INTERIM REPORT 2018

ENGAGEMENT

連繫 前行

恒生銀行

HANG SENG BANK

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

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

	30 June 2018	30 June 2017
For the half-year ended	**HK$m**	HK$m
Operating profit excluding change in expected credit losses and other credit impairment charges	**14,900**	12,402
Operating profit	**14,662**	11,732
Profit before tax	**14,864**	11,646
Profit attributable to shareholders	**12,647**	9,838
	%	%
Return on average ordinary shareholders' equity	**17.4**	14.6
Cost efficiency ratio	**27.7**	29.8
Average liquidity coverage ratio (quarter ended 30 Jun)	**209.6**	256.7
Average liquidity coverage ratio (quarter ended 31 Mar)	**207.0**	267.7
Net Stable Funding Ratio (quarter ended 30 Jun)	**153.6**	N/A
Net Stable Funding Ratio (quarter ended 31 Mar)	**152.9**	N/A
	HK$	HK$
Earnings per share	**6.62**	5.15
Dividends per share	**2.60**	2.40

	At 30 June 2018	At 31 December 2017
At period-end	**HK$m**	HK$m
Shareholders' equity	**155,635**	152,030
Total assets	**1,534,622**	1,478,418
	%	%
Capital ratios under Basel III		
– Common Equity Tier 1 ("CET1") Capital Ratio	**16.2**	16.5
– Tier 1 Capital Ratio	**17.4**	17.7
– Total Capital Ratio	**19.6**	20.1

Change to presentation from 1 January 2018

Hong Kong Financial Reporting Standard 9 ("HKFRS 9")

The Group adopted the requirements of HKFRS 9 "*Financial Instruments*" from 1 January 2018, with the exception of the provisions relating to the presentation of gains and losses on financial liabilities designated at fair value, which were adopted from 1 January 2017. The impact of HKFRS 9 at 1 January 2018 on the consolidated financial statements of the Group was a decrease in net assets of HK$854m, arising from:

- A decrease of HK$1,077m from additional impairment allowances;
- An increase of HK$46m from the remeasurement of financial assets and liabilities as a consequence of classification changes; and
- An increase in net deferred tax assets of HK$177m.

Refer to "Standards applied during the half-year to 30 June 2018" and "Effects of reclassification and remeasurement upon adoption of HKFRS 9" in Note 2 and 3 for further detail.

The world economy maintained a moderate pace of growth in the first half of 2018, prompting central banks in key economies to continue raising interest rates and tighten monetary policies. However, such developments were relatively modest in nature, given ongoing uncertainty over international trade and longer-term global economic and financial trends.

Hang Seng deployed more resources in enhancing efficiency, understanding customers better and improving infrastructure for responding quickly to changing market conditions and new business opportunities. These actions built on our well-established competitive strengths, while also marking us out as a forward-thinking bank with a clear vision for long-term sustainable growth.

Attributable profit grew by 29% to HK$12,647m. Earnings per share also rose by 29% to HK$6.62 per share. Compared with the second half of 2017, attributable profit increased by 24% and earnings per share were up 29%.

Return on average ordinary shareholders' equity was 17.4%, compared with 14.6% and 13.9% in the first and second halves of last year.

The Directors have declared a second interim dividend of HK$1.30 per share. This brings the total distribution for the first half of 2018 to HK$2.60 per share, compared with HK$2.40 per share in the first half of 2017.

Economic Environment

Hong Kong's economic growth hit its fastest pace since 2011 in the first quarter, with GDP rising by 4.7% year on year after increasing by 3.8% last year. While higher US interest rates are putting upward pressure on their counterparts in Hong Kong, domestic demand has remained strong and the labour market is in robust health. We expect Hong Kong's full-year growth for 2018 to reach 3.7%.

In mainland China, GDP growth averaged 6.8% in the first half. Trade posted double-digit growth, but ongoing economic deleveraging resulted in a further slowdown in investment growth. Despite concerns over the future of international trade policies, we expect the Mainland economy to remain on a stable trajectory and achieve full-year growth of 6.6% for 2018.

Looking ahead, while we remain cautiously optimistic, continuing credit tightening in the US and the deteriorating world trade outlook are increasing the long-tail risk on the downside. Nevertheless, our core banking services strength provides a firm foundation for capitalising on new opportunities created by dynamic growth in the Guangdong-Hong Kong-Macao Greater Bay Area and the changing face of financial service delivery.

We will continue to invest in strengthening customer relationships. Leveraging technology, our diverse portfolio of products and services, and the professionalism of our people, we will take further advantage of our leading market position and respected brand to deliver service excellence and create value for shareholders.

Raymond Ch'ien
Chairman
Hong Kong, 6 August 2018

Hang Seng achieved strong results in the first half of 2018. Building on the good business momentum we established last year, we saw further success with our customer-centric strategy for progressive growth.

We grew profit before tax by 28%, with solid increases in net interest income and non-interest income. All business lines recorded growth in revenue and profitability.

Initiatives to enhance service convenience, access and choice deepened existing relationships and provided us with new business opportunities in key segments. We achieved balanced growth in lending and deposits, and improvement in the net interest margin.

Enhanced data analytics and more effective customer engagement across our diversified distribution channels improved our understanding of the preferences of our clients. Supported by our all-weather portfolio of wealth-and-health products, this strengthened our ability to deliver tailored financial management solutions and respond swiftly to changing customer needs, resulting in double-digit growth in wealth management income.

With increasingly mobile lifestyles shaping service expectations, particularly among the younger segment, we added value with investments in technology and operational infrastructure that give customers greater flexibility over when and where they manage their finances.

Our new AI chatbots offer retail and commercial customers around-the-clock assistance with a range of service enquiries and information. We expanded the use of biometric authentication and launched a mobile security key to ensure customers enjoy easy and secure access to our digital services.

Our strong cross-border and cross-business connectivity continued to play a key role in capturing new business in Hong Kong and mainland China. Hang Seng China recorded satisfactory growth in profitability despite the high cost of renminbi funding in the first half of the year.

We continued with actions to strengthen staff engagement, enhance their well-being and establish working environments and practices that encourage innovation, collaboration and creativity.

Financial Performance

Attributable profit and earnings per share both increased by 29% to HK$12,647m and HK$6.62 per share respectively. Profit before tax was up 28% at HK$14,864m. Compared with the second half of 2017, attributable profit and profit before tax both rose by 24%, and earnings per share were up 29%.

Operating profit increased by 25% to HK$14,662m. Operating profit excluding change in expected credit losses and other credit impairment charges was up 20% at HK$14,900m. Compared with the second half of 2017, operating profit increased by 24% and operating profit excluding change in expected credit losses grew by 22%.

Net operating income increased by 20% to HK$20,411m. Compared with the second half of 2017, net operating income was up 18%.

Net interest income grew by 20% to HK$14,228m, reflecting the 11% increase in average interest-earning assets and the improvement in the net interest margin. Compared with the second half of 2017, net interest income rose by 11%. The net interest margin was 2.10%, up from 1.94% for both the first and second halves of 2017.

Supported by enhanced data analytics and our customer segmentation capabilities, we further leveraged our comprehensive portfolio of wealth-and-health products to achieve a 10% increase in non-interest income and a 14% rise in wealth management income. Compared with the second half of 2017, non-interest income grew by 30% and wealth management income was up 31%.

Our cost efficiency ratio was 27.7%, compared with 29.8% and 31.1% for the first and second halves of last year, demonstrating our ability to enhance productivity while delivering growth.

We continued to actively manage our lending portfolio to maintain good overall asset quality. Change in expected credit losses and other credit impairment charges was HK$238m, compared with HK$670m and HK$372m for the first and second halves of 2017.

At 30 June 2018, our common equity tier 1 capital ratio was 16.2% and our tier 1 capital ratio was 17.4%, compared with 16.5% and 17.7% respectively at 31 December 2017. Our total capital ratio was 19.6%, compared with 20.1% at the end of last year.

Delivering Excellence for Progressive Growth

Turning to the outlook for the rest of the year, we expect operating conditions to become more challenging. The recent volatility in the world's major financial markets may continue in the months ahead, as uncertainty over international trade policies and geopolitical developments increases. Alongside the upward trend in interest rates, this may cause companies to exercise greater caution when considering their short-to-medium-term investment plans. Such market conditions are also likely to affect consumer sentiment.

In this rapidly evolving operating environment, our progressive approach to business will reinforce our position as Hong Kong's leading domestic bank. Competitive advantages such as our trusted brand, large customer base and extensive distribution network provide a firm foundation for growth. However, we cannot rely solely on our established strengths. We will keep moving forward and sharpen our ability to meet the increasingly sophisticated needs of current and future customers.

We are allocating more capital and resources to further leverage technology in support of long-term business growth, enhancing the customer experience and driving innovation in our industry.

Data analytics and our customer segmentation model are strengthening client engagement. This is facilitating the provision of tailored wealth management solutions for different customer groups.

Our increased investments in digital platforms reflect growing customer expectations that financial services must integrate fully with their fast-paced and mobile lifestyles.

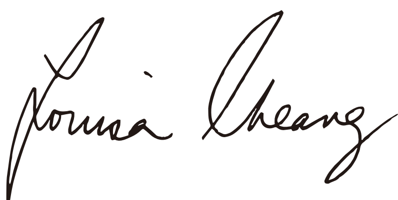
We are working with our peers to develop an industry-wide trade finance blockchain platform that will enhance service efficiency, reduce risk and improve financing accessibility. We are also actively involved in other fintech initiatives, including Faster Payment System and Open Banking API, that will encourage greater creativity and collaboration in the development of innovative and convenient banking services.

We will continue to adopt technology and operational systems that drive greater efficiency, enable us to act quickly on new market opportunities and give our staff more capacity to add value when serving customers.

Our well-integrated cross-border infrastructure will facilitate initiatives to grow our core banking business on the Mainland and capitalise on new opportunities arising from major developments such as the Guangdong-Hong Kong-Macao Greater Bay Area and 'One Belt, One Road'.

I wish to thank my colleagues for their significant contributions to our results. In a fast-changing service environment, we are listening to and learning from our people. We will continue to equip our staff to provide high-value services and quality specialist advice tailored to the needs of customers. We remain committed to promoting a working culture and conditions that support personal well-being and enable our people to perform at their best, take pride in their work and feel valued as members of the Hang Seng team.

Under our progressive growth strategy, we will emphasise customer convenience and choice as central to the service experience. We will continue to actively engage stakeholders, drive product and service innovation, and uphold high operational and compliance standards as we deliver excellence as an employer, a financial services provider and a responsible corporate member of our community.



Louisa Cheang
Vice-Chairman and Chief Executive
Hong Kong, 6 August 2018

FINANCIAL PERFORMANCE

Income Analysis

Summary of financial performance

Figures in HK$m	***Half-year ended 30 June 2018***	*Half-year ended 30 June 2017*
Total operating income	**29,595**	25,685
Operating expenses	**5,722**	5,255
Operating profit	**14,662**	11,732
Profit before tax	**14,864**	11,646
Profit attributable to shareholders	**12,647**	9,838
Earnings per share (in HK$)	**6.62**	5.15

First half of 2018 compared with first half of 2017

Hang Seng Bank Limited ("the Bank") and its subsidiaries ("the Group") achieved good growth momentum to record strong results for the first half of 2018. **Profit attributable to shareholders** increased by 29% compared with the first half of 2017 to reach HK$12,647m. **Profit before tax** was up 28% at HK$14,864m. **Operating profit** rose by 25% to HK$14,662m. **Operating profit excluding change in expected credit losses and other credit impairment charges** increased by 20% to HK$14,900m, with solid growth in both net interest income and non-interest income. Supported by its all-weather product portfolio, customer segmentation strategy and strong time-to-market capabilities, the Bank's swift response to the changing investment and insurance needs of customers drove a 14% increase in wealth management income to HK$5,328m.

Net interest income increased by HK$2,414m, or 20%, to HK$14,228m, driven mainly by the increase in average interest-earning assets and improvement in net interest margin.

Figures in HK$m	***Half-year ended 30 June 2018***	*Half-year ended 30 June 2017*
Net interest income/(expense) arising from:		
– financial assets and liabilities that are not at fair value through profit and loss	**15,093**	12,369
– trading assets and liabilities	**90**	(533)
– financial instruments designated and otherwise mandatorily measured at fair value	**(955)**	(22)
	14,228	11,814
Average interest-earning assets	**1,367,995**	1,230,985
Net interest spread	**1.97%**	1.84%
Net interest margin	**2.10%**	1.94%

Average interest-earning assets rose by HK$137bn, or 11%, when compared with the first half of 2017. Average customer lending increased by 19%, with notable growth in corporate and commercial and mortgage lending. Average interbank placement grew by 4% whereas financial investments remained broadly unchanged when compared with same period last year.

Net interest margin improved by 16 basis points to 2.10%, mainly from the widening of customer deposits spreads and a change in asset portfolio mix as average customer lending grew. Treasury realized opportunities in the interbank market and proactively managed the interest rate risk to enhance the portfolios yield. Average loan spread on customer lending reduced, notably on corporate and commercial term lending.

Compared with the second half of 2017, net interest income increased by HK$1,465m, or 11%, mainly supported by increase in average interest-earning assets and widening of net interest margin despite more calendar days in the second half of 2017.

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

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

Figures in HK$m	**Half-year ended 30 June 2018**	Half-year ended 30 June 2017
Net interest income and expense reported as "Net interest income"		
– Interest income	**16,967**	13,791
– Interest expense	**(1,882)**	(1,449)
– Net interest income	**15,085**	12,342
Net interest income and expense reported as "Net income from financial instruments measured at fair value"	**(857)**	(528)
Average interest-earning assets	**1,318,550**	1,190,694
Net interest spread	**2.21%**	2.02%
Net interest margin	**2.31%**	2.09%

Net fee income increased by HK$695m, or 21%, to HK$3,989m, with growth being recorded across all core business lines. Income from stockbroking and related services was up 46% and retail investment funds grew by 10%, mainly due to higher turnover and the favourable equities markets. Gross fee income from credit card business increased by 14%. Credit facilities fee income rose by 41%, reflecting higher fees from increased corporate lending. Enhanced cross-border commercial payment capabilities resulted in a 16% increase in remittance-related fees. Fees from account services, insurance-related business and trade services increased by 8%, 6% and 10% respectively.

Net income from financial instruments measured at fair value decreased by HK$1,381m, or 58%, to HK$995m.

The Bank has considered market practices for the presentation of certain financial liabilities that contain both deposit and derivative components. It was determined that a change in accounting policy and presentation with respect to "trading liabilities – structured deposits and structured debt securities in issue" is appropriate to better align with the presentation of similar financial instruments by industry peers and therefore provide more relevant information about the effect of these financial liabilities on the Bank's financial position and performance. This change in accounting policy and presentation took effect on 1 January 2018. Accordingly, rather than classifying "trading liabilities – structured deposits and structured debt securities in issue" as held for trading, such financial liabilities are now designated as at fair value through profit or loss since they are managed and their performance is evaluated on a fair-value basis. Further information is set out in the "additional information" section of the press release and the "accounting policies" section of the Group's 2018 interim report.

Net trading income and net income from financial instruments designated at fair value together decreased by HK$250m, or 18%, to HK$1,140m. Increased customer activity led to a rise in foreign exchange income, but this was more than offset by lower income from funding swaps. Income from interest rate derivatives, debt securities, equities and other trading activities was down compared with a year earlier.

Net income from assets and liabilities of insurance business measured at fair value recorded a loss of HK$145m compared with a gain of HK$986m for the same period last year. Investment returns on financial assets supporting insurance liabilities contracts were adversely affected by unfavourable movements in the equities markets. To the extent that these investment returns were attributable to policyholders, there was an offsetting movement in net insurance claims and benefits paid and movement in liabilities to policyholders or movement in present value of in-force long-term insurance business ("PVIF").

Analysis of income from wealth management business

Figures in HK$m	***Half-year ended 30 June 2018***	*Half-year ended 30 June 2017 (restated)*
Investment services income*:		
– retail investment funds	**1,064**	904
– structured investment products	**357**	305
– securities broking and related services	**1,028**	705
– margin trading and others	**43**	46
	2,492	1,960
Insurance income:		
– life insurance:		
– net interest income and fee income	**1,856**	1,747
– investment returns on life insurance funds (including share of associate's profit and surplus on property revaluation backing insurance contracts)	**(326)**	980
– net insurance premium income	**8,732**	7,107
– net insurance claims and benefits paid and movement in liabilities to policyholders	**(8,946)**	(8,028)
– movement in present value of in-force long-term insurance business	**1,379**	742
	2,695	2,548
– general insurance and others	**141**	156
	2,836	2,704
Total	**5,328**	4,664

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

Wealth management income increased by 14% when compared with same period last year. Investment services income rose strongly by 27%, with retail investment funds and securities broking related services income increased by 18% and 46% respectively. Life insurance business income increased by 6%.

Net interest income and fee income from life insurance business rose by 6%. Investment returns on life insurance business recorded a loss of HK$326m compared with a gain of HK$980m for the same period last year, reflecting the unfavourable movements in the equities markets. To the extent that these investment returns were attributable to policyholders, there was an offsetting movement in net insurance claims and benefits paid and movement in liabilities to policyholders or movement in PVIF under other operating income.

Net insurance premium income increased by 23%, reflecting higher new premiums attributable to the success of our total solution retirement planning propositions covering a wide range of wellness and protection products as well as increase in renewal premiums. The rise in insurance premiums resulted in a corresponding increase in net insurance claims and benefits paid and movement in liabilities to policyholders. The movement in PVIF increased by 86%, mainly attributable to higher new business sales and the market conditions update.

General insurance income decreased by 10%.

Change in expected credit losses and other credit impairment charges/Loan impairment charges and other credit risk provisions decreased by HK$432m, or 64%, to HK$238m.

Under Hong Kong Financial Reporting Standard ("HKFRS") 9 "*Financial Instruments*", the recognition and measurement of expected credit losses ("ECL") is different to that required under Hong Kong Accounting Standard ("HKAS") 39 "*Financial Instruments: Recognition and Measurement*". The change in expected credit losses relating to financial assets under HKFRS 9 is more forward-looking and recorded in the income statement under "change in expected credit losses and other credit impairment charges". As relevant figures in the prior period have not been restated, changes in impairment of financial assets in the comparative period have been reported in accordance with HKAS 39 under "Loan impairment charges and other credit risk provisions" and are therefore not necessarily comparable to the ECL recorded for the current period. Further information is provided in the accounting policies section of the Group's 2018 interim report.

Gross impaired loans and advances increased by HK$454m, or 21%, to HK$2,628m against 2017 year-end on HKFRS 9 basis. Gross impaired loans and advances as a percentage of gross loans and advances to customers stood at 0.31% at the end of June 2018, compared with 0.27% on an HKFRS 9 basis at the end of December 2017. Overall credit quality remained stable.

Change in expected credit losses and other credit impairment charges recorded a charge of HK$238m for the first half of 2018. Retail Banking and Wealth Management ("RBWM") recorded an ECL charge of HK$169m, mainly in credit card and personal loan portfolios. ECL for the Commercial Banking ("CMB"), Global Banking and Markets and "Other" business segments collectively recorded impairment charges of HK$69m. New ECL arising from the downgrading of several CMB customers was partly offset by the decrease in ECL resulting from improved macroeconomic forecasts in Hong Kong.

Loan impairment charges and other credit risk provisions were HK$670m for the first half of 2017. Individually assessed impairment charges were HK$327m, with the adverse impact of the downgrading of several CMB customers partly offset by a release in impairment charges. Collectively assessed impairment charges were HK$343m, with credit card and personal loan portfolios accounting for HK$272m and the remaining related to collectively assessed impairment charges for loans not individually identified as impaired.

HKFRS 9 requires the recognition of impairment earlier in the lifecycle of a financial asset, taking forward-looking information into consideration. As a result, measurement involves more complex judgement with impairment likely to be more volatile as the economic outlook changes. The Bank's senior management will continue to closely monitor market developments and shifts in the economic environment in its management and assessment of the credit performance of financial assets.

Expected credit loss/Loan impairment allowances as a percentage of gross loans and advances to customers are as follows:

	At 30 June 2018	*At 31 December 2017*
	%	*%*
Expected credit loss/Loan impairment allowances as a percentage of gross loans and advances to customers	**0.28**	0.20

Expected credit losses at 1 January 2018 to reflect the adoption of HKFRS 9 from this date is HK$2,540m and the corresponding ratio of expected credit losses as a percentage of gross loans and advances to customers is 0.31%.

Gross impaired loans and advances as a percentage of gross loans and advances to customers	**0.31**	0.24

Gross impaired loans and advances at 1 January 2018 to reflect the adoption of HKFRS 9 from this date is HK$2,174m and the corresponding ratio of gross impaired loans and advances as a percentage of gross loans and advances to customers is 0.27%.

Operating expenses increased by HK$467m, or 9%, to HK$5,722m, due mainly to the Bank's continued investment in technology, services enhancement and staff-related costs. Staff costs were up 13%, reflecting the salary increment and higher performance-related pay expenses.

Depreciation charges increased by 11%, due mainly to higher depreciation charges on business premises following the upward commercial property revaluation at last year-end. General and administrative expenses increased by 4%, reflecting the increases in marketing and advertising expenses, processing charges and professional fees.

The Group continued to focus on enhancing operational efficiency while maintaining growth momentum. With the increase in net operating income before change in expected credit losses and other credit impairment charges outpacing the growth in operating expenses, the Bank's cost efficiency ratio improved by 2.1 percentage points compared with the same period last year to 27.7%.

Full-time equivalent staff numbers by region	***At 30 June 2018***	*At 30 June 2017*
Hong Kong and others	**8,365**	7,751
Mainland	**1,727**	1,705
Total	**10,092**	9,456
Cost efficiency ratio	**27.7%**	29.8%

Operating profit was HK$14,662m, up 25% compared with the first half of 2017.

Profit before tax increased by HK$3,218m, or 28%, to HK$14,864m after taking into account the following major items:

- a HK$28m increase in **net surplus on property revaluation**; and
- a gain of HK$124m compared with a loss of HK$136m in the first half of 2017 in **share of profits/(losses) of associates**, mainly reflecting the revaluation surplus of a property investment company in the current period compared with a revaluation loss in the same period last year.

First half of 2018 compared with second half of 2017

Against the second half of 2017, the Group leveraged its core strengths to deliver strong results. Attributable profit grew by HK$2,467m, or 24%, driven by solid growth in both net interest income and non-interest income.

Net interest income increased by HK$1,465m, or 11%, benefiting from the increase in average interest-earning assets and improvement in the net interest margin, despite there being more calendar days in the second half of 2017. Non-interest income rose by HK$1,484m, or 30%, driven mainly by solid growth in wealth management income. There was an improvement in investment services income, with higher income from retail investment funds, securities brokerage and structured investment products. Insurance income recorded strong growth, driven by the increase in new business sales and higher renewals, though this was partly offset by the loss on investment portfolio resulting from unfavourable movements in the equities markets.

Operating expenses rose by HK$209m, or 4%, with increases in staff costs and depreciation largely offset by lower general and administrative expenses. ECL charge decreased by HK$134m, or 36%, reflecting lower impairment charges for RBWM and CMB.

Segmental Analysis

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

Figures in HK$m	*Retail Banking and Wealth Management*	*Commercial Banking*	*Global Banking and Markets*	*Other*	*Total*
Half-year ended 30 June 2018					
Profit before tax	**7,683**	**4,439**	**2,734**	**8**	**14,864**
Share of profit before tax	**51.7%**	**29.9%**	**18.4%**	**0.0%**	**100.0%**
Half-year ended 30 June 2017					
Profit/(loss) before tax	6,238	2,993	2,473	(58)	11,646
Share of profit/(loss) before tax	53.6%	25.7%	21.2%	(0.5)%	100.0%

Retail Banking and Wealth Management ("RBWM") recorded a 17% year-on-year increase in operating profit excluding change in expected credit losses and other credit impairment charges to HK$7,730m in the first half of 2018. Operating profit increased by 19% to HK$7,561m and profit before tax rose by 23% to HK$7,683m.

Net interest income increased by 19% year-on-year to HK$7,873m. Leveraging our extensive network, trusted brand and sophisticated customer propositions, we uplifted our core banking relationships with customers to achieve strong balance sheet growth. Deposit and loan balances rose by 5% and 4% respectively compared with 2017 year-end. Net interest income in mainland China grew by 7%, reflecting the continued success of our low-cost funding strategy.

Non-interest income increased by 7% to HK$3,396m. Backed by sophisticated data analytics and our customer segmentation strategy, we used our comprehensive all-weather product portfolio to grow wealth management business, resulting in a 13% rise in wealth management business income to HK$4,545m. Wealth management business in mainland China grew by 117% year-on-year.

Investment services income increased by 31%. We grew securities turnover and revenue by 75% and 66% respectively. Investment services revenue excluding securities-related income was up 17%. Our diverse suite of investment funds, and structured, fixed-income and foreign currency products, enabled us to meet a wide variety of financial needs and risk appetites.

Insurance income was in line with the first half of 2017. The unfavourable impact of market movements on life insurance portfolio investment returns was slightly offset by net interest income and fee income from life insurance business, which grew by 6% – due in part to an enhanced product suite and effective use of our extensive distribution network. We offered total wellness and protection solutions to customers through our retirement planning propositions. The launch of a new whole life insurance product, EmbraceLife, drove continuous growth in new business. Life insurance new annualised premiums grew by 27%.

With the continuing positive sentiment in the property market, we enhanced our mortgage distribution capabilities to capture new business opportunities, resulting in a higher transaction volume and a 4% increase in mortgage balances in Hong Kong compared with 2017 year-end. Our new mortgage business continued to rank among the top three in Hong Kong.

Unsecured lending remained a key contributor to revenue. Effective marketing campaigns and our deep understanding of our client base helped us achieve 5% growth in card receivables year-on-year. The personal and tax loan portfolio in Hong Kong grew by 7% compared with 2017 year-end.

Led by our sophisticated customer segmentation strategy and enhanced analytics, our customer-centric approach enabled us to build closer relationship with clients and strengthened our ability to provide needs-based financial products and services. In the Prestige Banking segment, we leveraged our high-value proposition and premium wealth management solutions to acquire new business. We successfully expanded our Prestige Signature customer base by 26% year-on-year in Hong Kong. On the Mainland, Prestige and Preferred Banking customers grew by 9%.

We are committed to investing in financial technology and building robust digital infrastructure to better engage our customers by offering a safe, fast and convenient end-to-end digital banking journey. We continued to implement efficient, innovative solutions in our efforts to enhance the retail banking service experience. We were the first bank in Hong Kong to launch retail banking artificial intelligence ("AI") chatbots – "HARO" and "DORI" – that can assist with a wide variety of customer enquiries and services. The launch of mobile security key, together with the extension of biometric authentication coverage, further strengthened our simple-yet-secure digital solutions. We continued to enrich the product range and functionality of our digital platforms. We launched new online insurance products and investment products. The number of Personal e-Banking customers increased by 8% year-on-year in Hong Kong, and the number of active mobile banking users increased by 38%.

Commercial Banking ("CMB") recorded a 33% year-on-year increase in operating profit excluding change in expected credit losses and other credit impairment charges to HK$4,519m in the first half of 2018. Both operating profit and profit before tax rose by 48% to HK$4,439m.

We achieved solid balance sheet growth in both average customer loans and average customer deposits, which rose by 19% and 16% respectively, driving the 32% increase in net interest income to HK$4,329m.

Non-interest income increased by 22% to HK$1,767m, underpinned by initiatives such as the introduction of improved analytics in identifying the product and service needs of SME customers and strengthening our channel capabilities by uplifting our digital infrastructure. Closer collaboration between CMB and Global Markets teams, together with the enhancement of our online foreign exchange capabilities, supported a 17% increase in foreign exchange business. Net insurance income rose by 36%.

To facilitate cross-border payments by customers, we went live on SWIFT's global payments innovation service, which provides a fast, transparent and traceable payment service experience. Gross fee income from remittances and account-related services was up 14%.

We were an active participant in the syndicated loans market, ranking first in the Mandated Arranger League Table for Hong Kong Syndicated Loans in the first half of 2018 in terms of number of deals according to Thomson Reuters LPC data.

We continued on our journey to provide comprehensive and user-friendly digital banking services. Our new Business Banking AI chatbot – "BERI" – is now available on our Business Banking homepage and the Hang Seng Business Mobile App to handle general enquiries. We also launched Live Chat, an online messaging service that enables customers to contact customer service officers at any time and from any location with online access. To speed up the account opening process, customers can now use our new online platform to pre-fill account opening information and upload related documents before coming to one of our Business Banking Centres to complete the procedure. The introduction of biometric authentication for our Mobile App provides customers with a fast and secure service access option.

We maintained good credit quality and sought to optimise returns through proactive credit risk management and active portfolio management.

We gained external recognition for providing outstanding customer service. We received several awards from *The Asian Banker*, including "Best Transaction Bank", "Best Cash Management Bank" and "Best Payment Bank". We were also named "Best Bank in Hong Kong" in the Corporate Treasurer Awards.

Global Banking and Markets ("GBM") reported year-on-year growth of 10% in operating profit excluding change in expected credit losses and other credit impairment charges to HK$2,723m. Operating profit and profit before tax both rose by 11% to HK$2,734m.

Global Banking ("GB") recorded a 21% year-on-year increase in operating profit excluding change in expected credit losses and other credit impairment charges to HK$1,018m. Both operating profit and profit before tax rose by 22% to HK$1,027m.

Net interest income grew by 20% to HK$1,088m. We recorded increases in both deposit and loan interest income. Average customer loans and average customer deposits grew by 34% and 9% respectively. Compared with the second half of 2017, net interest income was up 5%.

Our close relationships with customers helped us identify good opportunities for lending, resulting in a 4% rise in the loan balance compared with the end of 2017. Deposits in Hong Kong increased by 2%. However, with active management of the deposit mix for balance sheet optimisation on the Mainland, Global Banking's total deposits fell by 3%.

Non-interest income declined by 1%, due mainly to tighter commission rates on merchant card products, which outweighed solid growth in fee income from credit facilities. Compared with the second half of last year, non-interest income grew by 13%.

Global Markets ("GM") reported a 5% year-on-year increase in operating profit excluding change in expected credit losses and other credit impairment charges to HK$1,705m. Operating profit and profit before tax both increased by 5% to HK$1,707m.

Net interest income increased by 3% to HK$1,096m. Good growth in customer lending reduced surplus funds available for investment. Our balance sheet management team identified good opportunities for achieving enhanced yields under its diverse investment strategy. In addition, our interest rate management team proactively managed its fixed-income portfolio, resulting in strong growth in interest income.

Non-interest income remained stable at HK$843m. A 31% increase in non-fund income from sales and trading activities offset the less favourable mark-to-market position on balance sheet management-related funding swap activities. We continued to cross-sell GM products to a diverse range of customers through close collaboration with RBWM, CMB and GB teams.

With the gradual upward trend in HKD and USD interest rates, we responded to growing customer demand for related treasury products. Together with our active management of interest rate risk, interest rate-related income grew significantly.

The active stock market in Hong Kong in the first half of the year drove a 103% year-on-year rise in income from equity-linked products.

Balance Sheet Analysis

Assets

Total assets increased by HK$56bn, or 4%, to HK$1,535bn compared with last year-end, with the Group maintaining good business momentum and continuing to pursue its strategy of enhancing profitability through sustainable growth.

Cash and sight balances at central banks decreased by HK$11bn, or 52%, to HK$10bn, due mainly to the decrease in the commercial surplus placed with the Hong Kong Monetary Authority ("HKMA"). Placing with banks fell by HK$6bn, or 6%, to HK$97bn and trading assets dropped by HK$9bn, or 18%, to HK$44bn, reflecting redeployment of these assets to customer loans and advances.

Customer loans and advances (net of ECL allowances) grew by HK$49bn, or 6%, to HK$855bn compared with the end of 2017. Loans for use in Hong Kong increased by 7%, mainly reflecting growth in lending to the property development and investment, and wholesale and retail trade sectors, as well as working capital financing for certain large corporate customers. Lending to individuals increased by 5% compared with the end of 2017. The Group continued to maintain its market share for mortgage business, with residential mortgages and Government Home Ownership Scheme/Private Sector Participation Scheme/Tenants Purchase Scheme lending growing by 5% and 3% respectively. Trade finance lending decreased by 6% against last year-end. Loans and advances for use outside Hong Kong increased by 8%, due mainly to lending by our Hong Kong operation.

Financial investments increased by HK$17bn, or 4%, to HK$402bn, reflecting the partial redeployment of the commercial surplus in debt securities for yield enhancement and the increase in the insurance financial instruments portfolio.

Customer deposits

Customer deposits, including certificates of deposit and other debt securities in issue, increased by HK$47bn, or 4%, to HK$1,162bn against last year-end. Growth in time deposits was partly offset by the decrease in current and savings account deposits. At 30 June 2018, the advances-to-deposits ratio was 73.6%, compared with 72.3% at 31 December 2017.

Equity

At 30 June 2018, shareholders' equity was up HK$4bn, or 2%, at HK$156bn against last year-end. Retained profits grew by HK$4bn, or 3%, reflecting profit accumulation partly offset by the payment of the 2017 fourth interim dividend and the 2018 first interim dividend. The premises revaluation reserve increased by HK$0.6bn, or 3%, reflecting the upward trend in the commercial property market. Financial assets at fair value through other comprehensive income reserve/available-for-sale investment reserve decreased by HK$0.4bn, or 21%, mainly reflecting the fair-value movement of the Group's investments in financial assets measured at fair value. Other reserves decreased by HK$0.2bn, or 13%, due mainly to a decline in the foreign exchange reserve with the depreciation of the renminbi.

Risk Management

Principal risks and uncertainties

The Group continuously monitors and identifies risks. Our principal risks are credit risk, liquidity and funding risk, market risk, operational risk, regulatory compliance risk, financial crime risk, reputational risk, pension risk, sustainability risk and insurance risk. There is no material change in the principal risks and uncertainties for the remaining six months of the financial year, the description of which can be found in the risk report of the Annual Report 2017. A summary of our current policies and practices regarding the management of risk is set out in the "Risk Management" section of the Annual Report 2017.

Key developments in the first half of 2018

We attach the highest importance to delivering fair outcomes for our customers, and the orderly and transparent operation of financial markets. The embedding and deepening of our approach to conduct across the Group is a priority. This means continuing to focus on key areas of conduct including those relating to support for potentially vulnerable customers, digital channels, and oversight of the conduct standards of key third parties with whom we do business. Such measures are complemented by processes to ensure the consideration of conduct in decision making across the Group and in initiatives relating to culture, values and behaviours. Specific actions to improve our conduct in the first half of 2018 included:

– introducing a framework designed to further ensure conduct considerations are a key part of the Group's strategic planning and decision-making processes; and

– further developing conduct monitoring and testing activity by the Regulatory Compliance sub-function, to help assess the Group-wide embedding of conduct behaviours and processes.

We are on track to transition from the Global Standards Programme by the end of 2018 except the "Transaction Monitoring" capability which will be completed by 3Q 2019, and ensuring the 12 core capabilities are embedded and integrated into our day-to-day operations as well as being effective and sustainable over the long term. The official closure of the above 12 core capabilities will be officially closed by early 2019, except the "Transaction Monitoring" capability which is scheduled for closure in 4Q 2019. We continue to strengthen our governance and policy frameworks and improve our management information on standardised financial crime controls. We continue to make good progress with the three-year programme to further strengthen the bank's anti-bribery and corruption (ABC) risk management capability and are making enhancements to our ABC policy. We have commenced several initiatives to define the next phase of financial crime risk management and to improve effectiveness through the use of artificial intelligence and applying advanced analytics techniques.

(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.

Credit risk in the first half of 2018

The Group has adopted the requirements of HKFRS 9 from 1 January 2018. Under HKFRS 9, the scope of impairment now covers amortised cost financial assets, loan commitments and financial guarantees, as well as debt instruments measured at Fair Value through Other Comprehensive Income ("FVOCI"). Impairment is calculated in three stages and financial instruments are allocated into one of the three stages where the transfer mechanism depends on whether there is a significant increase in credit risk in the relevant reporting period. After the allocation, the measurement of expected credit loss ("ECL"), which is the product of probability of default ("PD"), loss given default ("LGD") and exposure at default ("EAD"), will reflect the change in risk of default occurring over the remaining life of the instruments.

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

Summary of credit risk

The following tables analyse the financial instruments to which the impairment requirements of HKFRS 9 are applied and the related allowance for ECL.

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

	Gross carrying/ nominal amount	Allowance for ECL[1]
Loans and advances to customers at amortised cost:	857,662	(2,425)
– personal	301,531	(1,039)
– corporate and commercial	535,080	(1,354)
– non-bank financial institutions	21,051	(32)
Placings with and advances to banks at amortised cost	85,766	(3)
Other financial assets measured at amortised costs:	140,760	(39)
– cash and sight balances at central banks	10,387	–
– reverse repurchase agreements – non-trading	3,172	–
– financial investments	101,317	(33)
– other assets[2]	25,884	(6)
Total gross carrying amount on balance sheet	1,084,188	(2,467)
Loans and other credit related commitments:	312,657	(70)
Financial guarantee and similar contracts:	17,759	(6)
Total nominal amount off balance sheet[3]	330,416	(76)
At 30 June 2018	1,414,604	(2,543)

	Fair value	Memorandum Allowance for ECL
At 30 June 2018		
Debt instruments measured at Fair Value through Other Comprehensive Income ("FVOCI")[4]	296,547	(5)

1 *For retail 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 commitment.*

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 *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 37(a) of the condensed consolidated financial statements. The figure represents the maximum amount at risk should the contracts be fully drawn upon and clients default.*

4 *For debt instruments measured at FVOCI, the allowance for ECL is a memorandum item and the debt instruments continue to be measured at fair value without netting off the ECL in the condensed consolidated balance sheet.*

5 *The above table does not include balances due from HSBC Group companies.*

(a) Credit Risk *(continued)*

Measurement uncertainty and sensitivity analysis of ECL estimates

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

Methodology

For most portfolios, the Group has adopted the use of three economic scenarios, representative of our view of forecast economic conditions, sufficient to calculate unbiased ECL. They represent a "most likely outcome", (the Central scenario) and two, less likely, "outer" scenarios on either side of the Central, referred to as an "Upside" and a "Downside" scenario respectively. Each outer scenario is consistent with a probability of 10% while the Central scenario is assigned the remaining 80%. This weighting scheme is deemed appropriate for the computation of unbiased ECL. Key scenario assumptions are set using the average of forecasts from external economists, helping to ensure that the HKFRS 9 scenarios are unbiased and maximise the use of independent information.

For the Central scenario, the Group sets key assumptions – such as GDP growth, inflation, unemployment and policy rates – using either the average of external forecasts (commonly referred to as consensus forecasts) for most economies or market prices. An external provider's global macro model, conditioned to follow the consensus forecasts, projects the other paths required as inputs to credit models. This external provider model is subject to the Group's risk governance framework, with oversight by a specialist internal unit.

The Upside and Downside scenarios are designed to be cyclical, in that GDP growth, inflation and unemployment usually revert back to the Central scenario after the first three years for major economies. We determine the maximum divergence of GDP growth from the Central scenario using the 10th and the 90th percentile of the entire distribution of forecast outcomes for major economies. Using externally available forecast distributions ensures independence in scenario construction. While key economic variables are set with reference to external distributional forecasts, we also align the overall narrative of the scenarios to the macroeconomic risks described in the Group's top and emerging risks. This ensures that scenarios remain consistent with the more qualitative assessment of risks captured in top and emerging risks. We project additional variable paths using the external provider's global macro model.

The Central, Upside and Downside scenarios selected with reference to external forecast distributions using the above approach are termed the "Consensus Economic Scenarios".

We apply the following to generate the three economic scenarios:

- Economic risk assessment – We develop a shortlist of the downside and upside economic and political risks most relevant to the Group and the HKFRS 9 measurement objective. These risks include local and global economic and political risks which together affect economies that materially matter to the Group, namely Hong Kong, mainland China, the US, eurozone and UK. We compile this list by monitoring developments in the global economy, by reference to the Group's top and emerging risks, and by consulting external and internal subject matter experts.

- Scenario generation – For the Central scenario, we obtain a pre-defined set of economic forecasts from the average forecast taken from the consensus forecast survey of professional forecasters. Paths for the outer scenarios are benchmarked to the Central scenario and reflect the economic risk assessment. Scenario probabilities reflect management judgement and are informed by data analysis of past recessions, transitions in and out of recession, and the current economic outlook. The key assumptions made, and the accompanying paths, represent our "best estimate" of a scenario at a specified probability. Suitable narratives are developed for the Central scenario and the paths of the outer scenarios.

- Variable enrichment – We expand each scenario through enrichment of variables. This includes the production of more than 400 variables that are required to calculate ECL estimates. The external provider expands these scenarios by using as inputs the agreed scenario narratives and the variables aligned to these narratives. Scenarios, once expanded, continue to be benchmarked to the latest events and information. Late-breaking events could lead to revision of scenarios to reflect management judgement.

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

The Group recognises that the Consensus Economic Scenario approach using three scenarios will be insufficient in certain economic environments. Additional analysis may be requested at management's discretion, including the production of extra scenarios. We anticipate there will be only limited instances when the standard approach will not apply.

The Central scenario

The Group's Central scenario is characterised by steady growth over the forecast period 2018-2023. Global GDP growth is expected to be 3% on average over the period which is marginally higher than the average growth rate over 2011-2016. GDP growth rate is forecast at 3.2% in 2018 and 3.1% in 2019. The elevated growth rates through 2018-19 are considered temporary in nature and global growth reverts to a trend rate of 2.9% by the third year of the five-year projection.

Across the key markets, we note that:

- Expected average rates of growth over the 2018-2023 period are lower than those experienced in the recent past for mainland China, suggesting a rebalancing at a pace in line with expectations.

- Hong Kong is expected to display similar average rates of GDP growth over the forecast period to recent historical experience, supported by cyclical factors.

Inflation is expected to be higher in 2018 across most of our key markets compared with 2017, but is expected to converge back towards central bank targets with varying speed over the projection period. As a consequence, US and eurozone central banks are expected to raise rates very gradually. Policy interest rates in advanced economies are expected to remain below their historical long-term averages over the five year forecast horizon.

Unemployment rates displayed considerable positive cyclical momentum in 2017 across our key markets and such momentum is expected to continue to underpin labour market performance in the forecast period. Central scenario forecasts of the unemployment rate are stable and, for some markets, at historical lows. Stabilisation of oil prices in 2017, helped by the Organization of Petroleum Exporting Countries' output cuts and a fall in inventory, has enabled a stronger price outlook to develop. Despite this, Central scenario oil price expectations remain range-bound between $60 – $62 per barrel over the forecast period.

Central scenario (average Q3 2018 – Q2 2023)

	Hong Kong	*Mainland China*
GDP growth rate (%)	2.7	6.0
Inflation (%)	2.4	2.5
Unemployment (%)	3.2	4.0
Property price growth (%)	4.1	5.6

The Upside scenario

Globally, real GDP growth rises in the first two years of the Upside scenario before converging to the Central scenario. Improved confidence, accommodative monetary policy, fiscal expansion across major economies, including tax reform in the US and diminished political risk are the key themes that support the Upside scenario.

Upside scenario (five-year average)

	Hong Kong	*Mainland China*
GDP growth rate (%)	2.8	6.0
Inflation (%)	2.9	2.7
Unemployment (%)	3.2	3.7
Property price growth (%)	4.0	6.9

(a) Credit Risk *(continued)*

The Downside scenario

Globally, real GDP growth declines for two years in the Downside scenario before recovering to the Central scenario. Property price growth either stalls or contracts and equity markets correct abruptly. The global slowdown in demand drives commodity prices lower and inflation falls. Central banks remain accommodative. This is consistent with the risk themes of rising protectionism, central bank policy uncertainty, mainland China choosing to rebalance at a faster pace and an absence of fiscal support.

Downside scenario (five-year average)

	Hong Kong	*Mainland China*
GDP growth rate (%)	2.0	5.5
Inflation (%)	2.2	2.0
Unemployment (%)	3.8	4.2
Property price growth (%)	1.7	3.0

How economic scenarios are reflected in the wholesale calculation of ECL

The Group has developed a globally consistent methodology for the application of forward economic guidance ("FEG") into the calculation of ECL. This involves the incorporation of FEG into the estimation of the term structure of probability of default ("PD") and loss given default ("LGD"). For PDs, we consider the correlation of FEG to default rates for a particular industry in a country. For LGD calculations we consider the correlation of FEG to loss rates and collateral values for a particular country. PDs and LGDs are estimated for the entire term structure of each instrument.

For stage 3 impaired loans, LGD estimates take into account independent recovery valuations provided by external consultants where available, or internal forecasts corresponding to anticipated economic conditions and individual company conditions. In estimating the ECL on impaired loans that are individually considered not to be significant, the Group incorporates FEG via the application of a scalar. The scalar reflects the ratio of the probability-weighted outcome to the Central scenario outcome for non-stage 3 populations.

How economic scenarios are reflected in the retail calculation of ECL

The impact of FEG on PD is modelled at a portfolio level. Historic relationships between observed default rates and macroeconomic variables are integrated into HKFRS 9 ECL estimates by using economic response models. The impact of FEG on PD is modelled over a period equal to the remaining maturity of underlying asset(s). The impact on LGD is modelled for mortgage portfolios by forecasting future loan-to-value ("LTV") profiles for the remaining maturity of the asset, by using national-level forecasts of the property price index ("PPI") and applying the corresponding LGD expectation.

Effect of multiple economic scenarios on ECL

The ECL recognised in the financial statements (the "HKFRS 9 ECL") reflects the effect on expected credit losses of a range of possible outcomes, calculated on a probability-weighted basis, based on the economic scenarios described above, including management overlays where required. The probability-weighted amount is typically a higher number than would result from using only the Central (most likely) economic scenario. Expected losses typically have a non-linear relationship to the many factors which influence credit losses, such that more favourable macroeconomic factors do not reduce defaults as much as less favourable macroeconomic factors increase defaults. The HKFRS 9 ECL is 0.1% higher than the ECL prepared using only Central Scenario assumptions, reflecting the relatively stable and benign economic outlook across most markets.

(a) Credit Risk (continued)

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

	Non credit – impaired				*Credit – impaired*				*Total*	
	Stage 1		*Stage 2*		*Stage 3*		*POCI*[1]			
	Gross exposure	*Allowance/ provision for ECL*	*Gross exposure*	*Allowance/ provision for ECL*	*Gross exposure*	*Allowance/ provision for ECL*	*Gross exposure*	*Allowance/ provision for ECL*	*Gross exposure*	*Allowance/ provision for ECL*
At 1 January 2018	1,121,935	(692)	78,449	(1,175)	2,001	(745)	173	(18)	1,202,558	(2,630)
Transfers of financial instruments:										
– transfers from Stage 1 to Stage 2	(24,588)	49	24,588	(49)	–	–	–	–	–	–
– transfers from Stage 2 to Stage 1	37,062	(365)	(37,062)	365	–	–	–	–	–	–
– transfers to Stage 3	(771)	2	(616)	14	1,387	(16)	–	–	–	–
– transfers from Stage 3	11	–	8	(1)	(19)	1	–	–	–	–
Net remeasurement of ECL arising from transfer of stage	–	251	–	(169)	–	(3)	–	–	–	79
Changes due to modifications not derecognised	–	–	–	–	(1)	–	–	–	(1)	–
New financial assets originated or purchased, assets derecognised, repayments and further lending	80,470	(73)	(6,312)	187	(351)	103	(122)	12	73,685	229
Changes to risk parameters (model inputs)	–	76	–	(183)	–	(516)	–	–	–	(623)
Changes to model used for ECL calculation	–	–	–	–	–	–	–	–	–	–
Assets written off	–	–	–	–	(433)	433	(4)	4	(437)	437
Foreign exchange and others	(1,787)	2	(171)	2	(2)	–	(1)	–	(1,961)	4
At 30 June 2018	1,212,332	(750)	58,884	(1,009)	2,582	(743)	46	(2)	1,273,844	(2,504)
ECL income statement (charge)/release for the period	N/A	254	N/A	(165)	N/A	(416)	N/A	12	N/A	(315)
Add: Recoveries	N/A	–	N/A	–	N/A	72	N/A	–	N/A	72
Add: Modification gains/(losses) on contractual cash flows that did not result in derecognition	N/A	–	N/A	–	N/A	–	N/A	–	N/A	–
Add/(less): Others	N/A	–	N/A	–	N/A	–	N/A	–	N/A	–
Total ECL (charge)/release for the period	N/A	254	N/A	(165)	N/A	(344)	N/A	12	N/A	(243)

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

2 *The provision for ECL balance at 30 June 2018 and total ECL charge for the period does not include ECL related to other financial assets measured at amortised cost which has an ECL balance of HK$39m at period end and an ECL release of HK$5m during the period.*

3 *The above table does not include balances due from HSBC Group companies.*

(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*	*Allowance for ECL*	*Net*
Placings with and advances to banks at amortised cost	82,914	2,168	684	–	–	85,766	(3)	85,763
– stage 1	82,887	2,008	680	–	–	85,575	(3)	85,572
– stage 2	27	160	4	–	–	191	–	191
– stage 3	–	–	–	–	–	–	–	–
– POCI	–	–	–	–	–	–	–	–
Loans and advances to customers at amortised cost	414,874	220,645	216,271	3,244	2,628	857,662	(2,425)	855,237
– stage 1	411,788	214,067	174,255	1,268	–	801,378	(690)	800,688
– stage 2	3,086	6,578	42,016	1,976	–	53,656	(990)	52,666
– stage 3	–	–	–	–	2,582	2,582	(743)	1,839
– POCI	–	–	–	–	46	46	(2)	44
Other financial assets measured at amortised cost	119,629	14,457	6,663	1	10	140,760	(39)	140,721
– stage 1	119,625	14,228	5,639	–	–	139,492	(36)	139,456
– stage 2	4	229	1,024	1	–	1,258	(3)	1,255
– stage 3	–	–	–	–	10	10	–	10
– POCI	–	–	–	–	–	–	–	–
Loan and other credit-related commitments[2]	248,090	33,165	30,624	778	–	312,657	(70)	312,587
– stage 1	248,020	32,768	28,974	738	–	310,500	(55)	310,445
– stage 2	70	397	1,650	40	–	2,157	(15)	2,142
– stage 3	–	–	–	–	–	–	–	–
– POCI	–	–	–	–	–	–	–	–
Financial guarantees and similar contracts[2]	3,455	7,850	6,388	66	–	17,759	(6)	17,753
– stage 1	3,455	7,377	4,031	16	–	14,879	(2)	14,877
– stage 2	–	473	2,357	50	–	2,880	(4)	2,876
– stage 3	–	–	–	–	–	–	–	–
– POCI	–	–	–	–	–	–	–	–
At 30 June 2018	868,962	278,285	260,630	4,089	2,638	1,414,604	(2,543)	1,412,061
Debt instruments at FVOCI[1]								
– stage 1	296,192	785	–	–	–	296,977	(5)	296,972
– stage 2	–	–	–	–	–	–	–	–
– stage 3	–	–	–	–	–	–	–	–
At 30 June 2018	296,192	785	–	–	–	296,977	(5)	296,972

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 allowance. As such the gross carrying value of debt instruments at FVOCI as presented above will not reconcile to the 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 37(a) of the condensed consolidated financial statements.*

3 *The above table does not include balances due from HSBC Group companies.*

Quality classification definitions

"Strong" exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default.

"Good" exposures demonstrate a good capacity to meet financial commitments, with low default risk.

"Satisfactory" exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk.

"Sub-standard" exposures require varying degrees of special attention and default risk is of greater concern.

"Credit-impaired" exposures have been assessed as impaired.

(a) Credit Risk (continued)

The five credit quality classifications defined above 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 HKAS 39 retail lending credit quality was disclosed based on expected-loss percentages. Under HKFRS 9 retail lending credit quality is now disclosed based on a twelve-month probability-weighted PD. The credit quality classifications for wholesale lending are unchanged and are based on internal credit risk ratings.

Credit quality classification

	Debt securities and other bills	*Wholesale lending*		*Retail lending*	
Quality classification	*External credit rating*	*Internal credit rating*	*12-month Basel probability of default %*	*Internal credit rating*	*12-month Basel probability-weighted PD %*
Strong	A- and above	CRR1 to CRR2	0.000–0.169	Band 1 and 2	0.000–0.500
Good	BBB+ to BBB-	CRR3	0.170–0.740	Band 3	0.501–1.500
Satisfactory	BB+ to B and unrated	CRR4 to CRR5	0.741–4.914	Band 4 and 5	1.501–20.000
Sub-standard	B– to C	CRR6 to CRR8	4.915–99.999	Band 6	20.001–99.999
Credit-impaired	Default	CRR9 to CRR10	100.000	Band 7	100.000

2017 Interim Report credit disclosures

The below disclosures were included in the 2017 Interim Report and do not reflect the adoption of HKFRS 9. As these tables are not directly comparable to the current 2018 credit risk tables which are disclosed on an HKFRS 9 basis, the 2017 Interim Report disclosures have been shown below and not adjacent to 2018 tables.

Concentration of credit risk

Concentration of credit risk exists when changes in geographic, economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is material in relation to the Group's total exposures. The Group's portfolio of financial instruments is diversified along geographic, industry and product sectors. Analysis of geographical concentration of the Group's assets is disclosed in note 17 of the Group's 2017 Interim Report.

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

	At 30 June 2017
Cash and sight balances at central banks	15,872
Placings with and advances to banks	101,685
Trading assets	45,079
Financial assets designated at fair value	393
Derivative financial instruments	7,834
Loans and advances to customers	743,179
Financial investments	389,671
Other assets	15,839
Financial guarantees and other credit related contingent liabilities	7,558
Loan commitments and other credit related commitments	487,749
	1,814,859

(a) Credit Risk *(continued)*

Impaired loans and advances

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

The Group's policy for recognising and measuring impairment allowances on both individually assessed advances and those which are collectively assessed on a portfolio basis is described in note 3(e) on the consolidated financial statements for the year ended 31 December 2017. Further information is also set out on pages 55 to 56 of the Group's Annual Report 2017.

Analysis of impairment allowances at 30 June 2017 and the movement of such allowances during the period are disclosed in note 23 of the Group's 2017 Interim Report condensed consolidated financial statements as below:

	Individually assessed	*Collectively assessed*	*Total*
At 1 January 2017	923	936	1,859
Amounts written off	(114)	(338)	(452)
Recoveries of loans and advances written off in previous years	9	43	52
New impairment allowances charged to condensed consolidated income statement (note 12)	380	386	766
Impairment allowances released to condensed consolidated income statement (note 12)	(53)	(43)	(96)
Unwinding of discount of loan impairment allowances recognised as "interest income"	(29)	(2)	(31)
Exchange difference	13	9	22
At 30 June 2017	1,129	991	2,120

(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 2018.

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 page 57 to 61 of the Group's Annual Report 2017.

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

Liquidity information

The Banking (Liquidity) Rules were introduced by the HKMA in 2014 and became effective from 1 January 2015. Under rule 11(1), the Group is required to calculate its Liquidity Coverage Ratio ("LCR") on a consolidated basis. During 2018, the Group is required to maintain a LCR of not less than 90%, increasing in steps of 10% each year to not less than 100% by January 2019.

The average LCR for the reportable periods are as follows:

	Quarter ended 30 June 2018	***Quarter ended 31 March 2018***	*Quarter ended 30 June 2017*	*Quarter ended 31 March 2017*
Average Liquidity Coverage Ratio	**209.6%**	**207.0%**	256.7%	267.7%

In accordance with the Banking (Liquidity) Rules, the Net Stable Funding Ratio ("NSFR") is implemented in Hong Kong with effect from 1 January 2018 and the Group is required to calculate NSFR in a consolidated basis. During 2018, the Group is required to maintain a NSFR of not less than 100%.

The NSFR for the reportable periods are as follows:

	Quarter ended 30 June 2018	***Quarter ended 31 March 2018***
Net Stable Funding Ratio	**153.6%**	**152.9%**

The liquidity position of the Group remained strong for the first half of 2018. The average LCR were 209.6 % and 207.0% for the quarters ended 30 June and 31 March 2018 respectively, compared with 256.7% and 267.7% for the quarters ended 30 June and 31 March 2017. The period end NSFR were 153.6% and 152.9% for the quarters ended 30 June and 31 March 2018 respectively.

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

The composition of the Group's high quality liquid assets ("HQLA") as defined under Schedule 2 of the Banking (Liquidity) Rules 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 2018	***31 March 2018***	*30 June 2017*	*31 March 2017*
Level 1 assets	**262,800**	**265,754**	283,481	295,635
Level 2A assets	**11,615**	**12,866**	14,980	13,669
Level 2B assets	**551**	**552**	528	766
Total weighted amount of HQLA	**274,966**	**279,172**	298,989	310,070

(c) Market risk

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

There is no material change to the Group's policies and practices for the management of market risk for the first half of 2018.

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 62 to 69 of the Group's Annual Report 2017.

Value at risk ("VaR")

VaR is a technique that estimates the potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. The use of VaR is integrated into market risk management and is calculated for all trading positions regardless of how the Group capitalises those exposures. Where there is no approved internal model, the Group uses the appropriate local rules to capitalise exposures.

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

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

The historical simulation models used incorporate the following features:

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

- potential market movements utilised for VaR are calculated with reference to those historical data; and

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

Risk not in VaR ("RNIV") framework

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

The RNIV framework aims to manage and capitalise material market risks that are not adequately covered in the VaR model. In such instances the RNIV framework uses stress tests to quantify the capital requirement. For the average of the first half of 2018, the capital requirement derived from these stress tests represented 2.4% of the total internal model-based market risk requirement.

RNIV is not viewed as being a material component of the Group's market risk capital requirement. Risks covered by RNIV represent 2.4% of market risk RWAs for models with regulatory approval.

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

Trading portfolios

VaR of the trading portfolios

Trading VaR predominantly resides within Global Markets. The VaR for trading activity at 30 June 2018 was higher while comparing with 30 June 2017, mainly led by interest rate trading activities.

(c) Market risk *(continued)*

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

Trading, 99% 1 day

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

	At 30 June 2017	*Minimum during the period*	*Maximum during the period*	*Average for the period*
VaR				
Trading	27	17	41	27
Foreign exchange trading	14	11	23	18
Interest rate trading	21	12	25	18
Portfolio diversification	(8)	–	–	(9)
Stressed VaR				
Trading	82	68	105	85
Foreign exchange trading	27	24	38	31
Interest rate trading	63	55	92	74
Portfolio diversification	(8)	–	–	(20)

(c) Market risk *(continued)*

Backtesting

While comparing the daily VaR measures to the actual and hypothetical profit and loss for the backtesting, no loss side exception was observed in the first half of 2018. Some profit side exceptions were identified for actual profit and loss and those were mainly driven by intraday profit arising from trading activities.

Non-trading portfolios

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

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

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

Foreign exchange exposure

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

The Group's structural foreign exchange 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 Group's structural foreign currency exposures are managed by the Group's ALCO with the primary objective of ensuring, where practical, that the Group's and the Bank's capital ratios are largely protected from the effect of changes in exchange rates.

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

Equities exposure

The Group's equities exposures in the first half of 2018 and for the year 2017 are mainly long-term equity investments which are reported as "Financial investments". Equities held for trading purpose are included under "Trading assets" and subject to trading limit and risk management control procedures and other market risk regime.

(d) Insurance risk

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

There is no material change to the Group's policies and practices for the management of risk arising in our insurance operations. A summary of the Group's policies and practices regarding the risk management of our insurance operations, insurance model and the main insurance contracts we manufacture are provided on pages 70 to 77 of the Group's Annual Report 2017.

(e) Operational risk

During the first half of 2018, the Group implemented a new Operational Risk Management Framework ("ORMF") and system of record. The new ORMF helps to provide an end to end view of non-financial risks for the first time, focusing on the risks that matter the most, and associated controls. The delivery of the new framework provides us with a platform to further improve our operational risk management capability across the Group.

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

A summary of the Group's current policies and practices for the management of operational risk is set out in "Operational Risk" section on pages 78 to 79 of the Group's Annual Report 2017.

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 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 2018 and 31 December 2017. 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.

Capital Base *(continued)*

	At 30 June 2018	*At 31 December 2017*
Common Equity Tier 1 ("CET1") Capital		
Shareholders' equity	**128,732**	126,241
– Shareholders' equity per condensed consolidated balance sheet	**155,635**	152,030
– Additional Tier 1 ("AT1") perpetual capital instrument	**(6,981)**	(6,981)
– Unconsolidated subsidiaries	**(19,922)**	(18,808)
Non-controlling interests	**–**	–
– Non-controlling interests per condensed consolidated balance sheet	**39**	49
– Non-controlling interests in unconsolidated subsidiaries	**(39)**	(49)
Regulatory deductions to CET1 capital	**(31,190)**	(31,783)
– Cash flow hedging reserve	**81**	41
– Changes in own credit risk on fair valued liabilities	**6**	(5)
– Property revaluation reserves*	**(25,487)**	(24,842)
– Regulatory reserve	**(4,871)**	(6,018)
– Intangible assets	**(454)**	(408)
– Defined benefit pension fund assets	**(48)**	(45)
– Deferred tax assets net of deferred tax liabilities	**(145)**	(211)
– Valuation adjustments	**(272)**	(295)
Total CET1 Capital	**97,542**	94,458
AT1 Capital		
Total AT1 capital before and after regulatory deductions	**6,981**	6,981
– Perpetual capital instrument	**6,981**	6,981
Total AT1 Capital	**6,981**	6,981
Total Tier 1 ("T1") Capital	**104,523**	101,439
Tier 2 ("T2") Capital		
Total T2 capital before regulatory deductions	**14,492**	14,723
– Property revaluation reserves*	**11,469**	11,179
– Impairment allowances and regulatory reserve eligible for inclusion in T2 capital	**3,023**	3,544
Regulatory deductions to T2 capital	**(915)**	(915)
– Significant capital investments in unconsolidated financial sector entities	**(915)**	(915)
Total T2 Capital	**13,577**	13,808
Total Capital	**118,100**	115,247

* *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 2018	*At 31 December 2017*
Credit risk	**534,048**	512,720
Market risk	**11,846**	7,208
Operational risk	**55,655**	52,795
Total	**601,549**	572,723

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 2018	*At 31 December 2017*
CET1 capital ratio	**16.2%**	16.5%
Tier 1 capital ratio	**17.4%**	17.7%
Total capital ratio	**19.6%**	20.1%

The Basel III rules set out the minimum capital requirements, to be phased in sequentially from 1 January 2013 and become fully effective on 1 January 2019. On a pro-forma basis that takes no account of, for example, any future profits or management action and any change in the current regulations or their application before full implementation, the Group's capital ratios at Basel III end point are the same as above as at 30 June 2018. The pro-forma Basel III end point basis position is a mechanical application of the current rules to the capital base as at 30 June 2018, it is not a projection.

In addition, the capital ratios of all tiers as of 30 June 2018 would be reduced by approximately 0.4 percentage point after the prospective second interim dividend payment for 2018. The following table shows the pro-forma basis position of the capital ratios after the prospective interim dividend.

	Pro-forma At 30 June 2018	*Pro-forma At 31 December 2017*
CET1 capital ratio	**15.8%**	15.5%
Tier 1 capital ratio	**17.0%**	16.7%
Total capital ratio	**19.2%**	19.1%

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

Condensed Consolidated Income Statement

	note	Half-year ended 30 June 2018	Half-year ended 30 June 2017
Interest income	5	**17,363**	13,989
Interest expense	6	**(3,135)**	(2,175)
Net interest income		**14,228**	11,814
Fee income		**5,247**	4,418
Fee expense		**(1,258)**	(1,124)
Net fee income	7	**3,989**	3,294
Net income from financial instruments measured at fair value	8	**995**	2,376
Gains less losses from financial investments	9	**24**	48
Dividend income	10	**6**	7
Net insurance premium income		**8,732**	7,107
Other operating income	11	**1,621**	1,039
Total operating income		**29,595**	25,685
Net insurance claims and benefits paid and movement in liabilities to policyholders		**(8,946)**	(8,028)
Net operating income before change in expected credit losses and other credit impairment charges		**20,649**	17,657
Change in expected credit losses and other credit impairment charges	12	**(238)**	N/A
Loan impairment charges and other credit risk provisions	12	**N/A**	(670)
Net operating income		**20,411**	16,987
Employee compensation and benefits		**(2,866)**	(2,540)
General and administrative expenses		**(2,133)**	(2,059)
Depreciation of premises, plant and equipment		**(668)**	(603)
Amortisation of intangible assets		**(55)**	(53)
Operating expenses	13	**(5,722)**	(5,255)
Impairment loss on intangible assets		**(27)**	–
Operating profit		**14,662**	11,732
Net surplus on property revaluation		**78**	50
Share of profits/(losses) of associates		**124**	(136)
Profit before tax		**14,864**	11,646
Tax expense	14	**(2,227)**	(1,812)
Profit for the period		**12,637**	9,834
Attributable to:			
Shareholders of the company		**12,647**	9,838
Non-controlling interests		**(10)**	(4)
(Figures in HK$)			
Earnings per share – basic and diluted	15	**6.62**	5.15

Details of dividends payable to shareholders of the Bank attributable to the profit for the half year are set out in note 16.

The notes on pages 38 to 87 form part of these condensed consolidated financial statements.

Condensed Consolidated Statement of Comprehensive Income

	Half-year ended 30 June 2018	*Half-year ended 30 June 2017*
Profit for the period	**12,637**	9,834
Other comprehensive income		
Items that will be reclassified subsequently to the condensed consolidated income statement when specific conditions are met:		
Available-for-sale investment reserve:		
– fair value changes taken to equity:		
– on debt securities	**N/A**	343
– on equity shares	**N/A**	211
– fair value changes transferred to condensed consolidated income statement:		
– on hedged items	**N/A**	(52)
– on disposal	**N/A**	(48)
– deferred taxes	**N/A**	(24)
– exchange difference and others	**N/A**	70
Debt instruments at fair value through other comprehensive income reserve:		
– fair value changes taken to equity	**(103)**	N/A
– fair value changes transferred to condensed consolidated income statement:		
– on hedged items	**303**	N/A
– on disposal	**(24)**	N/A
– expected credit losses recognised in the condensed consolidated income statement	**(1)**	N/A
– deferred taxes	**(51)**	N/A
– exchange difference	**13**	N/A
Cash flow hedging reserve:		
– fair value changes taken to equity	**22**	(1,372)
– fair value changes transferred to condensed consolidated income statement	**(96)**	1,575
– deferred taxes	**13**	(34)
Exchange differences on translation of:		
– financial statements of overseas branches, subsidiaries and associates	**(176)**	343
Items that will not be reclassified subsequently to the condensed consolidated income statement:		
Change in fair value of financial liabilities designated at fair value arising from changes in own credit risk	**(11)**	(6)
Equity instrument:		
– fair value changes taken to equity	**(456)**	N/A
– exchange difference	**(44)**	N/A
Premises:		
– unrealised surplus on revaluation of premises	**1,040**	1,043
– deferred taxes	**(174)**	(176)
– exchange difference	**(3)**	6
Defined benefit plans:		
– actuarial gains/(losses) on defined benefit plans	**(37)**	180
– deferred taxes	**6**	(29)
Other comprehensive income for the period, net of tax	**221**	2,030
Total comprehensive income for the period	**12,858**	11,864
Total comprehensive income for the period attributable to:		
– shareholders of the company	**12,868**	11,868
– non-controlling interests	**(10)**	(4)
	12,858	11,864

The notes on pages 38 to 87 form part of these condensed consolidated financial statements.

Condensed Consolidated Balance Sheet

	note	At 30 June 2018	At 31 December 2017
ASSETS			
Cash and sight balances at central banks	18	**10,387**	21,718
Placings with and advances to banks	19	**97,183**	103,113
Trading assets	20	**44,283**	53,704
Financial assets designated and otherwise mandatorily measured at fair value	21	**13,070**	N/A
Financial assets designated at fair value	21	**N/A**	9,313
Derivative financial instruments	22	**9,329**	10,836
Reverse repurchase agreements – non-trading		**3,172**	–
Loans and advances to customers	23	**855,237**	806,573
Financial investments	24	**402,167**	385,261
Interest in associates	25	**2,408**	2,170
Investment properties	26	**9,858**	10,166
Premises, plant and equipment	27	**29,742**	28,499
Intangible assets	28	**16,786**	15,354
Other assets	29	**41,000**	31,711
Total assets		**1,534,622**	1,478,418
LIABILITIES AND EQUITY			
Liabilities			
Current, savings and other deposit accounts	30	**1,116,777**	1,074,837
Repurchase agreements – non-trading		**5,796**	2,389
Deposits from banks		**5,552**	3,676
Trading liabilities	31	**41,921**	88,270
Financial liabilities designated at fair value	32	**46,049**	1,047
Derivative financial instruments	22	**9,666**	11,169
Certificates of deposit and other debt securities in issue	33	**–**	600
Other liabilities	34	**25,694**	22,222
Liabilities under insurance contracts		**118,731**	115,545
Current tax liabilities		**2,575**	568
Deferred tax liabilities		**6,187**	6,016
Total liabilities		**1,378,948**	1,326,339
Equity			
Share capital		**9,658**	9,658
Retained profits		**117,360**	113,646
Other equity instruments	36	**6,981**	6,981
Other reserves		**21,636**	21,745
Total shareholders' equity	35	**155,635**	152,030
Non-controlling interests		**39**	49
Total equity		**155,674**	152,079
Total equity and liabilities		**1,534,622**	1,478,418

The notes on pages 38 to 87 form part of these condensed consolidated financial statements.

Condensed Consolidated Statement of Changes in Equity

				Other reserves							
	Share capital	Other equity instruments	Retained profits	Premises revaluation reserve	Financial assets at FVOCI[1] reserve	Cash flow hedge reserve	Foreign exchange reserve	Others[2]	Total shareholders' equity	Non-controlling interests	Total equity
At 31 December 2017	9,658	6,981	113,646	18,379	2,116	(99)	706	643	152,030	49	152,079
Impact on transition to HKFRS 9	–	–	(776)	–	(78)	–	–	–	(854)	–	(854)
At 1 January 2018	9,658	6,981	112,870	18,379	2,038	(99)	706	643	151,176	49	151,225
Profit for the period	–	–	12,647	–	–	–	–	–	12,647	(10)	12,637
Other comprehensive income (net of tax)	–	–	(31)	863	(363)	(61)	(176)	(11)	221	–	221
Debt instruments at fair value through other comprehensive income	–	–	–	–	137	–	–	–	137	–	137
Equity instruments at fair value through other comprehensive income	–	–	–	–	(500)	–	–	–	(500)	–	(500)
Cash flow hedges	–	–	–	–	–	(61)	–	–	(61)	–	(61)
Change in fair value of financial liabilities designated at fair value arising from changes in own credit risk	–	–	–	–	–	–	–	(11)	(11)	–	(11)
Property revaluation	–	–	–	863	–	–	–	–	863	–	863
Actuarial losses on defined benefit plans	–	–	(31)	–	–	–	–	–	(31)	–	(31)
Exchange differences and others	–	–	–	–	–	–	(176)	–	(176)	–	(176)
Total comprehensive income for the period	–	–	12,616	863	(363)	(61)	(176)	(11)	12,868	(10)	12,858
Dividends paid	–	–	(8,412)	–	–	–	–	–	(8,412)	–	(8,412)
Coupon paid to holder of AT1 capital instrument	–	–	–	–	–	–	–	–	–	–	–
Movement in respect of share-based payment arrangements	–	–	(3)	–	–	–	–	6	3	–	3
Transfers and others	–	–	289	(289)	–	–	–	–	–	–	–
At 30 June 2018	9,658	6,981	117,360	18,953	1,675	(160)	530	638	155,635	39	155,674

1 *FVOCI stands for fair value through other comprehensive income and the balance at 31 December 2017 represents the available-for-sale investment reserve under HKAS 39 basis.*

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

The notes on pages 38 to 87 form part of these condensed consolidated financial statements.

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

	Share capital	Other equity instruments	Retained profits	Other reserves: Premises revaluation reserve	Other reserves: Available-for-sale investment reserve	Other reserves: Cash flow hedge reserve	Other reserves: Foreign exchange reserve	Other reserves: Others[2]	Total shareholders' equity	Non-controlling interests	Total equity
At 1 January 2017	9,658	6,981	105,204	16,982	1,434	(128)	(162)	657	140,626	60	140,686
Profit for the period	–	–	9,838	–	–	–	–	–	9,838	(4)	9,834
Other comprehensive income (net of tax)	–	–	151	873	500	169	343	(6)	2,030	–	2,030
Available-for-sale investments	–	–	–	–	500	–	–	–	500	–	500
Cash flow hedges	–	–	–	–	–	169	–	–	169	–	169
Change in fair value of financial liabilities designated at fair value arising from changes in own credit risk	–	–	–	–	–	–	–	(6)	(6)	–	(6)
Property revaluation	–	–	–	873	–	–	–	–	873	–	873
Actuarial gains on defined benefit plans	–	–	151	–	–	–	–	–	151	–	151
Exchange differences and others	–	–	–	–	–	–	343	–	343	–	343
Total comprehensive income for the period	–	–	9,989	873	500	169	343	(6)	11,868	(4)	11,864
Dividends paid	–	–	(7,647)	–	–	–	–	–	(7,647)	–	(7,647)
Coupon paid to holder of AT1 capital instrument	–	–	–	–	–	–	–	–	–	–	–
Movement in respect of share-based payment arrangements	–	–	(3)	–	–	–	–	(4)	(7)	–	(7)
Transfers and others	–	–	244	(244)	–	–	–	–	–	1	1
At 30 June 2017	9,658	6,981	107,787	17,611	1,934	41	181	647	144,840	57	144,897
At 1 July 2017	9,658	6,981	107,787	17,611	1,934	41	181	647	144,840	57	144,897
Profit for the period	–	–	10,180	–	–	–	–	–	10,180	(11)	10,169
Other comprehensive income (net of tax)	–	–	320	1,050	182	(140)	525	2	1,939	–	1,939
Available-for-sale investments	–	–	–	–	182	–	–	–	182	–	182
Cash flow hedges	–	–	–	–	–	(140)	–	–	(140)	–	(140)
Change in fair value of financial liabilities designated at fair value arising from changes in own credit risk	–	–	–	–	–	–	–	2	2	–	2
Property revaluation	–	–	–	1,050	–	–	–	–	1,050	–	1,050
Actuarial gains on defined benefit plans	–	–	320	–	–	–	–	–	320	–	320
Exchange differences and others	–	–	–	–	–	–	525	–	525	–	525
Total comprehensive income for the period	–	–	10,500	1,050	182	(140)	525	2	12,119	(11)	12,108
Dividends paid	–	–	(4,588)	–	–	–	–	–	(4,588)	–	(4,588)
Coupon paid to holder of AT1 capital instrument	–	–	(389)	–	–	–	–	–	(389)	–	(389)
Movement in respect of share-based payment arrangements	–	–	(1)	–	–	–	–	(15)	(16)	–	(16)
Transfers and others	–	–	337	(282)	–	–	–	9	64	3	67
At 31 December 2017	9,658	6,981	113,646	18,379	2,116	(99)	706	643	152,030	49	152,079

The notes on pages 38 to 87 form part of these condensed consolidated financial statements.

Condensed Consolidated Cash Flow Statement

	Half-year ended 30 June 2018	*Half-year ended 30 June 2017*
		(Re-presented)
Profit before tax	**14,864**	11,646
Adjustments for non-cash items:		
Depreciation	**668**	603
Amortisation of intangible assets	**55**	53
Net interest income	**(14,228)**	(11,814)
Dividend income	**(6)**	(7)
Gains less losses from financial investments	**(24)**	(48)
Share of profits/(losses) in associates	**(124)**	136
Net surplus on property revaluation	**(78)**	(50)
Change in expected credit losses and other credit impairment charges	**238**	N/A
Loan impairment charges and other credit risk provisions	**N/A**	670
Loans and advances written off net of recoveries	**(365)**	(400)
Movement in present value of in-force long-term insurance business ("PVIF")	**(1,379)**	(742)
Interest received	**14,550**	11,471
Interest paid	**(2,852)**	(1,944)
Elimination of exchange differences and other non-cash items	**(630)**	(8,252)
Changes in operating assets and liabilities		
Change in financial assets designated at fair value	**(3,150)**	(1,391)
Change in trading assets	**693**	(7,131)
Change in derivative financial instruments	**4**	4,199
Change in reverse repurchase agreements – non-trading	**(3,172)**	–
Change in placings with and advances to banks maturing after one month	**5,229**	21,816
Change in loans and advances to customers	**(49,335)**	(44,533)
Change in other assets	**(7,840)**	559
Change in current, savings and other deposit accounts	**41,940**	23,288
Change in deposits from banks	**1,876**	(9,948)
Change in repurchase agreements – non-trading	**3,407**	4,965
Change in certificates of deposit and other debt securities in issue	**(600)**	(3,965)
Change in financial liabilities designated at fair value	**45,002**	48
Change in trading liabilities	**(46,349)**	10,256
Change in liabilities under insurance contracts	**3,186**	4,146
Change in other liabilities	**4,013**	(2,288)
Interest received from financial investments	**2,800**	2,419
Dividends received from financial investments	**15**	9
Tax paid	**(9)**	(5)
Net cash from operating activities	**8,399**	3,766
Purchase of financial investments	**(285,382)**	(257,284)
Proceeds from sale or redemption of financial investments	**273,163**	277,697
Repayment of shareholders' loan from an associated company	**74**	–
Purchase of property, plant and equipment and intangible assets (excluding PVIF)	**(647)**	(371)
Net cash inflow from the sales of loan portfolio	**798**	54
Net cash from investing activities	**(11,994)**	20,096
Interest paid for subordinated liabilities	**–**	(60)
Dividends paid	**(8,412)**	(7,647)
Net cash from financing activities	**(8,412)**	(7,707)
Net increase/(decrease) in cash and cash equivalents	**(12,007)**	16,155
Cash and cash equivalents at 1 January	**110,673**	88,592
Exchange differences in respect of cash and cash equivalents	**(357)**	2,207
Cash and cash equivalents at 30 June	**98,309**	106,954

The notes on pages 38 to 87 form part of these condensed consolidated financial statements.

Condensed Consolidated Cash Flow Statement *(continued)*

	Half-year ended 30 June 2018	Half-year ended 30 June 2017
		(Re-presented)
Cash and cash equivalents comprise[1]:		
– cash and sight balances at central banks	**10,387**	15,872
– balances with banks	**7,180**	5,898
– items in the course of collection from other banks	**7,920**	4,958
– placings with and advances to banks maturing within one month	**54,096**	57,998
– treasury bills	**26,891**	29,115
– certificates of deposit	**4**	344
– less: items in the course of transmission to other banks	**(8,169)**	(7,231)
	98,309	106,954

1 *The balances of cash and cash equivalents included cash and sight balances at central banks, balances with banks and placings with and advances to banks maturing within one month that are subject to exchange control and regulatory restrictions, amounting to HK$15,814m at 30 June 2018 (30 June 2017: HK$20,108m).*

At 31 December 2017 we enhanced the presentation of the consolidated statement of cash flows. As a result of this change, certificates of deposit with maturity of more than three months and financial investments held for backing liabilities to long-term policyholders are now presented as investing activities (previously presented as operating activities) with immaterial changes in cash and cash equivalents. Corresponding figures for the half-year ended 30 June 2017 have been re-presented accordingly.

1 Basis of preparation

These condensed consolidated financial statements have been prepared in accordance with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and in compliance with Hong Kong Accounting Standard ("HKAS")34, Interim Financial Reporting, issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). The condensed consolidated financial statements was reviewed by the Audit Committee. The Board of Directors of the Bank has approved the condensed consolidated financial statements on 6 August 2018.

The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended 31 December 2017, which have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs").

The preparation of the condensed consolidated financial statements in conformity with HKAS 34 requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses on a year to date basis. Actual results may differ from these estimates. In preparing the condensed consolidated financial statements, the significant judgement made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements for the year ended 31 December 2017 other than those relating to HKFRS 9 which was first adopted on 1 January 2018.

The condensed consolidated financial statements are unaudited, but has been reviewed by PricewaterhouseCoopers ("PwC") in accordance with Hong Kong Standards on Review Engagements 2410, Review of Interim Financial Information Performed by the Independent Auditor of the Entity, issued by HKICPA. PwC's independent review report to the Board of Directors is included on page 88.

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 2017, as disclosed in the Annual Report for 2017.

<u>Standards applied during the half-year to 30 June 2018</u>
The Group has adopted the requirements of HKFRS 9 from 1 January 2018, with the exception of the provisions relating to the presentation of gains and losses on financial liabilities designated at fair value, which were adopted from 1 January 2017. This includes the adoption of "Prepayment Features with Negative Compensation (Amendments to HKFRS 9)" which is effective for annual periods beginning on or after 1 January 2019 with early adoption permitted. The effect of its adoption is not considered to be significant. HKFRS 9 includes an accounting policy choice to remain with HKAS 39 hedge accounting, which the Group has exercised. The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application. As permitted by HKFRS 9, the Group has not restated comparatives. Adoption reduced net assets at 1 January 2018 by HK$854m as set out in note 3.

In addition, the Group has adopted the requirements of HKFRS 15 "*Revenue from contracts with customers*" and a number of interpretations and amendments to standards which have had an insignificant effect on the condensed consolidated financial statements of the Group.

2 Accounting policies *(continued)*

Changes in accounting policy

While not necessarily required by the adoption of HKFRS 9, the following voluntary changes in accounting policy and presentation have been made as a result of reviews carried out in conjunction with its adoption. The effect of presentational changes at 1 January 2018 is included in the reconciliation in note 3 and the comparatives have not been restated.

– The Group has considered market practices for the presentation of certain financial liabilities which contain both deposit and derivative components. It was concluded that a change in accounting policy and presentation with respect to "trading liabilities – structured deposits and structured debt securities in issue" would be appropriate, since it would better align with the presentation of similar financial instruments by peers and therefore provide more relevant information about the effect of these financial liabilities on the financial position and performance. As a result, rather than being classified as held for trading, the Group will designate these financial liabilities as at fair value through profit or loss since they are managed and their performance evaluated on a fair value basis. A further consequence of this change in presentation is that the effect of changes in the liabilities' credit risk will be presented in other comprehensive income with the remaining effect presented in profit or loss in accordance with accounting policy adopted in 2017 (following the adoption of the requirements in HKFRS 9 relating to the presentation of gains and losses on financial liabilities designated at fair value).

– Cash collateral, margin and settlement accounts have been reclassified from "Trading assets", "Placings with and advances to banks" and "Loans and advances to customers" to "Other assets" and from "Trading liabilities" and "Deposits from banks" and "Current, savings and other deposit accounts" to "Other liabilities". Settlement accounts have been reclassified from "Trading assets" to "Other assets" in accordance with HKFRS 9. Cash collateral, margin and settlement accounts previously presented as "Placings with and advances to banks" and "Loans and advances to customers" have been represented in "Other assets" to ensure consistent presentation of such balances. The change in presentation for financial liabilities is considered to provide more relevant information, given the change in presentation for the financial assets. The change in presentation for financial liabilities has had no effect on measurement of these items and therefore on retained earnings or profit for any period.

Summary of significant accounting policies

Set out below are the new or substantially revised accounting policies implementing HKFRS 9 which replace the existing HKAS 39 policies. The accounting policies on hedge accounting are substantially unchanged and are not repeated. The following policies will substantially replace existing policies (d), (e), (f), (i) and (k) in the Annual Report for 2017 with subsequent policies in the Annual Report for 2018 being renumbered:

(a) Financial instruments measured at amortised cost

Financial assets that are held to collect the contractual cash flows and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest, such as most loans and advances to banks and customers and some debt securities, are measured at amortised cost. In addition, most financial liabilities are measured at amortised cost. The carrying value of these financial assets at initial recognition includes the directly attributed transactions costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some leveraged finance and syndicated lending activities, the difference is deferred and recognised over the life of the loan through the recognition of interest income, unless the loan becomes impaired.

The Group may commit to underwriting loans on fixed contractual terms for specified periods of time. When the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative. When the Group intends to hold the loan, the loan commitment is included in the impairment calculations set out below.

2 Accounting policies *(continued)*

Summary of significant accounting policies *(continued)*

(b) Financial assets measured at fair value through other comprehensive income ("FVOCI")

Financial assets held for a business model that is achieved by both selling and collecting contractual cash flows and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest are measured at FVOCI. These comprise primarily debt securities. They are recognised on the trade date when the Group enters into contractual arrangements to purchase and are normally derecognised when they are either sold or redeemed. They are subsequently remeasured at fair value and changes therein (except for those relating to impairment, interest income and foreign currency exchange gains and losses) are recognised in other comprehensive income until the assets are sold. Upon disposal, the cumulative gains or losses in other comprehensive income are recognised in the income statement as "Gains less losses from financial investments". Financial assets measured at FVOCI are included in the impairment calculations set out below and impairment is recognised in profit or loss.

(c) Equity securities measured at fair value with fair value movement presented in OCI

The equity securities for which fair value movements are shown in OCI are business facilitation and other similar investments where the Group holds the investments other than to generate a capital return. Gains or losses on the derecognition of these equity securities are not transferred to profit or loss. Otherwise equity securities are measured at fair value through profit or loss (except for dividend income which is recognised in profit or loss).

(d) Financial instruments designated at fair value

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below and are so designated irrevocably at inception:

- the use of the designation removes or significantly reduces an accounting mismatch;
- when a group of financial assets and liabilities or a group of financial liabilities is managed and its performance is evaluated on the fair value basis, in accordance with a documented risk management or investment strategy; and
- where the financial liabilities contains one or more non-closely related embedded derivatives.

Designated financial assets are recognised when the Group enters into contracts with counterparties, which is generally on trade date, and are normally derecognized when the rights to the cash flows expire or are transferred. Designated financial liabilities are recognised when the Group enters into contracts with counterparties, which is generally on settlement date, and are normally derecognised when extinguished. Subsequent changes in fair value are recognised in the income statement in "Net income from financial instruments measured at fair value".

Under the above criterion, the main classes of financial instruments designated by the Group are:

- Long-term debt issues
  The interest and/or foreign exchange exposure on certain fixed rate debt securities issued has been matched with the interest and/or foreign exchange exposure on certain swaps as part of a documented risk management strategy.
- Financial assets and financial liabilities under unit-linked and non-linked investment contracts
  A contract under which the Group does not accept significant insurance risk from another party is not classified as an insurance contract, other than investment contracts with discretionary participation features ("DPF"), but is accounted for as a financial liability. Customer liabilities under linked and certain non-linked investment contracts issued by insurance subsidiaries are determined based on the fair value of the assets held in the linked funds. If no fair value designation was made for the related assets, at least some of the assets would otherwise be measured at either fair value through other comprehensive income or amortised cost. The related financial assets and liabilities are managed and reported to management on a fair value basis. Designation at fair value of the financial assets and related liabilities allows changes in fair values to be recorded in the income statement and presented in the same line.

2 Accounting policies *(continued)*

Summary of significant accounting policies *(continued)*

(e) Derivatives

Derivatives are financial instruments that derive their value from the price of underlying item such as equities, interest rates or other indices. Derivatives are recognised initially and are subsequently measured at fair value. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative. This includes embedded derivatives in financial liabilities which are bifurcated from the host contract when they meet the definition of a derivative on a stand-alone basis.

Where the derivatives are managed with debt securities issued by the Group that are designated at fair value, the contractual interest is shown in "Interest expense" together with the interest payable on the issued debt.

(f) Impairment of amortised cost and FVOCI financial assets

Expected credit losses are recognised for loans and advances to banks and customers, non-trading reverse repurchase agreements, other financial assets held at amortised cost, debt instruments measured at fair value through other comprehensive income, and certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is required for ECL resulting from default events that are possible within the next 12 months (or less, where the remaining life is less than 12 months) ("12-month ECL"). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ("lifetime ECL"). Financial assets where 12-month ECL is recognised are considered to be "stage 1"; financial assets which are considered to have experienced a significant increase in credit risk are in "stage 2"; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit-impaired are in "stage 3". Purchased or originated credit-impaired financial assets (POCI) are treated differently as set out below.

Credit-impaired (stage 3)

The Group determines that a financial instrument is credit-impaired and in stage 3 by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are 90 days past due or above;
- there are other indications that the borrower is unlikely to pay such as that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and
- the loan is otherwise considered to be in default.

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due.

Interest income is recognised by applying the effective interest rate to the amortised cost amount, i.e. gross carrying amount less ECL allowance.

Write-off

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

2 Accounting policies *(continued)*

Summary of significant accounting policies *(continued)*

(f) Impairment of amortised cost and FVOCI financial assets *(continued)*

Renegotiation

Loans are identified as renegotiated and classified as credit-impaired when the contractual payment terms are modified due to significant credit distress of the borrower. Renegotiated loans remain classified as credit-impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows and retain the designation of renegotiated until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement is made on substantially different terms or if the terms of an existing agreement are modified such that the renegotiated loan is a substantially different financial instrument. Any new loans that arise following derecognition events in these circumstances are considered to be POCI and will continue to be disclosed as renegotiated loans.

Other than originated credit-impaired loans, all other modified loans could be transferred out of stage 3 if they no longer exhibit any evidence of being credit-impaired. In the case of renegotiated loans under wholesale portfolios, there should be sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, over the minimum observation period, and there are no other indicators of impairment. These loans could be transferred to stage 1 or 2 based on the mechanism as described below by comparing the risk of default occurring at the reporting date (based on the modified contractual terms) and the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms). Any amount written off as a result of the modification of contractual terms would not be reversed. While for retail portfolios, renegotiated loans remain in stage 3 for their renegotiated lifetime.

Loan modifications that are not credit-impaired

Loan modifications that are not identified as renegotiated are considered to be commercial restructuring. Where a commercial restructuring results in a modification (whether legalised through an amendment to the existing terms or the issuance of a new loan contract) such that the Group's rights to the cash flows under the original contract have expired, the old loan is derecognised and the new loan is recognised at fair value. The rights to cash flows are generally considered to have expired if the commercial restructuring is re-negotiated at market rates and no payment-related concession has been provided.

Significant increase in credit risk (stage 2)

An assessment of whether credit risk has increased significantly is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. The assessment explicitly or implicitly have experienced a significant increase in credit risk, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. The assessment is unbiased, probability-weighted, and to the extent relevant, uses forward-looking information consistent with that used in the measurement of ECL. The analysis of credit risk is multifactor. The determination of whether a specific factor is relevant and its weight compared with other factors depends on the type of product, the characteristics of the financial instrument, the borrower and the geographical region. Therefore, it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk and these criteria will differ for different types of lending, particularly between retail and wholesale. However, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when 30 days past due. In addition, wholesale loans that are individually assessed, typically corporate and commercial customers, and included on a watch or worry list are included in stage 2.

2 Accounting policies *(continued)*

Summary of significant accounting policies *(continued)*

(f) Impairment of amortised cost and FVOCI financial assets *(continued)*

Significant increase in credit risk (stage 2) *(continued)*

For wholesale portfolios, the quantitative comparison assesses default risk using a lifetime probability of default which encompasses a wide range of information including the obligor's customer risk rating, macroeconomic condition forecasts and credit transition probabilities. Significant increase in credit risk is measured by comparing the average probability of default ("PD") for the remaining term estimated at origination with the equivalent estimation at reporting date (or that the origination PD has doubled in the case of origination CRR greater than 3.3). The significance of changes in PD was informed by expert credit risk judgment, referenced to historical credit migrations and to relative changes in external market rates. The quantitative measure of significance varies depending on the credit quality at origination as follows:

Origination CRR	Significance trigger – PD to increase by
0.1 – 1.2	15bps
2.1 – 3.3	30bps
Greater than 3.3 and not impaired	2x

For loans originated prior to the implementation of HKFRS 9, the origination PD does not include adjustments to reflect expectations of future macroeconomic conditions since these are not available without the use of hindsight. In the absence of this data, origination PD must be approximated assuming through-the-cycle ("TTC") PDs and TTC migration probabilities, consistent with the instrument's underlying modelling approach and the CRR at origination. For these loans, the quantitative comparison is supplemented with additional CRR deterioration based thresholds as set out in the table below:

Origination CRR	Additional significance criteria – Number of CRR grade notches deterioration required to identify as significant credit deterioration (stage 2) (> or equal to)
0.1	5 notches
1.1–4.2	4 notches
4.3–5.1	3 notches
5.2–7.1	2 notches
7.2–8.2	1 notches
8.3	0 notches

Further information about the 23-grade scale used for CRR can be found on page 52 of the Annual Report for 2017.

For certain portfolios of debt securities where external market ratings are available and credit ratings are not used in credit risk management, the debt securities will be in stage 2 if their credit risk increases to the extent they are no longer considered investment grade. Investment grade is where the financial instrument has a low risk of incurring losses, the structure has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil their contractual cash flow obligations.

For retail portfolios, default risk is assessed using a reporting date PD derived from credit history which incorporate all available information about the customer. This PD is adjusted for the effect of macroeconomic forecasts and is considered to be a reasonable approximation of a lifetime PD measure. Retail exposures are divided into account level and homogeneous segment level measurement. Within each portfolio, the stage 2 accounts are defined as accounts with 12-month PD greater than the average 12-month PD of loans in that portfolio 12 months before they become 30 days past due.

2 Accounting policies *(continued)*

Summary of significant accounting policies *(continued)*

(f) Impairment of amortised cost and FVOCI financial assets *(continued)*

Unimpaired and without significant increase in credit risk (stage 1)

ECL resulting from default events that are possible within the next 12 months ("12-month ECL") are recognised for financial instruments that remain in stage 1.

Purchased or originated credit-impaired

Financial assets that are purchased or originated at a deep discount that reflects the incurred credit losses are considered to be POCI. This population includes the recognition of a new financial instrument following a renegotiation where concessions have been granted for economic or contractual reasons relating to the borrower's financial difficulty that otherwise would not have been considered. The amount of change-in-lifetime ECL is recognised in profit or loss until the POCI is derecognised, even if the lifetime ECL are less than the amount of ECL included in the estimated cash flows on initial recognition.

Movement between stages

Financial assets can be transferred between the different categories (other than POCI) depending on their relative increase in credit risk since initial recognition. Financial instruments are transferred out of stage 2 if their credit risk is no longer considered to be significantly increased since initial recognition based on the assessments described above. Except for renegotiated loans, financial instruments are transferred out of stage 3 when they no longer exhibit any evidence of credit impairment as described above. For wholesale portfolios, renegotiated loans that are not POCI will continue to be in stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, observed over a minimum one-year period and there are no other indicators of impairment. While for retail portfolios, renegotiated loans remain in stage 3 for their renegotiated lifetime. For loans that are assessed for impairment on a portfolio basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

Measurement of ECL

The assessment of credit risk, and the estimation of ECL, are unbiased and probability-weighted, and incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money.

In general, the Group calculates ECL using three main components, PD, a loss given default ("LGD") and the exposure at default ("EAD").

The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated using the lifetime PD instead. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument respectively.

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of committed facilities. The LGD represents expected losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realised and the time value of money.

2 Accounting policies *(continued)*

Summary of significant accounting policies *(continued)*

(f) Impairment of amortised cost and FVOCI financial assets *(continued)*

Measurement of ECL *(continued)*

The Group leverages the Basel framework where possible, with recalibration to meet the differing HKFRS 9 requirements as follows:

Model	Regulatory capital	HKFRS 9
PD	– Through the cycle (represents long-run average PD throughout a full economic cycle)	– Point in time (based on current conditions, adjusted to take into account estimates of future conditions that will impact PD)
	– The definition of default includes a backstop of 90+ days past due	– An obligor/an account being 90 days past due or above is considered as defaulted
	– Regulatory floors may apply according to regulatory requirements	– No floors is required under HKFRS 9
EAD	– Cannot be lower than current balance	– Amortisation captured for term products
LGD	– Downturn LGD (consistent losses expected to be suffered during a severe but plausible economic downturn)	– Expected LGD (based on estimate of loss given default including the expected impact of future economic conditions such as changes in value of collateral)
	– Regulatory floors may apply according to regulatory requirements	– No floors is required under HKFRS 9
	– Discounted using cost of capital	– Discounted using the effective interest rate of the loan
	– All collection costs included	– Only costs associated with obtaining/selling collateral included
Other		– Discounted back from point of default to balance sheet date

While 12-month PDs are recalibrated from Basel models where possible, the lifetime PDs are determined by projecting the 12-month PD using a term structure. For the wholesale methodology, the lifetime PD also takes into account credit migration, i.e. a customer migrating through the CRR bands over its life.

The ECL for wholesale stage 3 is determined on an individual basis using a discounted cash flow ("DCF") methodology. The expected future cash flows are based on the credit risk officer's estimates as at the reporting date, reflecting reasonable and supportable assumptions and projections of future recoveries and expected future receipts of interest. Collateral is taken into account if it is likely that the recovery of the outstanding amount will include realisation of collateral based on its estimated fair value of collateral at the time of expected realisation, less costs for obtaining and selling the collateral. The cash flows are discounted at a reasonable approximation of the original effective interest rate. For significant cases, cash flows under four different scenarios are probability-weighted by reference to the three economic scenarios applied more generally by the Group and the judgement of the credit risk officer in relation to the likelihood of the workout strategy succeeding or receivership being required. For less significant cases, the effect of different economic scenarios and work-out strategies is approximated and applied as an adjustment to the most likely outcome.

2 Accounting policies *(continued)*

Summary of significant accounting policies *(continued)*

(f) Impairment of amortised cost and FVOCI financial assets *(continued)*

Period over which ECL is measured

Expected credit loss is measured from the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the Group is exposed to credit risk. For wholesale overdrafts, credit risk management actions are taken no less frequently than on an annual basis and therefore this period is to the expected date of the next substantive credit review. The date of the substantive credit review also represents the initial recognition of the new facility. However, where the financial instrument includes both a drawn and undrawn commitment and the contractual ability to demand repayment and cancel the undrawn commitment does not serve to limit the Group's exposure to credit risk to the contractual notice period, the contractual period does not determine the maximum period considered. Instead, ECL is measured over the period the Group remains exposed to credit risk that is not mitigated by credit risk management actions. This applies to retail revolving loan, overdrafts and credit cards, where the period is the average time taken for stage 2 exposures to default or close as performing accounts, determined on a portfolio basis and ranging from between two and six years. In addition, for these facilities it is not possible to identify the ECL on the loan commitment component separately from the financial asset component. As a result, the total ECL is recognised in the loss allowance for the financial asset unless the total ECL exceeds the gross carrying amount of the financial asset, in which case the ECL in excess of the carrying amount of the financial asset is recognised as a provision.

Forward-looking economic inputs

The Group will in general apply three forward-looking global economic scenarios determined with reference to external forecast distributions, the Consensus Economic Scenario approach. This approach is considered sufficient to calculate unbiased expected loss in most economic environments. They represent a "most likely outcome" (the Central scenario) and two, less likely, "Outer" scenarios on either side of the Central, referred to as an Upside and a Downside scenario respectively. The Central scenario is used by the annual operating planning process and, with regulatory modifications, will also be used in enterprise-wide stress tests. The Upside and Downside are constructed following a standard process supported by a scenario narrative reflecting the Group's current top and emerging risks. The relationship between the Outer scenarios and Central scenario will generally be fixed with the Central scenario being assigned a weighting of 80% and the Upside and Downside scenarios 10% each, with the difference between the Central and Outer scenarios in terms of economic severity being informed by the spread of external forecast distributions among professional industry forecasts. The Outer scenarios are economically plausible, internally consistent states of the world and will not necessarily be as severe as scenarios used in stress testing. The period of forecast is five years, after which the forecasts will revert to a view based on average past experience. The central forecast and spread between the Central and Outer scenarios is grounded on the expected gross domestic product of the major countries, Hong Kong and mainland China. The economic factors include, but are not limited to, gross domestic product, unemployment, interest rates, inflation and commercial property prices across all the countries in which the Group operates.

In general, the consequences of the assessment of credit risk and the resulting ECL outputs will be probability-weighted using the standard probability weights. This probability weighting may be applied directly or the effect of the probability weighting determined on a periodic basis, at least annually, and then applied as an adjustment to the outcomes resulting from the central economic forecast. The central economic forecast is updated quarterly.

The Group recognises that the Consensus Economic Scenario approach using three scenarios will be insufficient in certain economic environments. Additional analysis may be requested at management's discretion, including the production of extra scenarios. If conditions warrant, this could result in a management overlay for economic uncertainty which is included in the ECL estimates.

2 Accounting policies *(continued)*

Differences between HKAS 39 and HKFRS 9

Classification and measurement

Key similarities and differences between HKAS 39 and HKFRS 9 for the classification and measurement of financial assets are set out below. There are no differences for financial liabilities, except for the presentation of gains and losses on financial liabilities designated at fair value and the requirements to reconsider fair value designation on transition to HKFRS 9.

	HKAS 39	HKFRS 9
Classification criteria	Financial assets are measured at amortised cost (loans & receivables and held to maturity), available-for-sale (AFS), or fair value through profit or loss (derivatives and trading) based on the nature of the instrument and the purpose for which it is held. Embedded derivatives are separated from their host contract unless the contract as a whole is measured at fair value through profit or loss. The fair value option applies where there are non-closely related embedded derivatives that are not bifurcated, financial instruments are managed on a fair value basis or where measuring at fair value through profit or loss would reduce or eliminate an accounting mismatch. AFS is the default category.	Debt instruments are measured at amortised cost or FVOCI based on their contractual terms and the business model in which they are held as set out in the accounting policies above. The concept of embedded derivatives does not apply to financial assets. Therefore, the fair value option only applies where it would reduce or eliminate an accounting mismatch. Fair value through profit or loss is the default category. Equity securities are measured at fair value through profit or loss unless the option has been exercised to measure at FVOCI.
Presentation for derecognition	Upon disposal of AFS securities (debt instruments and equity securities) the cumulative gains or losses in other comprehensive income are recognised in profit or loss.	Upon disposal of debt instruments measured at FVOCI the cumulative gains or losses in other comprehensive income are recognised in profit or loss. Cumulative gains or losses in other comprehensive income are not recognised in profit or loss on the disposal of equity securities measured at FVOCI.

2 Accounting policies *(continued)*

Differences between HKAS 39 and HKFRS 9 *(continued)*

Classification and measurement *(continued)*

A reconciliation of presentational and measurement differences resulting from the adoption of HKFRS 9 at 1 January 2018 is set out in note 3. In general:

– loans and advances to banks and to customers and non-trading reverse repurchase agreements that are classified as loans and receivables under HKAS 39 are measured at amortised cost under HKFRS 9;

– financial assets designated at Fair Value through Profit and Loss ("FVPL") remain at FVPL, because it is required under HKFRS 9 or the designation will continue;

– debt securities classified as available-for-sale are measured at amortised cost or FVOCI, with a small minority at FVPL either because of their contractual cash flow characteristics or the business model within which they are held;

– debt securities classified as held to maturity are measured at amortised cost;

– treasury and other eligible bills classified as available-for-sale are measured at amortised cost or FVOCI depending upon the business model in which they are held; and

– all equity securities remain measured at fair value. The equity securities for which fair value movements are shown in other comprehensive income are for business facilitation and other similar investments where the Group holds the investments other than to generate a capital return.

Impairment

Under HKFRS 9, the scope of impairment also covers amortised cost assets, debt instruments measured at FVOCI, as well as loan commitments and financial guarantees. The recognition and measurement of impairment is intended to be more forward-looking than under HKAS 39 and the resulting impairment charge may be more volatile. The adoption has resulted in an increase in the total level of impairment allowances as set out on pages 15 and 22, since all financial instruments are assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is larger than the population for which there is objective evidence of impairment in accordance with HKAS 39.

Key similarities and differences between HKAS 39 and HKFRS 9

	HKAS 39	HKFRS 9
Scope	For amortised cost assets, impairment is recognised when there is objective evidence of impairment. Losses are measured by comparing the carrying amount with the discounted future cash flows. Losses which may arise from future events are not recognised. For available-for-sale financial assets, impairment is recognised when there is objective evidence of a shortfall in the recovery of future cash flows. Impairment is measured as the decrease in fair value below the original cost at initial recognition.	Under HKFRS 9, the scope of impairment covers amortised cost assets, debt instruments measured at FVOCI, as well as loan commitments and financial guarantees. The same recognition and measurement requirements apply to both amortised cost and FVOCI financial assets. Impairment is not recognised on equity securities which are measured at FVOCI. Impairment is recognised for all financial assets in scope at either 12-month ECL or lifetime ECL. All reasonable and supportable information, including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date is used in measuring ECL.

2 Accounting policies *(continued)*

Differences between HKAS 39 and HKFRS 9 *(continued)*

Impairment *(continued)*

Key similarities and differences between HKAS 39 and HKFRS 9 (continued)

	HKAS 39	HKFRS 9
Application	Accounting policies generally make a distinction between individually significant loans and homogeneous groups of loans which are assessed collectively.	The distinction between individual and collective assessment is less relevant. In general, whether loans are managed through wholesale credit risk systems or retail credit risk systems is relevant because of differences in the types of information available and the way credit risk is managed.
Impaired/Stage 3	The criteria used to determine whether there is objective evidence of impairment are the same for individually significant loans assessed under HKAS 39 and for HKFRS 9. The determination of the realisable value of collateral is based on the most recently updated market value at the time the impairment assessment is performed and is not adjusted for expected future changes in market prices. Statistical methods are used to determine impairment losses on a collective basis for homogeneous groups of loans that are not considered individually significant using either roll rate methodologies or historical loss rate experience for loans. Under these methodologies, impairment allowances are recognised at a portfolio level. However, loans are classified as impaired for presentation purposes when they are more than 90 days past due or have been renegotiated for credit risk reasons.	The stage 3 population is very similar to impaired loans under HKAS 39 which are considered individually significant. For wholesale loans, individual discounted cash flow calculations continue to be performed. However, the net realisable value of collateral is adjusted for expected future changes in market and the losses reflecting cash flows under different scenarios are probability-weighted to determine the ECL rather than using the best estimate of cash flows. For the retail population, stage 3 is determined by considering the relevant objective evidence, primarily whether contractual payments of either principal or interest are 90 days past due or above, or a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition, or the loan is otherwise considered to be in default. The impairment allowance is determined by the specific LGD model for mortgage while the same calculation used for stage 2 for remaining portfolios, with the probability of default set to 1. The result may, therefore, not be the same as that determined by the HKAS 39 statistical methods and the population disclosed as stage 3 will not necessarily correspond with that disclosed as impaired in accordance with HKAS 39. The accounting policies setting out the criteria for loans to be transferred to stage 3 and for POCI financial assets are set out in policy (f) on page 41.

2 Accounting policies *(continued)*

Differences between HKAS 39 and HKFRS 9 *(continued)*

Impairment *(continued)*

Key similarities and differences between HKAS 39 and HKFRS 9 (continued)

	HKAS 39	HKFRS 9
Stage 2	This is not an HKAS 39 concept.	The accounting policies setting out the criteria for loans to be transferred to stage 2 and the measurement of lifetime ECL are set out in policy (f) on page 41.
Stage 1	This is not an HKAS 39 concept. However, incurred but not yet identified impairment is assessed for loans which have no evidence of impairment but have been specifically identified by estimating a collective allowance determined after taking into account factors including the estimated period between impairment occurring and the loss being identified. This is assessed empirically on a periodic basis and may vary over time. Similarly, for homogeneous groups of loans and advances which are assessed under HKAS 39 on a collective basis, the inherent loss is determined using risk factors including the period of time between loss identification and write-off which is regularly benchmarked against actual outcomes.	Financial instruments which are not considered to have significantly increased in credit risk have loss allowances measured at an amount equal to 12-month ECL. This 12-month time horizon is likely to be equal to or longer than the period estimated under HKAS 39 (typically between 6 and 12 months). The measurement of 12-month ECL is set out in policy (f) on page 41.

Use of estimates and judgements

Management believes that the Group's critical accounting estimates and judgements are those which relate to impairment of financial instruments, the valuation of financial instruments, deferred tax assets, provisions for liabilities and interests in associates. The implementation of HKFRS 9 resulted in a change to the assessment of the critical accounting estimates and judgements related to impairment of financial instruments.

In determining ECL, management is required to exercise judgement in defining what is considered to be a significant increase in credit risk and in making assumptions and estimates to incorporate relevant information about past events, current conditions and forecasts of economic conditions. Judgement has been applied in determining the lifetime and point of initial recognition of revolving facilities.

The PD, LGD and EAD models which support these determinations are reviewed regularly in light of differences between loss estimates and actual loss experience, but given that HKFRS 9 requirements have only just been applied, there has been little time available to make these comparisons. Therefore, the underlying models and their calibration, including how they react to forward-looking economic conditions remain subject to review and refinement. This is particularly relevant for lifetime PDs, which have not been previously used in regulatory modelling and for the incorporation of "Upside scenarios" which have not generally been subject to experience gained through stress testing.

2 Accounting policies *(continued)*

Use of estimates and judgements *(continued)*

The exercise of judgement in making estimations requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas. Many of the factors have a high degree of interdependency and there is no single factor to which loan impairment allowances as a whole are sensitive. Therefore, sensitivities are considered in relation to key portfolios which are particularly sensitive to a few factors and the results should not be further extrapolated. Page 17 set out the assumptions underlying the Central scenario and information about how that scenario and the Upside and Downside scenarios have been developed in relation to the Group's top and emerging risks and its judgements, informed by consensus forecasts of professional industry forecasters. The adjustment from the ECL determined by using the Central scenario alone, which is used to calculate an unbiased expected loss, provides an indication of the overall sensitivity of ECL to different economic assumptions.

There were no other changes in the current period to the critical accounting estimates and judgements applied in 2018, which are stated in note 2 of the Annual Report 2017.

Future accounting developments

In May 2016, the HKICPA issued HKFRS 16 "*Leases*" with an effective date for annual periods beginning on or after 1 January 2019. HKFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under HKAS 17 "*Leases*". Lessees will recognise a "right of use" asset and a corresponding financial liability on the balance sheet. The "right of use" asset will be amortised over the length of the lease and the financial liability will be measured at amortised cost. Lessor accounting remains substantially the same as under HKAS 17. The Group is currently assessing the impact of HKFRS 16, and it is not practicable to quantify the effect at the date of the publication of the condensed consolidated financial statements.

HKFRS 17 "*Insurance contracts*" was issued in January 2018 and sets out the requirements that an entity should apply in accounting for insurance contracts it issues and reinsurance contracts it holds. HKFRS 17 is effective from 1 January 2021 and the Group is considering its impact.

3 Effects of reclassification upon adoption of HKFRS 9

(a) Reconciliation of consolidated balance sheet at 31 December 2017 and 1 January 2018

						HKFRS 9 reclassification to					
	Footnotes	HKAS 39 measurement category	HKFRS 9 measurement category	HKAS 39 carrying amount at 31 Dec 2017	Other changes in classification	Fair value through profit and loss	Fair value through other comprehensive income	Amortised cost	Carrying amount post reclassification	HKFRS 9 remeasurement including expected credit losses[3]	HKFRS 9 carrying amount at 1 Jan 2018
Assets											
Cash and sight balances at central banks		Amortised cost	Amortised cost	**21,718**	**–**	**–**	**–**	**–**	**21,718**	**–**	**21,718**
Placings with and advances to banks	1,2	Amortised cost	Amortised cost	**103,113**	**(1,381)**	**(1,123)**	**–**	**–**	**100,609**	**(6)**	**100,603**
Trading assets	1	FVPL	FVPL	**53,704**	**–**	**–**	**–**	**(2,105)**	**51,599**	**–**	**51,599**
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	2,4,5	FVPL	FVPL	**9,313**	**–**	**2,547**	**–**	**(787)**	**11,073**	**29**	**11,102**
Derivative financial instruments		FVPL	FVPL	**10,836**	**–**	**–**	**–**	**–**	**10,836**	**–**	**10,836**
Loans and advances to customers	1,2,3	Amortised cost	Amortised cost	**806,573**	**(2,318)**	**(50)**	**–**	**–**	**804,205**	**(943)**	**803,262**
Financial investments	4	FVOCI (Available for sale – debt instruments)	FVOCI	**283,993**	**–**	**–**	**–**	**(2,880)**	**281,113**	**–**	**281,113**
	5	FVOCI (Available for sale – equity instruments)	FVOCI	**6,211**	**–**	**(1,374)**	**–**	**–**	**4,837**	**–**	**4,837**
	4	Amortised cost	Amortised cost	**95,057**	**–**	**–**	**–**	**3,667**	**98,724**	**(20)**	**98,704**
Interests in associates		N/A	N/A	**2,170**	**–**	**–**	**–**	**–**	**2,170**	**–**	**2,170**
Investment properties		N/A	N/A	**10,166**	**–**	**–**	**–**	**–**	**10,166**	**–**	**10,166**
Premises, plant and equipment		N/A	N/A	**28,499**	**–**	**–**	**–**	**–**	**28,499**	**–**	**28,499**
Intangible assets	6	N/A	N/A	**15,354**	**–**	**–**	**–**	**–**	**15,354**	**12**	**15,366**
Other assets	1	N/A	N/A	**31,711**	**3,699**	**–**	**–**	**2,105**	**37,515**	**(4)**	**37,511**
Total assets				**1,478,418**	**–**	**–**	**–**	**–**	**1,478,418**	**(932)**	**1,477,486**
Liabilities											
Current, savings and other deposit accounts	1	Amortised cost	Amortised cost	**1,074,837**	**(2,296)**	**–**	**–**	**–**	**1,072,541**	**–**	**1,072,541**
Repurchase agreements – non-trading		Amortised cost	Amortised cost	**2,389**	**–**	**–**	**–**	**–**	**2,389**	**–**	**2,389**
Deposits from banks	1	Amortised cost	Amortised cost	**3,676**	**(796)**	**–**	**–**	**–**	**2,880**	**–**	**2,880**
Trading liabilities	1,7	FVPL	FVPL	**88,270**	**(39,574)**	**–**	**–**	**–**	**48,696**	**–**	**48,696**
Financial liabilities designated at fair value	7	FVPL	FVPL	**1,047**	**39,437**	**–**	**–**	**–**	**40,484**	**–**	**40,484**
Derivative financial instruments		FVPL	FVPL	**11,169**	**–**	**–**	**–**	**–**	**11,169**	**–**	**11,169**
Certificates of deposit and other debt securities in issue		Amortised cost	Amortised cost	**600**	**–**	**–**	**–**	**–**	**600**	**–**	**600**
Other liabilities	1,3	N/A	N/A	**22,222**	**3,229**	**–**	**–**	**–**	**25,451**	**84**	**25,535**
Liabilities under insurance contracts	6	N/A	N/A	**115,545**	**–**	**–**	**–**	**–**	**115,545**	**15**	**115,560**
Current tax liabilities		N/A	N/A	**568**	**–**	**–**	**–**	**–**	**568**	**–**	**568**
Deferred tax liabilities		N/A	N/A	**6,016**	**–**	**–**	**–**	**–**	**6,016**	**(177)**	**5,839**
Total liabilities				**1,326,339**	**–**	**–**	**–**	**–**	**1,326,339**	**(78)**	**1,326,261**

3 Effects of reclassification upon adoption of HKFRS 9 *(continued)*

(a) Reconciliation of consolidated balance sheet at 31 December 2017 and 1 January 2018 (continued)

	Footnotes	HKAS 39 carrying amount at 31 Dec 2017	HKFRS 9 reclassification	Carrying amount post reclassification	HKFRS 9 remeasurement including expected credit losses[3]	Carrying amount at 1 Jan 2018
Equity						
Share capital		9,658	–	9,658	–	9,658
Other equity instruments		6,981	–	6,981	–	6,981
Other reserves	8	21,745	(83)	21,662	5	21,667
Retained profits		113,646	83	113,729	(859)	112,870
Total Shareholders' Equity		152,030	–	152,030	(854)	151,176
Non-controlling interests		49	–	49	–	49
Total equity		152,079	–	152,079	(854)	151,225

(b) Reconciliation of impairment allowance under HKAS 39 and provision under HKAS 37 to expected credit losses under HKFRS 9

		Reclassification to			Remeasurement		
	HKAS 39 measurement category	Fair value through profit and loss	Fair value through other comprehensive income	Amortised cost	Stage 3	Stage 1 & Stage 2	Total
Financial assets at amortised cost							
HKAS 39 impairment allowance at 31 December 2017		-	-	-	-	-	(1,597)
Cash and sight balances at central banks	Amortised cost (Loans and receivables)	-	-	-	-	-	-
Placings with and advances to banks	Amortised cost (Loans and receivables)	-	-	-	-	(6)	(6)
Loans and advances to customers	Amortised cost (Loans and receivables)	-	-	-	(91)	(852)	(943)
Financial investments	Amortised cost (Held to maturity)	-	-	(3)	-	(37)	(40)
Other assets	Amortised cost (Loans and receivables)	-	-	-	-	(4)	(4)
Expected credit loss allowance at 1 January 2018		-	-	(3)	(91)	(899)	(2,590)
Loan commitments and financial guarantee contracts							
HKAS 37 provisions at 31 Dec 2017		-	-	-	-	-	-
Provisions (loan commitments and financial guarantees)	N/A	N/A	N/A	N/A	-	(84)	(84)
Expected credit loss provision at 1 January 2018		N/A	N/A	N/A	-	(84)	(84)

The pre-tax net asset impact of additional impairment allowances on adoption of HKFRS 9 is HK$1,077m; HK$993m in respect of financial assets at amortised cost and HK$84m related to loan commitments and financial guarantee contracts. Total expected credit loss allowance at 1 January 2018 is HK$2,590m in respect of financial assets at amortised cost and HK$84m related to loan commitments and financial guarantee contracts.

3 Effects of reclassification upon adoption of HKFRS 9 *(continued)*

(c) Effects of reclassification upon adoption of HKFRS 9

	Carrying amount at 30 Jun 2018	Fair value at 30 Jun 2018	Assuming no reclassification: Gains/(losses) recognised in profit or loss	Assuming no reclassification: Gains/(losses) recognised in other comprehensive income	Effective interest rate determined on the date of initial application	Interest revenue/ expense
Reclassified from available-for-sale to amortised cost						
Assets						
Placings with and advances to banks	–	–	–	–	N/A	N/A
Loans and advances to customers	–	–	–	–	N/A	N/A
Reverse repurchase agreements – non-trading	–	–	–	–	N/A	N/A
Other financial assets held at amortised cost	2,885	2,752	–	(128)	N/A	N/A
Reclassified from fair value through profit and loss to amortised cost or fair value through other comprehensive income						
Assets						
Placings with and advances to banks	–	–	–	–	N/A	N/A
Loans and advances to customers	–	–	–	–	N/A	N/A
Reverse repurchase agreements – non-trading	–	–	–	–	N/A	N/A
Other financial assets held at amortised cost	401	362	(24)	–	2.3% – 5.3%	4
Debt instruments at fair value through other comprehensive income	–	–	–	–	N/A	N/A
Equity instruments designated at fair value through other comprehensive income	–	–	–	–	N/A	N/A
Liabilities						
Deposits from banks	–	–	–	–	–	–
Current, savings and other deposit accounts	–	–	–	–	–	–
Repurchase agreements – non-trading	–	–	–	–	–	–
Debt securities in use	–	–	–	–	–	–
Other liabilities	–	–	–	–	–	–
Subordinated liabilities	–	–	–	–	–	–

3 Effects of reclassification upon adoption of HKFRS 9 *(continued)*

(c) Effects of reclassification upon adoption of HKFRS 9 (continued)

Footnotes to Effects of reclassification upon adoption of HKFRS 9

1 Settlement accounts of HK$2,105m have been reclassified from "Trading assets" to "Other assets" as a result of the assessment of business model in accordance with HKFRS 9.

Cash collateral and settlement accounts previously presented as "Placings with and advances to banks" of HK$1,381m and "Loans and advances to customers" of HK$2,318m have been represented in "Other assets" to ensure consistent presentation of all such balances. Settlement accounts previously presented as "Trading liabilities" of HK$137m, "Deposits from banks" of HK$796m and "Current, savings and other deposit accounts" of HK$2,296m have been represented in "Other liabilities". This change in presentation for financial liabilities is considered to provide more relevant information, given the change in presentation for the financial assets.

2 "Loans and advances to customers" of HK$50m representing default fund contributions and "Placings with and advances to banks" of HK$1,123m did not meet the "solely payments of principal and interest" ("SPPI") requirement for amortised cost classification under HKFRS 9. As a result, these financial assets were reclassified to "Financial assets designated and otherwise mandatorily measured at fair value through profit or loss". This resulted in a HK$29m upward remeasurement of the aforesaid financial assets.

3 HKFRS 9 expected credit losses have decreased net assets by HK$1,077m (refer to note 3(b)) principally comprising of HK$943m reduction in the carrying value of assets classified as "Loans and advances to customers" and HK$84m increase in "Provisions" under "Other liabilities" relating to expected credit losses on loan commitments and financial guarantee contracts.

4 Debt instruments of HK$2,880m previously classified as available-for-sale under HKAS 39 have been reclassified to amortised cost as a result of "hold to collect" business model classification under HKFRS 9. This resulted in a HK$6m upward remeasurement of the financial assets now measured at amortised cost excluding expected credit losses. Debt instruments of HK$787m previously designated at fair value under HKAS 39 have been reclassified to amortised cost as a result of "hold to collect" business model classification under HKFRS 9. This resulted in a HK$14m upward remeasurement of the financial assets now measured at amortised cost excluding expected credit losses.

5 HK$1,374m of available-for-sale non-traded equity instruments have been reclassified as "Financial assets designated and otherwise mandatorily measured at fair value through profit or loss" in accordance with HKFRS 9. The Group has elected to apply the FVOCI option under HKFRS 9 for the remaining HK$4,837m.

6 Changes in the classification and measurement of financial assets held in our insurance business and the recognition of ECL under HKFRS 9 has resulted in secondary impacts on the present value of in-force long-term insurance business ("PVIF") and liabilities to holders of insurance and investment contracts. The gross carrying value of PVIF reported in "Intangible assets" and liabilities reported in "Liabilities under insurance contracts" has increased by HK$12m and HK$15m respectively.

7 We have considered market practices for the presentation of HK$39,437m of financial liabilities which contain both deposit and derivative components. We have concluded that a change in accounting policy and presentation in respect of "trading liabilities – structured deposits and structured debt securities in issue" would be appropriate, since it would better align with the presentation of similar financial instruments by peers and therefore provide more relevant information about the effect of these financial liabilities on our financial position and performance. As a result, rather than being classified as held for trading, we will designate these financial liabilities as at fair value through profit or loss since they are managed and their performance evaluated on a fair value basis.

8 While HKFRS 9 ECL has no effect on the carrying value of FVOCI financial assets, which remain measured at fair value, the adoption of HKFRS 9 results in a transfer from the FVOCI reserve (formerly AFS reserve) to retained earnings to reflect the cumulative impairment recognised in profit or loss in accordance with HKFRS 9. The amount transferred from "Other reserves" to "Retained earnings" was HK$6m (net of tax HK$5m). In addition, the cumulative AFS reserve relating to financial investments reclassified to "Financial assets designated and otherwise mandatorily measured at fair value through profit or loss" in accordance with HKFRS 9 has been transferred to retained earnings was HK$83m.

4 Basis of consolidation

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

5 Interest income

	Half-year ended 30 June 2018	*Half-year ended 30 June 2017*
Interest income arising from:		
– financial assets that are not at fair value through profit and loss	**16,967**	13,791
– trading assets	**373**	193
– financial assets designated and otherwise mandatorily measured at fair value	**23**	5
	17,363	13,989
of which:		
– interest income from impaired financial assets	**28**	31

6 Interest expense

	Half-year ended 30 June 2018	*Half-year ended 30 June 2017*
Interest expense arising from:		
– financial liabilities that are not at fair value through profit and loss	**1,874**	1,422
– trading liabilities	**283**	726
– financial liabilities designated at fair value	**978**	27
	3,135	2,175
of which:		
– interest expense from debt securities in issue maturing after five years	**–**	–
– interest expense from customer accounts maturing after five years	**–**	–
– interest expense from subordinated liabilities	**–**	60

7 Net fee income

	Half-year ended 30 June 2018	Half-year ended 30 June 2017 (restated)
– securities broking and related services	**1,049**	720
– retail investment funds	**1,070**	969
– insurance	**310**	293
– account services	**255**	236
– remittances	**307**	265
– cards	**1,468**	1,289
– credit facilities	**364**	259
– trade services	**223**	203
– other	**201**	184
Fee income	**5,247**	4,418
Fee expense	**(1,258)**	(1,124)
	3,989	3,294
of which:		
Net fee income, other than amounts included in determining the effective interest rate, arising from financial assets or financial liabilities that are not held for trading nor designated at fair value	**1,177**	1,044
– fee income	**2,319**	2,006
– fee expense	**(1,142)**	(962)
Net fee income on trust and other fiduciary activities where the Group holds or invests on behalf of its customers	**497**	472
– fee income	**526**	563
– fee expense	**(29)**	(91)

8 Net income from financial instruments measured at fair value

	Half-year ended 30 June 2018	Half-year ended 30 June 2017
Net trading income	**709**	1,388
– trading income	**701**	1,389
– net gain from hedging activities	**8**	(1)
Net income from financial instruments designated at fair value	**431**	2
Net income from assets and liabilities of insurance businesses measured at fair value	**(145)**	986
– financial assets held to meet liabilities under insurance and investment contracts	**(138)**	1,016
– liabilities to customers under investment contracts	**(7)**	(30)
Net income from financial instruments measured at fair value	**995**	2,376

9 Gains less losses from financial investments

	Half-year ended 30 June 2018	Half-year ended 30 June 2017
Net gains from disposal of debt securities	**24**	48

10 Dividend income

	Half-year ended 30 June 2018	Half-year ended 30 June 2017
Dividend income:		
– listed investments	**–**	–
– unlisted investments	**6**	7
	6	7

11 Other operating income

	Half-year ended 30 June 2018	Half-year ended 30 June 2017
Rental income from investment properties	**166**	183
Movement in present value of in-force long-term insurance business	**1,379**	742
Net losses from disposal of fixed assets	**(3)**	(15)
Others	**79**	129
	1,621	1,039

12 Change in expected credit losses and other credit impairment charges/Loan impairment charges and other credit risk provisions

	Half-year ended 30 June 2018	*Half-year ended 30 June 2017*
Change in expected credit losses/Loan impairment charges	**238**	670
New allowances net of allowance releases	**310**	722
Recoveries of amounts previously written off	**(72)**	(52)
Impairment allowances/(releases) of available-for-sale debt securities	**N/A**	–
Other credit impairment charges/(releases)	**–**	–
Change in expected credit losses and other credit impairment charges/ Loan impairment charges and other credit risk provisions	**238**	670
Attributable to:		
– loans and advances to banks and customers	**251**	670
– other financial assets	**(5)**	–
– loan and other credit related commitments and guarantees	**(8)**	–
Change in expected credit losses and other credit impairment charges/ Loan impairment charges and other credit risk provisions	**238**	670

13 Operating expenses

	Half-year ended 30 June 2018	*Half-year ended 30 June 2017*
Employee compensation and benefits:		
– salaries and other costs	**2,656**	2,343
– retirement benefit costs		
– defined benefit scheme	**85**	97
– defined contribution scheme	**125**	100
	2,866	2,540
General and administrative expenses:		
– rental expenses	**304**	312
– other premises and equipment	**536**	697
– marketing and advertising expenses	**241**	198
– other operating expenses	**1,052**	852
	2,133	2,059
Depreciation of premises, plant and equipment (note 27)	**668**	603
Amortisation of intangible assets	**55**	53
	5,722	5,255

14 Tax expense

Taxation in the condensed consolidated income statement represents:

	Half-year ended 30 June 2018	*Half-year ended 30 June 2017*
Current tax – provision for Hong Kong profits tax		
Tax for the period	**1,988**	1,554
Current tax – taxation outside Hong Kong		
Tax for the period	**19**	16
Adjustment in respect of prior periods	**–**	(2)
	19	14
Deferred tax		
Origination and reversal of temporary differences	**220**	244
Total tax expense	**2,227**	1,812

The current tax provision is based on the estimated assessable profit for the first half of 2018, 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 (2017: 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.

15 Earnings per share – basic and diluted

The calculation of basic and diluted earnings per share for the first half of 2018 is based on earnings of HK$12,647m (HK$9,838m for the first half of 2017) and on the weighted average number of ordinary shares in issue of 1,911,842,736 shares (unchanged from the first half of 2017).

16 Dividends per share

Dividends to ordinary shareholders

	Half-year ended 30 June 2018		*Half-year ended 30 June 2017*	
	per share HK$	***HK$m***	*per share HK$*	*HK$m*
First interim	**1.30**	**2,485**	1.20	2,294
Second interim	**1.30**	**2,485**	1.20	2,294
	2.60	**4,970**	2.40	4,588

17 Segmental analysis

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

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

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

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

- **Other** mainly represents the Bank's holdings of premises, investment properties, equity shares and subordinated debt funding as well as central support and functional costs with associated recoveries.

(a) Segmental result

For the purpose of segmental analysis, the allocation of revenue reflects the benefits of capital and other funding resources allocated to the business segments by way of internal capital allocation and fund transfer-pricing mechanisms. Cost allocation is based on the direct costs incurred by the respective business segments and apportionment of management overheads. Bank-owned premises are reported under the "Other" segment. When these premises are utilised by business segments, notional rent will be charged to the relevant business segments with reference to market rates.

17 Segmental analysis *(continued)*

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

	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Other	Total
Half-year ended 30 June 2018					
Net interest income/(expense)	7,873	4,329	2,184	(158)	14,228
Net fee income	2,631	1,097	156	105	3,989
Net income/(loss) from financial instruments measured at fair value	(115)	274	830	6	995
Gains less losses from financial investments	–	–	24	–	24
Dividend income	–	–	–	6	6
Net insurance premium income	7,982	750	–	–	8,732
Other operating income	1,254	236	3	128	1,621
Total operating income	19,625	6,686	3,197	87	29,595
Net insurance claims and benefits paid and movement in liabilities to policyholders	(8,356)	(590)	–	–	(8,946)
Net operating income before change in expected credit losses and other credit impairment charges	11,269	6,096	3,197	87	20,649
Change in expected credit losses and other credit impairment charges	(169)	(80)	11	–	(238)
Net operating income	11,100	6,016	3,208	87	20,411
Operating expenses *	(3,539)	(1,577)	(474)	(132)	(5,722)
Impairment loss on intangible assets	–	–	–	(27)	(27)
Operating profit/(loss)	7,561	4,439	2,734	(72)	14,662
Net surplus on property revaluation	–	–	–	78	78
Share of profits of associates	122	–	–	2	124
Profit before tax	7,683	4,439	2,734	8	14,864
Share of profit before tax	51.7%	29.9%	18.4%	0.0%	100.0%
Operating profit/(loss) excluding change in expected credit losses and other credit impairment charges	7,730	4,519	2,723	(72)	14,900
* *Depreciation/amortisation included in operating expenses*	(12)	(2)	(2)	(707)	(723)
At 30 June 2018					
Total assets	461,834	383,863	626,604	62,321	1,534,622
Total liabilities	898,370	306,777	169,133	4,668	1,378,948
Interest in associates	2,405	–	–	3	2,408

17 Segmental analysis *(continued)*

(a) Segmental result (continued)

	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Other	Total
Half-year ended 30 June 2018					
Net fee income by segment					
– securities broking and related services	930	106	13	–	1,049
– retail investment funds	1,059	11	–	–	1,070
– insurance	229	48	33	–	310
– account services	153	99	3	–	255
– remittances	53	236	18	–	307
– cards	672	780	16	–	1,468
– credit facilities	11	278	75	–	364
– trade services	–	211	12	–	223
– other	38	35	18	110	201
Fee income	3,145	1,804	188	110	5,247
Fee expense	(514)	(707)	(32)	(5)	(1,258)
Net fee income	2,631	1,097	156	105	3,989

17 Segmental analysis *(continued)*

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

	Retail Banking and Wealth Management	*Commercial Banking*	*Global Banking and Markets*	*Other*	*Total*
Half-year ended 30 June 2017					
Net interest income/(expense)	6,619	3,288	1,969	(62)	11,814
Net fee income	2,104	934	163	93	3,294
Net income/(loss) from financial instruments measured at fair value	1,330	255	829	(38)	2,376
Gains less losses from financial investments	30	–	18	–	48
Dividend income	1	–	–	6	7
Net insurance premium income	6,668	439	–	–	7,107
Other operating income	730	175	–	134	1,039
Total operating income	17,482	5,091	2,979	133	25,685
Net insurance claims and benefits paid and movement in liabilities to policyholders	(7,677)	(351)	–	–	(8,028)
Net operating income before loan impairment charges and other credit risk provisions	9,805	4,740	2,979	133	17,657
Loan impairment (charges)/releases and other credit risk provisions	(261)	(410)	1	–	(670)
Net operating income	9,544	4,330	2,980	133	16,987
Operating expenses *	(3,170)	(1,337)	(507)	(241)	(5,255)
Operating profit/(loss)	6,374	2,993	2,473	(108)	11,732
Net surplus on property revaluation	–	–	–	50	50
Share of losses of associates	(136)	–	–	–	(136)
Profit/(loss) before tax	6,238	2,993	2,473	(58)	11,646
Share of profit/(loss) before tax	53.6%	25.7%	21.2%	(0.5%)	100.0%
Operating profit/(loss) excluding loan impairment charges and other credit risk provisions	6,635	3,403	2,472	(108)	12,402
* *Depreciation/amortisation included in operating expenses*	(13)	(2)	(1)	(640)	(656)
At 31 December 2017					
Total assets	445,489	350,693	611,717	70,519	1,478,418
Total liabilities	860,396	288,476	156,806	20,661	1,326,339
Interest in associates	2,170	–	–	–	2,170

17 Segmental analysis *(continued)*

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

	Retail Banking and Wealth Management	*Commercial Banking*	*Global Banking and Markets*	*Other*	*Total*
Half-year ended 30 June 2017					
Net fee income by segment					
– securities broking and related services	604	104	12	–	720
– retail investment funds	958	11	–	–	969
– insurance	199	57	37	–	293
– account services	138	95	3	–	236
– remittances	48	200	17	–	265
– cards	606	660	23	–	1,289
– credit facilities	8	186	65	–	259
– trade services	–	190	13	–	203
– other	37	35	21	91	184
Fee income	2,598	1,538	191	91	4,418
Fee expense	(494)	(604)	(28)	2	(1,124)
Net fee income	2,104	934	163	93	3,294

17 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 2018					
Total operating income	**28,437**	**1,037**	**144**	**(23)**	**29,595**
Profit before tax	**14,472**	**297**	**95**	**–**	**14,864**
At 30 June 2018					
Total assets	**1,443,347**	**114,270**	**22,708**	**(45,703)**	**1,534,622**
Total liabilities	**1,291,920**	**101,502**	**21,704**	**(36,178)**	**1,378,948**
Equity	**151,427**	**12,768**	**1,004**	**(9,525)**	**155,674**
Share capital	**9,658**	**10,259**	**–**	**(10,259)**	**9,658**
Interest in associates	**2,405**	**3**	**–**	**–**	**2,408**
Non-current assets*	**55,235**	**1,140**	**11**	**–**	**56,386**
Half-year ended 30 June 2017					
Total operating income	24,657	921	140	(33)	25,685
Profit before tax	11,470	81	95	–	11,646
At 31 December 2017					
Total assets	1,385,176	121,941	20,944	(49,643)	1,478,418
Total liabilities	1,236,896	109,542	20,019	(40,118)	1,326,339
Equity	148,280	12,399	925	(9,525)	152,079
Share capital	9,658	10,396	–	(10,396)	9,658
Interest in associates	2,170	–	–	–	2,170
Non-current assets*	52,832	1,173	14	–	54,019

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

18 Cash and sight balances at central banks

	At 30 June 2018	At 31 December 2017
Cash in hand	**6,940**	7,409
Sight balances at central banks	**3,447**	14,309
	10,387	21,718

19 Placings with and advances to banks

	At 30 June 2018	At 31 December 2017
Balances with banks	**7,180**	5,182
Placings with and advances to banks maturing within one month	**54,096**	56,795
Placings with and advances to banks maturing after one month but less than one year	**34,622**	38,750
Placings with and advances to banks maturing after one year	**1,288**	2,386
Less: Expected credit losses	**(3)**	–
	97,183	103,113
of which:		
Placings with and advances to central banks	**9,754**	11,248

20 Trading assets

	At 30 June 2018	At 31 December 2017
Treasury bills	**25,740**	33,066
Other debt securities	**18,527**	18,509
Debt securities	**44,267**	51,575
Investment funds	**16**	24
Total trading securities	**44,283**	51,599
Other*	**–**	2,105
Total trading assets	**44,283**	53,704

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

21 Financial assets designated and otherwise mandatorily measured at fair value/Financial assets designated at fair value

	At 30 June 2018	At 31 December 2017
Treasury bills	**–**	400
Other debt securities	**4**	392
Debt securities	**4**	792
Equity shares	**5,626**	5,486
Investment funds	**6,252**	3,035
Other	**1,188**	–
	13,070	9,313

22 Derivative financial instruments

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

	At 30 June 2018			At 31 December 2017		
	Contract amounts	**Derivative assets**	**Derivative liabilities**	Contract amounts	Derivative assets	Derivative liabilities
Derivatives held for trading						
Exchange rate contracts	**966,807**	**5,830**	**5,679**	808,696	7,893	8,284
Interest rate contracts	**441,525**	**2,232**	**2,275**	379,937	1,327	1,386
Equity and other contracts	**39,305**	**286**	**822**	42,591	789	335
Total derivatives held for trading	**1,447,637**	**8,348**	**8,776**	1,231,224	10,009	10,005
Derivatives managed in conjunction with financial instruments designated at fair value						
Interest rate contracts	**2,000**	**5**	**8**	500	–	4
Cash flow hedge derivatives						
Exchange rate contracts	**20,184**	**254**	**682**	22,531	375	926
Interest rate contracts	**21,452**	**43**	**52**	18,026	55	30
	41,636	**297**	**734**	40,557	430	956
Fair value hedge derivatives						
Interest rate contracts	**45,854**	**679**	**148**	48,539	397	204
Total derivatives	**1,537,127**	**9,329**	**9,666**	1,320,820	10,836	11,169

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

23 Loans and advances to customers

(a) *Loans and advances to customers*

	At 30 June 2018	At 31 December 2017
Gross loans and advances to customers	**857,662**	808,170
Less: Expected credit losses/loan impairment allowances	**(2,425)**	(1,597)
	855,237	806,573
	%	%
Expected credit losses/loan impairment allowances as a percentage of gross loans and advances to customers	**0.28**	0.20

Expected credit losses at 1 January 2018 to reflect the adoption of HKFRS 9 from this date is HK$2,540m and the corresponding ratio of expected credit losses as a percentage of gross loans and advances to customers is 0.31%.

	At 30 June 2018	At 31 December 2017
Gross impaired loans and advances	**2,628**	1,970
	%	%
Gross impaired loans and advances as a percentage of gross loans and advances to customers	**0.31**	0.24

Gross impaired loans and advances at 1 January 2018 to reflect the adoption of HKFRS 9 from this date is HK$2,174m and the corresponding ratio of gross impaired loans and advances as a percentage of gross loans and advances to customers is 0.27%.

23 Loans and advances to customers *(continued)*

(b) Gross loans and advances to customers by industry sector

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

	At 30 June 2018		At 31 December 2017	
		% of gross advances covered by collateral		% of gross advances covered by collateral
Gross loans and advances to customers for use in Hong Kong				
Industrial, commercial and financial sectors				
– property development	66,935	41.5	62,715	46.5
– property investment	143,814	85.3	136,214	81.4
– financial concerns	10,508	56.4	8,757	59.8
– stockbrokers	463	4.3	150	13.3
– wholesale and retail trade	29,595	48.3	27,523	44.4
– manufacturing	23,401	39.9	23,548	40.2
– transport and transport equipment	13,979	57.3	14,153	55.0
– recreational activities	192	30.6	191	29.7
– information technology	7,751	4.0	7,027	1.1
– other	75,281	70.2	65,039	66.5
	371,919	64.9	345,317	63.2
Individuals				
– loans and advances for the purchase of flats under the Government Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	22,723	100.0	22,046	100.0
– loans and advances for the purchase of other residential properties	182,050	100.0	174,068	100.0
- credit card loans and advances	26,894	–	29,229	–
- other	31,247	55.4	24,888	48.3
	262,914	84.5	250,231	83.2
Total gross loans and advances for use in Hong Kong	634,833	73.0	595,548	71.6
Trade finance	44,074	21.7	47,125	21.1
Gross loans and advances for use outside Hong Kong	178,755	35.9	165,497	35.3
Gross loans and advances to customers	857,662	62.6	808,170	61.2
Expected credit losses/loan impairment allowances	(2,425)		(1,597)	
Net loans and advances to customers	855,237		806,573	

24 Financial investments

	At 30 June 2018	At 31 December 2017
Financial investments measured at fair value through other comprehensive income		
– treasury and other eligible bills	**185,953**	N/A
– debt securities	**110,594**	N/A
– equity shares	**4,336**	N/A
	300,883	N/A
Debt instruments measured at amortised cost		
– treasury and other eligible bills	**450**	N/A
– debt securities	**100,867**	N/A
Less: Expected credit losses	**(33)**	N/A
	101,284	N/A
Available-for-sale at fair value:		
– treasury bills	**N/A**	153,592
– debt securities	**N/A**	130,401
– equity securities (including investment funds)	**N/A**	6,211
	N/A	290,204
Held-to-maturity at amortised cost:		
– treasury bills	**N/A**	700
– debt securities	**N/A**	94,357
	N/A	95,057
	402,167	385,261

There were no overdue financial investsments at 30 June 2018 and 31 December 2017 for the Group. The Group did not hold any asset-backed securities, mortgage-backed securities and collateralised debt obligations.

25 Interest in associates

	At 30 June 2018	At 31 December 2017
Share of net assets	**2,408**	2,170

26 Investment properties

	Half-year ended 30 June 2018	*Half-year ended 30 June 2017*	*Half-year ended 31 December 2017*
Beginning of the period	**10,166**	9,960	10,034
Additions	**278**	–	–
Revaluation credited to condensed consolidated income statement	**71**	74	132
Transfer to premises (note 27)	**(657)**	–	–
End of the period	**9,858**	10,034	10,166
Representing:			
– measure at valuation	**9,858**	10,034	10,166

27 Premises, plant and equipment

Movement of premises, plant and equipment

	Premises	***Plant and equipment***	***Total***
Cost or valuation:			
At 1 January 2018	**27,157**	**5,241**	**32,398**
Additions	**60**	**171**	**231**
Disposals	**–**	**(35)**	**(35)**
Elimination of accumulated depreciation on revalued premises	**(458)**	**–**	**(458)**
Surplus on revaluation:			
– credited to premises revaluation reserve	**1,040**	**–**	**1,040**
Transfer from investment properties (note 26)	**657**	**–**	**657**
Exchange difference	**(13)**	**(6)**	**(19)**
At 30 June 2018	**28,443**	**5,371**	**33,814**
Accumulated depreciation:			
At 1 January 2018	**–**	**(3,899)**	**(3,899)**
Charge for the period (note 13)	**(458)**	**(210)**	**(668)**
Written off on disposal	**–**	**32**	**32**
Elimination of accumulated depreciation on revalued premises	**458**	**–**	**458**
Exchange difference	**–**	**5**	**5**
At 30 June 2018	**–**	**(4,072)**	**(4,072)**
Net book value at 30 June 2018	**28,443**	**1,299**	**29,742**
Representing:			
– measure at cost	**–**	**1,299**	**1,299**
– measure at valuation	**28,443**	**–**	**28,443**
	28,443	**1,299**	**29,742**

27 Premises, plant and equipment *(continued)*

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

	Premises	*Plant and equipment*	*Total*
Cost or valuation:			
At 1 January 2017	25,409	4,934	30,343
Additions	139	189	328
Disposals	–	(93)	(93)
Elimination of accumulated depreciation on revalued premises	(407)	–	(407)
Surplus on revaluation:			
– credited to premises revaluation reserve	1,043	–	1,043
Transfer from investment properties (note 26)	–	–	–
Transfer to assets held for sale	(12)	–	(12)
Exchange difference	28	15	43
At 30 June 2017	26,200	5,045	31,245
Accumulated depreciation:			
At 1 January 2017	–	(3,571)	(3,571)
Charge for the period (note 13)	(407)	(196)	(603)
Written off on disposal	–	77	77
Elimination of accumulated depreciation on revalued premises	407	–	407
Exchange difference	–	(12)	(12)
At 30 June 2017	–	(3,702)	(3,702)
Net book value at 30 June 2017	26,200	1,343	27,543
Representing:			
– measure at cost	–	1,343	1,343
– measure at valuation	26,200	–	26,200
	26,200	1,343	27,543

27 Premises, plant and equipment *(continued)*

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

	Premises	*Plant and equipment*	*Total*
Cost or valuation:			
At 1 July 2017	26,200	5,045	31,245
Additions	105	186	291
Disposals	–	(11)	(11)
Elimination of accumulated depreciation on revalued premises	(430)	–	(430)
Surplus on revaluation:			
– credited to premises revaluation reserve	1,242	–	1,242
Transfer from investment properties (note 26)	–	–	–
Transfer to assets held for sale	12	–	12
Exchange difference	28	21	49
At 31 December 2017	27,157	5,241	32,398
Accumulated depreciation:			
At 1 July 2017	–	(3,702)	(3,702)
Charge for the period	(430)	(196)	(626)
Written off on disposal	–	17	17
Elimination of accumulated depreciation on revalued premises	430	–	430
Exchange difference	–	(18)	(18)
At 31 December 2017	–	(3,899)	(3,899)
Net book value at 31 December 2017	27,157	1,342	28,499
Representing:			
– measure at cost	–	1,342	1,342
– measure at valuation	27,157	–	27,157
	27,157	1,342	28,499

28 Intangible assets

	At 30 June 2018	At 31 December 2017
Present value of in-force long-term insurance business	**15,965**	14,574
Internally developed software	**437**	375
Acquired software	**55**	76
Goodwill	**329**	329
	16,786	15,354

29 Other assets

	At 30 June 2018	At 31 December 2017
Items in the course of collection from other banks	**7,920**	6,464
Bullion	**4,284**	4,127
Prepayments and accrued income	**3,910**	3,773
Acceptances and endorsements	**6,641**	5,108
Less: Expected credit losses	**(6)**	N/A
Reinsurers' share of liabilities under insurance contracts	**8,316**	8,232
Other accounts*	**9,935**	4,007
	41,000	31,711

Other accounts included "Assets held for sale" of HK$28m (31 December 2017: HK$42m). It also included "Retirement benefit assets" of HK$58m (31 December 2017: HK$54m).

* *At 30 June 2018, figure includes settlement accounts of HK$4,574m which represents the amount receivable from counterparties on transactions not yet settled due to change in presentation.*

30 Current, savings and other deposit accounts

	At 30 June 2018	At 31 December 2017
Current, savings and other deposit accounts:		
– as stated in condensed consolidated balance sheet	**1,116,777**	1,074,837
– structured deposits reported as trading liabilities (note 31)	**N/A**	36,507
– structured deposits reported as financial liabilities designated as fair value (note 32)	**36,949**	N/A
	1,153,726	1,111,344
By type:		
– demand and current accounts	**113,796**	117,525
– savings accounts	**721,402**	757,828
– time and other deposits	**318,528**	235,991
	1,153,726	1,111,344

31 Trading liabilities

	At 30 June 2018	At 31 December 2017
Other structured debt securities in issue (note 33)	**N/A**	2,929
Structured deposits (note 30)	**N/A**	36,507
Short positions in securities and others	**41,921**	48,834
	41,921	88,270

32 Financial liabilities designated at fair value

	At 30 June 2018	At 31 December 2017
Certificates of deposit in issue (note 33)	**1,997**	493
Structured deposits (note 30)	**36,949**	N/A
Other structured debt securities in issue (note 33)	**6,628**	N/A
Liabilities to customers under investment contracts	**475**	554
	46,049	1,047

At 30 June 2018, the accumulated loss in fair value attributable to changes in credit risk for certificates of deposit in issue was HK$6m (31 December 2017: accumulated gain of HK$5m).

33 Certificates of deposit and other debt securities in issue

	At 30 June 2018	At 31 December 2017
Certificates of deposit and other debt securities in issue:		
– as stated in condensed consolidated balance sheet	**–**	600
– certificates of deposit in issue designated at fair value (note 32)	**1,997**	493
– other structured debt securities in issue reported as financial liabilities designated at fair value (note 32)	**6,628**	N/A
– other structured debt securities in issue reported as trading liabilities (note 31)	**N/A**	2,929
	8,625	4,022
By type:		
– certificates of deposit in issue	**1,997**	1,093
– other debt securities in issue	**6,628**	2,929
	8,625	4,022

34 Other liabilities

	At 30 June 2018	At 31 December 2017
Items in the course of transmission to other banks	**8,169**	8,987
Accruals	**3,214**	3,511
Acceptances and endorsements	**6,641**	5,108
Retirement benefit liabilities	**155**	89
Other*	**7,515**	4,527
	25,694	22,222

* *At 30 June 2018, figure includes settlement accounts of HK$2,443m which represents the amount payable to counterparties on transactions not yet settled due to change in presentation.*

35 Shareholders' equity

	At 30 June 2018	At 31 December 2017
Share capital	**9,658**	9,658
Retained profits	**117,360**	113,646
Other equity instruments (note 36)	**6,981**	6,981
Premises revaluation reserve	**18,953**	18,379
Cash flow hedging reserve	**(160)**	(99)
Available-for-sale investment reserve		
– on debt securities	**N/A**	(90)
– on equity securities	**N/A**	2,206
Financial assets at fair value through other comprehensive income reserve	**1,675**	N/A
Other reserves	**1,168**	1,349
Total reserves	**145,977**	142,372
Total shareholders' equity	**155,635**	152,030
Annualised return on average ordinary shareholders' equity for the half-year ended	**17.4%**	13.9%

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 2018.

To satisfy the provisions of the Hong Kong Banking Ordinance and local regulatory requirements for prudential supervision purposes, the Group has earmarked a "regulatory reserve" directly from retained profits. As at 30 June 2018, the effect of this requirement is to restrict the amount of reserves which can be distributed by the Group to shareholders by HK$4,871m (31 December 2017: HK$6,018m).

36 Other equity instruments

Nominal value	Description	At 30 June 2018	At 31 December 2017
US$900 million	Floating rate perpetual capital instrument callable from December 2019[1]	**6,981**	6,981

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

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

37 Contingent liabilities and commitments

(a) Off-balance sheet contingent liabilities and commitments

	At 30 June 2018	At 31 December 2017
Contingent liabilities and financial guarantee contracts		
Guarantee and irrevocable letters of credit pledged as collateral security	**17,761**	15,267
Other contingent liabilities	**55**	61
	17,816	15,328
Commitments		
Documentary credits and short-term trade-related transactions	**3,586**	3,188
Forward asset purchases and forward forward deposits placed	**2,079**	983
Undrawn formal standby facilities, credit lines and other commitments to lend	**452,209**	433,970
	457,874	438,141

The above "Commitments" table discloses the nominal principal amounts of commitments excluding capital commitments, guarantees and other contingent liabilities, which are mainly credit-related instruments including both financial and non-financial guarantees and commitments to extend credit. Contractual amounts represent the amounts at risk should contracts be fully drawn upon and clients default. The amount of the loan commitments shown above reflects, where relevant, the expected level of take-up of pre-approved facilities. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contractual amounts is not representative of 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.

38 Material related-party transactions

There were no changes in the related party transactions described in the 2017 Annual Report that have had a material effect on the financial position or performance of the Group in the half-year to 30 June 2018. All related party transactions that took place in the half-year to 30 June 2018 were similar in nature to those disclosed in the 2017 Annual Report.

39 Fair value of financial instruments

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

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following tables provides an analysis of the fair value hierarchy of the financial instruments carried at fair value.

	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 2018						
Assets						
Trading assets	**42,893**	**1,390**	**–**	**44,283**	**–**	**44,283**
Financial assets designated and otherwise mandatorily measured at fair value	**7,108**	**2,514**	**3,448**	**13,070**	**–**	**13,070**
Derivative financial instruments	**376**	**6,479**	**18**	**6,873**	**2,456**	**9,329**
Financial investments	**260,947**	**38,454**	**1,482**	**300,883**	**–**	**300,883**
Liabilities						
Trading liabilities	**41,921**	**–**	**–**	**41,921**	**–**	**41,921**
Financial liabilities designated at fair value	**–**	**44,528**	**1,521**	**46,049**	**–**	**46,049**
Derivative financial instruments	**47**	**6,854**	**–**	**6,901**	**2,765**	**9,666**
At 31 December 2017						
Assets						
Trading assets	40,793	12,900	–	53,693	11	53,704
Financial assets designated at fair value	6,481	1,000	1,832	9,313	–	9,313
Derivative financial instruments	319	8,104	8	8,431	2,405	10,836
Available-for-sale financial investments	178,390	110,359	1,455	290,204	–	290,204
Liabilities						
Trading liabilities	48,695	39,154	392	88,241	29	88,270
Financial liabilities designated at fair value	–	1,047	–	1,047	–	1,047
Derivative financial instruments	17	9,057	3	9,077	2,092	11,169

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

39 Fair value of financial instruments *(continued)*

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

	Assets				Liabilities		
	Financial Investments	***Trading Assets***	***Designated and otherwise mandatorily measured at fair value***	***Derivatives***	***Trading Liabilities***	***Designated at fair value***	***Derivatives***
At 30 June 2018							
Transfer from Level 1 to Level 2	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Transfer from Level 2 to Level 1	**55,329**	**7,217**	**–**	**–**	**–**	**–**	**–**
	Available-for-sale	*Held for trading*	*Designated at fair value through profit or loss*	*Derivatives*	*Held for trading*	*Designated at fair value through profit or loss*	*Derivatives*
At 31 December 2017							
Transfer from Level 1 to Level 2	1,463	9,437	–	–	–	–	–
Transfer from Level 2 to Level 1	–	–	–	–	–	–	–

Transfers between levels of the fair value hierarchy are deemed to occur at the end of semi-annual 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.

Details of the control framework, valuation techniques used to determine fair value, fair value adjustments, and the approach used to calculate the fair value of each type of financial instrument are included in note 55(a) of the Group's Annual Report 2017.

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

	Assets				Liabilities		
	Financial Investments	***Trading Assets***	***Designated and otherwise mandatorily measured at fair value***	***Derivatives***	***Trading Liabilities***	***Designated at fair value***	***Derivatives***
At 30 June 2018							
Private equity	**1,482**	**–**	**3,448**	**–**	**–**	**–**	**–**
Structured notes	**–**	**–**	**–**	**–**	**–**	**1,521**	**–**
Derivatives	**–**	**–**	**–**	**18**	**–**	**–**	**–**
	1,482	**–**	**3,448**	**18**	**–**	**1,521**	**–**
	Available-for-sale	*Held for trading*	*Designated at fair value*	*Derivatives*	*Held for trading*	*Designated at fair value*	*Derivatives*
At 31 December 2017							
Private equity	1,455	–	1,832	–	–	–	–
Structured notes	–	–	–	–	392	–	–
Derivatives	–	–	–	8	–	–	3
	1,455	–	1,832	8	392	–	3

39 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	Designated and otherwise mandatorily measured at fair value	Derivatives	Trading Liabilities	Designated at fair value	Derivatives
At 1 January 2018	1,455	–	1,832	8	392	–	3
Total gains or losses recognised in profit or loss							
– net income from financial instruments measured at fair value	–	–	95	17	6	(131)	(2)
– gains less losses from financial investments	–	–	–	–	–	–	–
– expected credit loss and other credit impairment charges	–	–	–	–	–	–	–
– fair value gains transferred to the income statement on disposal	–	–	–	–	–	–	–
Total gains or losses recognised in other comprehensive income							
– fair value gains	59	–	–	–	–	–	–
– exchange differences	–	–	–	–	–	–	–
Purchases	–	–	1,690	–	–	–	–
Issues/deposit taking	–	–	–	–	–	1,660	–
Sales	–	–	–	–	–	–	–
Settlements	–	–	(201)	–	–	(47)	–
Transfers out	(32)	–	–	(7)	(398)	(33)	(1)
Transfers in	–	–	32	–	–	72	–
At 30 June 2018	1,482	–	3,448	18	–	1,521	–
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	–	–	95	18	–	132	–

39 Fair value of financial instruments *(continued)*

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

Movement in Level 3 financial instruments (continued)

	Assets				Liabilities		
	Available-for-sale	*Held for trading*	*Designated at fair value*	*Derivatives*	*Held for trading*	*Designated at fair value*	*Derivatives*
At 1 January 2017	1,222	–	727	32	79	–	46
Total gains or losses recognised in profit or loss							
– trading income	–	–	–	(15)	1	–	(29)
– net income from financial instruments designated at fair value	–	–	121	–	–	–	–
– gains less losses from financial investments	–	–	–	–	–	–	–
Total gains or losses recognised in other comprehensive income							
– fair value gains	75	–	–	–	–	–	–
– exchange differences	–	–	–	–	–	–	–
Purchases	–	–	408	–	–	–	–
Issues/deposit taking	–	–	–	–	369	–	–
Sales	–	–	–	–	–	–	–
Settlements	–	–	(43)	–	(32)	–	–
Transfers out	–	–	–	(1)	(50)	–	(1)
Transfers in	–	–	–	–	–	–	–
At 30 June 2017	1,297	–	1,213	16	367	–	16
Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of the reporting period							
– trading income	–	–	–	(13)	(1)	–	23
– net income from financial instruments designated at fair value	–	–	121	–	–	–	–

39 Fair value of financial instruments *(continued)*

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

Movement in Level 3 financial instruments (continued)

	Assets				*Liabilities*		
	Available-for-sale	*Held for trading*	*Designated at fair value*	*Derivatives*	*Held for trading*	*Designated at fair value*	*Derivatives*
At 1 July 2017	1,297	–	1,213	16	367	–	16
Total gains or losses recognised in profit or loss							
– trading income	–	–	–	3	(166)	–	1
– net income from other financial instruments designated at fair value	–	–	204	–	–	–	–
– gains less losses from financial investments	–	–	–	–	–	–	–
Total gains or losses recognised in other comprehensive income							
– fair value losses	158	–	–	–	–	–	–
– exchange differences	–	–	–	–	–	–	–
Purchases	–	–	589	–	–	–	–
Issues/deposit taking	–	–	–	–	393	–	–
Sales	–	–	–	–	–	–	–
Settlements	–	–	(174)	–	(34)	–	–
Transfers out	–	–	–	(11)	(168)	–	(15)
Transfers in	–	–	–	–	–	–	1
At 31 December 2017	1,455	–	1,832	8	392	–	3
Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of the reporting period							
– trading income	–	–	–	21	7	–	(25)
– net income from other financial instruments designated at fair value	–	–	204	–	–	–	–

For the first half of 2018, the transfer out of Level 3 derivative assets and derivative liabilities were predominantly resulted from increase in observability in equity volatilities. The transfer out of Level 3 trading liabilities reflected the change in observability of correlations between equity and equity index used for pricing the instrument and partly due to reclassification of structured deposits from trading liabilities to financial liabilities designated at fair value. The transfer out of Level 3 liabilities designated at fair value through profit or loss reflected the change in observability of FX volatility and correlations between equity and equity index used for pricing the instrument. The transfer out of Level 3 financial investments reflected the reclassification of equity investment from fair value through other comprehensive income to mandatorily measured at fair value under HKFRS 9.

39 Fair value of financial instruments *(continued)*

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

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

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

Sensitivity of fair values to reasonably possible alternative assumptions

	Reflected in profit or loss		*Reflected in other comprehensive income*	
	Favourable changes	*Unfavourable changes*	*Favourable changes*	*Unfavourable changes*
At 30 June 2018				
Private equity	**172**	**(172)**	**95**	**(95)**
Structured notes	**–**	**–**	**–**	**–**
Derivatives	**–**	**–**	**–**	**–**
	172	**(172)**	**95**	**(95)**
At 31 December 2017				
Private equity	92	(92)	63	(63)
Structured notes	–	–	–	–
Derivatives	–	–	–	–
	92	(92)	63	(63)

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

For private equity, favourable and unfavourable changes are determined on the basis of 5% changes (31 December 2017: 5%) in the value of the instrument as a result of varying the levels of the unobservable parameters using statistical techniques. When parameters are not amendable to statistical analysis, quantification of uncertainty is judgemental.

39 Fair value of financial instruments *(continued)*

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

Quantitative information about significant unobservable inputs in Level 3 valuations

	Valuation technique(s)	*Unobservable input(s)*	*Range*
Assets			
Private equity	Net asset value	N/A	**N/A**
	Market-comparable approach	Earnings Multiple	**24-39** (31 Dec 2017: 24 – 35)
		P/B ratios	**0.56 – 1.35** (31 Dec 2017: 0.69 – 1.68)
		Liquidity Discount	**10% – 30%** (31 Dec 2017: 10% – 30%)
Derivatives	Option model	Equity Volatility	**26.15% – 32.04%** (31 Dec 2017: 20.80% – 83.54%)
		FX Volatility	**7.20% – 14.00%** (31 Dec 2017: 5.51% – 20.31%)
Liabilities			
Structured notes	Option model	FX Volatility	**6.80% – 10.78%** (31 Dec 2017: 5.49% – 10.77%)
		Equity Volatility	**11.95% – 19.56%** (31 Dec 2017: N/A)
		Equity and Equity Index Correlation	**0.19 – 0.85** (31 Dec 2017: 0.14 – 0.52)
Derivatives	Option model	Equity Volatility	**31.13% – 31.13%** (31 Dec 2017: 13.00% – 83.54%)
		FX Volatility	**7.20% – 14.00%** (31 Dec 2017: 7.68% – 20.31%)

Key unobservable inputs to Level 3 financial instruments

The table above lists the key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 30 June 2018. Detailed description of the categories of key unobservable inputs are set out in note 55(a) of the Group's Annual Report 2017.

39 Fair value of financial instruments *(continued)*

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

The following table provides an analysis of the fair value of financial instruments not measured at fair value on the condensed consolidated balance sheet. For all other instruments, the fair value is equal to the carrying value.

	At 30 June 2018		At 31 December 2017	
	Carrying Amounts	Fair Value	Carrying Amounts	Fair Value
Financial Assets				
Placings with and advances to banks	**97,183**	**97,128**	103,113	103,146
Reverse repurchase agreements – non-trading	**3,172**	**3,172**	–	–
Loans and advances to customers	**855,237**	**854,414**	806,573	808,220
Held-to-maturity debt securities	**N/A**	**N/A**	95,057	97,614
Financial investments – at amortised cost	**101,284**	**100,151**	N/A	N/A
Financial Liabilities				
Current, savings and other deposit accounts	**1,116,777**	**1,116,746**	1,074,837	1,074,903
Repurchase agreements – non-trading	**5,796**	**5,796**	2,389	2,389
Deposits from banks	**5,552**	**5,552**	3,676	3,676
Certificates of deposit and other debt securities in issue	**–**	**–**	600	600

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 55(b) of the Group's Annual Report 2017.

40 Condensed consolidated financial statements and statutory financial statements

The financial information relating to the year ended 31 December 2017 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 2017. 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 2017, which includes the statutory financial statements, can be obtained from the Bank's website (www.hangseng.com) and the website of HKEX (www.hkexnews.hk).

The Banking Disclosure Statement, together with the disclosures in the Group's Interim Report, contained all the disclosures required by the Banking (Disclosure) Rules issued by the HKMA. The disclosures as required under the Banking (Disclosures) Rules can be viewed in the Banking Disclosure Statement that is available in the Regulatory Disclosures section of the Bank's website (www.hangseng.com) in late August 2018.

41 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.

42 Comparative figures

The presentation of the condensed consolidated cash flow statement for the first half of 2017 was enhanced. For details, please refer to the footnote under the condensed consolidated cash flow statement. Other than the above, certain comparative figures in the condensed consolidated financial statements have also been reclassified to conform with current period's presentation.

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

(incorporated in Hong Kong with limited liability)

Introduction

We have reviewed the condensed consolidated financial statements set out on pages 31 to 87, which comprises the condensed consolidated balance sheet of Hang Seng Bank Limited (the "Bank") and its subsidiaries (together, the "Group") as at 30 June 2018 and the related condensed consolidated income statement, condensed consolidated statement of comprehensive income, condensed consolidated statement of changes in equity and condensed consolidated cash flow statement for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes. The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of a report on condensed consolidated financial statements to be in compliance with the relevant provisions thereof and Hong Kong Accounting Standard 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants. The directors of the Bank are responsible for the preparation and presentation of these condensed consolidated financial statements in accordance with Hong Kong Accounting Standard 34 "Interim Financial Reporting". Our responsibility is to express a conclusion on these condensed consolidated financial statements based on our review and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Scope of Review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed consolidated financial statements 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, 6 August 2018

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 2018.

Changes in Directors' Details

Changes in Directors' details since the date of the Annual Report 2017 of the Bank and up to the date of release of the interim results of the Bank which are required to be disclosed pursuant to Rule 13.51(2) and Rule 13.51B(1) of the Listing Rules, are set out below.

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

Cessation of appointment
- Economic Development Commission of HKSAR Government (Non-official Member)

Ms Louisa CHEANG

New appointments
- Hang Seng Management College (Chairman of the Board of Governors)
- Hang Seng School of Commerce (Chairman of the Board of Directors)

Cessation of appointment
- HSBC Amanah Malaysia Berhad (Non-Independent Executive Director)

Dr John CHAN Cho Chak GBS, JP

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

Mr Nixon CHAN Lik Sang

Cessation of appointment
- Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Review Tribunal (Member)

Ms CHIANG Lai Yuen JP

New appointments
- Chen Hsong Holdings Limited[1] (Chairman)
- Hang Seng Bank Limited[1] (Member of Audit Committee)

Ms Margaret KWAN Wing Han

New appointment
- Hang Seng Securities Limited (Chairman)

Ms Irene LEE Yun Lien

New appointments
- Hong Kong Monetary Authority (Member of The Exchange Fund Advisory Committee)
- HSBC Holdings plc[1] (Member of Chairman's Committee; Member of Group Remuneration Committee; Member of Nomination & Corporate Governance Committee)

Cessation of appointments
- CLP Holdings Limited[1] (Independent Non-executive Director; Member of Audit Committee; Member of Finance and General Committee; Member of Sustainability Committee)

Dr Eric LI Ka Cheung GBS, OBE, JP

New appointment
- The Thirteenth National Committee of the Chinese People's Political Consultative Conference (Member)

Dr Vincent LO Hong Sui GBM, JP

Cessation of appointment
- The Twelfth National Committee of the Chinese People's Political Consultative Conference (Member)

Mr Peter WONG Tung Shun JP

New appointments
- Hong Kong General Chamber of Commerce (Deputy Chairman; Chairman of Membership Committee)
- Hong Kong Trade Development Council (Council Member; Member of Belt and Road Committee)
- The Thirteenth National Committee of the Chinese People's Political Consultative Conference (Member; Vice Chairman of Committee for Agricultural and Rural Affairs)

Cessation of appointments
- Economic Development Commission of HKSAR Government (Non-official Member)
- Hong Kong General Chamber of Commerce (Vice Chairman)
- HSBC Bank Malaysia Berhad (Non-Independent Executive Director)

Mr Michael WU Wei Kuo

New appointment
- Hang Seng Bank Limited[1] (Member of Risk Committee)

Cessation of appointments
- Hang Seng Bank Limited[1] (Member of Audit Committee)
- The Community Chest of Hong Kong (Member of Executive Committee)

Notes:

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

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

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

Directors' and Alternate Chief Executives' Interests

As at 30 June 2018, 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 Margaret W H Kwan	65	—	—	—	65	0.00
Number of ordinary shares of US$0.50 each in HSBC Holdings plc						
Directors:						
Dr Raymond K F Ch'ien	59,799	—	—	—	59,799	0.00
Ms Louisa Cheang	369,493	—	—	194,218[2]	563,711	0.00
Dr John C C Chan	24,605[1]	—	—	—	24,605	0.00
Mr Nixon L S Chan	137,871	—	—	20,536[2]	158,407	0.00
Ms Margaret W H Kwan	36,294	10,041	—	14,033[2]	60,368	0.00
Ms Irene Y L Lee	10,809	—	—	—	10,809	0.00
Ms Sarah C Legg	200,552	2,695	—	120,643[2]	323,890	0.00
Dr Eric K C Li	—	58,823	—	—	58,823	0.00
Mr Kenneth S Y Ng	433,571	—	—	7,230[2]	440,801	0.00
Mr Peter T S Wong	1,788,949	24,909	—	1,244,820[2]	3,058,678	0.02
Alternate Chief Executives:						
Mrs Eunice L C Y Chan	35,013	—	—	11,494[2]	46,507	0.00
Mr Donald Y S Lam	120,108	—	—	19,452[2]	139,560	0.00
Mr Andrew W L Leung	17,528	—	—	16,877[2]	34,405	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 2018, 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 2018	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 2018
Directors:				
Ms Louisa Cheang	246,178	79,656	136,777	194,218[1]
Mr Nixon L S Chan	24,800	—	4,783	20,536[1]
Ms Margaret W H Kwan	9,411	19,762	15,338	14,033[1]
Ms Sarah C Legg	115,650	47,042	44,477	120,643[1]
Mr Kenneth S Y Ng	19,582	—	12,762	7,230[1]
Mr Peter T S Wong	1,063,868	179,627	567,514	698,285[1]
Alternate Chief Executives:				
Mrs Eunice L C Y Chan	13,356	4,779	6,921	11,494[1]
Mr Donald Y S Lam	19,263	19,452	19,667	19,452[1]
Mr Andrew W L Leung	21,198	6,230	10,994	16,877[1]

Note:

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

During the first half of 2018, Ms Sarah C Legg, Mrs Eunice L C Y Chan and Mr Donald Y S Lam also acquired and were awarded ordinary shares of HSBC Holdings plc under the HSBC International Employee Share Purchase Plan. Their interests in ordinary shares of HSBC Holdings plc under this plan have been included in their "Personal Interests" disclosed in the table under "Interests in shares".

All the interests stated above represented long positions. As at 30 June 2018, 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 2018.

Substantial Interests in Share Capital

The register maintained by the Bank pursuant to the SFO recorded that, as at 30 June 2018, the following corporations had interests or short positions in the shares or underlying shares (as defined in the SFO) in the Bank set opposite their respective names:

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

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

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

All the interests stated above represented long positions. As at 30 June 2018, 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 2018.

Remuneration and Staff Development

There have been no material changes to the information disclosed in the Annual Report 2017 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 2018. Further, the Bank constantly reviews and enhances its corporate governance framework, by making reference to market trend as well as guidelines and requirements issued by regulatory authorities, to ensure that it is in line with international and local corporate governance best practices.

The Audit Committee of the Bank has reviewed the results of the Bank for the six months ended 30 June 2018.

2018 Second Interim Dividend

Announcement date	6 August 2018
Ex-dividend date	17 August 2018
Book close and record date	21 August 2018
Payment date	6 September 2018

Register of Shareholders

The Register of Shareholders of the Bank will be closed on Tuesday, 21 August 2018, during which no transfer of shares can be registered. To qualify for the second interim dividend, all transfers, accompanied by the relevant share certificates, must be lodged with the Bank's Registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712–1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, for registration not later than 4:30 pm on Monday, 20 August 2018.

Board and Committees

Board

Independent Non-executive Chairman
Raymond CH'IEN Kuo Fung

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

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

Independent Non-executive Directors
John CHAN Cho Chak
CHIANG Lai Yuen
Irene LEE Yun Lien
Eric LI Ka Cheung
Michael WU Wei Kuo

Committees

Executive Committee
Louisa CHEANG (Chairman)
Eunice CHAN
Ivy CHAN Shuk Pui
Walter CHEUNG Shu Wai
CHOW Tan Ling
Margaret KWAN Wing Han
Donald LAM Yin Shing
Gilbert LEE Man Lung
LEE Sai Kit
Andrew LEUNG Wing Lok
LI Chi Chung
Ryan SONG Yue Sheng
Elaine WANG Yee Ning
Daphne WAT Wing Kam
Katie YIP Kay Chun

Audit Committee
Eric LI Ka Cheung (Chairman)
CHIANG Lai Yuen
Irene LEE Yun Lien

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

Risk Committee
Irene LEE Yun Lien (Chairman)
Eric LI Ka Cheung
Michael WU Wei Kuo

Nomination Committee
Raymond CH'IEN Kuo Fung (Chairman)
John CHAN Cho Chak
Louisa CHEANG
Peter WONG Tung Shun
Michael WU Wei Kuo

Notes:

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

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

Registered Office

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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
Telephone: 1–888-BNY-ADRS
Website: www.mybnymdr.com
Email: shrrelations@cpushareownerservices.com

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

Interim Report 2018

This Interim Report 2018 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 2018 on the Bank's website and wish to receive a printed copy; or
B) receive this Interim Report 2018 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 2018 on the Bank's website, have difficulty in reading or gaining access to this Interim Report 2018 via the Bank's website for any reason, the Bank will promptly send this Interim Report 2018 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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