;

– the viability of the Bank and our industry peers; or

– the ability of our customers to access our services

We seek to understand the effects and outcomes of these events, prioritising services which are both vulnerable to disturbance and critical to our customer service offering.

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

A summary of the Group's current policies and practices for the management of resilience risk is set out in 'Resilience risk' section on pages 101 to 102 of the Annual Report 2020.

Capital Management

The following tables show the capital base, risk-weighted assets and capital ratios as contained in the 'Capital Adequacy Ratio' return required to be submitted to the Hong Kong Monetary Authority ('HKMA') by the Bank on a consolidated basis that is specified by the HKMA under the requirements of section 3C(1) of the Banking (Capital) Rules. The basis is different from that for accounting purposes. Further information on the regulatory consolidation basis is set out in the Banking Disclosure Statement that is available in the Regulatory Disclosures section of our website www.hangseng.com.

The Group uses the advanced internal ratings-based approach to calculate its credit risk for the majority of its non-securitisation exposures. For counterparty credit risk, the Group replaces the current exposure method with standardised (counterparty credit risk) approach to calculate its default risk exposures starting from 30 June 2021. For market risk, the Group uses an internal models approach to calculate its general market risk for the risk categories of interest rate and foreign exchange (including gold) exposures and the standardised (market risk) approach for calculating other market risk positions. For operational risk, the Group uses the standardised (operational risk) approach to calculate its operational risk.

Capital Base

The following table sets out the composition of the Group's capital base under Basel III at 30 June 2021 and 31 December 2020. A more detailed breakdown of the capital position and a full reconciliation between the Group's accounting and regulatory balance sheets can be viewed in the Banking Disclosure Statement in the Regulatory Disclosures section of our website www.hangseng.com.

	At 30 June 2021	At 31 December 2020
Common Equity Tier 1 ('CET1') Capital		
Shareholders' equity	**144,701**	145,915
– Shareholders' equity per Condensed Consolidated Balance Sheet	**183,677**	183,100
– Additional Tier 1 ('AT1') perpetual capital instruments	**(11,744)**	(11,744)
– Unconsolidated subsidiaries	**(27,232)**	(25,441)
Non-controlling interests	**–**	–
– Non-controlling interests per Condensed Consolidated Balance Sheet	**90**	95
– Non-controlling interests in unconsolidated subsidiaries	**(90)**	(95)
Regulatory deductions to CET1 capital	**(28,477)**	(27,306)
– Cash flow hedging reserve	**(25)**	(51)
– Changes in own credit risk on fair valued liabilities	**(5)**	(10)
– Property revaluation reserves*	**(24,340)**	(24,067)
– Regulatory reserve	**(1,997)**	(1,323)
– Intangible assets	**(1,838)**	(1,566)
– Defined benefit pension fund assets	**(14)**	(6)
– Deferred tax assets net of deferred tax liabilities	**(106)**	(183)
– Valuation adjustments	**(152)**	(100)
Total CET1 Capital	**116,224**	118,609
AT1 Capital		
Total AT1 capital before and after regulatory deductions	**11,744**	11,744
– Perpetual capital instruments	**11,744**	11,744
Total AT1 Capital	**11,744**	11,744
Total Tier 1 ('T1') Capital	**127,968**	130,353
Tier 2 ('T2') Capital		
Total T2 capital before regulatory deductions	**12,087**	11,762
– Property revaluation reserves*	**10,953**	10,831
– Impairment allowances and regulatory reserve eligible for inclusion in T2 capital	**1,134**	931
Regulatory deductions to T2 capital	**(1,045)**	(1,045)
– Significant capital investments in unconsolidated financial sector entities	**(1,045)**	(1,045)
Total T2 Capital	**11,042**	10,717
Total Capital	**139,010**	141,070

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

Risk-weighted assets by risk type

	At 30 June 2021	At 31 December 2020
Credit risk	654,023	624,487
Market risk	16,676	14,332
Operational risk	63,833	66,709
Total	734,532	705,528

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

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

	At 30 June 2021	At 31 December 2020
CET1 capital ratio	15.8%	16.8%
Tier 1 capital ratio	17.4%	18.5%
Total capital ratio	18.9%	20.0%

In addition, the capital ratios of all tiers as of 30 June 2021 would be reduced by approximately 0.3 percentage point after the prospective second interim dividend payment for 2021. The following table shows the pro-forma basis position of the capital ratios after the prospective interim dividend.

	Pro-forma At 30 June 2021	Pro-forma At 31 December 2020
CET1 capital ratio	15.5%	16.1%
Tier 1 capital ratio	17.1%	17.7%
Total capital ratio	18.6%	19.2%

Dividend policy

Objective

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

Considerations

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

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

Phasing and Timing

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

(unaudited)
(Expressed in millions of Hong Kong dollars)

Condensed Consolidated Income Statement

	note	*Half-year ended 30 June 2021*	*Half-year ended 30 June 2020*
Interest income calculated using effective interest method		**13,945**	20,020
Interest income – others		**229**	408
Interest income	4	**14,174**	20,428
Interest expense	5	**(2,291)**	(5,636)
Net interest income		**11,883**	14,792
Fee income		**4,893**	4,208
Fee expense		**(1,184)**	(1,033)
Net fee income	6	**3,709**	3,175
Net income/(loss) from financial instruments measured at fair value through profit or loss	7	**2,685**	(52)
Gains less losses from financial investments	8	**148**	20
Dividend income	9	**5**	6
Net insurance premium income		**6,798**	7,171
Other operating income	10	**405**	2,147
Total operating income		**25,633**	27,259
Net insurance claims and benefits paid and movement in liabilities to policyholders		**(8,307)**	(8,072)
Net operating income before change in expected credit losses and other credit impairment charges		**17,326**	19,187
Change in expected credit losses and other credit impairment charges	11	**(339)**	(1,760)
Net operating income		**16,987**	17,427
Employee compensation and benefits		**(3,165)**	(3,090)
General and administrative expenses		**(2,349)**	(2,033)
Depreciation expenses		**(1,030)**	(1,039)
Amortisation of intangible assets		**(210)**	(131)
Operating expenses	12	**(6,754)**	(6,293)
Impairment loss on intangible assets		**(10)**	–
Operating profit		**10,223**	11,134
Net surplus/(deficit) on property revaluation		**39**	(428)
Share of profits/(losses) of associates		**36**	(87)
Profit before tax		**10,298**	10,619
Tax expense	13	**(1,537)**	(1,484)
Profit for the period		**8,761**	9,135
Profit Attributable to:			
Shareholders of the Bank		**8,767**	9,143
Non-controlling interests		**(6)**	(8)
(Figures in HK$)			
Earnings per share – basic and diluted	14	**4.44**	4.64

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

The notes on pages 62 to 91 form part of these Condensed Consolidated Financial Statements.

(Expressed in millions of Hong Kong dollars)

Condensed Consolidated Statement of Comprehensive Income

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
Profit for the period	**8,761**	9,135
Other comprehensive income		
Items that will be reclassified subsequently to the Condensed Consolidated Income Statement when specific conditions are met:		
Debt instruments at fair value through other comprehensive income ('FVOCI'):		
– fair value changes taken to equity	**(729)**	1,313
– fair value changes transferred to the Condensed Consolidated Income Statement:		
– on hedged items	**491**	(1,004)
– on disposal	**(87)**	(20)
– expected credit losses recognised in the Condensed Consolidated Income Statement	**–**	46
– deferred taxes	**6**	(40)
– exchange difference	**254**	16
Cash flow hedge reserve:		
– fair value changes taken to equity	**1,519**	395
– fair value changes transferred to the Condensed Consolidated Income Statement	**(1,625)**	(120)
– deferred taxes	**18**	(45)
Exchange differences on translation of:		
– financial statements of overseas branches, subsidiaries and associates	**198**	(268)
Items that will not be reclassified subsequently to the Condensed Consolidated Income Statement:		
Change in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk:		
– before deferred taxes	**–**	4
– deferred taxes	**–**	(1)
Equity instruments designated at fair value through other comprehensive income:		
– fair value changes taken to equity	**(1,427)**	(869)
– exchange difference	**88**	(74)
Premises:		
– unrealised surplus/(deficit) on revaluation of premises	**648**	(1,061)
– deferred taxes	**(109)**	175
– exchange difference	**4**	(3)
Defined benefit plans:		
– actuarial gains/(losses) on defined benefit plans	**369**	(450)
– deferred taxes	**(61)**	74
Exchange difference and others	**(4)**	–
Other comprehensive income for the period, net of tax	**(447)**	(1,932)
Total comprehensive income for the period	**8,314**	7,203
Total comprehensive income for the period attributable to:		
– shareholders of the Bank	**8,320**	7,211
– non-controlling interests	**(6)**	(8)
	8,314	7,203

The notes on pages 62 to 91 form part of these Condensed Consolidated Financial Statements.

Condensed Consolidated Balance Sheet

	note	At 30 June 2021	At 31 December 2020
ASSETS			
Cash and balances at central banks	17	**12,283**	11,226
Trading assets	18	**32,299**	37,117
Derivative financial instruments	19	**12,985**	17,181
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	20	**25,783**	20,695
Reverse repurchase agreements – non-trading		**14,733**	13,360
Placings with and advances to banks	21	**61,791**	44,357
Loans and advances to customers	22	**1,013,463**	944,774
Financial investments	23	**499,236**	554,720
Interest in associates	24	**2,351**	2,358
Investment properties	25	**9,808**	9,415
Premises, plant and equipment	25	**30,566**	30,925
Intangible assets	26	**25,189**	24,733
Other assets	27	**59,728**	48,926
Total assets		**1,800,215**	1,759,787
LIABILITIES AND EQUITY			
Liabilities			
Deposits from banks		**22,196**	12,943
Current, savings and other deposit accounts	28	**1,190,438**	1,209,472
Repurchase agreements – non-trading		**20,405**	6,270
Trading liabilities	29	**27,494**	30,937
Derivative financial instruments	19	**12,780**	20,861
Financial liabilities designated at fair value	30	**35,809**	32,530
Certificates of deposit and other debt securities in issue	31	**79,418**	62,500
Other liabilities	32	**51,563**	31,334
Liabilities under insurance contracts		**148,475**	142,680
Current tax liabilities		**923**	282
Deferred tax liabilities		**7,461**	7,302
Subordinated liabilities	33	**19,486**	19,481
Total liabilities		**1,616,448**	1,576,592
Equity			
Share capital		**9,658**	9,658
Retained profits		**139,222**	137,580
Other equity instruments	34	**11,744**	11,744
Other reserves		**23,053**	24,118
Total shareholders' equity		**183,677**	183,100
Non-controlling interests		**90**	95
Total equity		**183,767**	183,195
Total equity and liabilities		**1,800,215**	1,759,787

The notes on pages 62 to 91 form part of these Condensed Consolidated Financial Statements.

(Expressed in millions of Hong Kong dollars)

Condensed Consolidated Statement of Changes in Equity

				Other reserves							
	Share capital	*Other equity instruments*	*Retained profits*[1]	*Premises revaluation reserve*	*Financial assets at FVOCI reserve*	*Cash flow hedge reserve*	*Foreign exchange reserve*	*Others*[2]	*Total shareholders' equity*	*Non-controlling interests*	*Total equity*
At 1 January 2021	**9,658**	**11,744**	**137,580**	**17,960**	**4,557**	**260**	**658**	**683**	**183,100**	**95**	**183,195**
Profit for the period	–	–	8,767	–	–	–	–	–	8,767	(6)	8,761
Other comprehensive income (net of tax)	–	–	304	543	(1,404)	(88)	198	–	(447)	–	(447)
Debt instruments at fair value through other comprehensive income	–	–	–	–	(65)	–	–	–	(65)	–	(65)
Equity instruments designated at fair value through other comprehensive income	–	–	–	–	(1,339)	–	–	–	(1,339)	–	(1,339)
Cash flow hedges	–	–	–	–	–	(88)	–	–	(88)	–	(88)
Change in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	–	–	–	–	–	–	–	–	–	–	–
Property revaluation	–	–	–	543	–	–	–	–	543	–	543
Actuarial gains on defined benefit plans	–	–	308	–	–	–	–	–	308	–	308
Exchange differences and others	–	–	(4)	–	–	–	198	–	194	–	194
Total comprehensive income for the period	–	–	9,071	543	(1,404)	(88)	198	–	8,320	(6)	8,314
Dividends paid[3]	–	–	(7,456)	–	–	–	–	–	(7,456)	–	(7,456)
Coupons paid on AT1 capital instruments	–	–	(280)	–	–	–	–	–	(280)	–	(280)
Movement in respect of share-based payment arrangements	–	–	(3)	–	–	–	–	(4)	(7)	–	(7)
Others	–	–	–	–	–	–	–	–	–	1	1
Transfers	–	–	310	(310)	–	–	–	–	–	–	–
At 30 June 2021	**9,658**	**11,744**	**139,222**	**18,193**	**3,153**	**172**	**856**	**679**	**183,677**	**90**	**183,767**

1 *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. 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 30 June 2021, the effect of this requirement is to restrict the amount of reserves which can be distributed by the Group to shareholders by HK$1,997m (31 December 2020: HK$1,323m).*

2 *Other reserves comprise share-based payment reserve and own credit risk reserve. The share-based payment reserve is used to record the amount relating to share awards and options granted to employees of the Group by the ultimate holding company. The own credit risk reserve is for the change in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk.*

3 *Dividends paid represented the payment of fourth interim dividend of 2020 and the first interim dividend of 2021 amounted to HK$5,353m and HK$2,103m respectively.*

The notes on pages 62 to 91 form part of these Condensed Consolidated Financial Statements.

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

				Other reserves							
	Share capital	*Other equity instruments*	*Retained profits*	*Premises revaluation reserve*	*Financial assets at FVOCI reserve*	*Cash flow hedge reserve*	*Foreign exchange reserve*	*Others*	*Total shareholders' equity*	*Non-controlling interests*	*Total equity*
At 1 January 2020	9,658	11,744	133,734	19,889	3,296	16	(196)	669	178,810	107	178,917
Profit for the period	–	–	9,143	–	–	–	–	–	9,143	(8)	9,135
Other comprehensive income (net of tax)	–	–	(376)	(889)	(632)	230	(268)	3	(1,932)	–	(1,932)
Debt instruments at fair value through other comprehensive income	–	–	–	–	311	–	–	–	311	–	311
Equity instruments designated at fair value through other comprehensive income	–	–	–	–	(943)	–	–	–	(943)	–	(943)
Cash flow hedges	–	–	–	–	–	230	–	–	230	–	230
Change in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	–	–	–	–	–	–	–	3	3	–	3
Property revaluation	–	–	–	(889)	–	–	–	–	(889)	–	(889)
Actuarial losses on defined benefit plans	–	–	(376)	–	–	–	–	–	(376)	–	(376)
Exchange differences and others	–	–	–	–	–	–	(268)	–	(268)	–	(268)
Total comprehensive income for the period	–	–	8,767	(889)	(632)	230	(268)	3	7,211	(8)	7,203
Dividends paid	–	–	(9,750)	–	–	–	–	–	(9,750)	–	(9,750)
Coupons paid on AT1 capital instruments	–	–	(279)	–	–	–	–	–	(279)	–	(279)
Movement in respect of share-based payment arrangements	–	–	8	–	–	–	–	19	27	–	27
Others	–	–	–	–	–	–	–	–	–	(3)	(3)
Transfers	–	–	337	(337)	–	–	–	–	–	–	–
At 30 June 2020	9,658	11,744	132,817	18,663	2,664	246	(464)	691	176,019	96	176,115
At 1 July 2020	9,658	11,744	132,817	18,663	2,664	246	(464)	691	176,019	96	176,115
Profit for the period	–	–	7,544	–	–	–	–	–	7,544	(9)	7,535
Other comprehensive income (net of tax)	–	–	368	(382)	1,893	14	1,122	(4)	3,011	–	3,011
Debt instruments at fair value through other comprehensive income	–	–	–	–	(220)	–	–	–	(220)	–	(220)
Equity instruments designated at fair value through other comprehensive income	–	–	–	–	2,113	–	–	–	2,113	–	2,113
Cash flow hedges	–	–	–	–	–	14	–	–	14	–	14
Change in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	–	–	–	–	–	–	–	(4)	(4)	–	(4)
Property revaluation	–	–	–	(382)	–	–	–	–	(382)	–	(382)
Actuarial gains on defined benefit plans	–	–	368	–	–	–	–	–	368	–	368
Exchange differences and others	–	–	–	–	–	–	1,122	–	1,122	–	1,122
Total comprehensive income for the period	–	–	7,912	(382)	1,893	14	1,122	(4)	10,555	(9)	10,546
Dividends paid	–	–	(3,058)	–	–	–	–	–	(3,058)	–	(3,058)
Coupons paid on AT1 capital instruments	–	–	(421)	–	–	–	–	–	(421)	–	(421)
Movement in respect of share-based payment arrangements	–	–	9	–	–	–	–	(4)	5	–	5
Others	–	–	–	–	–	–	–	–	–	8	8
Transfers	–	–	321	(321)	–	–	–	–	–	–	–
At 31 December 2020	9,658	11,744	137,580	17,960	4,557	260	658	683	183,100	95	183,195

The notes on pages 62 to 91 form part of these Condensed Consolidated Financial Statements.

(Expressed in millions of Hong Kong dollars)

Condensed Consolidated Cash Flow Statement

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
Profit before tax	**10,298**	10,619
Adjustments for non-cash items:		
Depreciation and amortisation	**1,240**	1,170
Net interest income	**(11,883)**	(14,792)
Dividend income	**(5)**	(6)
Gains less losses from financial investments	**(148)**	(20)
Share of (profits)/losses in associates	**(36)**	87
Net (surplus)/deficit on property revaluation	**(39)**	428
Change in expected credit losses and other credit impairment charges	**339**	1,760
Impairment loss on intangible assets	**10**	–
Loans and advances written off net of recoveries	**(341)**	(403)
Movement in present value of in-force long-term insurance business ('PVIF')	**(131)**	(2,106)
Interest received	**13,958**	19,740
Interest paid	**(2,241)**	(5,855)
Elimination of exchange differences and other non-cash items	**2,536**	(94)
Changes in operating assets and liabilities		
Change in trading assets	**4,818**	11,367
Change in derivative financial instruments	**(3,885)**	652
Change in financial assets designated and otherwise mandatorily measured at fair value through profit or loss	**(5,088)**	3,985
Change in reverse repurchase agreements – non-trading maturing after one month	**2,917**	(1,480)
Change in placings with and advances to banks maturing after one month	**(21,759)**	(7,228)
Change in loans and advances to customers	**(70,447)**	(14,480)
Change in other assets	**4,560**	3,796
Change in repurchase agreements – non-trading	**14,135**	1,259
Change in deposits from banks	**9,253**	1,466
Change in current, savings and other deposit accounts	**(19,034)**	37,698
Change in trading liabilities	**(3,443)**	(9,602)
Change in financial liabilities designated at fair value	**3,279**	1,097
Change in certificates of deposit and other debt securities in issue	**16,918**	13,439
Change in other liabilities	**(620)**	607
Change in liabilities under insurance contracts	**5,795**	4,389
Dividends received from financial investments	**6**	(4)
Tax paid	**(806)**	(4,194)
Net cash from operating activities	**(49,844)**	53,295
Purchase of financial investments	**(361,479)**	(341,172)
Proceeds from sale or redemption of financial investments	**390,200**	295,279
Purchase of property, plant and equipment and intangible assets (excluding PVIF)	**(854)**	(956)
Net cash inflow from the sales of loan portfolio	**1,812**	2,920
Net cash from investing activities	**29,679**	(43,929)
Interest paid for subordinated liabilities	**(172)**	(327)
Principal and interest elements of lease payments	**(297)**	(305)
Dividends paid	**(7,456)**	(9,750)
Coupons paid on AT1 capital instruments	**(280)**	(279)
Net cash from financing activities	**(8,205)**	(10,661)
Net decrease in cash and cash equivalents	**(28,370)**	(1,295)
Cash and cash equivalents at 1 January	**109,615**	92,702
Exchange differences in respect of cash and cash equivalents	**(365)**	(1,279)
Cash and cash equivalents at 30 June	**80,880**	90,128

The notes on pages 62 to 91 form part of these Condensed Consolidated Financial Statements.

Condensed Consolidated Cash Flow Statement *(continued)*

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
Cash and cash equivalents comprise[1]:		
– cash and balances at central banks	**12,283**	8,801
– balances with banks	**6,376**	7,059
– items in the course of collection from other banks	**7,491**	10,646
– placings with and advances to banks maturing within one month	**25,833**	31,798
– reverse repurchase agreements with banks maturing within one month	**8,699**	5,290
– treasury bills	**31,143**	39,597
– net settlement accounts with banks and cash collateral to banks within one month	**15,521**	(5,956)
– less: items in the course of transmission to other banks	**(26,466)**	(7,107)
	80,880	90,128

1 *At 30 June 2021, the amount of cash and cash equivalents that was not available for use by the Group was HK$13,333m (30 June 2020: HK$13,138m), of which HK$10,009m (30 June 2020: HK$8,992m) was related to mandatory deposits at central banks.*

The notes on pages 62 to 91 form part of these Condensed Consolidated Financial Statements.

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

1 Basis of preparation

The Condensed Consolidated Financial Statements of Hang Seng Bank Limited ('the Bank') and all its subsidiaries ('the Group') have been prepared in accordance with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and in compliance with Hong Kong Accounting Standard ('HKAS') 34, Interim Financial Reporting, issued by the Hong Kong Institute of Certified Public Accountants ('HKICPA'). The Condensed Consolidated Financial Statements were reviewed by the Audit Committee. The Board of Directors of the Bank has approved the Condensed Consolidated Financial Statements on 2 August 2021.

The Condensed Consolidated Financial Statements should be read in conjunction with the consolidated financial statements for the year ended 31 December 2020, which have been prepared in accordance with Hong Kong Financial Reporting Standard ('HKFRS').

The preparation of the Condensed Consolidated Financial Statements in conformity with HKAS 34 requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses on a year to date basis. Actual results may differ from these estimates. In preparing the Condensed Consolidated Financial Statements, the significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements for the year ended 31 December 2020, except those mentioned in 'Use of estimates and judgments' in note 2.

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

– Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers, including loan commitments and financial guarantees; and

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

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

The Condensed Consolidated Financial Statements are unaudited, but has been reviewed by PricewaterhouseCoopers ('PwC') in accordance with Hong Kong Standard on Review Engagements 2410, Review of Interim Financial Information Performed by the Independent Auditor of the Entity, issued by HKICPA. PwC's independent review report to the Board of Directors is included on page 92.

2 Accounting policies

Except as described below, the accounting policies applied in preparing this Condensed Consolidated Financial Statements are the same as those applied in preparing the consolidated financial statements for the year ended 31 December 2020, as disclosed in the Annual Report for 2020.

Standards applied during the half-year ended 30 June 2021

There were no new standards or amendments to standards that had a material effect on these interim Condensed Consolidated Financial Statements.

Future accounting developments

HKFRS 17 'Insurance contracts' was issued in January 2018 with amendments to the standard issued in October 2020. The standard sets out the requirements that an entity should apply in accounting for insurance contracts it issues and reinsurance contracts it holds. Following the amendments, HKFRS 17 will be effective from 1 January 2023. The Group is in the process of implementing HKFRS 17. Industry practice and interpretation of the standard is still developing. Therefore, the likely impact of its implementation remains uncertain. However, compared with the Group's current accounting policy for insurance, there will be no PVIF asset recognised; rather the estimated future profit will be included in the measurement of the insurance contract liability as the contractual service margin and gradually recognised in revenue as services are provided over the duration of the insurance contract.

Use of estimates and judgements

Management believes that the Group's critical accounting estimates and judgements are those which related to impairment of amortised cost and fair value through other comprehensive income ('FVOCI') debt financial assets, the valuation of financial instruments, the provisions for liabilities, interest in associates and the present value of in-force long-term insurance business. There was no major change in the current period to the critical accounting estimates and judgements applied in 2020, which are stated in note 1 of the Annual Report 2020. However, the level of estimated uncertainty and judgement for the calculation of expected credit losses ('ECL') remained significant since 31 December 2020 as a result of the economic effects of the COVID-19 outbreak as set out in 'Measurement uncertainty and sensitivity analysis of ECL estimates' on pages 27 to 34.

3 Basis of consolidation

These Condensed Consolidated Financial Statements cover the consolidated position of the Group, unless otherwise stated, and include the attributable share of the results and reserves of its associates. For regulatory reporting, the basis of consolidation is different from the basis of consolidation for accounting purposes. They are disclosed under the 'Risk and Capital Management' section.

4 Interest income

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
Interest income arising from:		
– financial assets that are not at fair value through profit and loss	**13,945**	20,020
– trading assets	**213**	385
– financial assets designated and otherwise mandatorily measured at fair value through profit or loss	**16**	23
	14,174	20,428
of which:		
– interest income from impaired financial assets	**18**	1

5 Interest expense

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
Interest expense arising from:		
– financial liabilities that are not at fair value through profit and loss	**1,602**	4,852
– trading liabilities	**156**	266
– financial liabilities designated at fair value	**533**	518
	2,291	5,636
of which:		
– interest expense from subordinated liabilities	**169**	308

6 Net fee income

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
– securities broking and related services	**1,225**	978
– retail investment funds	**903**	656
– insurance	**264**	317
– account services	**185**	191
– remittances	**128**	147
– cards	**1,250**	1,132
– credit facilities	**429**	377
– trade services	**183**	183
– other	**326**	227
Fee income	**4,893**	4,208
Fee expense	**(1,184)**	(1,033)
	3,709	3,175
of which:		
Net fee income on financial assets that are not at fair value through profit or loss (other than amounts included in determining the effective interest rate)	**988**	962
– fee income	**2,044**	1,877
– fee expense	**(1,056)**	(915)
Net fee income on trust and other fiduciary activities where the Group holds or invests on behalf of its customers	**528**	469
– fee income	**580**	510
– fee expense	**(52)**	(41)

7 Net income/(loss) from financial instruments measured at fair value through profit or loss

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
Net trading income	**914**	487
– trading income	**919**	483
– other trading income/(expense) from ineffective fair value hedges	**(5)**	4
Net income/(expense) from financial instruments designated at fair value through profit or loss	**(50)**	750
Net income/(expense) from assets and liabilities of insurance businesses measured at fair value through profit or loss	**1,821**	(1,284)
– financial assets held to meet liabilities under insurance and investment contracts	**1,834**	(1,286)
– liabilities to customers under investment contracts	**(13)**	2
Changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss	**–**	(5)
	2,685	(52)

8 Gains less losses from financial investments

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
Net gains from disposal of debt securities measured at amortised cost	**61**	–
Net gains from disposal of debt securities measured at fair value through other comprehensive income	**87**	20
	148	20

9 Dividend income

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
Dividend income:		
– listed investments	**–**	–
– unlisted investments	**5**	6
	5	6

10 Other operating income

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
Rental income from investment properties	**132**	139
Movement in present value of in-force long-term insurance business	**131**	2,106
Net losses from disposal of fixed assets	**(10)**	(6)
Net gains/(losses) from the derecognition of loans and advances to customers measured at amortised cost	**6**	(1)
Others	**146**	(91)
	405	2,147

11 Change in expected credit losses and other credit impairment charges

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
Loans and advances to banks and customers	**319**	1,456
– new allowances net of allowance releases	**372**	1,484
– recoveries of amounts previously written off	**(78)**	(42)
– other movements	**25**	14
Loan commitments and guarantees	**(84)**	53
Other financial assets	**104**	251
	339	1,760

12 Operating expenses

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
Employee compensation and benefits:		
– salaries and other costs	**2,917**	2,846
– retirement benefit costs		
– defined benefit scheme	**84**	90
– defined contribution scheme	**164**	154
	3,165	3,090
General and administrative expenses:		
– rental expenses	**6**	11
– other premises and equipment	**856**	785
– marketing and advertising expenses	**131**	97
– other operating expenses	**1,356**	1,140
	2,349	2,033
Depreciation of premises, plant and equipment (note 25)	**744**	746
Depreciation of right-of-use assets	**286**	293
Amortisation of intangible assets	**210**	131
	6,754	6,293

13 Tax expense

Taxation in the Condensed Consolidated Income Statement represents:

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
Current tax – provision for Hong Kong profits tax		
– Tax for the period	**1,406**	1,380
– Adjustment in respect of prior periods	**2**	–
Current tax – taxation outside Hong Kong		
– Tax for the period	**45**	15
– Adjustment in respect of prior periods	**(7)**	–
Deferred tax		
– Origination and reversal of temporary differences	**91**	89
Total tax expense	**1,537**	1,484

13 Tax expense *(continued)*

The current tax provision is based on the estimated assessable profit for the first half of 2021, 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 (2020: 16.5 per cent). For subsidiaries and branches operating in other jurisdictions, the appropriate tax rates prevailing in the relevant countries are used. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised.

14 Earnings per share – basic and diluted

The calculation of basic and diluted earnings per share for the first half of 2021 is based on earnings of HK$8,487m (HK$8,864m for the first half of 2020), adjusted for the AT1 capital instrument related deductions and on the weighted average number of ordinary shares in issue of 1,911,842,736 shares (unchanged from 2020).

15 Dividends/Distributions

(a) Dividends to ordinary shareholders

	Half-year ended 30 June 2021		*Half-year ended 30 June 2020*	
	per share HK$	**HK$m**	*per share HK$*	*HK$m*
First interim	**1.10**	**2,103**	1.10	2,103
Second interim	**1.10**	**2,103**	0.80	1,529
	2.20	**4,206**	1.90	3,632

On 2 August 2021, the Directors of the Bank declared a second interim dividend in respect of the year ending 31 December 2021 of HK$1.10 per ordinary share (HK$2,103m). This distribution will be paid on 2 September 2021. No liability is recognised in the Condensed Consolidated Financial Statements in respect of this dividend.

(b) Distributions to holders of AT1 capital instruments classified as equity

	Half-year ended 30 June 2021	*Half-year ended 30 June 2020*
US$600 million Fixed to floating rate perpetual capital instrument (coupon rate at 6.0 per cent and then three-month US dollar LIBOR plus 4.06 per cent from the first call date)	**280**	279
	280	279

16 Segmental analysis

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

– **Wealth and Personal Banking** offers a broad range of products and services to meet the personal banking, consumer lending and wealth management needs of individual customers. Personal banking products typically include current and savings accounts, time deposits, mortgages and personal loans, credit cards, insurance and wealth management;

– **Commercial Banking** offers a comprehensive suite of products and services to corporate, commercial and small and medium-sized enterprises ('SME') customers – including corporate lending, trade and receivable finance, payments and cash management, treasury and foreign exchange, general insurance, key-person insurance, investment services and corporate wealth management;

– **Global Banking and Markets** provides tailored financial solutions to major corporate and institutional clients. Undertaking a long-term relationships management approach, its services include general banking, corporate lending, interest rates, foreign exchange, money markets, structured products and derivatives, etc. Global Banking and Markets also manages the funding and liquidity positions of the Bank and other market risk positions arising from banking activities;

– **Other** mainly represents the Bank's holdings of premises apart from outlets dedicated for Wealth and Personal Banking, investment properties, equity shares and subordinated debt funding as well as central support and functional costs with associated recoveries.

16 Segmental analysis *(continued)*

(a) Segmental result

For the purpose of segmental analysis, the allocation of revenue reflects the benefits of capital and other funding resources allocated to the business segments by way of internal capital allocation and fund transfer-pricing mechanisms. Cost of central support services and functions are allocated to business segments based on cost drivers which reflect or correlate with the use of services. Bank-owned premises apart from outlets dedicated for Wealth and Personal Banking are reported under the 'Other' segment. When these premises are utilised by business segments, notional rent will be charged to the relevant business segments with reference to market rates.

	Wealth and Personal Banking	*Commercial Banking*	*Global Banking and Markets*	*Other*[1]	*Total*
Half-year ended 30 June 2021					
Net interest income/(expense)	6,531	3,495	2,029	(172)	11,883
Net fee income	2,545	859	175	130	3,709
Net income from financial instruments measured at fair value through profit or loss	2,051	188	414	32	2,685
Gains less losses from financial investments	57	4	87	–	148
Dividend income	–	–	–	5	5
Net insurance premium income	5,994	804	–	–	6,798
Other operating income	274	12	–	119	405
Total operating income	17,452	5,362	2,705	114	25,633
Net insurance claims and benefits paid and movement in liabilities to policyholders	(7,557)	(750)	–	–	(8,307)
Net operating income before change in expected credit losses and other credit impairment charges	9,895	4,612	2,705	114	17,326
Change in expected credit losses and other credit impairment charges	(226)	(188)	75	–	(339)
Net operating income	9,669	4,424	2,780	114	16,987
Operating expenses*	(4,128)	(1,644)	(603)	(379)	(6,754)
Impairment loss on intangible assets	–	–	–	(10)	(10)
Operating profit/(loss)	5,541	2,780	2,177	(275)	10,223
Net surplus on property revaluation	–	–	–	39	39
Share of profits of associates	36	–	–	–	36
Profit/(loss) before tax	5,577	2,780	2,177	(236)	10,298
Share of profit/(loss) before tax	54.2%	27.0%	21.1%	(2.3)%	100.0%
Operating profit/(loss) excluding change in expected credit losses and other credit impairment charges	5,767	2,968	2,102	(275)	10,562
** Depreciation/amortisation included in operating expenses*	(410)	(6)	(2)	(822)	(1,240)
At 30 June 2021					
Total assets	578,028	433,372	787,623	1,192	1,800,215
Total liabilities	1,025,634	335,777	250,123	4,914	1,616,448
Interest in associates	2,351	–	–	–	2,351

16 Segmental analysis *(continued)*

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

	Wealth and Personal Banking	*Commercial Banking*	*Global Banking and Markets*	*Other*[1]	*Total*
Half-year ended 30 June 2021					
Net fee income by segment					
– securities broking and related services	1,110	99	16	–	1,225
– retail investment funds	885	18	–	–	903
– insurance	176	49	39	–	264
– account services	119	62	4	–	185
– remittances	28	83	17	–	128
– cards	1,239	11	–	–	1,250
– credit facilities	9	313	107	–	429
– trade services	–	170	13	–	183
– other	107	66	27	126	326
Fee income	3,673	871	223	126	4,893
Fee expense	(1,128)	(12)	(48)	4	(1,184)
Net fee income	2,545	859	175	130	3,709

1 *Including inter-segment elimination, of which total assets amounted to HK$75.3bn (31 December 2020: HK$62.2bn) and total liabilities amounted to HK$64.1bn (31 December 2020: HK$51.1bn).*

16 Segmental analysis *(continued)*

(a) Segmental result *(continued)*

	Wealth and Personal Banking	Commercial Banking	Global Banking and Markets	Other[2]	Total
Half-year ended 30 June 2020 (restated)[1]					
Net interest income/(expense)	8,119	4,514	2,415	(256)	14,792
Net fee income	2,088	827	135	125	3,175
Net income/(loss) from financial instruments measured at fair value through profit or loss	(939)	128	788	(29)	(52)
Gains less losses from financial investments	–	–	20	–	20
Dividend income	–	–	–	6	6
Net insurance premium income	6,279	892	–	–	7,171
Other operating income/(loss)	2,054	(17)	3	107	2,147
Total operating income/(loss)	17,601	6,344	3,361	(47)	27,259
Net insurance claims and benefits paid and movement in liabilities to policyholders	(7,338)	(734)	–	–	(8,072)
Net operating income/(loss) before change in expected credit losses and other credit impairment charges	10,263	5,610	3,361	(47)	19,187
Change in expected credit losses and other credit impairment charges	(740)	(821)	(199)	–	(1,760)
Net operating income/(loss)	9,523	4,789	3,162	(47)	17,427
Operating expenses *	(3,945)	(1,581)	(519)	(248)	(6,293)
Operating profit/(loss)	5,578	3,208	2,643	(295)	11,134
Net deficit on property revaluation	–	–	–	(428)	(428)
Share of profits/(losses) of associates	(89)	–	–	2	(87)
Profit/(loss) before tax	5,489	3,208	2,643	(721)	10,619
Share of profit/(loss) before tax	51.7%	30.2%	24.9%	(6.8)%	100.0%
Operating profit/(loss) excluding change in expected credit losses and other credit impairment charges	6,318	4,029	2,842	(295)	12,894
** Depreciation/amortisation included in operating expenses*	(424)	(3)	(1)	(742)	(1,170)
At 31 December 2020 (restated)[1]					
Total assets	556,503	404,157	785,858	13,269	1,759,787
Total liabilities	1,037,041	323,783	217,188	(1,420)	1,576,592
Interest in associates	2,358	–	–	–	2,358

16 Segmental analysis *(continued)*

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

	Wealth and Personal Banking	*Commercial Banking*	*Global Banking and Markets*	*Other*[2]	*Total*
Half-year ended 30 June 2020 (restated)[1]					
Net fee income by segment					
– securities broking and related services	857	109	12	–	978
– retail investment funds	645	11	–	–	656
– insurance	243	40	34	–	317
– account services	113	75	3	–	191
– remittances	32	98	17	–	147
– cards	1,122	10	–	–	1,132
– credit facilities	12	296	69	–	377
– trade services	–	160	23	–	183
– other	43	42	20	122	227
Fee income	3,067	841	178	122	4,208
Fee expense	(979)	(14)	(43)	3	(1,033)
Net fee income	2,088	827	135	125	3,175

1 *To better reflect the change of business model on card acquiring business and retail branches operation, management has made the decision to realign these functions within respective business segments during the period. Comparative figures have been re-presented to conform with current period's presentation.*

2 *Including inter-segment elimination, of which total assets amounted to HK$62.2bn and total liabilities amounted to HK$51.1bn.*

16 Segmental analysis *(continued)*

(b) Information by geographical region

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

	Hong Kong	Mainland China	Others	Inter-region elimination	Total
Half-year ended 30 June 2021					
Total operating income/(loss)	**24,007**	**1,503**	**139**	**(16)**	**25,633**
Profit before tax	**9,420**	**786**	**92**	**–**	**10,298**
At 30 June 2021					
Total assets	**1,695,315**	**155,388**	**23,985**	**(74,473)**	**1,800,215**
Total liabilities	**1,519,357**	**139,212**	**22,582**	**(64,703)**	**1,616,448**
Equity	**175,958**	**16,176**	**1,403**	**(9,770)**	**183,767**
Share capital	**9,658**	**10,772**	**–**	**(10,772)**	**9,658**
Interest in associates	**2,351**	**–**	**–**	**–**	**2,351**
Non-current assets*	**63,939**	**1,568**	**56**	**–**	**65,563**
Half-year ended 30 June 2020					
Total operating income/(loss)	25,753	1,390	144	(28)	27,259
Profit before tax	10,007	522	90	–	10,619
At 31 December 2020					
Total assets	1,648,014	149,586	23,420	(61,233)	1,759,787
Total liabilities	1,471,529	134,424	22,102	(51,463)	1,576,592
Equity	176,485	15,162	1,318	(9,770)	183,195
Share capital	9,658	10,632	–	(10,632)	9,658
Interest in associates	2,358	–	–	–	2,358
Non-current assets*	63,465	1,544	64	–	65,073

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

17 Cash and balances at central banks

	At 30 June 2021	*At 31 December 2020*
Cash in hand	**6,630**	6,937
Balances at central banks	**5,653**	4,289
	12,283	11,226

18 Trading assets

	At 30 June 2021	*At 31 December 2020*
Treasury bills	**10,131**	16,533
Other debt securities	**22,121**	20,539
Debt securities	**32,252**	37,072
Investment funds/equity shares	**47**	45
	32,299	37,117

19 Derivative financial instruments

Use of derivatives

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

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

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

	Notional contract amount			***Fair value – Assets***			***Fair value – Liabilities***		
	Trading	***Hedging***	***Total***	***Trading***	***Hedging***	***Total***	***Trading***	***Hedging***	***Total***
Exchange rate	**1,157,580**	**20,586**	**1,178,166**	**8,167**	**534**	**8,701**	**8,018**	**113**	**8,131**
Interest rate	**582,029**	**45,043**	**627,072**	**3,506**	**183**	**3,689**	**3,523**	**692**	**4,215**
Equity and other	**28,089**	**–**	**28,089**	**595**	**–**	**595**	**434**	**–**	**434**
At 30 June 2021	**1,767,698**	**65,629**	**1,833,327**	**12,268**	**717**	**12,985**	**11,975**	**805**	**12,780**

	Notional contract amount			*Fair value – Assets*			*Fair value – Liabilities*		
	Trading	*Hedging*	*Total*	*Trading*	*Hedging*	*Total*	*Trading*	*Hedging*	*Total*
Exchange rate	1,010,478	29,851	1,040,329	11,833	14	11,847	13,791	704	14,495
Interest rate	532,761	62,932	595,693	4,653	164	4,817	4,663	1,351	6,014
Equity and other	33,863	–	33,863	517	–	517	352	–	352
At 31 December 2020	1,577,102	92,783	1,669,885	17,003	178	17,181	18,806	2,055	20,861

20 Financial assets designated and otherwise mandatorily measured at fair value through profit or loss

	At 30 June 2021	*At 31 December 2020*
Debt securities	**–**	2
Equity shares	**4,252**	4,253
Investment funds	**20,460**	15,158
Other	**1,071**	1,282
	25,783	20,695

21 Placings with and advances to banks

	At 30 June 2021	*At 31 December 2020*
Balances with banks	**6,376**	6,039
Placings with and advances to banks maturing within one month	**25,833**	30,494
Placings with and advances to banks maturing after one month but less than one year	**23,274**	1,531
Placings with and advances to banks maturing after one year	**6,309**	6,293
Less: Expected credit losses	**(1)**	–
	61,791	44,357
of which:		
Placings with and advances to central banks	**9,256**	13,216

22 Loans and advances to customers

	At 30 June 2021	*At 31 December 2020*
Gross loans and advances to customers	**1,018,595**	949,954
Less: Expected credit losses	**(5,132)**	(5,180)
	1,013,463	944,774
	%	*%*
Expected credit losses as a percentage of gross loans and advances to customers	**0.50**	0.55
Gross impaired loans and advances	**7,011**	5,724
	%	*%*
Gross impaired loans and advances as a percentage of gross loans and advances to customers	**0.69**	0.60

23 Financial investments

	At 30 June 2021	At 31 December 2020
Financial investments measured at fair value through other comprehensive income		
– treasury bills	**218,697**	268,031
– debt securities	**131,544**	144,814
– equity shares	**5,714**	7,051
	355,955	419,896
Debt instruments measured at amortised cost		
– treasury bills	**3,502**	3,667
– debt securities	**140,036**	131,330
Less: Expected credit losses	**(257)**	(173)
	143,281	134,824
	499,236	554,720

There were no overdue financial investments at 30 June 2021 and 31 December 2020 for the Group. The Group did not hold any asset-backed securities, mortgage-backed securities and collateralised debt obligations.

24 Interest in associates

	At 30 June 2021	At 31 December 2020
Share of net assets	**2,351**	2,358

25 Property, plant and equipment

	At 30 June 2021	At 31 December 2020
Premises	**26,763**	26,898
Plant and equipment[1]	**1,971**	1,944
Other right of use assets	**1,832**	2,083
Premises, plant and equipment	**30,566**	30,925
Investment properties	**9,808**	9,415
	40,374	40,340

1 *Includes leasehold land and building assets for which the rights of use are considered sufficient to constitute control and for which there are insignificant lease liabilities. They are therefore presented as owned assets.*

25 Property, plant and equipment *(continued)*

Movement in owned property, plant and equipment

	Premises	*Investment properties*	*Plant and equipment*	*Total*
Cost or valuation:				
At 1 January 2021	**26,898**	**9,415**	**3,982**	**40,295**
Additions	23	2	287	312
Disposals and write-offs	–	–	(81)	(81)
Elimination of accumulated depreciation on revalued premises	(492)	–	–	(492)
Surplus on revaluation:				
– credited to premises revaluation reserve	648	–	–	648
– credited to income statement	–	65	–	65
Transfer	(326)	326	–	–
Exchange adjustments and other	12	–	5	17
At 30 June 2021	**26,763**	**9,808**	**4,193**	**40,764**
Accumulated depreciation:				
At 1 January 2021	–	–	(2,038)	(2,038)
Charge for the period (note 12)	(492)	–	(252)	(744)
Attributable to assets sold or written off	–	–	71	71
Elimination of accumulated depreciation on revalued premises	492	–	–	492
Exchange adjustments and other	–	–	(3)	(3)
At 30 June 2021	–	–	(2,222)	(2,222)
Net book value at 30 June 2021	**26,763**	**9,808**	**1,971**	**38,542**
Representing:				
– measure at cost	–	–	1,971	1,971
– measure at valuation	26,763	9,808	–	36,571
	26,763	9,808	1,971	38,542

25 Property, plant and equipment *(continued)*

Movement in owned property, plant and equipment *(continued)*

	Premises	*Investment properties*	*Plant and equipment*	*Total*
Cost or valuation:				
At 1 January 2020	29,498	10,121	5,919	45,538
Additions	6	14	620	640
Disposals and write-offs	–	–	(2,785)	(2,785)
Elimination of accumulated depreciation on revalued premises	(526)	–	–	(526)
Deficit on revaluation:				
– debited to premises revaluation reserve	(1,061)	–	–	(1,061)
– debited to income statement	–	(597)	–	(597)
Transfer	(107)	107	–	–
Exchange adjustments and other	(19)	–	(9)	(28)
At 30 June 2020	27,791	9,645	3,745	41,181
Accumulated depreciation:				
At 1 January 2020	–	–	(4,514)	(4,514)
Charge for the period (note 12)	(526)	–	(220)	(746)
Attributable to assets sold or written off	–	–	2,778	2,778
Elimination of accumulated depreciation on revalued premises	526	–	–	526
Exchange adjustments and other	–	–	3	3
At 30 June 2020	–	–	(1,953)	(1,953)
Net book value at 30 June 2020	27,791	9,645	1,792	39,228
Representing:				
– measure at cost	–	–	1,792	1,792
– measure at valuation	27,791	9,645	–	37,436
	27,791	9,645	1,792	39,228

25 Property, plant and equipment *(continued)*

Movement in owned property, plant and equipment *(continued)*

	Premises	*Investment properties*	*Plant and equipment*	*Total*
Cost or valuation:				
At 1 July 2020	27,791	9,645	3,745	41,181
Additions	78	7	397	482
Disposals and write-offs	–	–	(189)	(189)
Elimination of accumulated depreciation on revalued premises	(507)	–	–	(507)
Deficit on revaluation:				
– debited to premises revaluation reserve	(481)	–	–	(481)
– debited to income statement	–	(295)	–	(295)
Transfer	(58)	58	–	–
Exchange adjustments and other	75	–	29	104
At 31 December 2020	26,898	9,415	3,982	40,295
Accumulated depreciation:				
At 1 July 2020	–	–	(1,953)	(1,953)
Charge for the period	(507)	–	(238)	(745)
Attributable to assets sold or written off	–	–	179	179
Elimination of accumulated depreciation on revalued premises	507	–	–	507
Exchange adjustments and other	–	–	(26)	(26)
At 31 December 2020	–	–	(2,038)	(2,038)
Net book value at 31 December 2020	26,898	9,415	1,944	38,257
Representing:				
– measure at cost	–	–	1,944	1,944
– measure at valuation	26,898	9,415	–	36,313
	26,898	9,415	1,944	38,257

26 Intangible assets

	At 30 June 2021	At 31 December 2020
Present value of in-force long-term insurance business	**22,682**	22,551
Internally developed software	**2,060**	1,737
Acquired software	**118**	116
Goodwill	**329**	329
	25,189	24,733

27 Other assets

	At 30 June 2021	At 31 December 2020
Items in the course of collection from other banks	**7,491**	5,062
Bullion	**8,940**	12,337
Prepayments and accrued income	**4,037**	3,917
Acceptances and endorsements	**10,068**	9,027
Less: Expected credit losses	**(9)**	(14)
Reinsurers' share of liabilities under insurance contracts	**5,902**	5,471
Settlement accounts	**17,719**	4,329
Cash collateral	**2,460**	5,286
Other accounts	**3,120**	3,511
	59,728	48,926

Other accounts included 'Assets held for sale' of HK$39m (31 December 2020: HK$28m). It also included 'Retirement benefit assets' of HK$17m (31 December 2020: HK$7m).

28 Current, savings and other deposit accounts

	At 30 June 2021	At 31 December 2020
Current, savings and other deposit accounts:		
– as stated in Condensed Consolidated Balance Sheet	**1,190,438**	1,209,472
– structured deposits reported as financial liabilities designated as fair value (note 30)	**29,858**	26,840
	1,220,296	1,236,312
By type:		
– demand and current accounts	**152,655**	137,050
– savings accounts	**845,670**	825,547
– time and other deposits	**221,971**	273,715
	1,220,296	1,236,312

29 Trading liabilities

	At 30 June 2021	At 31 December 2020
Short positions in securities	**27,494**	30,937

30 Financial liabilities designated at fair value

	At 30 June 2021	At 31 December 2020
Certificates of deposit in issue (note 31)	**–**	1,516
Structured deposits (note 28)	**29,858**	26,840
Other structured debt securities in issue (note 31)	**5,542**	3,755
Liabilities to customers under investment contracts	**409**	419
	35,809	32,530

At 30 June 2021, the accumulated loss in fair value attributable to changes in own credit risk for financial liabilities designated at fair value was HK$6m (31 December 2020: accumulated loss of HK$6m).

31 Certificates of deposit and other debt securities in issue

	At 30 June 2021	At 31 December 2020
Certificates of deposit and other debt securities in issue:		
– as stated in Condensed Consolidated Balance Sheet	**79,418**	62,500
– certificates of deposit in issue designated at fair value (note 30)	**–**	1,516
– other structured debt securities in issue reported as financial liabilities designated at fair value (note 30)	**5,542**	3,755
	84,960	67,771
By type:		
– certificates of deposit in issue	**79,418**	64,016
– other debt securities in issue	**5,542**	3,755
	84,960	67,771

32 Other liabilities

	At 30 June 2021	At 31 December 2020
Items in the course of transmission to other banks	**26,466**	6,316
Accruals	**2,852**	3,490
Acceptances and endorsements	**10,068**	9,027
Retirement benefit liabilities	**303**	630
Settlement accounts	**4,280**	5,124
Cash collateral	**1,968**	1,060
Lease liabilities	**1,865**	2,102
Other	**3,761**	3,585
	51,563	31,334

33 Subordinated liabilities

Nominal value	Description	At 30 June 2021	At 31 December 2020
HK$5,460 million	Floating rate subordinated loan due May 2028, callable from 2027[1]	**5,460**	5,460
HK$4,680 million	Floating rate subordinated loan due June 2029, callable from 2028[2]	**4,680**	4,680
HK$6,240 million	Floating rate subordinated loan due June 2026, callable from 2025[3]	**6,240**	6,240
US$400 million	Floating rate subordinated loan due June 2030, callable from 2029[4]	**3,106**	3,101
		19,486	19,481
Representing:			
– measured at amortised cost		**19,486**	19,481

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

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

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

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

The Bank has not had any defaults of principal, interest or other breaches with respect to its debt instruments during the first half of 2021 (2020: Nil).

34 Other equity instruments

Nominal value	Description	At 30 June 2021	At 31 December 2020
US$900 million	Fixed to floating rate perpetual capital instrument callable from September 2024[1]	**7,044**	7,044
US$600 million	Fixed to floating rate perpetual capital instrument callable from June 2024[2]	**4,700**	4,700
		11,744	11,744

1 *Coupon rate is 6.03% and then three-month US dollar LIBOR plus 4.02 per cent from the first call date.*

2 *Coupon rate is 6.00% and then three-month US dollar LIBOR plus 4.06 per cent from the first call date.*

The additional tier 1 capital instruments, which are qualified as loss-absorbing capacity, are perpetual and subordinated. The coupon payments of these capital instruments may be cancelled at the sole discretion of the Bank. The capital instruments will be written down at the point of non-viability on the occurrence of a trigger event as defined in the Banking (Capital) Rules. They rank higher than ordinary shares in the event of a winding-up.

35 Contingent liabilities, contractual commitments and guarantees

(a) Off-balance sheet contingent liabilities and commitments

	At 30 June 2021	*At 31 December 2020*
Contingent liabilities and financial guarantee contracts		
Financial guarantees	**2,226**	3,024
Performance and other guarantees	**18,479**	16,774
Other contingent liabilities	**50**	49
	20,755	19,847
Commitments		
Documentary credits and short-term trade-related transactions	**3,110**	3,248
Forward asset purchases and forward forward deposits placed	**8,252**	7,432
Undrawn formal standby facilities, credit lines and other commitments to lend	**487,879**	488,813
	499,241	499,493

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

(b) Contingencies

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

36 Other commitments

Capital commitments

At 30 June 2021, capital commitments, mainly related to the commitment for renovation of branches and offices, were HK$880m (31 December 2020: HK$916m).

37 Material related-party transactions

All related party transactions that took place in the half-year to 30 June 2021 were similar in nature to those disclosed in the 2020 Annual Report. There were no changes in the related party transactions described in the 2020 Annual Report that have had a material effect on the financial position or performance of the Group in the half-year to 30 June 2021.

38 Fair value of financial instruments

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

The accounting policies, control framework and hierarchy used to determine fair values at 30 June 2021 are consistent with those applied for the Annual Report 2020. The following table provides an analysis of financial instruments carried at fair value and bases of valuation:

	Fair value hierarchy					
	Quoted market price Level 1	*Using observable inputs Level 2*	*With significant unobservable inputs Level 3*	*Third party total*	*Amounts with HSBC entities**	*Total*
Recurring fair value measurements						
At 30 June 2021						
Assets						
Trading assets	**29,064**	**3,235**	**–**	**32,299**	**–**	**32,299**
Derivative financial instruments	**291**	**9,454**	**8**	**9,753**	**3,232**	**12,985**
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	**10,222**	**4,073**	**11,488**	**25,783**	**–**	**25,783**
Financial investments	**283,758**	**70,617**	**1,580**	**355,955**	**–**	**355,955**
Liabilities						
Trading liabilities	**27,494**	**–**	**–**	**27,494**	**–**	**27,494**
Derivative financial instruments	**9**	**8,726**	**2**	**8,737**	**4,043**	**12,780**
Financial liabilities designated at fair value	**–**	**29,310**	**6,499**	**35,809**	**–**	**35,809**
At 31 December 2020						
Assets						
Trading assets	33,371	3,746	–	37,117	–	37,117
Derivative financial instruments	295	12,680	3	12,978	4,203	17,181
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	9,903	1,859	8,933	20,695	–	20,695
Financial investments	359,139	57,850	2,907	419,896	–	419,896
Liabilities						
Trading liabilities	30,937	–	–	30,937	–	30,937
Derivative financial instruments	8	14,712	–	14,720	6,141	20,861
Financial liabilities designated at fair value	–	26,828	5,702	32,530	–	32,530

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

38 Fair value of financial instruments *(continued)*

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

Transfers between Level 1 and Level 2 fair values

	Assets				Liabilities		
	Financial Investments	Trading Assets	Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	Derivatives	Trading Liabilities	Financial liabilities designated at fair value	Derivatives
At 30 June 2021							
Transfer from Level 1 to Level 2	**13,756**	**756**	**–**	**–**	**–**	**–**	**–**
Transfer from Level 2 to Level 1	**5,278**	**467**	**–**	**–**	**–**	**–**	**–**
At 31 December 2020							
Transfer from Level 1 to Level 2	8,214	251	–	–	–	–	–
Transfer from Level 2 to Level 1	12,011	664	–	–	–	–	–

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

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

	Assets				Liabilities		
	Financial Investments	Trading Assets	Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	Derivatives	Trading Liabilities	Financial liabilities designated at fair value	Derivatives
At 30 June 2021							
Private equity	**1,580**	**–**	**11,488**	**–**	**–**	**–**	**–**
Structured notes	**–**	**–**	**–**	**–**	**–**	**6,499**	**–**
Derivatives	**–**	**–**	**–**	**8**	**–**	**–**	**2**
	1,580	**–**	**11,488**	**8**	**–**	**6,499**	**2**
At 31 December 2020							
Private equity	2,907	–	8,933	–	–	–	–
Structured notes	–	–	–	–	–	5,702	–
Derivatives	–	–	–	3	–	–	–
	2,907	–	8,933	3	–	5,702	–

38 Fair value of financial instruments *(continued)*

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

Movement in Level 3 financial instruments

	Assets				Liabilities		
	Financial Investments	*Trading Assets*	*Financial assets designated and otherwise mandatorily measured at fair value through profit or loss*	*Derivatives*	*Trading Liabilities*	*Financial liabilities designated at fair value*	*Derivatives*
At 1 January 2021	**2,907**	**–**	**8,933**	**3**	**–**	**5,702**	**–**
Total gains or losses recognised in profit or loss							
– net income from financial instruments measured at fair value through profit or loss	**–**	**–**	**1,171**	**2**	**–**	**17**	**5**
Total gains or losses recognised in other comprehensive income							
– fair value losses	**(1,327)**	**–**	**–**	**–**	**–**	**(1)**	**–**
– exchange differences	**–**	**–**	**–**	**–**	**–**	**38**	**–**
Purchases	**–**	**–**	**1,976**	**–**	**–**	**–**	**–**
Issues/deposit taking	**–**	**–**	**–**	**–**	**–**	**5,772**	**–**
Settlements	**–**	**–**	**(592)**	**–**	**–**	**(5,434)**	**–**
Transfers out	**–**	**–**	**–**	**–**	**–**	**(22)**	**(3)**
Transfers in	**–**	**–**	**–**	**3**	**–**	**427**	**–**
At 30 June 2021	**1,580**	**–**	**11,488**	**8**	**–**	**6,499**	**2**
Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of reporting period							
– net income from financial instruments measured at fair value through profit or loss	**–**	**–**	**1,171**	**8**	**–**	**(37)**	**(2)**

38 Fair value of financial instruments *(continued)*

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

Movement in Level 3 financial instruments (continued)

	Assets				*Liabilities*		
	Financial Investments	*Trading Assets*	*Financial assets designated and otherwise mandatorily measured at fair value through profit or loss*	*Derivatives*	*Trading Liabilities*	*Financial liabilities designated at fair value*	*Derivatives*
At 1 January 2020	2,179	–	5,509	3	–	7,741	–
Total gains or losses recognised in profit or loss							
– net income from financial instruments measured at fair value through profit or loss	–	–	(122)	5	–	–	5
Total gains or losses recognised in other comprehensive income							
– fair value losses	(137)	–	–	–	–	–	–
– exchange differences	–	–	–	–	–	–	–
Purchases	–	–	1,142	–	–	–	–
Issues/deposit taking	–	–	–	–	–	5,464	–
Settlements	–	–	(217)	–	–	(8,923)	–
Transfers out	–	–	–	(7)	–	(353)	(5)
Transfers in	–	–	–	–	–	–	–
At 30 June 2020	2,042	–	6,312	1	–	3,929	–
Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of reporting period							
– net income from financial instruments measured at fair value through profit or loss	–	–	(120)	1	–	1	–

38 Fair value of financial instruments *(continued)*

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

Movement in Level 3 financial instruments (continued)

	Assets				Liabilities		
	Financial Investments	*Trading Assets*	*Financial assets designated and otherwise mandatorily measured at fair value through profit or loss*	*Derivatives*	*Trading Liabilities*	*Financial liabilities designated at fair value*	*Derivatives*
At 1 July 2020	2,042	–	6,312	1	–	3,929	–
Total gains or losses recognised in profit or loss							
– net income from financial instruments measured at fair value through profit or loss	–	–	734	4	–	(17)	–
Total gains or losses recognised in other comprehensive income							
– fair value gains	865	–	–	–	–	2	–
– exchange differences	–	–	–	–	–	132	–
Purchases	–	–	2,102	–	–	–	–
Issues/deposit taking	–	–	–	–	–	7,125	–
Settlements	–	–	(215)	–	–	(6,573)	–
Transfers out	–	–	–	(2)	–	(223)	–
Transfers in	–	–	–	–	–	1,327	–
At 31 December 2020	2,907	–	8,933	3	–	5,702	–
Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of reporting period							
– net income from financial instruments measured at fair value through profit or loss	–	–	650	2	–	(51)	–

For the first half of 2021, the transfer in of Level 3 derivative assets and transfer out of Level 3 derivatives liabilities were predominantly resulted from change in observability of equity volatilities and stock correlation. The transfer in/out of Level 3 financial liabilities designated at fair value reflected the change in observability of FX and equity volatilities for pricing the instrument.

38 Fair value of financial instruments *(continued)*

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

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

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

Favourable and unfavourable changes are determined on the basis of sensitivity analysis. The sensitivity analysis aims to measure a range of fair values consistent with the application of a 95% confidence interval. Methodologies take into account of the nature of the valuation technique employed, the availability and reliability of observable proxies and historical data. When the available data is not amenable to statistical analysis, the quantification of uncertainty is judgemental, but remains guided by the 95% confidence interval. The sensitivity of Level 3 fair values to reasonably possible alternative assumptions is not significant.

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

	Reflected in profit or loss		***Reflected in other comprehensive income***	
	Favourable changes	***Unfavourable changes***	***Favourable changes***	***Unfavourable changes***
At 30 June 2021				
Private equity	**574**	**(574)**	**79**	**(79)**
Derivatives	**–**	**–**	**–**	**–**
	574	**(574)**	**79**	**(79)**
At 31 December 2020				
Private equity	447	(447)	145	(145)
Derivatives	–	–	–	–
	447	(447)	145	(145)

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

38 Fair value of financial instruments *(continued)*

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

Key unobservable inputs to Level 3 financial instruments

Quantitative information about significant unobservable inputs in Level 3 valuations

	Valuation technique(s)	*Unobservable input(s)*	*Range*
Assets			
Private equity	Net asset value	N/A	**N/A**
	Market-comparable approach	Earnings Multiple	**32 – 58** (31 Dec 2020: 31 – 53)
		P/B ratios	**0.33 – 1.90** (31 Dec 2020: 0.35 – 2.20)
		Liquidity Discount	**10% – 60%** (31 Dec 2020: 10% – 60%)
Derivatives	Option model	Equity Volatility	**22.67% – 41.80%** (31 Dec 2020: 29.07% – 57.94%)
Liabilities			
Structured notes	Option model	Equity Volatility	**6.89% – 23.87%** (31 Dec 2020: 6.89% – 30.67%)
		FX Volatility	**5.36% – 11.25%** (31 Dec 2020: 6.05% – 22.68%)

The table above lists the key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 30 June 2021. Detailed description of the categories of key unobservable inputs are set out in note 51 (a) of the Group's Annual Report 2020.

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

The following table provides an analysis of the fair value of financial instruments not measured at fair value on the Condensed Consolidated Balance Sheet. For all other instruments, the fair value is equal to the carrying value.

	At 30 June 2021		*At 31 December 2020*	
	Carrying Amounts	***Fair Value***	*Carrying Amounts*	*Fair Value*
				(restated)
Financial Assets				
Reverse repurchase agreements – non-trading	**14,733**	**14,733**	13,360	13,354
Placings with and advances to banks	**61,791**	**61,791**	44,357	44,325
Loans and advances to customers	**1,013,463**	**1,011,784**	944,774	939,957
Financial investments – at amortised cost	**143,281**	**151,823**	134,824	146,275
Financial Liabilities				
Deposits from banks	**22,196**	**22,196**	12,943	12,943
Repurchase agreements – non-trading	**20,405**	**20,404**	6,270	6,270
Current, savings and other deposit accounts	**1,190,438**	**1,190,469**	1,209,472	1,209,501
Certificates of deposit and other debt securities in issue	**79,418**	**79,434**	62,500	62,539
Subordinated liabilities	**19,486**	**20,190**	19,481	20,092

38 Fair value of financial instruments *(continued)*

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

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

Details of how the fair values of financial instruments that are not carried at fair value on the balance sheet are calculated are set out in note 51 (b) of the Group's Annual Report 2020.

39 Condensed Consolidated Financial Statements and statutory financial statements

The financial information relating to the year ended 31 December 2020 that is included in these Condensed Consolidated Financial Statements does not constitute the Bank's statutory financial statements for that year but is extracted from those financial statements which have been delivered to the Registrar of Companies as required by section 662 (3) of, and Part 3 of Schedule 6 to, the Hong Kong Companies Ordinance (Cap. 622) and to the Hong Kong Monetary Authority.

The auditor has reported on those statutory financial statements for the year ended 31 December 2020. The auditor's report was unqualified; did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying its report; and did not contain a statement under sections 406 (2), 407 (2) or (3) of the Hong Kong Companies Ordinance (Cap. 622).

The Annual Report for the year ended 31 December 2020, which includes the statutory financial statements, can be obtained from the Bank's website (www.hangseng.com) and the website of Hong Kong Exchanges and Clearing Limited (www.hkexnews.hk).

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

40 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.

41 Comparative figures

Certain comparative figures in the Condensed Consolidated Financial Statements have been restated to conform with current period's presentation.

REPORT ON REVIEW OF CONDENSED CONSOLIDATED FINANCIAL STATEMENTS TO THE BOARD OF DIRECTORS OF HANG SENG BANK LIMITED

(incorporated in Hong Kong with limited liability)

Introduction

We have reviewed the condensed consolidated financial statements set out on pages 55 to 91, which comprises the condensed consolidated balance sheet of Hang Seng Bank Limited (the 'Bank') and its subsidiaries (together, the 'Group') as at 30 June 2021 and the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed consolidated statement of changes in equity and the condensed consolidated cash flow statement for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes[1]. The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of a report on condensed consolidated financial statements to be in compliance with the relevant provisions thereof and Hong Kong Accounting Standard 34 'Interim Financial Reporting' issued by the Hong Kong Institute of Certified Public Accountants. The directors of the Bank are responsible for the preparation and presentation of these condensed consolidated financial statements in accordance with Hong Kong Accounting Standard 34 'Interim Financial Reporting'. Our responsibility is to express a conclusion on these condensed consolidated financial statements based on our review and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

1 *As described in Note 1 on the condensed consolidated financial statements, certain other disclosures have been presented elsewhere in the Interim Report 2021, rather than in the notes on the condensed consolidated financial statements. These are cross-referenced from the condensed consolidated financial statements and are identified as reviewed.*

Scope of Review

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

Conclusion

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

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 2 August 2021

The Code for Securities Transactions by Directors

The Bank has adopted a Code for Securities Transactions by Directors on terms no less exacting than the required standards as set out in the Model Code for Securities Transactions by Directors of Listed Issuers (as set out in Appendix 10 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ('Listing Rules')). Specific enquiries have been made with all Directors who have confirmed that they have complied with the Bank's Code for Securities Transactions by Directors throughout the six months ended 30 June 2021.

Changes in Directors' Details

Changes in Directors' details since the date of the Annual Report 2020 of the Bank or (as the case may be) the date of announcement for the appointment of Director issued by the Bank subsequent to the date of the Annual Report 2020, and up to the date of release of the interim results of the Bank which are required to be disclosed pursuant to Rule 13.51 (2) and Rule 13.51B(1) of the Listing Rules, are set out below.

Ms Irene LEE Yun Lien

New appointments

- Hang Seng Bank Limited[1] (Chairman of the Board; Chairman of Nomination Committee; Member of Remuneration Committee)

Re-designation

- Hang Seng Bank Limited[1] (re-designated from Chairman of Risk Committee to Member of Risk Committee)

Cessation of appointments

- HSBC Holdings plc[1] (Member of Group Remuneration Committee)

Ms Louisa CHEANG Wai Wan

Cessation of appointments

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

Dr John CHAN Cho Chak GBS, JP

Cessation of appointments

- The Community Chest of Hong Kong (Second Vice President and Campaign Committee Chairman)

Ms CHIANG Lai Yuen JP

New appointments

- Food and Health Bureau (Member of Advisory Council on Food and Environmental Hygiene)

Cessation of appointments

- Aviation Development and Three-runway System Advisory Committee (Member)

Ms Margaret KWAN Wing Han

New appointments

- Hang Seng Bank Limited[1] (Acting Chief Executive)

Mr Peter WONG Tung Shun GBS, JP

New appointments
- HSBC Holdings plc[1] (Adviser to Group Chairman and Group Chief Executive)
- The Community Chest of Hong Kong (Vice Patron)
- The Hongkong and Shanghai Banking Corporation Limited (Chairman; Member of Nomination Committee)

Re-designation
- The Hongkong and Shanghai Banking Corporation Limited (re-designated from Executive Director to Non-Executive Director)

Cessation of appointments
- Hong Kong Monetary Authority (Member of The Exchange Fund Advisory Committee)
- HSBC Holdings plc[1] (Group Managing Director; Member of Group Executive Committee)
- The Hongkong and Shanghai Banking Corporation Limited (Deputy Chairman; Chief Executive)

Notes:

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

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

(3) *Dr Raymond CH'IEN Kuo Fung retired as an Independent Non-executive Chairman of the Bank, and ceased to be the Chairman of the Nomination Committee and a member of the Remuneration Committee of the Bank, all with effect from 27 May 2021.*

(4) *Dr Eric LI Ka Cheung retired as an Independent Non-executive Director of the Bank, and ceased to be the Chairman of the Audit Committee and a member of the Risk Committee of the Bank, all with effect from 27 May 2021.*

(5) *Mr Clement KWOK King Man was appointed as an Independent Non-executive Director and the Chairman of the Audit Committee of the Bank, both with effect from 27 May 2021.*

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

Directors' and Alternate Chief Executives' Interests

As at 30 June 2021, the interests of the Directors and Alternate Chief Executives in the shares, underlying shares of equity derivatives and debentures of the Bank and its associated corporations (all within the meaning of Part XV of the Securities and Futures Ordinance ('SFO')) disclosed in accordance with the Listing Rules were detailed below.

Interests in shares

	Personal Interests (held as beneficial owner)	Family Interests (interests of spouse or child under 18)	Corporate Interests (interests of controlled corporation)	Other Interests	Total Interests	Total Interests as % of the relevant shares in issue/issued share capital
Number of ordinary shares in the Bank						
Directors:						
Dr John C C Chan	1,000[1]	–	–	–	1,000	0.00
Ms Kathleen C H Gan	2,500	–	–	–	2,500	0.00
Ms Margaret W H Kwan	65	–	–	–	65	0.00
Number of ordinary shares of US$0.50 each in HSBC Holdings plc						
Directors:						
Ms Louisa Cheang	669,831	–	–	230,857[2]	900,688	0.00
Dr John C C Chan	24,605[1]	–	–	–	24,605	0.00
Ms Kathleen C H Gan	379,917	–	–	103,421[2]	483,338	0.00
Ms Margaret W H Kwan	110,370	10,041	–	26,423[2]	146,834	0.00
Ms Irene Y L Lee	15,000	–	–	–	15,000	0.00
Mr Kenneth S Y Ng	440,723	–	–	–	440,723	0.00
Mr Peter T S Wong	2,913,530	27,442	–	1,093,536[2]	4,034,508	0.02
Alternate Chief Executives:						
Mrs Eunice L C Y Chan	30,946	–	–	14,555[2]	45,501	0.00
Mr Donald Y S Lam	200,290	–	–	31,162[2]	231,452	0.00
Mr Andrew W L Leung	12,866	–	–	21,094[2]	33,960	0.00

Notes:

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

(2) *These included interests in conditional awards of ordinary shares of US$0.50 each in HSBC Holdings plc under the HSBC Share Plans made in favour of Directors and Alternate Chief Executives.*

Conditional Awards of Shares

As at 30 June 2021, the interests of the Directors and Alternate Chief Executives in the conditional awards of ordinary shares of US$0.50 each in HSBC Holdings plc made in favour of them under various HSBC Share Plans were as follows:

	Awards held as at 1 January 2021	Awards made during the Director's/ Alternate Chief Executive's term of office in the first half of the year	Awards released during the Director's/ Alternate Chief Executive's term of office in the first half of the year	Awards held as at 30 June 2021
Directors:				
Ms Louisa Cheang	213,883	144,543	127,569	230,857[1]
Ms Kathleen C H Gan	77,852	95,343	69,774	103,421[1]
Ms Margaret W H Kwan	23,543	32,561	29,681	26,423[1]
Mr Peter T S Wong	506,947	346,039	305,985	547,001[1]
Alternate Chief Executives:				
Mrs Eunice L C Y Chan	12,571	7,955	5,971	14,555[1]
Mr Donald Y S Lam	28,747	32,190	29,775	31,162[1]
Mr Andrew W L Leung	20,296	10,384	9,586	21,094[1]

Notes:

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

During the first half of 2021, Mrs Eunice L C Y Chan and Mr Donald Y S Lam also acquired and were awarded ordinary shares of HSBC Holdings plc under the HSBC International Employee Share Purchase Plan. Their interests in ordinary shares of HSBC Holdings plc under this plan have been included in their 'Personal Interests' disclosed in the table under 'Interests in shares'.

All the interests stated above represented long positions. As at 30 June 2021, no short positions were recorded in the Register of Directors' and Alternate Chief Executives' Interests and Short Positions required to be kept under section 352 of the SFO.

No right to subscribe for equity or debt securities of the Bank has been granted by the Bank to, nor have any such rights been exercised by, any person during the six months ended 30 June 2021.

Substantial Interests in Share Capital

The register maintained by the Bank pursuant to the SFO recorded that, as at 30 June 2021, the following corporations had interests or short positions in the shares or underlying shares (as defined in the SFO) in the Bank set opposite their respective names:

Name of Corporation	Number of Ordinary Shares in the Bank (Percentage of total)
The Hongkong and Shanghai Banking Corporation Limited	1,188,057,371 (62.14%)
HSBC Asia Holdings Limited	1,188,057,371 (62.14%)
HSBC Holdings plc	1,188,057,371 (62.14%)

The Hongkong and Shanghai Banking Corporation Limited is a wholly-owned subsidiary of HSBC Asia Holdings Limited, which in turn is a wholly-owned subsidiary of HSBC Holdings plc. Accordingly, the interests of The Hongkong and Shanghai Banking Corporation Limited are recorded as the interests of HSBC Asia Holdings Limited and HSBC Holdings plc.

The Directors regard HSBC Holdings plc to be the beneficial owner of 1,188,057,371 ordinary shares in the Bank (62.14%).

All the interests stated above represented long positions. As at 30 June 2021, no short positions were recorded in the Register of Interests in Shares and Short Positions required to be kept under section 336 of the SFO.

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

There was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank's listed securities during the first half of 2021.

Remuneration and Staff Development

There have been no material changes to the information disclosed in the Annual Report 2020 in respect of the remuneration of employees, remuneration policies and staff development.

Corporate Governance Principles and Practices

The Bank is committed to maintaining and upholding high standards of corporate governance with a view to safeguarding the interests of shareholders, customers, employees and other stakeholders. The Bank has followed the module on 'Corporate Governance of Locally Incorporated Authorised Institutions' under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority. The Bank has also fully complied with all the code provisions and most of the recommended best practices set out in the Corporate Governance Code contained in Appendix 14 of the Listing Rules throughout the six months ended 30 June 2021.

Further, the Bank constantly reviews and enhances its corporate governance framework, by making reference to market trend as well as guidelines and requirements issued by regulatory authorities, to ensure that it is in line with international and local corporate governance best practices. The Bank has also implemented the 'Subsidiary Accountability Framework' initiative introduced by the HSBC Group to simplify the subsidiary oversight framework, and strengthen and enhance corporate governance, and continued to embed Group governance requirements to enhance meeting effectiveness. Lastly, a comprehensive Subsidiary Governance Review was initiated by the HSBC Group in 2020 for sharing of best governance practices and the Bank was on track in implementing the recommendations from such Review, with full support of the Board.

The Audit Committee of the Bank has reviewed the results of the Bank for the six months ended 30 June 2021.

2021 Second Interim Dividend

Announcement date	2 August 2021
Ex-dividend date	13 August 2021
Book close and record date	17 August 2021
Payment date	2 September 2021

Register of Shareholders

The Register of Shareholders of the Bank will be closed on Tuesday, 17 August 2021, during which no transfer of shares can be registered. To qualify for the second interim dividend for 2021, all transfers, accompanied by the relevant share certificates, must be lodged with the Bank's Registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, for registration not later than 4:30 pm on Monday, 16 August 2021.

Board and Committees

Board

Independent Non-executive Chairman

Irene LEE Yun Lien

Executive Directors

Louisa CHEANG (Vice-Chairman and Chief Executive)
Margaret KWAN Wing Han (Acting Chief Executive)

Non-executive Directors

Kathleen GAN Chieh Huey
Vincent LO Hong Sui
Kenneth NG Sing Yip
Peter WONG Tung Shun

Independent Non-executive Directors

John CHAN Cho Chak
CHIANG Lai Yuen
Clement KWOK King Man
Michael WU Wei Kuo

Committees

Executive Committee

Louisa CHEANG (Chairman)
Eunice CHAN
Rose CHO Mui
Liz CHOW Tan Ling
Margaret KWAN Wing Han
Donald LAM Yin Shing
Gilbert LEE Man Lung
Andrew LEUNG Wing Lok
Godwin LI Chi Chung
Ryan SONG Yue Sheng
Christopher TSANG Hing Keung
Elaine WANG Yee Ning
WONG May Kay
YEO Chee Leong

Audit Committee
Clement KWOK King Man (Chairman)
CHIANG Lai Yuen
Irene LEE Yun Lien

Remuneration Committee
John CHAN Cho Chak (Chairman)
CHIANG Lai Yuen
Irene LEE Yun Lien

Risk Committee
Irene LEE Yun Lien
Kenneth NG Sing Yip
Michael WU Wei Kuo

Nomination Committee
Irene LEE Yun Lien (Chairman)
John CHAN Cho Chak
Louisa CHEANG
Peter WONG Tung Shun
Michael WU Wei Kuo

Notes:

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

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

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Website: www.hangseng.com
Email: hangseng@computershare.com.hk

Stock Code

The Stock Exchange of Hong Kong Limited: 11

Registrar

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

Depositary*

BNY Mellon Shareowner Services
PO Box 505000
Louisville, KY 40233-5000
USA
Website: www.mybnymdr.com
Email: shrrelations@cpushareownerservices.com

* *The Bank offers investors in the United States a Sponsored Level-1 American Depositary Receipts Programme through The Bank of New York Mellon Corporation.*

Interim Report 2021

This Interim Report 2021 in both English and Chinese is now available in printed form and on the Bank's website (www.hangseng.com) and the website of HKEx (www.hkexnews.hk).

Shareholders who:

A) browse this Interim Report 2021 on the Bank's website and wish to receive a printed copy; or

B) receive this Interim Report 2021 in either English or Chinese and wish to receive a printed copy in the other language version,

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

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

If shareholders who have chosen (or are deemed to have chosen) to read this Interim Report 2021 on the Bank's website, have difficulty in reading or gaining access to this Interim Report 2021 via the Bank's website for any reason, the Bank will promptly send this Interim Report 2021 in printed form free of charge upon the shareholders' request.

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

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