ENGAGEMENT

連繫 前行

ANNUAL REPORT 2017

恒生銀行
HANG SENG BANK

ENGAGED AND EVER-GROWING...

The cover and images appearing inside this year's annual report illustrate the integral relationship between Hang Seng Bank and the communities it serves.

Founded in 1933, Hang Seng is one of Hong Kong's largest listed companies. Our market capitalisation as at 31 December 2017 was HK$370.9 billion.

We serve over half the adult residents of Hong Kong – more than 3 million people – through about 270 service outlets. We also maintain branches in Macau and Singapore and a representative office in Taipei.

Established in May 2007, wholly owned subsidiary Hang Seng Bank (China) Limited is headquartered in Pudong, Shanghai, and operates a mainland China network with outlets in the Pearl River Delta, the Yangtze River Delta, the Bohai Rim Region and midwest China.

Hang Seng is a principal member of the HSBC Group, one of the world's largest banking and financial services organisations.

RATINGS

MOODY'S

Long-term Bank Deposit (local & foreign currency)	Short-term Bank Deposit (local & foreign currency)	Outlook
Aa3	Prime-1	Stable

STANDARD & POOR'S

Long-term Counterparty Credit (local & foreign currency)	Short-term Counterparty Credit (local & foreign currency)	Outlook
AA-	A-1+	Stable

Contents

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

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

Results in Brief

For the Year

Operating profit excluding loan impairment charges and other credit risk provisions
24,589 HK$m
2016 20,347 HK$m

Operating profit
23,547 HK$m
2016 19,034 HK$m

Profit before tax
23,674 HK$m
2016 19,090 HK$m

Profit attributable to shareholders
20,018 HK$m
2016 16,212 HK$m

Return on average ordinary shareholders' equity
14.2%
2016 12.1%

Cost efficiency ratio
30.5%
2016 33.5%

Average liquidity coverage ratio (quarter ended 31 Dec)
209.5%
2016 253.6%

Average liquidity coverage ratio (quarter ended 30 Sep)
242.3%
2016 284.0%

Average liquidity coverage ratio (quarter ended 30 Jun)
256.7%
2016 257.1%

Average liquidity coverage ratio (quarter ended 31 Mar)
267.7%
2016 257.1%

Earnings per share
10.30 HK$
2016 8.30 HK$

Dividends per share
6.70 HK$
2016 6.10 HK$

At Year-End (at 31 December)

Shareholders' equity
152,030 HK$m
2016 140,626 HK$m

Total assets
1,478,418 HK$m
2016 1,377,242 HK$m

Capital ratios
under Basel III

Common Equity Tier 1 ("CET1") Capital Ratio
16.5%
2016 16.6%

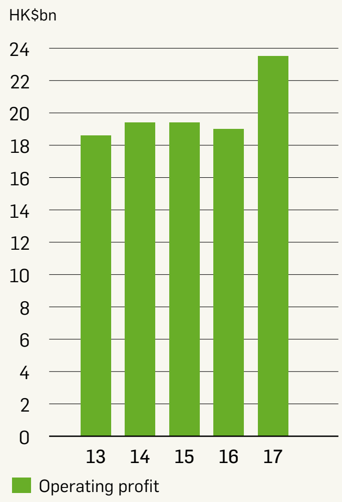
Tier 1 Capital Ratio
17.7%
2016 17.9%

Total Capital Ratio
20.1%
2016 20.8%

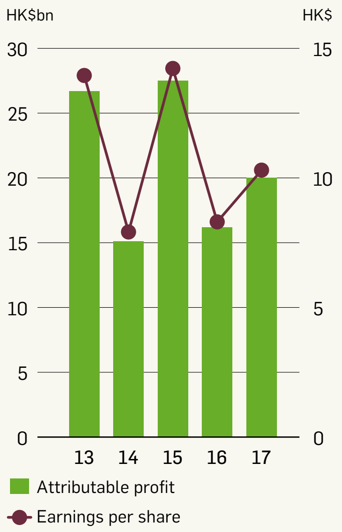
Five-Year Financial Summary

	2013	2014	2015	2016	**2017**
For the Year	HK$bn	HK$bn	HK$bn	HK$bn	**HK$bn**
Operating profit	18.6	19.4	19.4	19.0	**23.5**
Profit before tax	28.5	18.0	30.5	19.1	**23.7**
Profit attributable to shareholders	26.7	15.1	27.5	16.2	**20.0**
At Year-end	HK$bn	HK$bn	HK$bn	HK$bn	**HK$bn**
Shareholders' equity	107.8	139.2	142.0	140.6	**152.0**
Issued and paid up capital	9.6	9.7	9.7	9.7	**9.7**
Total assets	1,143.7	1,264.0	1,334.4	1,377.2	**1,478.4**
Total liabilities	1,035.9	1,124.8	1,192.4	1,236.6	**1,326.3**
Per Share	HK$	HK$	HK$	HK$	**HK$**
Earnings per share	13.95	7.91	14.22	8.30	**10.30**
Dividends per share					
– 1st to 4th interim dividends	5.50	5.60	5.70	6.10	**6.70**
– special interim dividend	–	–	3.00	–	**–**
Ratios	%	%	%	%	**%**
Return on average ordinary shareholders' equity	25.4	13.4	20.7	12.1	**14.2**
Post-tax return on average total assets	2.4	1.3	2.1	1.2	**1.4**
Capital ratios under Basel III					
– Common Equity Tier 1 ("CET1") Capital Ratio	13.8	15.6	17.7	16.6	**16.5**
– Tier 1 Capital Ratio	13.8	15.6	19.1	17.9	**17.7**
– Total Capital Ratio	15.8	15.7	22.1	20.8	**20.1**
Cost efficiency ratio	32.4	31.8	33.8	33.5	**30.5**

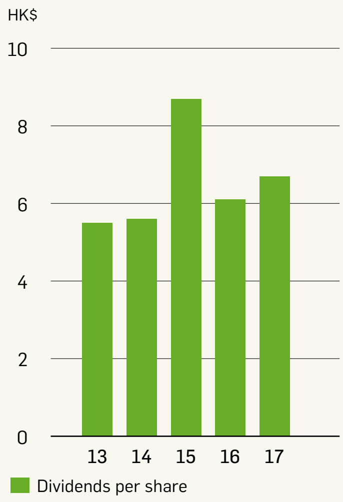
Results



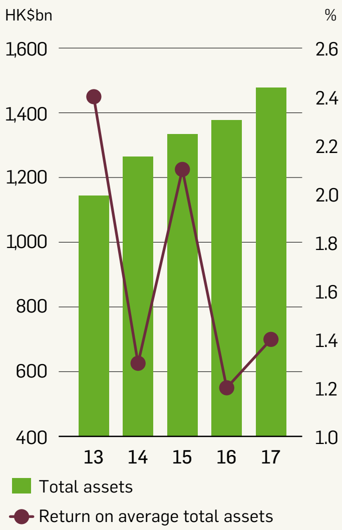
Attributable Profit and Earnings per Share



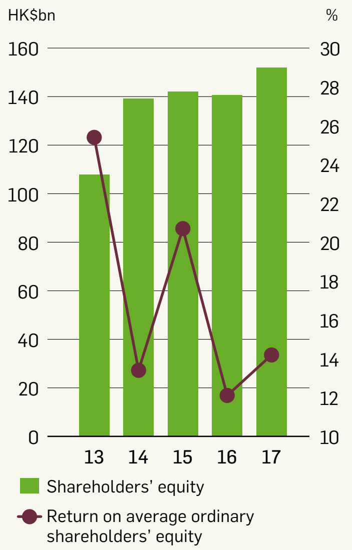
Dividends per Share



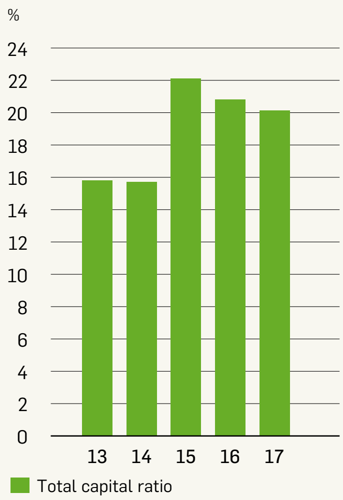
Total Assets and Return on Average Total Assets



Shareholders' Equity and Return on Average Ordinary Shareholders' Equity



Total Capital Ratio



Chairman's Statement

The international economy regained its footing in 2017. The US and the Eurozone recorded full-year growth rates of 2.3% and 2.5% respectively, compared with 1.5% and 1.8% in 2016.

Hang Seng leveraged its strong market position and growing technological capabilities to capitalise on improved customer appetite for investment and the active property sector in Hong Kong. Investments in our digital and mobile channels, as well as our physical outlets, created more opportunities for customer contact, supporting robust balance sheet growth.

Attributable profit grew by 23% to HK$20,018m and earnings per share increased by 24% to HK$10.30 per share.

Return on average ordinary shareholders' equity was 14.2%, compared with 12.1% in 2016. Return on average total assets was 1.4%, compared with 1.2% for the previous year.

The Directors have declared a fourth interim dividend of HK$3.10 per share. This brings the total distribution for 2017 to HK$6.70 per share, compared with HK$6.10 per share in 2016.

Economic Outlook

Benefitting from the positive shift in the external environment, Hong Kong's economic growth averaged 4% in the first three quarters of 2017. Further US rate rises will put upward pressure on local interest rates, but given the current abundant liquidity in the domestic market, the impact is likely to be modest. We expect full-year GDP growth to slow slightly to 2.8% for 2018, due largely to the high base of comparison established last year.

Growth in mainland China picked up by 0.2 percentage points to 6.9% in 2017. Trade has rebounded on the back of the stronger global economy, but ongoing economic deleveraging on the domestic front has seen a slowdown in investment growth. With the Mainland economy now settling into the 'new normal' era of development, we forecast full-year GDP growth of 6.6% for 2018.

The Fed's intention to continue gradually raising interest rates and the European Central Bank's move to begin scaling back quantitative easing indicate growing confidence that the global economy has returned to a more even keel. However, factors such as longer term shifts in international trade patterns and economic transition on the Mainland mean that operating conditions for our business will remain dynamic.

Since taking up her position in July, Hang Seng Vice-Chairman and Chief Executive Louisa Cheang has built on the good growth momentum established by her predecessor. Her vision and drive in continuing to strengthen the Bank's overall management capabilities will lead Hang Seng to new successes.

We will make further investments in strengthening customer relationships, enhancing efficiency and the ability to respond swiftly to new business opportunities and market developments. We will continue to take a proactive approach to achieving sustainable growth through service excellence to deliver value for shareholders.

Raymond K.F. Ch'ien

Raymond Ch'ien
Chairman
Hong Kong, 20 February 2018

Chief Executive's Report

In today's fast-moving market environment, customers value a personalised banking experience that offers greater control and choice, and services that are convenient and easy to use. As an integral part of our customer-centric business strategy, we are delivering on these expectations through investments in technology, staff development and operational infrastructure.

Our progressive approach to enhancing customer engagement and addressing the changing face of banking and financial services led to a strong set of results for 2017. Operating profit grew by 24% to reach a record high of HK$23,547m, with healthy and balanced expansion in lending and deposits.

We deepened our understanding of the preferences and lifestyles of clients through effective use of data analytics. Supported by our customer segmentation strategy, we anticipated their evolving needs, leveraging our comprehensive portfolio of wealth-and-health offerings to provide products and services in a timely manner. Along with our trusted brand, this facilitated the acquisition of new customers and good growth in wealth management income.

To strengthen our engagement with customers where they live, work and play, we continued to modernise, diversify and digitise our distribution channels, launching innovative and inclusive solutions that enhance convenience and enrich our customer-centred service proposition. Initiatives such as biometric authentication and real-time transaction updates on mobile devices reflect our drive to make banking with Hang Seng a fast, secure and value-added experience. In December, we launched a Mobile Branch to serve public housing estates in remote areas of Hong Kong.

We consolidated our Hang Seng Bank (China) Limited operations by re-establishing our strategic priorities and portfolio on the Mainland. We also took steps to enhance our business agility and ensure we are better prepared to comply with future changes in the regulatory environment. Hang Seng China recorded balanced growth in loans and deposits and enhanced overall credit quality, but tighter lending margins had an adverse impact on the bottom line.

In line with our long-term commitment to the Mainland market, we continued to invest in strengthening our service scope and distribution capabilities. In April, we launched our first public fund for Mainland investors through Hang Seng Qianhai Fund Management Company, our foreign-majority-owned joint venture fund management company.

We rolled out new initiatives to more effectively engage staff and improve their well-being. This is driving a stronger sense of empowerment and brand ownership among our people that will help us build closer relationships with customers and the local community.

Financial Performance

Attributable profit grew by 23% to HK$20,018m and earnings per share were up 24% at HK$10.30 per share. Profit before tax rose by 24% to HK$23,674m.

Operating profit excluding loan impairment charges grew by 21% to HK$24,589m.

Net operating income rose by 17% to HK$34,315m.

Net interest income was up 10% at HK$24,577m, reflecting the 6% increase in average interest-earning assets, an enhanced deposit mix and the improved net interest margin, which rose by 9 basis points to 1.94%.

Non-interest income grew by 29% to HK$10,780m. In the upbeat investment environment, we used our enhanced data analytics capabilities and diverse range of wealth-and-health products to provide customers with tailored wealth management solutions. Our securities broking business also performed strongly in the supportive market conditions. Wealth management income increased by 33% to HK$8,769m.

Our cost efficiency ratio was 30.5%, compared with 33.5% in 2016.

At 31 December 2017, our common equity tier 1 capital ratio, tier 1 capital ratio and total capital ratio were 16.5%, 17.7% and 20.1% respectively, compared with 16.6%, 17.9% and 20.8% at the end of 2016.

Engaging For Future Growth

The global economy regained momentum during 2017 and this has continued into the new year. At the same time, the impact of ongoing economic adjustment on the Mainland and potential future shifts in international trade policies may create new challenges for business.

Our forward-looking approach to business is driven by the desire to help our customers achieve their aspirations by providing financial services that are efficient, add value and are convenient to use. In line with our long-standing support of various successful community programmes for youth development, we are building a strong pipeline for future growth by serving customers of today better and increasing our appeal among younger generations as the customers of tomorrow.

Backed by our firm financial fundamentals, we will continue to leverage competitive advantages – including our trusted brand, extensive distribution and large base of customers – that are not easily replicated by our peers.

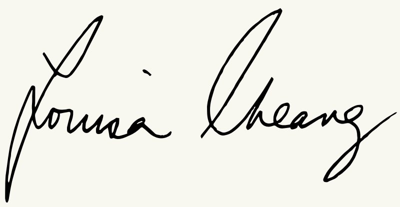
We will strengthen client engagement by extending our service reach, enhancing efficiency and supporting the development of customised wealth management solutions that address evolving customer needs and market complexities.

As Hong Kong's leading domestic bank, we will launch more fintech initiatives that align with our customer-centric business strategy to help drive in a new era of 'smart banking' in our city. In January this year, we rolled out Hong Kong's first AI virtual assistants for retail banking customers.

The sharper focus of our Mainland business and our highly integrated cross-border infrastructure will serve us well in maintaining the growth momentum of our core banking services and capitalising on new opportunities created by major policy initiatives and financial liberalisation on the Mainland. Our Qianhai JV's second public fund was recently approved and will be launched in the coming months.

We will continue to improve staff engagement to ensure we provide the workplace environment, support and career development opportunities our people need to reach their potential, enjoy job satisfaction and become great ambassadors of our brand. I wish to express sincere thanks to all my colleagues for their contributions to achieving Hang Seng's strong 2017 results and advancing our strategy for sustainable growth as a progressive, customer-centred business.

As we move forward alongside our clients, integrity, innovation and inclusion will remain central in our actions to achieve our strategic goals and deliver service excellence as a financial institution and good corporate citizen.



Louisa Cheang
Vice-Chairman and Chief Executive
Hong Kong, 20 February 2018

ENGAGE-MENT

As Hong Kong's leading domestic bank, Hang Seng Bank grows ever stronger by engaging with social, generational, technological and economic change and innovation.

Through inclusive engagement with our customers, our community, our employees, our partners and other stakeholders, we are renewing our commitment to finding creative and pragmatic solutions to current and future challenges.

ENGAGING WITH

customers

Using data analytics and our broad service platform, we are deepening our engagement with retail and commercial banking customers – refining our customer-centric service model, tailoring products for each market segment and strengthening our proposition for younger generations.

24%

INCREASE IN PRESTIGE SIGNATURE CUSTOMER BASE

30%

INCREASE IN NUMBER OF SECURITIES-RELATED TRANSACTIONS COMPLETED VIA DIGITAL CHANNELS


DORI
HARO

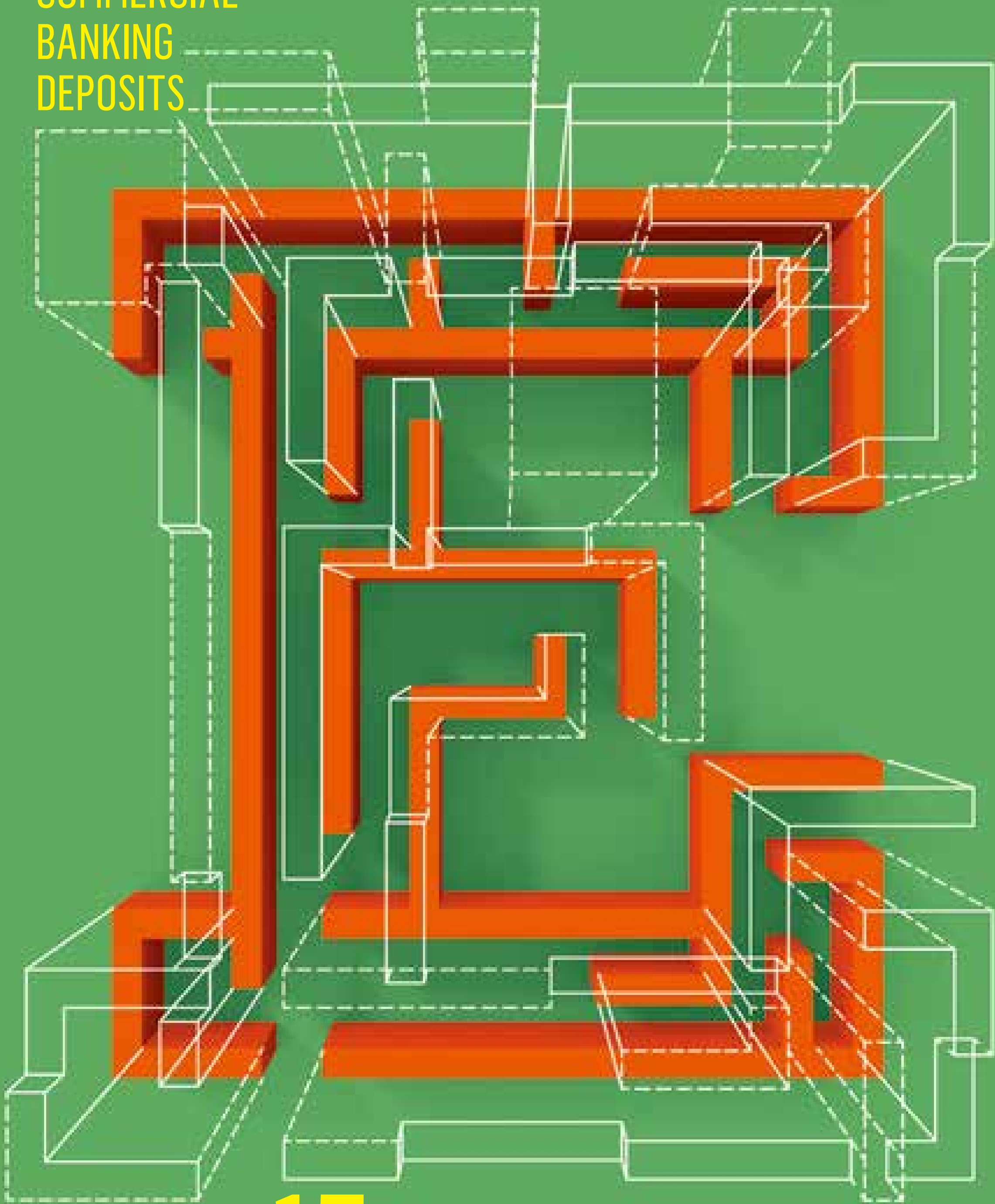
ENGAGING WITH

data

We are engaging analytical and interactive tools and technology to enhance digital and physical banking channels, and to strengthen our ability to respond swiftly to fast-changing user needs and preferences.

14%

INCREASE IN COMMERCIAL BANKING DEPOSITS



15%

GROWTH IN COMMERCIAL BANKING LENDING

ENGAGING WITH

enterprise

We are enhancing our engagement with SMEs, start-ups and entrepreneurs, using our unequaled experience and shared business values to fulfil their unique financing and operating needs.

SINCE 2001, CLOSE TO

350,000

INDIVIDUALS HAVE TAKEN PART IN ACTIVITIES ORGANISED BY HANG SENG TABLE TENNIS ACADEMY

ENGAGING WITH
excellence

We are ever-more deeply engaged with our community, meeting our corporate sustainability goals, and embracing our social responsibilities, our values and our culture of excellence and diversity.

Our people play a central role in demonstrating our core values as active members of the community we serve.

Business Review

With the upturn in investment sentiment during 2017, our effective use of technology, diverse range of service channels and all-weather product portfolio enabled us to act swiftly and deliver tailored financial solutions in response to changing customer needs. Supported by our customer segmentation strategy, this strengthened our relationships with existing clients and won us new business.

Facilitated by our leading market position for core banking services and in-depth industry sector knowledge, we capitalised on the active property market and rising demand for loans among commercial customers to achieve a 15% year-on-year increase in gross loans and advances to HK$808.2bn. Our closer engagement with clients supported the acquisition of new deposits, driving an 8% rise in customer deposits (including certificates of deposit and other debt securities in issue) to HK$1,115.4bn.

Retail Banking and Wealth Management

Retail Banking and Wealth Management achieved a 37% increase in operating profit excluding loan impairment charges to HK$12,961m. Operating profit was up 43% at HK$12,471m.

Building on our long history of having the highest-rated banking services in Hong Kong, we rolled out new initiatives to further enhance customer satisfaction and strengthen our position as a preferred brand.

Leveraging our data analytics capabilities, diverse range of wealth-and-health products and customer-centric service model, we tailored needs-based wealth management solutions for different client segments. We achieved a 24% increase in the Prestige Signature customer base.

We stepped up our use of technology and upgraded our digital platform to enhance customer convenience and provide a swift and simple service experience. We extended the product coverage and service functionality of our online platform and implemented Face, Touch and Voice ID to provide secure access to services via our Personal Banking mobile app and Phone Banking hotlines.

We continued with initiatives to drive our upward trend in digital engagement and year-on-year growth in the use of our e-services and other self-directed channels. Non-branch channels accounted for 98% of securities-related transactions and the number of securities-related and travel insurance transactions completed via digital channels increased by 30% and 11% respectively year on year. Our convenient network of new foreign exchange ATMs offers the widest choice of foreign currencies available via automated banking channels in Hong Kong. We will continue to expand the coverage of this service to other high-traffic locations.

Our enhanced portfolio management capabilities and trusted brand helped us deepen customer relationships and achieve solid balance sheet growth. Net interest income grew by 12% to HK$13,667m. Customer deposits increased by 8% compared with a year earlier and we further improved the deposit mix. Lending rose by 9% year on year.

A CUSTOMER-CENTRIC APPROACH

Every Hang Seng customer is an individual with unique financial objectives and aspirations. Backed by our diverse portfolio of products, we apply the combined strength of our in-depth understanding of customer needs and data analytics to provide tailor-made wealth management solutions for clients from all backgrounds and at different life stages.

Delivering Efficiency

The diversity and reach of our network enables Hang Seng customers to enjoy service convenience at home, at work and on the move. Located in high-traffic areas, our new foreign currency ATMs offer exchange and withdrawal services for 12 different currencies – the widest choice available in Hong Kong. Our Mobile Branch reinforces our status as an inclusive community bank by improving access to financial services for residents in remote areas.

USING INNOVATION TO ENGAGE CUSTOMERS

Our investments in fintech and digital channels are making it easier for customers to manage their financial and lifestyle needs. Our biometric authentication services offer swift and secure access to our Personal Banking mobile app and Phone Banking hotlines. We are also spearheading the use of AI technologies for retail banking in Hong Kong, with chatbots 'HARO' and 'DORI' providing round-the-clock assistance with enquiries about various products and services, and relevant credit card offers.

We grew non-interest income by 55% to HK$5,678m. Supported by our time-to-market advantage and diverse range of products, investments in our distribution network and data analytics strengthened our ability to meet the changing needs of different customer segments in a fast-moving market, resulting in a 34% increase in wealth management income to HK$7,707m.

Investment services income increased by 27% to HK$3,557m. Positive investor sentiment drove increases in securities turnover and income of 58% and 39% respectively. Leveraging our diverse suite of investment products, we grew investment services revenue excluding securities by 21%.

Insurance income rose by 41% to HK$4,150m, due mainly to an 11% increase in new annualised life insurance premiums and higher returns from the life insurance investment portfolio.

In the active property sector, we strengthened our mortgage distribution capabilities in strategic locations to provide more customers with one-stop home loan solutions. This enhanced service proposition led to an 8% year-on-year increase in mortgage balances in Hong Kong. In a competitive market, we continue to rank among the top three banks for new mortgage business in Hong Kong.

Our good understanding of the interests and behaviours of our large base of customers helped us achieve an 8% increase in card receivables and grow personal lending in Hong Kong by 13% year on year.

We continued to enrich our service offerings in mainland China and strengthen our position for achieving long-term sustainable business growth. Hang Seng Qianhai Fund Management Company Limited, our foreign-majority-owned joint venture fund management company on the Mainland, launched its first public fund in April.

Commercial Banking

Commercial Banking grew operating profit excluding loan impairment charges by 18% to HK$6,893m. Operating profit was up 21% at HK$6,349m.

Further initiatives to support SME clients in a dynamic operating environment and provide a seamless cross-border service experience strengthened customer engagement, driving good balance sheet growth. Our professional Relationship Management teams were recognised by our customers for providing timely and reliable banking solutions to support their business growth.

Net interest income rose by 15% to HK$7,030m. Our strong transactional banking capabilities facilitated the acquisition of deposits, which increased by 14%. Leveraging our market sector expertise and cross-border business strength, we identified new opportunities for quality lending to grow customer loans by 15%. We continued to proactively manage our credit risk and maintained good overall credit quality.

Non-interest income increased by 21% to HK$2,679m. We added value with flexible financial management solutions – including our new Virtual Account for efficient daily cash management – that help customers respond swiftly to changing market conditions and new business opportunities.

In the active investment environment, our Receivables Management System enhanced transaction efficiency for securities firm customers by facilitating the faster resolution of their trading activities. Fees from remittances and account-related services rose by 15%. Effective collaboration with Global Markets resulted in a 20% rise in foreign exchange income. In the positive investment environment, we used our extensive distribution network and strong relationships with SME customers to achieve a 43% increase in investment services income. Revenue from insurance was up 14%.

We continued to expand the scope and functionality of our digital services to make banking faster, easier and more convenient. We introduced Touch ID logon for our Hang Seng HSBCnet mobile app and added new features such as a real-time Trade Transaction Tracker that provides round-the-clock status updates.

Initiatives to enhance the ease and efficiency of service delivery at our Business Banking Centres, including upgrades to our outlet in Sheung Shui, helped drive a 28% increase in SME-related operating profit excluding loan impairment charges and earn us the title of 'Best Bank for SMEs' in *Asiamoney*'s Best Bank Awards.

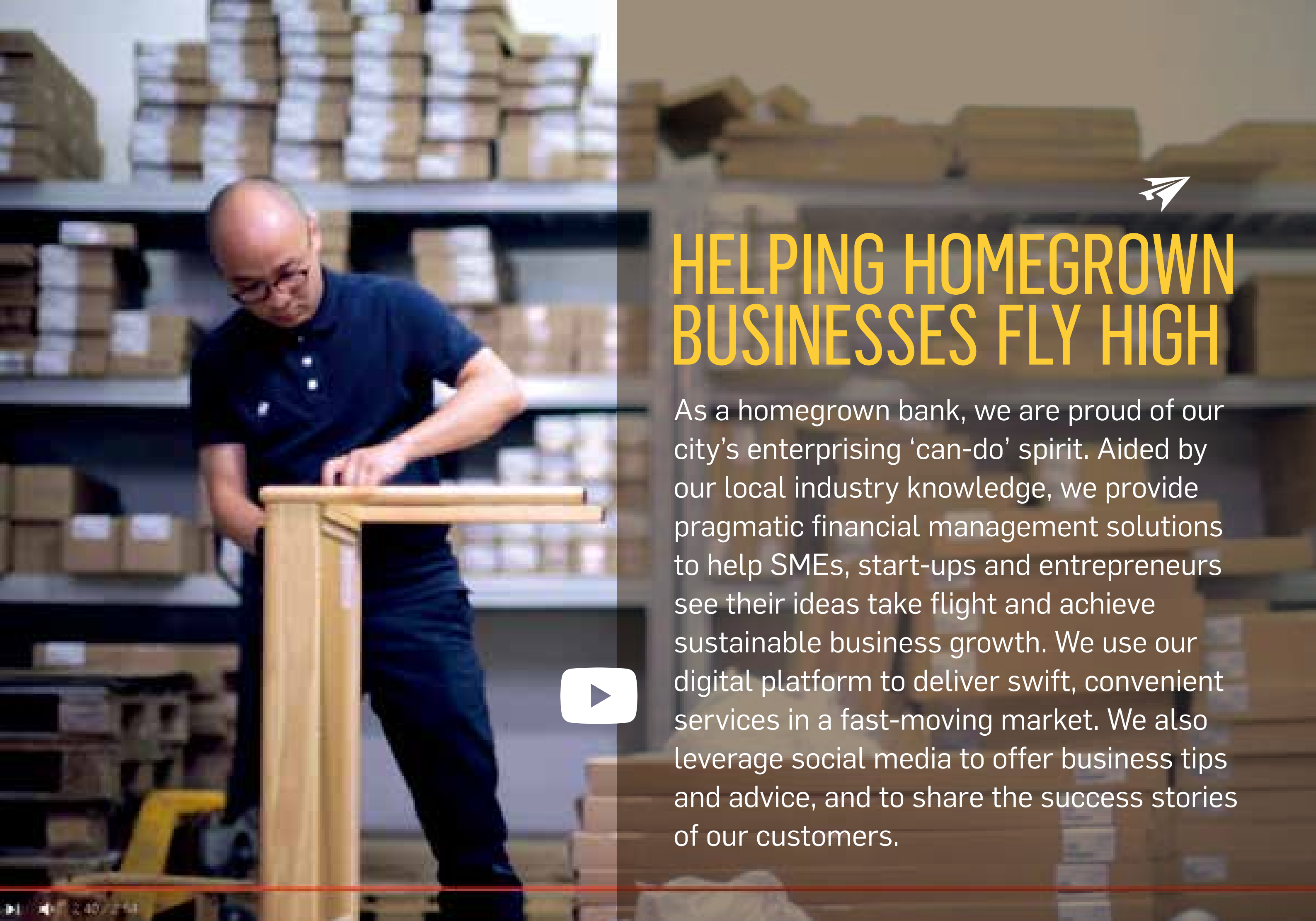
Other external recognition of our efforts to facilitate the operation and growth of our customers' businesses include the 'Outstanding Import & Export Industry Partner Award' from the Hong Kong Chinese Importers' & Exporters' Association and being named 'Hong Kong Domestic Trade Finance Bank of the Year' by *Asian Banking & Finance*.

Global Banking and Markets

Global Banking and Markets reported a 1% decline in both operating profit excluding loan impairment charges and operating profit to HK$4,763m and HK$4,755m respectively.

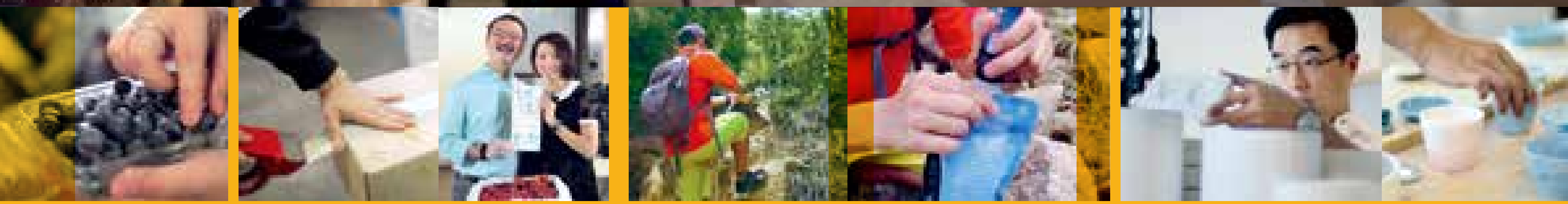
Despite limited opportunities for deploying new and maturing funds, Global Markets recorded a 1% increase in net interest income by actively managing the balance sheet and closely monitoring the market to achieve yield enhancement. Global Banking capitalised on the upturn in loan demand during the second half to achieve a 27% year-on-year increase in customer lending in 2017. Continuing efforts to promote transactional banking services supported a 5% rise in customer deposits compared with a year earlier, with a 34% increase in current and savings account deposits. Net interest income in the second half was up 15% compared with the first half, but tighter loan margins resulted in a 3% drop for the full year.

In the challenging interest rate environment, Global Markets focused on growing non-fund revenue, leading to a 5% rise in non-interest income. We enhanced our suite of wealth management and hedging solutions by strengthening our product capabilities in foreign exchange, interest rates and equity. Facilitated by close collaboration with the Bank's retail and commercial banking teams, this supported increased cross-selling of Global Markets products to serve the needs of different customers. Vanilla foreign exchange income recorded strong growth of 27%. The buoyant investment conditions drove a significant increase in customer demand for equity-linked structured products, leading to a doubling of growth in related income compared with the previous year.



HELPING HOMEGROWN BUSINESSES FLY HIGH

As a homegrown bank, we are proud of our city's enterprising 'can-do' spirit. Aided by our local industry knowledge, we provide pragmatic financial management solutions to help SMEs, start-ups and entrepreneurs see their ideas take flight and achieve sustainable business growth. We use our digital platform to deliver swift, convenient services in a fast-moving market. We also leverage social media to offer business tips and advice, and to share the success stories of our customers.



Well Connected for Cross-border Services

The close connectivity of our Hong Kong and mainland China operations provides customers with seamless cross-border services and will enable us to capture new opportunities arising from major developments such as the Guangdong-Hong Kong-Macao Bay Area and the Belt and Road initiative. Leveraging our rich experience in Hong Kong, we are continuing to invest in strengthening our service capabilities. In April 2017, Hang Seng Qianhai Fund Management Company, our foreign-majority-owned Mainland joint venture fund management company, launched its first public fund.

We made further investments in infrastructure to capture business opportunities arising from the Mainland's ongoing financial liberalisation and measures to promote the internationalisation of the renminbi. As an interbank foreign exchange market member of the China Foreign Exchange Trade System, we widened our scope to cover the onshore bond market under the Bond Connect initiative that was implemented in the second half of 2017. We continued to provide various renminbi-related financial services to eligible offshore investors in our role as a Hong Kong Monetary Authority-appointed settlement bank.

Against a backdrop of rapidly changing international and local regulations, our robust internal control systems ensured we continued to uphold high standards of compliance while delivering service excellence. We maintained the Bank's liquidity ratio at a strong level that is well above regulatory requirements.

AWARDS

Best Bank – Domestic (Hong Kong)
(18th consecutive year)
THE ASSET

Best Domestic Bank (Hong Kong)
ASIAMONEY

Best Bank for SMEs (Hong Kong)
ASIAMONEY

Best Bank in Hong Kong
CORPORATE TREASURER

Safest Bank in Hong Kong
GLOBAL FINANCE

Hong Kong Domestic Trade Finance Bank of the Year
ASIAN BANKING & FINANCE

Superbrands Award
SUPERBRANDS

Wealth Management Provider of the Year
NANFANG DAILY

Best Foreign Bank in Cross-border Investment and Wealth Management
21ST CENTURY BUSINESS HERALD

Best Foreign Bank in Wealth Management
CHINA FINANCIAL HERALD

For Corporate Sustainability recognition, please refer to page 90.

Hang Seng Indexes

Wholly owned subsidiary Hang Seng Indexes Company Limited (Hang Seng Indexes) continued to develop innovative market benchmarks and indexes that can serve as the basis for the development of index-linked products by local and global market participants.

Twenty three new exchange-traded products based on the Hang Seng Family of Indexes were listed in 2017, taking the total number of such products to 67 worldwide, with listings on 17 different stock exchanges. As at the end of 2017, assets under management through these products had reached close to US$30bn – an 11% increase compared with the previous year.

Supported by improvements in global economic fundamentals, investor appetite for index-linked derivative trading increased during the year. The turnover of Mini-Hang Seng Index Options and the open interests of Hang Seng China Enterprises Index Options and HSI Dividend Point Index Futures all reached record highs in 2017.

To meet the growing demand arising from the development of mutual market access between mainland China and Hong Kong, Hang Seng Indexes launched more Stock Connect Hong Kong indexes, including the Hang Seng SCHK Mainland China Banks Index, the Hang Seng SCHK HK Companies Index, the Hang Seng SCHK Mainland China Companies Index and the Hang Seng SCHK ex-AH Companies Index. The Hang Seng SCHK High Dividend Low Volatility Index provides a representative benchmark for factor investing strategies.

In May, following a series of consultations with market participants, Hang Seng Indexes announced its decision to enhance the Hang Seng China Enterprises Index by extending its universe of eligible constituents to Red-chips and P-chips with effect from the February 2018 index review. This development will make the index more representative of the performance of Mainland enterprises listed in Hong Kong.

As at 2017 year-end, Hang Seng Indexes was compiling 515 indexes – 86 real-time and 429 daily indexes – under 99 different index series, including 15 cross-border series.

Financial Performance

Income Statement

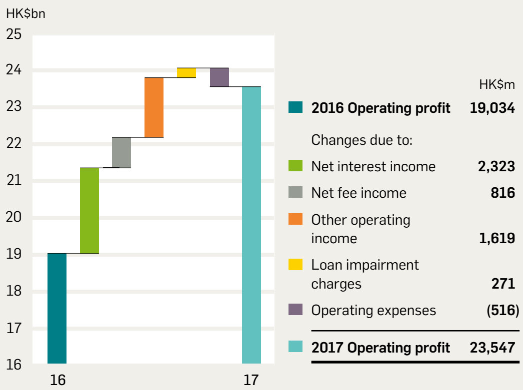
Summary of Financial Performance

Figures in HK$m	2017	2016
Total operating income	50,076	44,133
Operating expenses	10,768	10,252
Operating profit	23,547	19,034
Profit before tax	23,674	19,090
Profit attributable to shareholders	20,018	16,212
Earnings per share (in HK$)	10.30	8.30

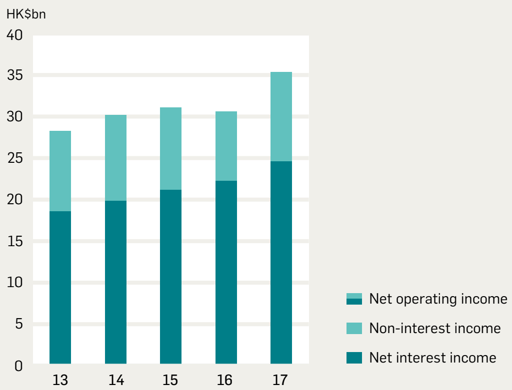
Leveraging its trusted brand and strong market position, Hang Seng Bank Limited ("the Bank") and its subsidiaries ("the Group") made good progress with its customer-centred strategy to achieve strong results for 2017.

Operating profit grew by HK$4,513m, or 24% to HK$23,547m. **Operating profit excluding loan impairment charges and other credit risk provisions** was HK$24,589m, up 21% compared with 2016. **Profit before tax** increased by 24% to HK$23,674m. **Profit attributable to shareholders** rose by 23% to HK$20,018m.

Operating Profit Analysis



Net Operating Income
(Before loan impairment charges)



Net interest income increased by HK$2,323m, or 10%, to HK$24,577m, driven by the increase in both the average interest-earning assets and net interest margin.

Figures in HK$m	2017	2016
Net interest income/(expense) arising from:		
– financial assets and liabilities that are not at fair value through profit and loss	25,924	23,124
– trading assets and liabilities	(1,314)	(845)
– financial instruments designated at fair value	(33)	(25)
	24,577	22,254
Average interest-earning assets	1,267,484	1,201,207
Net interest spread	1.85%	1.76%
Net interest margin	1.94%	1.85%

Average interest-earning assets increased by HK$66bn, or 6%, when compared with last year. The increase in the average balance of customer deposits as well as net free funds led to an increase in the average customer lending.

Net interest margin and net interest spread increased by nine basis points to 1.94% and 1.85% respectively as the Group optimise the asset and liability structure. Customer deposits spread was widened as a result of the enhanced deposit mix, with increased contribution from low-cost savings and current account balances. Effective interest rate risk management drove an improvement in balance sheet management income. These were partly offset by compressed customer lending spread, notably on corporate and commercial term lending. Contribution from net free funds was unchanged at 0.09%.

Net interest income in the second half of 2017 increased by HK$949m, or 8%, when compared with the first half, mainly supported by 6% increase in average interest-earning assets and more calendar days in the second half. Net interest margin maintained at 1.94% for both first and second halves of 2017.

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

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

Figures in HK$m	2017	2016
Net interest income and expense reported as “Net interest income”		
– Interest income	28,745	26,193
– Interest expense	(2,865)	(3,110)
– Net interest income	25,880	23,083
Net interest income and expense reported as “Net trading income”	(1,314)	(845)
Net interest income and expense reported as “Net income/(loss) from financial instruments designated at fair value”	11	16
Average interest-earning assets	1,223,050	1,155,824
Net interest spread	2.04%	1.92%
Net interest margin	2.12%	2.00%

Net fee income increased by HK$816m, or 14%, to HK$6,755m, as the Bank continued to pursue a balanced growth strategy through service enhancements and diversification of revenue. The Group captured opportunities arising from improved investment sentiment and registered strong growth in fee income from securities-related services and retail investment funds, which increased by 42% and 20% respectively. The Group made effective use of its diversified business platform to sustain the good growth momentum in core number of business. Fees from account services and remittances rose by 10% and 12% respectively, underpinned by increased business volumes as a result of the Bank's initiatives to facilitate cross-border transactions by customers. Gross fee income from credit card business grew by 10%, with the Bank's effective marketing and premium customer base supporting increases in card spending and the number of cards in circulation. Our good progress in syndicated lending business led to an 18% increase in credit facilities fee income. Insurance commission, however, fell by 13%, reflecting the impact of the one-off distribution fees received from our exclusive partnership arrangement with Bupa in 2016.

Net trading income grew by HK$699m, or 41%, to HK$2,384m. Foreign exchange income was up HK$520m, or 33%, due mainly to the increase in customer activity. There was also a gain on cross-currency swaps supporting life insurance contracts compared with a loss in 2016.

Income from interest rate derivatives, debt securities, equities and other trading activities increased by HK$200m to reach HK$300m. Income from sales of the Bank's equity-linked structured products recorded higher income but the loss of equity-linked derivatives products in the life insurance business investment portfolio was higher as a result of the unfavourable fair value movement when compared with 2016. The favourable market interest rate movement also benefitted interest rate derivatives trading and debt securities income.

Net income from financial instruments designated at fair value increased by HK$1,700m to reach HK$1,773m, reflecting improved returns on financial assets supporting insurance contracts liabilities as a result of the upward trend in the equities market. 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 and movement in present value of in-force long-term insurance business ("PVIF").

Analysis of income from wealth management business

Figures in HK$m	2017	2016
Investment income#:		
– retail investment funds	1,765	1,458
– structured investment products#	543	454
– securities broking and related services	1,638	1,143
– margin trading and others	92	103
	4,038	3,158
Insurance income:		
– life insurance:		
– net interest income and fee income	3,664	3,582
– investment returns on life insurance funds (including share of associate's profit and surplus on property revaluation backing insurance contracts)	1,761	(239)
– net insurance premium income	12,817	11,059
– net insurance claims and benefits paid and movement in liabilities to policyholders	(14,719)	(13,534)
– movement in present value of in-force long-term insurance business	910	2,233
	4,433	3,101
– general insurance and others	298	355
Total	8,769	6,614

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 trading income.

Wealth management business income increased strongly by HK$2,155m, or 33%, to HK$8,769m, reflecting our success in capturing opportunities created by the upturn in investment sentiment among customers. In the more active equities market, investment income grew by 28% to HK$4,038m, notably in retail investment funds and securities broking and related services. Insurance business income grew by 37% to HK$4,731m, reflecting strong returns from life insurance investment portfolio in the favourable market conditions.

Income from insurance business increased by HK$1,275m, or 37%, to HK$4,731m. Net interest income and fee income from life insurance business grew by 2%, with the net inflow from new and renewed life insurance premiums resulting in a growth in the size of the life insurance funds investment portfolio. Investment returns on life insurance business recorded a gain of HK$1,761m, compared with a loss of HK$239m in the previous year, driven partly by gains on the equities portfolio as a result of the favourable movement of equities market. The improvement in investment returns also reflects a gain on cross-currency swaps supporting insurance business for 2017 compared with a loss in 2016. 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 and movement in present value of in-force long-term insurance business ("PVIF") under other operating income.

Net insurance premium income increased by 16%, reflecting the combined effects of higher sales of annuity and traditional whole life products and increased renewal business. The rise in insurance premiums was largely offset by a corresponding movement in net insurance claims and benefits paid and movement in liabilities to policyholders.

The movement in PVIF decreased by 59%, reflecting the net result of market conditions, the update in actuarial assumptions and new business written throughout the year. General insurance and other income dropped by 16%, reflecting the impact of the one-off distribution fees received from our exclusive partnership arrangement with Bupa in 2016.

Loan impairment charges and other credit risk provisions fell by HK$271m, or 21%, to HK$1,042m. Through active management of our loan portfolio, we enhanced overall credit quality. Gross impaired loans and advances fell by HK$1,265m, or 39%, to HK$1,970m against 2016 year-end, due mainly to loan repayment, write-offs and the disposal of certain corporate exposures. Gross impaired loans and advances as a percentage of gross loans and advances to customers stood at 0.24% at the end of December 2017, compared with 0.42% at the end of June 2017 and 0.46% at the end of December 2016.

Figures in HK$m	2017	2016
Net charge for impairment of loans and advances to customers:		
Individually assessed impairment charges:		
– new charges	542	662
– releases	(56)	(43)
– recoveries	(43)	(80)
	443	539
Collectively assessed impairment charges	599	774
	1,042	1,313

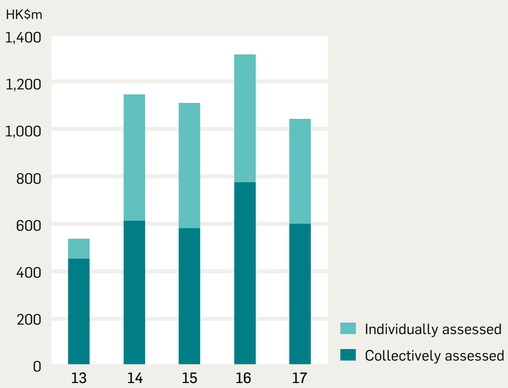
Individually assessed impairment charges fell by HK$96m, or 18%, to HK$443m. There was a reduction in new and additional impairment charges, due mainly to lower impairment charges for commercial banking customers in mainland China in 2017 although this was partly offset by higher impairment charge for commercial banking customers in Hong Kong.

Collectively assessed impairment charges decreased by HK$175m, or 23%, to HK$599m, due largely to the reductions in collectively assessed impairment charges on the credit card and personal loan portfolios. There was an increase in impairment charges for loans not individually identified as impaired, due mainly to higher loan growth for Hong Kong loan portfolios in 2017, partly offset by lower charges for Mainland loan portfolios as a result of the improvement in the historical loss rate. The Group maintains a cautious outlook on the credit environment and will continue to proactively enhance asset quality by upholding a prudent approach in its efforts to grow the loan portfolio.

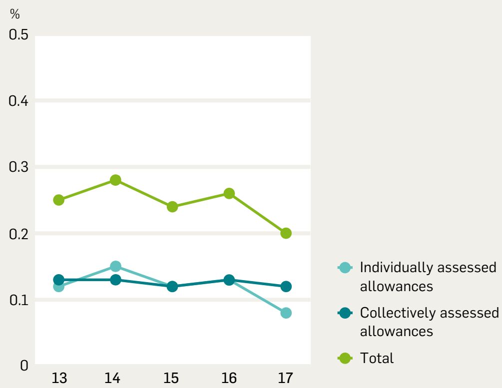
Total loan impairment allowances as a percentage of gross loans and advances to customers are as follows:

	At 31 December 2017 %	At 31 December 2016 %
Loan impairment allowances:		
– individually assessed	**0.08**	0.13
– collectively assessed	**0.12**	0.13
Total loan impairment allowances	**0.20**	0.26

Loan Impairment Charges

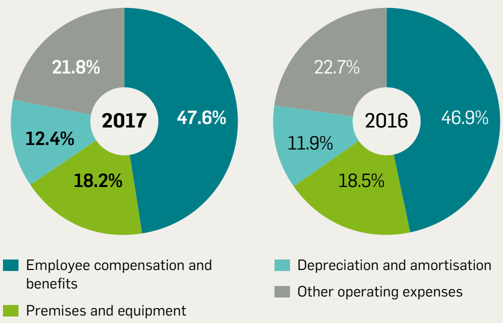


Loan Impairment Allowances as a Percentage of Gross Loans and Advances to Customers



Operating expenses rose by HK$516m, or 5%, to HK$10,768m, reflecting the Bank's continued investment in new business platforms and service capabilities. Staff costs increased by 7%, due to the salary increment, higher performance-related pay expenses and increased staff numbers to support business expansion.

Operating Expenses



Depreciation charges were up 10%, reflecting higher depreciation charges on business premises following the upward commercial property revaluation last year and an increase in depreciation on a bank property as a result of the change in property usage to support back-office functions.

General and administrative expenses increased by 2%, due mainly to higher processing charges and continued investment in information technology infrastructure. Marketing and advertising expenses were lower as, with effective from April 2016, certain expenditures in respect of credit card loyalty programmes are now presented in "Fee expense" to more appropriately reflect the nature of this item.

With the increase in net operating income before loan impairment charges outpacing the growth in operating expenses, the cost efficiency ratio improved by 3.0 percentage points to 30.5%.

Full-time equivalent staff numbers by region

	2017	2016
Hong Kong and others	8,215	7,977
Mainland	1,765	1,731
Total	9,980	9,708

Profit before tax increased by HK$4,584m, or 24%, to HK$23,674m after taking the following major items into account:

- a revaluation surplus of HK$141m compared with a revaluation deficit of HK$37m in 2016 in **net surplus/(deficit) on property revaluation**; and
- a loss of HK$14m compared with a profit of HK$93m in **share of profits/(losses) from associates**, mainly from a revaluation deficit on a property investment company.

Second half of 2017 compared with first half of 2017

Against the first half of 2017, the Group continued to make good progress and achieved growth in revenues to return solid results for the second half. Attributable profit in the second half grew by HK$342m, or 3%, compared with the first half, driven mainly by increases in net interest income and share of profits from associates as well as a reduction in loan impairment charges. These were partly offset by reduction in non-interest income and increase in operating expenses.

Net interest income grew by HK$949m, or 8%, due mainly to the 6% increase in average interest-earning assets, more calendar days in the second half and a stable net interest margin. Effective portfolio management and focused customer and deposit acquisition strategies drove increases in average customer loans and deposits in the second half. The net interest margin in the second half was unchanged from the first half of 2017 at 1.94%.

Non-interest income decreased by HK$906m, or 16%. There was an improvement in investment income, reflecting higher income from securities-related services, but this was more than offset by lower insurance income, due mainly to lower sales and the update of actuarial assumptions.

Operating expenses increased by 5%, due mainly to an increase in general and administrative expenses. Loan impairment charges dropped by 44%, reflecting lower individually and collectively assessed impairment charges. The Bank continued to uphold high standards of credit risk management and enhanced the overall credit quality.

Segmental Analysis

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

Figures in HK$m	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Other	Total
Year ended 31 December 2017					
Profit before tax	**12,459**	**6,349**	**4,755**	**111**	**23,674**
Share of profit before tax	**52.6%**	**26.8%**	**20.1%**	**0.5%**	**100.0%**
Year ended 31 December 2016 (restated)					
Profit before tax	8,824	5,251	4,806	209	19,090
Share of profit before tax	46.2%	27.5%	25.2%	1.1%	100.0%

Retail Banking and Wealth Management ("RBWM") recorded a 37% year-on-year increase in operating profit excluding loan impairment charges to HK$12,961m. Operating profit increased by 43% to HK$12,471m and profit before tax rose by 41% to HK$12,459m.

Net interest income increased by 12% year-on-year to HK$13,667m. Leveraging our extensive network, quality services and trusted brand, we strengthened core banking relationships with customers, driving sustainable growth in the balance sheet. Deposits and loan balances rose by 8% and 9% year-on-year. Net interest income in mainland China grew by 13%, reflecting the success of our low-cost funding strategy.

We achieved a 55% increase in non-interest income to HK$5,678m. Supported by our comprehensive all-weather product portfolio and sophisticated customer analytics and segmentation strategy, we successfully grew wealth management business to record a 34% rise in the related income to HK$7,707m.

Investment services income grew by 27% benefitting in part from the positive investment market sentiment. We grew securities turnover and revenue by 58% and 39% respectively. Enrichments to our diverse range of investment funds and structured, fixed income and foreign currency products strengthened our ability to meet a wide variety of risk appetites and financial needs, driving a 21% increase in investment services revenue excluding securities-related income.

Insurance income increased by 41%. Along with our extensive distribution network, our tailored wealth-and-health propositions and enhanced product suite continued to drive new business growth. Life insurance new annualised premiums rose by 11%. Active portfolio management in the buoyant investment market conditions resulted in better investment returns on insurance business.

Improved sentiment in the property market led to a higher transactions volume in 2017 compared with the previous year. We uplifted mortgage distribution capability in strategic locations to capture new business opportunities, resulting in an 8% year-on-year increase in mortgage balances in Hong Kong. Our new mortgage business continued to rank among the top three in Hong Kong, with a market share of 15% in terms of new mortgage registrations.

Unsecured lending remained a key revenue contributor. Effective marketing campaigns and deep understanding of our client base helped us achieve 8% growth in card receivables. The personal and tax loan portfolio grew by 13% in Hong Kong.

Our sophisticated customer segmentation strategy and enhanced analytics 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 drive solid business growth. We successfully expanded our Prestige Signature customer base by 24% year-on-year in Hong Kong.

We are committed to investing in new technology and upgrading our digital platform to better engage our customers by offering a safe, fast and convenient end-to-end digital banking experience. We extended online document submission to cover new products, enhanced straight-through online general insurance services and improved functionality of our digital platform. We launched biometric authentication – including Touch ID, Voice ID and Face ID – to make service activity conducted through our Personal Banking mobile app and Phone Banking channels easy, efficient and secure. The number of Personal e-Banking customers increased by 7% year-on-year in Hong Kong, and the proportion of active users accessing this service via mobile devices rose by 7 percentage points. Securities and travel insurance transactions conducted via digital channels increased by 30% and 11% respectively by count, and non-branch channels continued to account for 98% of securities transactions by count. Sited in high-traffic locations, our new foreign exchange ATMs offer the widest choice of foreign currencies available via automated banking channels in Hong Kong.

Commercial Banking ("CMB") recorded an 18% year-on-year increase in operating profit excluding loan impairment charges to HK$6,893m. Operating profit and profit before tax both increased by 21% to HK$6,349m.

Our continued focus on growing small and medium-sized enterprises ("SME") business and deepened engagement with commercial customers led to a good growth in the balance sheet, which drove a sustainable increase in revenue. Net interest income rose by 15% to HK$7,030m, supported by increases in customer loans and deposits of 15% and 14% respectively. We maintained good overall credit quality in 2017 and remain proactive in managing our credit risk.

We achieved a 21% increase in non-interest income to HK$2,679m. We enhanced our ability to provide customers with comprehensive transactional banking services that facilitate cash flow management. We launched a Virtual Account solution to help customers manage their daily cash receivables more efficiently by making their latest cash position visible immediately upon receipt of new funds. Our new Receivable Management System, which facilitates faster trading activity for securities firm customers, helped us capture new business in the active stock market environment. Fees from remittances and account-related services grew by 15%. Our close collaboration with Global Markets also drove a 20% increase in foreign exchange business. Benefitted from the favourable investment market sentiment, we leveraged our diverse product portfolio and time-to-market advantage to deepen our customer penetration rate and achieve a 43% rise in investment services income. Leveraging our broad range of insurance products, we grew insurance income by 14%.

We continued to enhance our digital banking platform to offer more efficient, secure and convenient banking services for customers on the move. We introduced Touch ID logon on Hang Seng HSBCnet Mobile App to provide a simpler and faster login experience for performing account enquiries. We also launched Trade Transaction Tracker that gives trade customers round-the-clock access to the real-time status of their trade transactions via the Hang Seng HSBCnet Mobile App. We continued to revamp our Business e-Banking platform to further enhance the online banking experience for customers.

Our strategy in growing SME business continued to yield solid growth, with a 28% increase in related operating profit excluding loan impairment charges. Our Sheung Shui Business Banking Centre was upgraded to provide customers with greater comfort and privacy when meeting with our relationship managers to discuss their financial needs. Our dedicated efforts to offer comprehensive and convenient services earned us the "Best Bank for SMEs (Hong Kong)" award in the *Asiamoney* Best Bank Awards 2017.

Global Banking and Markets ("GBM") reported a year-on-year drop of 1% in both operating profit excluding loan impairment charges and profit before tax to HK$4,763m and HK$4,755m respectively.

Global Banking ("GB") reported a decline of 4% in operating profit excluding loan impairment charges to HK$1,783m. After a slow start in first half of 2017, loan demand picked up in the second half, supporting a 27% increase in lending for the year compared with the end of 2016. Net interest income in the second half year increased by 15% over first half, but lower margins on lending resulted in a 3% drop for the year. Non-interest income fell by 6% due to lower commission income from transactional banking activities. Current and savings account deposits increased by 34% and total deposits rose by 5% over last year-end.

Global Markets ("GM") reported a 1% year-on-year rise in both operating profit and profit before tax to HK$2,980m.

Net interest income rose by 1% to HK$2,015m. Effective interest rate risk management by the balance sheet management team, including taking steps to proactively defend the interest margin and achieve yield enhancement while upholding prudent risk management standards outweighed the adverse effects of the drop in surplus funds available for deployment throughout the year and limited opportunities for deploying new and maturing proceeds.

Non-interest income increased by 5% to HK$1,456m, driven by a 5% increase in trading income to HK$1,457m.

In the challenging interest rate environment, we focused on growing non-fund income. We achieved solid revenue growth, notably from foreign exchange and the increased cross-selling of GM products through close collaboration with RBWM, CMB and GB colleagues and our deep understanding of the needs of different customers.

Income from equity-linked structured products registered good growth. The favourable investment market sentiment and higher stock market turnover in Hong Kong drove a significant increase in customer demand for equity-related products.

Balance Sheet

Total assets rose by HK$101bn, or 7%, to HK$1,478bn at 31 December 2017 compared with 2016 year-end, reflecting good progress with the Group's strategy to enhance profitability through sustainable business growth.

Cash and sight balances at central banks decreased by HK$1.6bn, or 7%, to HK$22bn, mainly reflecting the redeployment of surplus funds to maximise returns.

Trading assets rose by HK$9bn, or 21%, to HK$54bn, reflecting increased Exchange Fund Bills and Notes, partly offset by the decreased balances in settlement accounts.

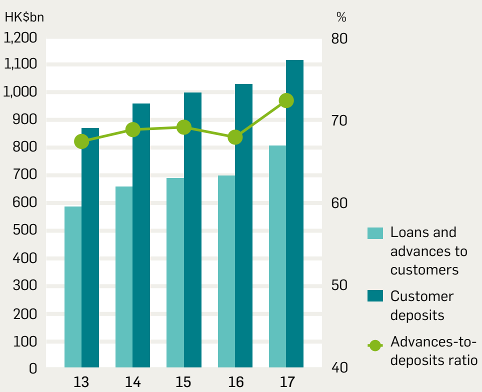
Customer loans and advances (net of impairment allowances) grew by HK$108bn, or 15%, to HK$807bn, compared with the end of 2016. Loans for use in Hong Kong increased by 16%. Lending to industrial, commercial and financial sectors grew by 19%, mainly reflecting increased lending to clients in property development and investment, financial concerns and transportation as well as working capital financing for certain large corporate customers. Lending to individuals sector increased by 11% compared with the end of 2016. The Group maintained its market share for mortgage business, with residential mortgages and Government Home Ownership Scheme/ Private Sector Participation Scheme/Tenants Purchase Scheme lending growing by 8% and 24% respectively. Effective marketing campaigns and the Bank's good quality customer base drove an 8% increase in credit card advances and a 22% rise in other personal lending. With a focus on growing core trade business, the Bank recorded a 9% rise in trade finance lending. Loans and advances for use outside Hong Kong rose by 16%, reflecting an increase in Mainland-related lending and loans granted by the Hong Kong office.

Financial investments decreased by HK$13bn, or 3%, to HK$385bn, reflecting redeployment to higher yielding lending assets.

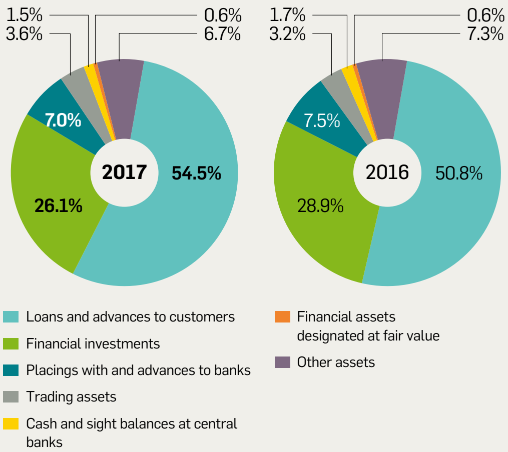
Assets Deployment

Figures in HK$m	2017	%	2016	%
Cash and sight balances at central banks	21,718	1.5	23,299	1.7
Placings with and advances to banks	103,113	7.0	103,460	7.5
Trading assets	53,704	3.6	44,427	3.2
Financial assets designated at fair value	9,313	0.6	8,523	0.6
Loans and advances to customers	806,573	54.5	698,992	50.8
Financial investments	385,261	26.1	398,137	28.9
Other assets	98,736	6.7	100,404	7.3
Total assets	1,478,418	100.0	1,377,242	100.0
Return on average total assets		1.4%		1.2%

Loans and Advances to Customers and Customer Deposits



Assets Deployment



Loans and Advances to Customers

At 31 December 2017, gross loans and advances to customers increased strongly by HK$107bn, or 15%, to HK$808bn when compared with last year-end.

Loans and advances for use in Hong Kong rose by 16%. Lending to the industrial, commercial and financial sectors grew by 19%. Lending to property development and investment remained active, increasing by 21% and 14% respectively under the buoyant property market. Financial concerns grew by 73%. The Bank's continued efforts to support local business saw lendings to both wholesale and retail trade and manufacturing sectors up by 2% respectively. Lending to transport and transport equipment and information technology sectors grew by 52% and 6% respectively. Underpinned by a deep understanding of our customers' business, we extended new working capital financing to certain large corporate customers, driving a strong increase of 40% in lending to "Other" sector.

Lending to individuals grew by 11% compared with last year-end. We strengthened our mortgage sales capabilities in strategic areas to capture new business opportunities and grew our residential mortgages and Government Home Ownership Scheme/Private Sector Participation Scheme/Tenants Purchase Scheme mortgages lending by 8% and 24% respectively. Sustained consumer spending saw credit card advances grew by 8% whilst other personal lending grew by 22%.

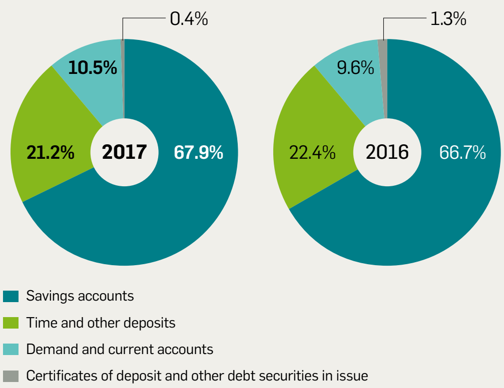
With a focus on growing core trade business, the Bank recorded a 9% rise in trade finance lending.

Loans and advances for use outside Hong Kong rose by 16% compared with the end of 2016, reflecting an increase in Mainland-related lending and loans granted by the Hong Kong office.

Customer Deposits

Customer deposits, including certificates of deposit and other debt securities in issue, increased by HK$86bn, or 8%, to HK$1,115bn since 2016 year-end, with increased contribution from savings and current accounts. At 31 December 2017, the advances-to-deposits ratio was 72.3%, compared with 67.9% at 31 December 2016.

Customer Deposits



Shareholders' equity

Figures in HK$m	At 31 December 2017	At 31 December 2016
Share capital	**9,658**	9,658
Retained profits	**113,646**	105,204
Other equity instruments	**6,981**	6,981
Premises revaluation reserve	**18,379**	16,982
Cash flow hedging reserve	**(99)**	(128)
Available-for-sale investment reserve		
– on debt securities	**(90)**	(144)
– on equity securities	**2,206**	1,578
Other reserves	**1,349**	495
Total reserves	**142,372**	130,968
Total shareholders' equity	**152,030**	140,626
Return on average ordinary shareholders' equity	**14.2%**	12.1%

Shareholders' equity increased by HK$11bn, or 8%, to HK$152bn compared with 2016 year-end. Retained profits grew by HK$8.4bn, or 8%, reflecting profit accumulation, net of dividend payments. The premises revaluation reserve increased by HK$1.4bn, or 8%, reflecting the upward trend in the commercial property market. The available-for-sale investment reserve increased by HK$0.7bn, or 48% compared with the end of previous year, due mainly to the fair value movement of the Group's equity investments. Other reserves rose by HK$0.9bn, or 173%, due largely to the appreciation of the renminbi.

Return on average ordinary shareholders' equity was 14.2% (12.1% for 2016).

There was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank's listed securities during 2017.

All the Group's activities involve to varying degrees, the analysis, measurement, evaluation, acceptance and management of risk or combination of risks. As a provider of banking and financial services, we actively manage risk as a core part of our day-to-day activities. The principal types of risk faced by the Group are credit risk, liquidity risk, market risk, insurance risk, operational risk and reputational risk.

Risk management framework

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

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

The Group has long recognised the importance of a strong risk culture, the fostering of which is a key responsibility of senior executives. We use clear and consistent employee communications on risk to convey strategic messages and set the tone from senior management. A suite of mandatory training on risk and compliance topics is deployed to embed skills and understanding in order to strengthen our risk culture and reinforce the attitude to risk in the behaviour expected of employees.

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

The ongoing monitoring, assessment and management of the risk environment and the effectiveness of risk management policies resides with the RMM. It monitors risk inherent to the financial services business, receives reports, determines action to be taken and reviews the efficiency of the risk management framework.

Day-to-day responsibility for risk management is delegated to senior management with individual accountability. These managers are supported by functions by the "Three lines of defence" model on risk management described under Operational Risk section.

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

Risk management tools

The Group uses a range of tools to identify, monitor and manage risk. The key tools are summarised below.

Risk appetite

The Group's Risk Appetite Statement ("RAS") sets out the types and amount of risk that is prepared to accept in achieving our medium and long-term strategic goals. It is integrated with other risk management tools such as stress testing, top and emerging risks report, to ensure consistency in risk management practices. This is reviewed on an ongoing basis, with formal approval from the Board on an annual basis on the recommendation of the Risk Committee.

The RMM regularly reviews the Group's actual risk appetite profile against the limits set out in the RAS on monthly basis to enable senior management to monitor the risk profile and guide business activities in order to balance risk and return. The actual risk appetite profile is also reported to the Risk Committee and Board from Chief Risk Officer including material deviation and related management mitigating actions.

Risk map

The Group uses a risk map to provide a point-in-time view of its risk profile across a suite of risk categories, including our material banking risks and insurance risks. This highlights the potential for these risks to materially affect our financial results, reputation or business sustainability on current and projected bases. Risk stewards assign current and projected risk ratings, supported by commentary. Risks that have an "Amber" or "Red" risk rating require monitoring and mitigating action plans being either in place or initiated to manage the risk down to acceptable levels.

Top and emerging risks

The Group uses a top and emerging risks analysis process to provide a forward-looking view of issues that have the potential to threaten the execution of our strategy or operations over the medium to long term.

Top risk is defined as a thematic issue that has arisen across any number of risk map categories, regions or global businesses which has the potential to have a material impact on the financial results, reputation or long term business model to the Group, and which may form and crystallise between a 6 month and one year horizon. The risk impact may be well understood by senior management, with some mitigating actions already in place. Stress tests of varying granularity may also have been carried out to assess impact.

An emerging risk is defined as a thematic issue that has large unknown components, which may form and crystallise beyond a one year horizon. If these risks were to materialise, they could have a material impact on the Group's long term strategy, affect profitability and damage the Group's reputation. Existing management action plans are likely to be minimal, reflecting the uncertain nature of these risks. Some high-level analysis or stress testing may have been carried out to try to assess and quantify impact.

Stress testing

Stress testing and scenario analysis programme examines the sensitivities and resilience of our capital plan under adverse macroeconomic events to assess the sensitivities and resilience of capital adequacy. Action plans are developed to mitigate identified risks where needed. Reverse stress testing is conducted on Group level and is used to strengthen our resilience by identifying potential stresses and vulnerabilities which the Group might face and helping to inform early-warning triggers and design contingency plan to mitigate their effect were they to occur.

Independent risk function

The Group's Risk function, headed by the Group's Chief Risk Officer, is responsible for enterprise-wide risk oversight. This includes establishing and monitoring of risk profiles and forward-looking risk identification and management. The Group's Risk function is made up of sub-functions covering all risks to our operations and forms part of the second line of defence. They are independent from the sales and trading functions, ensuring the necessary balance in risk/return decisions.

Risks managed by the Group

The principal risks associated with our banking and insurance manufacturing operations are described in the tables below:

Description of risks — banking operations
(audited)

Risks	Arising from	Measurement, monitoring and management of risk
Credit risk		
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: – is measured as the amount which could be lost if a customer or counterparty fails to make repayments. – is monitored within limits, approved by individuals within a framework of delegated authorities; and – is managed through a robust risk control framework which outlines clear and consistent policies, principles and guidance for risk managers.
Liquidity and funding risk		
The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due or that it can only do so at excessive cost.	Liquidity risk arises from mismatches in the timing of cash flows. Funding risk arises when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.	Liquidity and funding risk: – is measured using a range of different metrics including liquidity coverage ratio and net stable finding ratio; – is monitored against the Group's liquidity and funding risk framework and overseen by the Group's ALCO and the RMM; and – is managed on a standalone basis with no reliance on any Group entity (unless pre-committed) or central bank unless this represents routine established business as usual market practice.
Market risk		
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.	Exposure to market risk is separated into two portfolios: – Trading portfolios comprise positions arising from market-making and warehousing of customer derived positions. – Non-trading portfolios comprise positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, and financial investments designated as available-for-sale.	Market risk: – is measured in terms of value at risk ("VaR"), which is used to estimate potential losses on risk positions over a specified time horizon for a given level of confidence. It is augmented with stress testing; – is monitored using VaR, stress testing and other measures including the sensitivity of net interest income and the sensitivity of structural foreign exchange; and – is managed using risk limits approved by the Group. These limits are allocated across business lines and to the Group's legal entities.

Description of risks — banking operations continued

Risks	Arising from	Measurement, monitoring and management of risk
Operational risk		
The risk to achieving our strategy or objectives as a result of inadequate or failed internal processes, people and systems or from external events.	Operational risk arises from day to day operations or external events, and is relevant to every aspect of our business. Regulatory compliance risk and financial crime risk are discussed below.	Operational risk: – is measured using the risk and control assessment process, which assesses the level of risk and effectiveness of controls; – is monitored using key indicators and other internal control activities; and – is primarily managed by business and functional managers. They identify and assess risks, implement controls to manage them and monitor the effectiveness of these controls utilising the operational risk management framework.
Regulatory compliance risk		
The risk that we fail to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice, and incur fines and penalties and suffer damage to our business as a consequence.	Regulatory compliance risk is part of operational risk and arises from the provision of products and services to clients and counterparties.	Regulatory compliance risk: – is measured by reference to identified metrics, incident assessments, regulatory feedback and the judgement and assessment of our Regulatory Compliance teams; – is monitored against our compliance risk assessments and metrics, the results of the monitoring and control activities of the second line of defence functions, and the results of internal and external audits and regulatory inspections; and – is managed by establishing and communicating appropriate policies and procedures, training employees in them, and monitoring activity to assure their observance. Proactive risk control and/or remediation work is undertaken where required.
Financial crime compliance risk		
The risk that we knowingly or unknowingly help parties to commit or to further potentially illegal activity through the Group.	Financial crime compliance risk is part of operational risk and arises from day to day banking operations.	Financial crime compliance risk: – is measured by reference to identified metrics, incident assessments, regulatory feedback and the judgement and assessment of our Financial Crime Compliance teams; – is monitored against the results of the monitoring and control activities of the second line of defence functions, and the results of internal and external audits and regulatory inspections; and – is managed by establishing and communicating appropriate policies and procedures, training employees in them, and monitoring activity to assure their observance. Proactive risk control and/or remediation work is undertaken where required.

Description of risks — banking operations continued

Risks	Arising from	Measurement, monitoring and management of risk
Other material risks		
Reputational risk		
The risk of failure to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by the Group itself, our employees or those with whom we are associated, that might cause stakeholders to form a negative view of the Group.	Primary reputational risks arise directly from an action or inaction by the Group, its employees or associated parties that are not the consequence of another type of risk. Secondary reputational risks are those arising indirectly and are a result of a failure to control any other risks.	Reputational risk: – is measured by reference to our reputation as indicated by our dealings with all relevant stakeholders, including media, regulators, customers and employees; – is monitored through a reputational risk management framework, taking into account the results of the compliance risk monitoring activity; and – is managed by every member of staff and is covered by a number of policies and guidelines. There is a clear structure of committees and individuals charged with mitigating reputational risk.
Pension risk		
The risk that the performance of assets held in pension funds is insufficient to cover existing pension liabilities resulting in an increase in obligation to support the plan.	Pension risk arises from investments delivering an inadequate return, adverse changes in interest rates or inflation, or members living longer than expected. Pension risk includes operational risks listed above.	Pension risk: – is measured in terms of the scheme's ability to generate sufficient funds to meet the cost of their accrued benefits; – is monitored through the specific risk appetite that has been developed at Group level; and – is managed through the appropriate pension risk governance structure.
Sustainability risk		
The risk that financial services provided to customers by the Group indirectly result in unacceptable impacts on people or on the environment.	Sustainability risk arises from the provision of financial services to companies or projects which indirectly result in unacceptable impacts on people or on the environment.	Sustainability risk: – is measured by assessing the potential sustainability effect of a customer's activities and assigning a Sustainability Risk Rating to all high risk transactions; and – is managed using sustainability risk policies covering project finance lending and sector-based sustainability policies for sectors and themes with potentially high environmental or social impacts.

Our insurance manufacturing subsidiary is separately regulated from our banking operations. Risks in the insurance entities are managed using methodologies and processes appropriate to insurance manufacturing operations, but remain subject to oversight at Group level. Our insurance operations are also subject to the operational and other material risks presented in relation to the banking operations, and these are covered by the Group's respective risk management processes.

Description of risks – insurance manufacturing operations

Risks	Arising from	Measurement, monitoring and management of risk
Insurance risk		
The risk that, over time, the cost of acquiring and administering an insurance contract, and paying claims and benefits may exceed the aggregate amount of premiums received and investment income.	The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, lapse and surrender rates and, if the policy has a savings element, the performance of the assets held to support the liabilities.	Insurance risk: – is measured in terms of economic capital; – is monitored by the RMM of the insurance operations; and – is managed both centrally and locally using asset and liability matching, product design, underwriting, reinsurance and claims-handling procedures.
Financial risk		
Our ability to effectively match the liabilities arising under insurance contracts with the asset portfolios that back them are contingent on the management of financial risks such as market, credit and liquidity risks, and the extent to which these risks are not borne by the policyholders. Contracts with discretionary participating feature share the performance of the underlying assets between policyholders and the shareholder in line with the type of contract and the specific contract terms.	Exposure to financial risk arises from: – market risk of changes in the fair values of financial assets or their future cash flows from fluctuations in variables such as interest rates, foreign exchange rates and equity prices; – credit risk and the potential for financial loss following the default of third parties in meeting their obligations; and – liquidity risk of entities not being able to make payments to policyholders as they fall due as there are insufficient assets that can be realised as cash within the required timeframe.	Financial risk: – is measured separately for each type of risk: – market risk is measured in terms of exposure to fluctuations in key financial variables; – credit risk is measured as the amount which could be lost if counterparty fails to make required payments; and – liquidity risk is measured using internal metrics including stressed operational cash flow projections; – is monitored within limits approved by individuals within a framework of delegated authorities; – is managed through a robust risk control framework which outlines clear and consistent policies, principles and guidance for risk managers. Subsidiary manufacturing products with guarantees are usually exposed to falls in market interest rates and equity prices to the extent that the market exposure cannot be managed by utilising any discretionary participation (or bonus) features within the policy contracts they issue; and – can be mitigated through sharing of risk with policyholders under the discretionary participation features for participating products.

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

(a) Credit risk

(audited)

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

There are dedicated functions, reported to Chief Risk Officer, responsible for centralised management of credit risk through:

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

Impaired loan management and recovery

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

Risk rating framework

A risk rating framework on counterparty credit risk based on default probability and loss estimates is implemented across the Group. The rating methodology is based upon a wide range of financial analytics together with market data-based tools, which are core inputs to the assessment of counterparty risk. Although automated risk-rating processes are increasingly used, the ultimate responsibility for setting risk grades rests in each cases with the final approving executives. Risk grades are reviewed frequently and amendments, where necessary, are implemented promptly. This approach will allow a more granular analysis of risk and trends. The information generated from the risk rating framework is mainly, but not exclusively, applied to credit approval, credit monitoring, pricing, loan classification and capital adequacy assessment. The Group also has control mechanisms in place to validate the performance and accuracy of the risk rating framework.

(a) Credit risk continued

Collateral and other credit enhancements

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

- in the personal sector, charges over the properties, securities, investment funds and deposits;
- in the commercial and industrial sector, charges over business assets such as properties, stock, debtors, investment funds, deposits and machinery; and
- in the commercial real estate sector, charges over the properties being financed.

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

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

Settlement risk

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

Concentration of credit risk

Concentration of credit risk exists when changes in geographic, economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is material in relation to the Group's total exposures. The Group's portfolio of financial instrument is diversified along geographic, industry and product sectors. Analysis of geographical concentration of the Group's assets is disclosed in note 22 to the financial statements and credit risk concentration of respective financial assets is disclosed in notes 27, 28, 30 and 31.

(a) Credit risk continued

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

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

(audited)

Our credit exposure is spread across a broad range of asset classes, including derivatives, trading assets, loans and advances to customers, loans and advances to banks and financial investments.

The following table presents the maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements (unless such credit enhancements meet accounting offsetting requirements). For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees and similar contracts granted, it is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, it is generally the full amount of the committed facilities.

	2017	2016
Cash and sight balances at central banks	21,718	23,299
Placings with and advances to banks	103,113	103,460
Trading assets	53,680	44,411
Financial assets designated at fair value	792	369
Derivative financial instruments	10,836	16,695
Loans and advances to customers	806,573	698,992
Financial investments	379,050	393,836
Other assets	18,913	17,865
Financial guarantees and other credit related contingent liabilities	3,409	7,934
Loan commitments and other credit related commitments	516,588	493,726
	1,914,672	1,800,587

(ii) Collateral and other credit enhancements

Loans and advances

(audited)

Although collateral can be an important mitigant of credit risk, it is the Group's practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured. However, for certain lending decisions a charge over collateral is usually obtained, and is important for the credit decision and pricing, and it is the Bank's practice to obtain that collateral and sell it in the event of default as a source of repayment. Such collateral has a significant financial effect and the objective of the disclosure below is to quantify these forms. We may also manage our risk by employing other types of collateral and credit risk enhancements, such as second charges, other liens and unsupported guarantees, but the valuation of such mitigants is less certain and their financial effect has not been quantified in the loans shown below.

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

(a) Credit risk continued

Personal lending

(audited)

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

Residential mortgages

(audited)

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

Residential mortgages

	2017	2016
Unimpaired loans		
Fully collateralised	223,528	205,325
– Less than 50% LTV	165,076	137,893
– 51% to 60% LTV	28,889	36,462
– 61% to 70% LTV	14,966	15,517
– 71% to 80% LTV	8,708	8,114
– 81% to 90% LTV	4,549	5,874
– 91% to 100% LTV	1,340	1,465
Partially collateralised		
– Greater than 100% LTV (A)	–	6
– Collateral value on A	–	5
	223,528	205,331
Impaired loans		
Fully collateralised	128	192
– Less than 50% LTV	111	140
– 51% to 60% LTV	13	23
– 61% to 70% LTV	–	11
– 71% to 80% LTV	4	4
– 81% to 90% LTV	–	8
– 91% to 100% LTV	–	6
Total	223,656	205,523

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

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

Other personal lending

(audited)

The remainder of our personal lending consists primarily of credit cards, instalment loan, overdraft or revolving loan. Credit cards are generally unsecured. Instalment loan, overdraft and revolving loan could be partially secured by cash or marketable securities.

(a) Credit risk continued

Corporate and commercial and financial (non-bank) lending
(audited)

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

Commercial real estate
(audited)

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

Commercial real estate loans and advances

	2017	2016
Rated — CRR/EL* 1 to 7	108,500	93,820
Uncollateralised	21,424	16,957
Fully collateralised	83,446	73,681
Partially collateralised (A)	3,630	3,182
– Collateral value on A	1,706	1,837
	108,500	93,820
Rated CRR/EL 8		
Fully collateralised	2	2
Rated CRR/EL 9 to 10		
Fully collateralised	9	27
– Less than 25% LTV	–	9
– 25% to 50% LTV	–	1
– 51% to 75% LTV	9	8
– 76% to 90% LTV	–	9
Partially collateralised (C)	–	9
– Collateral value on C	–	3
	9	36
Total	108,511	93,858

* For details of CRR/EL, please refer to section (iii) Credit Quality.

(a) Credit risk continued

The collateral included in the table above consists of fixed first charges on real estate and charges over cash for the commercial real estate sector. The table includes lending to major property developers which is typically secured by guarantees or is unsecured.

The value of commercial real estate collateral is determined through a combination of professional and internal valuations and physical inspection. Due to the complexity of collateral valuations for commercial real estate, local valuation policies determine the frequency of review based on local market conditions. Revaluations are sought with greater frequency where, as part of the regular credit assessment of the obligor, material concerns arise in relation to the transaction which may reflect on the underlying performance of the collateral, or in circumstances where an obligor's credit quality has declined sufficiently to cause concern that the principal payment source may not fully meet the obligation (i.e. the obligor's credit quality classification indicates it is at the lower end e.g. sub-standard, or approaching impaired).

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

The following table shows corporate, commercial and financial (non-bank) lending rated CRR/EL 8 to 10 only including off-balance sheet loan commitments by level of collateralisation.

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

	2017	2016
Rated CRR/EL 8		
Uncollateralised	9	16
Fully collateralised	–	10
– Less than 25% LTV	–	9
– 51% to 75% LTV	–	1
Partially collateralised (A)	–	89
– Collateral value on A	–	19
	9	115
Rated CRR/EL 9 to 10		
Uncollateralised	766	1,156
Fully collateralised	671	847
– Less than 25% LTV	98	118
– 25% to 50% LTV	379	192
– 51% to 75% LTV	12	85
– 76% to 90% LTV	17	375
– 91% to 100% LTV	165	77
Partially collateralised (B)	136	725
– Collateral value on B	72	460
	1,573	2,728
Total	1,582	2,843

(a) Credit risk continued

The collateral used in the assessment of the above primarily includes first legal charges over real estate and charges over cash in the commercial and industrial sector and charges over cash and marketable financial instruments in the financial sector. Government sector lending is typically unsecured.

It should be noted that the table above excludes other types of collateral which are commonly taken for corporate and commercial lending such as unsupported guarantees and floating charges over the assets of a customer's business. While such mitigants have value, often providing rights in insolvency, their assignable value is insufficiently certain. They are assigned no value for disclosure purposes.

As with commercial real estate the value of real estate collateral included in the table above is generally determined through a combination of professional and internal valuations and physical inspection. The frequency of revaluation is undertaken on a similar basis to commercial real estate loans and advances; however, for financing activities in corporate and commercial lending that are not predominantly commercial real estate-oriented, collateral value is not as strongly correlated to principal repayment performance. Collateral values will generally be refreshed when an obligor's general credit performance deteriorates and it is necessary to assess the likely performance of secondary sources of repayment should reliance upon them prove necessary. For this reason, the table above reports values only for customers with CRR 8 to 10, reflecting that these loans and advances generally have valuations which are of comparatively recent vintage. For the purposes of the table above, cash is valued at its nominal value and marketable securities at their fair value.

Loans and advances to banks

(audited)

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

Loans and advances to banks

	2017	2016
Rated CRR/EL 1 to 8		
Uncollateralised	103,113	103,460
Total loans and advances to banks	103,113	103,460

Derivatives

(audited)

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

(a) Credit risk continued

Other credit risk exposures

(audited)

In addition to collateralised lending described above, other credit enhancements are employed and methods used to mitigate credit risk arising from financial assets. These are described in more detail below.

Government, bank and other financial institution issued securities may benefit from additional credit enhancement, notably through government guarantees that reference these assets. Corporate issued debt securities are primarily unsecured. Debt securities issued by banks and financial institutions include covered bonds, which are supported by underlying pools of financial assets.

Trading assets include loans and advances held with trading intent, the majority of which consist of reverse repos and securities borrowing which by their nature are collateralised. Collateral accepted as security that the Group is permitted to sell or repledge under these arrangements is described in Note 32 "Assets transferred, assets charged as security for liabilities, and collateral accepted as security for assets".

The Group's maximum exposure to credit risk includes financial guarantees and similar arrangements that it issues or enters into, and loan commitments to which it is irrevocably committed. Depending on the terms of the arrangement, the Bank may have recourse to additional credit mitigation in the event that a guarantee is called upon or a loan commitment is drawn and subsequently defaults. The risks and exposures from these are captured and managed in accordance with the Group's overall credit risk management policies and procedures.

Collateral and other credit enhancements obtained

(audited)

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

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

	2017	2016
Nature of assets:		
Residential properties	42	23
Commercial and industrial properties	–	1
	42	24

(iii) Credit quality

(audited)

Five broad classifications describe the credit quality of the Group's lending and debt securities portfolios. These classifications each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending business, as well as the external ratings attributed by external agencies to debt securities. For debt securities and certain other financial instruments, external ratings have been aligned to five credit quality classifications based on the mapping of related customer risk ratings ("CRR") to external credit ratings. The mapping is reviewed on a regular basis.

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

(a) Credit risk continued

(unaudited)

	Sovereign debt securities	Other debt securities	Wholesale lending and derivatives		Retail lending	
Credit quality classification	External credit rating	External credit rating	Internal credit rating	12 month probability of default %	Internal credit rating	Expected loss %
Strong	BBB and above	A- and above	CRR 1 to CRR 2	0-0.169	EL 1 to EL 2*	0-0.999
Good	BBB- to BB	BBB+ to BBB-	CRR 3	0.170-0.740	EL 3*	1.000-4.999
Satisfactory	BB- to B, and unrated	BB+ to B, and unrated	CRR 4 to CRR 5	0.741-4.914	EL 4 to EL 5*	5.000-19.999
Sub-standard	B- to C	B- to C	CRR 6 to CRR 8	4.915-99.999	EL 6 to EL 8*	20.000-99.999
Impaired	Default	Default	CRR 9 to CRR 10	100	EL 9 to EL 10* and all EL 1 to EL 8 exposures past due 90 days and above	100+ or defaulted

* All retail exposures past due 90 days and above are classified as "impaired". The EL percentage is derived through a combination of PD and LGD, and may exceed 100% in circumstances where the LGD is above 100% reflecting the cost recoveries.

Quality classification definitions:
(audited)

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

– Good: Exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.

– Satisfactory: Exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk. Retail accounts typically show only short periods of delinquency, with losses expected to be minor following the adoption of recovery process.

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

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

The Group's policy in respect of impairment on loans and advances and debt securities is set out in note 3 on the financial statements. Analysis of impairment allowances as at 31 December 2017 and the movement of such allowances during the year are disclosed in note 30.

Granular risk rating scales:
(unaudited)

The CRR 10-grade scale summaries to a more granular underlying 23-grade scale of obligor probability of default. The Group's wholesale customers are rated using the 10 or 23-grade scale, depending on which regulatory approach is adopted for the exposure. The expected loss ("EL") 10-grade scale for retail business summarises a more granular scale combining obligor and facility/product risk factors in a composite measure, used Group-wide. The external ratings cited above have for clarity of reporting been assigned to the quality classifications defined for internally-rated exposures, although there is no fixed correlation between internal and external ratings.

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

(a) Credit risk continued

Distribution of financial instruments by credit quality (audited)

	Neither past due nor impaired							
	Strong	Good	Satisfactory	Sub-standard	Past due but not impaired	Impaired	Impairment allowances	Total
2017								
Items in the course of collection from other banks	6,157	–	307	–	–	–	–	6,464
Trading assets:								
– treasury and eligible bills	33,066	–	–	–	–	–	–	33,066
– debt securities	18,509	–	–	–	–	–	–	18,509
– loans and advances to banks	2,011	84	–	–	–	–	–	2,095
– loans and advances to customers	10	–	–	–	–	–	–	10
	53,596	84	–	–	–	–	–	53,680
Financial assets designated at fair value:								
– treasury and eligible bills	400	–	–	–	–	–	–	400
– debt securities	390	–	2	–	–	–	–	392
	790	–	2	–	–	–	–	792
Derivatives	8,375	1,745	554	162	–	–	–	10,836
Loans and advances held at amortised cost:								
– sight balances at central banks	14,309	–	–	–	–	–	–	14,309
– placings with and advances to banks	98,511	3,761	841	–	–	–	–	103,113
– loans and advances to customers	382,207	215,556	201,116	2,869	4,452	1,970	(1,597)	806,573
	495,027	219,317	201,957	2,869	4,452	1,970	(1,597)	923,995
Financial investments:								
– treasury and similar bills	154,292	–	–	–	–	–	–	154,292
– debt securities	210,120	10,255	4,383	–	–	–	–	224,758
	364,412	10,255	4,383	–	–	–	–	379,050
Other assets:								
– acceptances and endorsements	373	2,266	2,430	39	–	–	–	5,108
– other	3,081	412	3,763	7	78	–	–	7,341
	3,454	2,678	6,193	46	78	–	–	12,449

(a) Credit risk continued

	Neither past due nor impaired							
	Strong	Good	Satisfactory	Sub-standard	Past due but not impaired	Impaired	Impairment allowances	Total
2016								
Items in the course of collection from other banks	5,303	–	1,051	–	–	–	–	6,354
Trading assets:								
– treasury and eligible bills	27,733	–	–	–	–	–	–	27,733
– debt securities	10,880	–	–	–	–	–	–	10,880
– loans and advances to banks	264	5,497	–	–	–	–	–	5,761
– loans and advances to customers	37	–	–	–	–	–	–	37
	38,914	5,497	–	–	–	–	–	44,411
Financial assets designated at fair value:								
– treasury and eligible bills	–	–	–	–	–	–	–	–
– debt securities	367	–	2	–	–	–	–	369
	367	–	2	–	–	–	–	369
Derivatives	13,690	1,824	1,061	120	–	–	–	16,695
Loans and advances held at amortised cost:								
– sight balances at central banks	15,681	–	–	–	–	–	–	15,681
– placings with and advances to banks	99,154	3,702	604	–	–	–	–	103,460
– loans and advances to customers	318,490	201,806	168,088	4,921	4,311	3,235	(1,859)	698,992
	433,325	205,508	168,692	4,921	4,311	3,235	(1,859)	818,133
Financial investments:								
– treasury and similar bills	180,951	–	–	–	–	–	–	180,951
– debt securities	203,365	7,449	2,071	–	–	–	–	212,885
	384,316	7,449	2,071	–	–	–	–	393,836
Other assets:								
– acceptances and endorsements	467	1,813	2,573	439	–	–	–	5,292
– other	2,570	389	3,174	10	76	–	–	6,219
	3,037	2,202	5,747	449	76	–	–	11,511

(a) Credit risk continued

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

The amounts in the following table reflect exposures designated as past due but not impaired. Examples of exposures designated past due but not impaired include loans that have missed the most recent payment date but on which there is no evidence of impairment; short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

	Up to 29 days	30–59 days	60–89 days	90–180 days	Over 180 days	Total
2017						
Loans and advances to customers held at amortised cost[#]	4,031	338	83	–	–	4,452
Other assets	12	4	16	1	45	78
	4,043	342	99	1	45	4,530
2016						
Loans and advances to customers held at amortised cost[#]	3,766	405	140	–	–	4,311
Other assets	31	12	6	11	16	76
	3,797	417	146	11	16	4,387

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

Impaired loans and advances
(audited)

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) to the financial statements.

Analysis of impairment allowances at 31 December 2017 and the movement of such allowances during the year are disclosed in note 30 to the financial statements.

Impaired loans and advances are those that meet any of the following criteria:

- wholesale loans and advances classified as CRR 9 or CRR 10. These grades are assigned when the bank considers that either the customer is unlikely to pay its credit obligations in full, without recourse to security, or when the customer is past due 90 days or more on any material credit obligation to the Group;
- retail loans and advances:
  - classified as EL 9 or EL 10; or
  - classified as EL 1 to EL 8 with 90 days and over past due; or
  - that have been with either 90 days and over past due or with economic loss incurred by the Group irrespective of the delinquency status.
- renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet its contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment. For loans that are assessed for impairment on a collective basis, the evidence to support reclassification as no longer impaired typically comprises a history of payment performance against the original or revised terms, depending on the nature and volume of renegotiation and the credit risk characteristics surrounding the renegotiation. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case by case basis.

(a) Credit risk continued

Impairment assessment
(audited)

It is Group's policy that each operating company in the Group creates impairment allowances for impaired loans promptly and appropriately. For details of our impairment policies on loans and advances and financial investments, see notes 3(e) and 3(k) to the financial statements.

Impairment and credit risk mitigation
The existence of collateral has an impact when calculating impairment on individually assessed impaired loans. When we no longer expect to recover the principal and interest due on a loan in full or in accordance with the original terms and conditions, it is assessed for impairment. If exposures are secured, the current net realisable value of the collateral will be taken into account when assessing the need for an impairment allowance. No impairment allowance is recognised in cases where all amounts due are expected to be settled in full on realisation of the security.

Personal lending portfolios are generally assessed for impairment on a collective basis as the portfolios typically consist of large groups of homogeneous loans. Two methods are used to calculate allowances on a collective basis: a roll-rate methodology or a more basic formulaic approach based on historical losses.

The historical loss methodology is typically used to calculate collective impairment allowances for secured, or low default portfolios, until the point at which they are individually identified and assessed as impaired. For loans which are collectively assessed using historical loss methodology, the historical loss rate is derived from the average contractual write-off net of recoveries over a defined period. The net contractual write-off rate is the actual amount of loss experienced after the realisation of collateral and receipt of recoveries.

A roll-rate methodology is more commonly adopted for unsecured portfolios when there are sufficient volumes of empirical data to develop robust statistical models.

The nature of the collective allowance assessment prevents individual collateral values or LTV ratios from being included within the calculation. However, the loss rates used in the collective assessment are adjusted for the collateral realisation experiences which will vary depending on the LTV composition of the portfolio.

For wholesale collectively assessed loans and secured personal lending, historical loss methodologies are applied to estimate impairment losses which have been incurred but not individually identified. Loss rates are derived from the observed contractual write-off net of recoveries over a defined period of at least 60 months. The net contractual write-off rate is the actual amount of loss experienced after realisation of collateral and receipt of recoveries. These historical loss rates are adjusted by an economic factor which adjusts the historical averages to better represent current economic conditions affecting the portfolio. In order to reflect the likelihood of a loss event not being identified and assessed an emergence period assumption is applied. This reflects the period between a loss occurring and its identification. The emergence period is estimated by local management for each identified portfolio. The factors that may influence this estimation include economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. A fixed range for the period between a loss occurring and its identification is not defined across the Group and as it is assessed empirically on a periodic basis, it may vary over time as these factors change.

(b) Liquidity and funding risk

(audited)

The purpose of liquidity and funding management is to ensure sufficient cash flows to meet all financial commitment and to capitalise on opportunities for business expansion. This includes the Group's ability to meet deposit withdrawals either on demand or at contractual maturity, to repay borrowings as they mature, to comply with the statutory liquidity ratio, and to make new loans and investments as opportunities arise. The Group maintains a stable and diversified funding base of core retail and corporate customer deposits as well as portfolios of highly liquid assets.

As part of our Asset, Liability and Capital Management structure, we have established Asset and Liability Management Committee ("ALCO") at Group level and in major operating entities. The terms of reference of all ALCOs include the monitoring and control of liquidity and funding. Management of liquidity is carried out both at Group and Bank levels as well as in individual branches and subsidiaries. The Group requires branches and subsidiaries to maintain a strong liquidity position and to manage the liquidity structure of their assets, liabilities and commitments so that cash flows are approximately balanced and all funding obligations are met when due.

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

The Board is ultimately responsible for determining the types and magnitude of liquidity risk that the Group is able to take and ensure that there is an appropriate organisation structure for managing this risk. Under authorities delegated by the Executive Committee, the Group ALCO is responsible for managing all Asset, Liability and Capital Management issues including liquidity and funding risk management.

The Group ALCO delegates to the Group Tactical Asset and Liability Management Committee ("TALCO") the task of reviewing various analyses of the Group pertaining to site liquidity and funding. TALCO's primary responsibilities include but are not limited to:

- reviewing the funding structure of operating entities and the allocation of liquidity among them;
- reviewing operating entities' list of liquid securities and documented proof that a deep and liquid market exists; and
- monitoring liquidity and funding limit breaches and providing direction to those operating entities that have not been able to rectify breaches on a timely basis.

Compliance with liquidity and funding requirements is monitored by the ALCO and is reported to the Risk Management Meeting ("RMM"), Executive Committee, Risk Committee and the Board of Directors on a regular basis. This process includes:

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

(b) Liquidity and funding risk continued

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

The LFRF is delivered using the following key aspects:

- Standalone management of liquidity and funding by operating entity;
- Minimum liquidity coverage ratio ("LCR") requirement;
- Minimum net stable funding ratio ("NSFR") requirement;
- Depositor concentration limit;
- Three-month and twelve-month cumulative rolling term contractual maturity limits covering deposits from banks, deposits from non-bank financial institutions and securities issued;
- Minimum LCR requirement by currency;
- Intraday liquidity management;
- Liquidity funds transfer pricing;
- Forward-looking funding assessments;
- Annual Individual Liquidity Adequacy Assessment ("ILAA").

The two key objectives of the ILAA process are to:

- Demonstrate that all material liquidity and funding risks are captured within the internal framework; and
- Validate the risk tolerance and risk appetite by demonstrating that reverse stress testing scenarios are acceptably remote; and vulnerabilities have been assessed through the use of severe stress scenarios.

The management of liquidity and funding risk

Liquidity coverage ratio
(Unaudited)

The LCR aims to ensure that a bank has sufficient unencumbered high-quality liquid assets ("HQLA") to meet its liquidity needs in a 30-calendar-day liquidity stress scenario. HQLA consist of cash or assets that can be converted into cash at little or no loss of value in markets.

As at 31 December 2017, all the Group's operating entities were within the risk tolerance level established by the Board and applicable under the LFRF.

Net stable funding ratio
(Unaudited)

The NSFR requires institutions to maintain sufficient available stable funding relative to required stable funding, and reflects a bank's long-term funding profile (funding with a term of more than a year). It is designed to complement the LCR.

As at 31 December 2017, all the Group's operating entities were within the risk tolerance level established by the Board and applicable under the LFRF.

(b) Liquidity and funding risk continued

Depositor concentration and term funding maturity concentration
(Unaudited)

The LCR and NSFR metrics assume a stressed outflow based on a portfolio of depositors within each deposit segment. The validity of these assumptions is challenged if the portfolio of depositors is not large enough to avoid depositor concentration. Operating entities are also exposed to term re-financing concentration risk if the current maturity profile results in future maturities being overly concentrated in any defined period.

As at 31 December 2017, all the Group's operating entities were within the risk tolerance levels set for depositor concentration and term funding maturity concentration. These risk tolerances were established by the Board and applicable under the LFRF.

Sources of funding
(unaudited)

Our primary sources of funding are customer current accounts and customer savings deposits payable on demand or at short notice. We issue wholesale securities (secured and unsecured) to supplement our customer deposits and change the currency mix or maturity profile of our liabilities.

Currency mismatch
(unaudited)

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

Additional contractual obligations
(Unaudited)

Under the terms of our current collateral obligations under derivative contracts (which are ISDA compliant CSA contracts), the additional collateral required to post in the event of one-notch and two-notch downgrade in credit ratings is immaterial.

Liquidity regulation
(unaudited)

The Banking (Liquidity) Rules ("BLR") were introduced by the HKMA in 2014 and became effective from 1 January 2015. The Group is required to calculate its LCR on a consolidated basis in accordance with rule 11(1) of the BLR. During 2017 the Group is required to maintain a LCR of not less than 80%, increasing in steps of 10% each year to not less than 100% by January 2019.

The average LCRs for the period are as follows:

	Quarter ended							
	31 December 2017	**30 September 2017**	**30 June 2017**	**31 March 2017**	31 December 2016	30 September 2016	30 June 2016	31 March 2016
Average LCR	**209.5%**	**242.3%**	**256.7%**	**267.7%**	253.6%	284.0%	257.1%	257.1%

The liquidity position of the Group remained strong in 2017. The average LCR ranged from 209.5% to 267.7% for the reportable quarters. The decrease in average LCR in 4th quarter mainly reflecting the increase in net cash outflow as a result of the increase in short-term funding for IPO activities. The LCR at 31 December 2017 was 232.3% (229.3% at 31 December 2016).

(b) Liquidity and funding risk continued

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

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

	Weighted amount (Average value) at quarter ended							
	31 December 2017	30 September 2017	30 June 2017	31 March 2017	31 December 2016	30 September 2016	30 June 2016	31 March 2016
Level 1 assets	261,705	269,223	283,481	295,635	301,633	296,792	290,202	249,886
Level 2A assets	15,520	16,748	14,980	13,669	15,526	16,628	16,139	14,492
Level 2B assets	563	393	528	766	595	640	599	589
Total	277,788	286,364	298,989	310,070	317,754	314,060	306,940	264,967

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

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

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

(b) Liquidity and funding risk continued

	Repayable on demand	Three months or less but not on demand	Over three months but within one year	Over one year but within five years	Over five years	Total
At 31 December 2017						
Current, savings and other deposit accounts	882,027	154,921	39,564	1,430	–	1,077,942
Repurchase agreements – non-trading	–	2,389	–	–	–	2,389
Deposits from banks	1,738	1,938	–	–	–	3,676
Financial liabilities designated at fair value	3	3	8	517	551	1,082
Trading liabilities	88,270	–	–	–	–	88,270
Derivative financial instruments	10,008	157	401	680	5	11,251
Certificates of deposit and other debt securities in issue	–	603	–	–	–	603
Other financial liabilities	7,545	10,964	1,414	4	–	19,927
	989,591	170,975	41,387	2,631	556	1,205,140
Loan commitments	353,925	84,216	–	–	–	438,141
Financial guarantee and credit risk related guarantee contracts	15,239	88	1	–	–	15,328
	369,164	84,304	1	–	–	453,469
At 31 December 2016						
Current, savings and other deposit accounts	790,305	161,830	37,747	1,647	–	991,529
Repurchase agreements – non-trading	–	1,805	–	–	–	1,805
Deposits from banks	1,477	12,600	–	–	–	14,077
Financial liabilities designated at fair value	3	16	3,048	528	504	4,099
Trading liabilities	68,124	–	–	–	–	68,124
Derivative financial instruments	12,728	204	215	337	–	13,484
Certificates of deposit and other debt securities in issue	–	35	5,153	–	–	5,188
Other financial liabilities	9,560	10,892	1,696	4	2	22,154
Subordinated liabilities	–	30	89	475	2,395	2,989
	882,197	187,412	47,948	2,991	2,901	1,123,449
Loan commitments	312,472	69,665	7	–	–	382,144
Financial guarantee and credit risk related guarantee contracts	17,927	88	1	–	–	18,016
	330,399	69,753	8	–	–	400,160

(c) Market risk

(audited)

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

There were no significant changes to our policies and practices for the management of market risk in 2017.

Exposure to market risk is separated into two portfolios:

– Trading portfolios comprise positions arising from market-making and warehousing of customer-derived positions.

– Non-trading portfolios comprise positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, and financial investments designated as available-for-sale.

The diagram below illustrates the major trading and non-trading market risk types and market risk measures used to monitor and limit exposures.

	Trading Risk	Non-Trading Risk
Risk Type	– Foreign exchange & Commodities – Interest rates – Credit spreads	– Structural foreign exchange – Interest rates – Credit spreads
Risk Measure	Value at risk / Sensitivity analysis / Stress testing	Value at risk / Sensitivity analysis / Stress testing

Where appropriate, the Group applies similar risk management policies and measurement techniques to both trading and non-trading portfolios. The Group's objective is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the status as a professional banking and financial services organisation.

The nature of the hedging and risk mitigation strategies range from the use of traditional market instruments, such as interest rate swaps, to more sophisticated hedging strategies to address a combination of risk factors arising at portfolio level.

Market risk governance

(audited)

Market risk is managed and controlled through limits approved by the Group's Chief Risk Officer, noting the support of Risk Management Meeting ("RMM"). These limits are allocated across business lines and to the Group's legal entities, including Hang Seng Bank (China) Limited.

The management of market risk is principally undertaken in Global Markets using risk limits allocated from the risk appetite, which is subject to the Board's approval. Limits are set for portfolios, products and risk types where appropriate, with market liquidity and business need being primary factors in determining the level of limits set.

An independent market risk management and control function is responsible for measuring, monitoring and reporting market risk exposures against the prescribed limits on a daily basis.

Model risk is governed through Model Oversight Committee ("MOC") at the Wholesale Credit and Market Risk ("WCMR") level. The MOC has direct oversight and approval responsibility on traded risk models utilised for risk measurement and management and stress testing to ensure that they remain within our risk appetite and business plans.

Our control of market risk in the trading and non-trading portfolios is based on a policy of restricting trading within a list of permissible instruments authorised for each business lines, of enforcing new product approval procedures, and of restricting trading in the more complex derivative products only to business lines with appropriate levels of product expertise and robust control systems.

(c) Market risk continued

Market risk measures

(audited)

Monitoring and limiting market risk exposures

The Group's objective is to manage and control market risk exposures while maintaining a market profile consistent with the Group's risk appetite. The Group uses a range of tools to monitor and limit market risk exposures including sensitivity analysis, value at risk ("VaR"), and stress testing.

Sensitivity analysis

(unaudited)

Sensitivity analysis measures the impact of individual market factor movements on specific instruments or portfolios including interest rates, foreign exchange rates and equity prices. The Group uses sensitivity measures to monitor the market risk positions within each risk type, for example, the present value of a basis point movement in interest rates for interest rate risk.

Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

Value at risk ("VaR")

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

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

Standard VaR is calculated at a 99% confidence level for a one-day holding period while Stressed VaR uses a 10-day holding period and a 99% confidence interval based on a continuous one-year historical significant stress period. The VaR models used by the Group are predominantly based on historical simulation which 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 Standard VaR are calculated with reference to data from the past two years; and

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

The models also incorporate the effect of the option features on the underlying exposures. The nature of the VaR models means that an increase in observed market volatility will lead to an increase in VaR without any changes in the underlying positions.

VaR model limitations

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

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

– the use of a holding period assumes that all positions can be liquidated or the risks offset during that period. This may not fully reflect the market risk arising at times of severe illiquidity, when the holding period may be insufficient to liquidate or hedge all positions fully;

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

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

(c) Market risk continued

Risk not in VaR ("RNIV") framework
(unaudited)

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. On average in 2017, the capital requirement derived from these stress tests represented 3.7% of the total internal model-based market risk requirement. RNIV is not viewed as being a material component of the Group's market risk capital requirement.

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.

Stress testing
(audited)

Stress testing is an important tool that is integrated into the Group's market risk management tool to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. In such abnormal scenarios, losses can be much greater than those predicted by VaR modelling.

Stress testing is implemented at the legal entity and the overall Group levels. Scenarios are tailored in order to capture the relevant events or market movements. A scoring framework is in place for management to effectively assess the severity of the potential stress losses and the likelihood of occurrence of the stress scenarios. The risk appetite around potential stress losses for the Group is set and monitored against referral limits.

Market risk reverse stress tests are undertaken based upon the premise that there is a fixed loss. The stress test process identifies which scenarios lead to this loss. The rationale behind the reverse stress test is to understand scenarios which are beyond normal business settings that could have contagion and systemic implications.

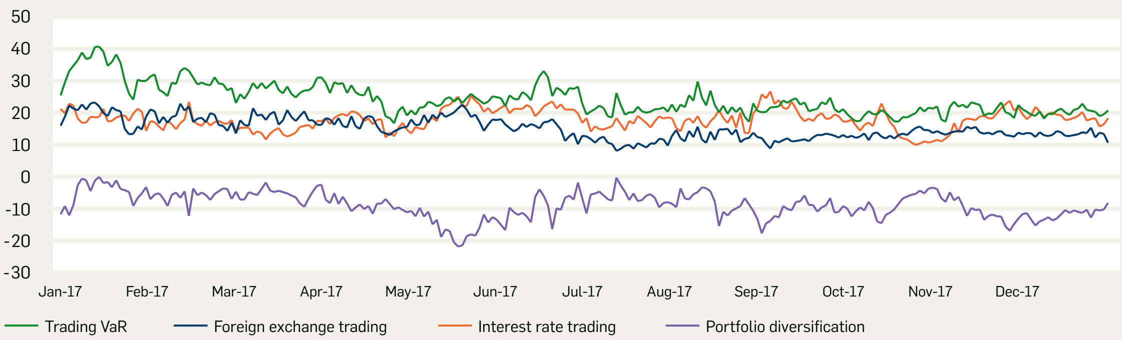
Stressed VaR and stress testing, together with reverse stress testing, provide management with insights regarding the "tail risk" beyond VaR for which the Group appetite is limited.

Trading portfolios
(audited)

Value at risk of the trading portfolios
Trading VaR predominantly resides within Global Markets. The VaR at 31 December 2017 was lower than at 31 December 2016, mainly due to the overall reduced exposures in interest rate and foreign exchange as well as the updated scenario set. Meanwhile, the increase in stressed VaR was driven by larger CNY and HKD interest rate exposures.

The daily levels of total trading VaR over the last year are set out in the graph below.

Daily VaR (trading portfolios), 99% 1 day (HK$m)
(unaudited)



(c) Market risk continued

The Group's trading VaR for the year is shown in the table below.

Trading, 99% 1 day
(audited)

	At 31 December 2017	Minimum during the year	Maximum during the year	Average for the year
VaR				
Trading	21	17	41	24
Foreign exchange trading	11	8	23	15
Interest rate trading	18	10	27	18
Portfolio diversification	(8)	–	–	(9)
Stressed VaR				
Trading	169	68	178	106
Foreign exchange trading	56	18	58	34
Interest rate trading	140	56	178	95
Portfolio diversification	(27)	–	–	(23)

	At 31 December 2016	Minimum during the year	Maximum during the year	Average for the year
VaR				
Trading	24	17	45	30
Foreign exchange trading	16	6	22	14
Interest rate trading	21	16	48	28
Portfolio diversification	(13)	–	–	(12)
Stressed VaR				
Trading	108	52	220	129
Foreign exchange trading	28	3	42	24
Interest rate trading	94	58	226	144
Portfolio diversification	(14)	–	–	(39)

1 Trading portfolios comprise positions arising from the market-making and warehousing of customer-derived positions.

2 Portfolio diversification is the market risk dispersion effect of holding a portfolio containing different risk types. It represents the reduction in unsystematic market risk that occurs when combining a number of different risk types, for example, interest rate and foreign exchange, together in one portfolio. It is measured as the difference between the sum of the VaR by individual risk type and the combined total VaR. A negative number represents the benefit of portfolio diversification. As the maximum and minimum occur on different days for different risk types, it is not meaningful to calculate a portfolio diversification benefit for these measures.

(c) Market risk continued

Backtesting

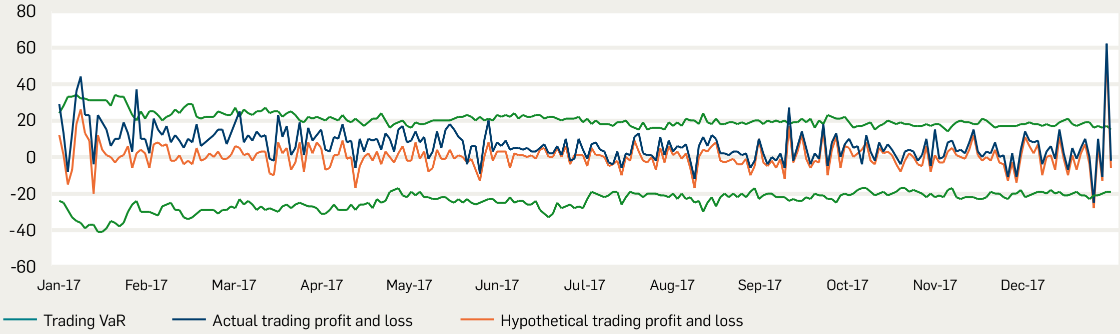
(unaudited)

In 2017, there was one loss exception and seven profit exceptions for the Group.

One loss side exception is observed in December 2017 due to exceptional market volatility approaching the end of the year. Some profit side exceptions are identified for actual P&L and those are mainly driven by intraday profit arising from trading activities.

The graph below shows the daily trading VaR against actual and hypothetical profit and loss for the Group during 2017.

Backtesting of trading VaR against actual and hypothetical profit and loss for 2017 (HK$m)



The Group routinely validates the accuracy of the VaR models by back-testing both actual and hypothetical profit and loss against the trading VaR numbers. Hypothetical profit and loss excludes non-modelled items such as fees, commissions and revenues of intra-day transactions. The actual number of profits or losses in excess of VaR over a one-year period is used to gauge how well the models are performing.

Non-trading portfolios

(unaudited)

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.

(c) Market risk continued

Sensitivity of net interest income
(audited)

A principal part of the Group's management of non-traded interest rate risk is to monitor the sensitivity of projected net interest income at least quarterly under varying interest rate scenarios (simulation modelling), where all other economic variables are held constant.

The table below sets out the effect on future net interest income of an incremental 100 basis points parallel rise or fall in all yield curves at the beginning of year from 1 January 2018 and an incremental 25 basis points parallel rise or fall in all yield curves at the beginning of each quarter during the 12-month period from 1 January 2018.

Assuming no management actions and all other non-interest rate risk variables remain constant, such a series of incremental parallel rises in all yield curves would increase projected net interest income for the year ending 31 December 2018 by HK$3,316m for 100 basis points case and by HK$2,290m for 25 basis points case, while such a series of incremental parallel falls in all yield curves would decrease planned net interest income by HK$5,613m for 100 basis points case and by HK$3,319m for 25 basis points case.

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

	100bp parallel increase	100bp parallel decrease	25bp increase at the beginning of each quarter	25bp decrease at the beginning of each quarter
Change in 2018 projected net interest income				
– HKD	**2,045**	**(3,858)**	**1,496**	**(2,287)**
– USD	**555**	**(1,154)**	**374**	**(670)**
– other	**716**	**(601)**	**420**	**(362)**
Total	**3,316**	**(5,613)**	**2,290**	**(3,319)**
Change in 2017 projected net interest income				
– HKD	1,453	(3,227)	1,051	(1,894)
– USD	679	(1,239)	457	(719)
– other	700	(382)	389	(204)
Total	2,832	(4,848)	1,897	(2,817)

The interest rate sensitivities set out in the table above represent the effect of the pro forma movements in projected yield curves based on a static balance sheet size and structure assumption. This effect, however, does not incorporate actions which would probably be taken by BSM or in the business units to mitigate the effect of interest rate risk. In reality, BSM proactively seeks to change the interest rate risk profile to optimise net revenues. The net interest income sensitivity calculations assume that interest rates of all maturities move by the same amount in the "up-shock" scenario. Rates are not assumed to become negative in the "down-shock" scenario unless the central bank rate is already negative and then not assumed to go further negative, which may, in certain currencies, effectively result in non-parallel shock. In addition, the net interest income sensitivity calculations take into account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates over which the entity has discretion in terms of the timing and extent of rate changes.

Key assumptions used in the measurement of interest rate sensitivities include business line interest rate pass-on assumptions, re-investment of maturing assets and liabilities at market rates per shock scenario and prepayment risk. BSM is modelled based on no management actions i.e. the risk profile at the month end is assumed to remain constant throughout the forecast horizon. The projections make other assumptions, including that contractually fixed term positions run to maturity, managed rate products and non-interest bearing balances, such as interest-free current accounts, are subject to interest rate risk behaviouralisation.

(c) Market risk continued

Sensitivity of reserves

Available-for-sale ("AFS") reserves are included as part of CET1 capital. The Group measures the potential downside risk to the CET1 ratio due to interest rate and credit spread risk in the AFS portfolio by the portfolio's stressed VaR, using 99% confidence level and an assumed holding period of one quarter. At 31 December 2017, the stressed VaR of the portfolio was HK$880m.

The Group monitors the sensitivity of reported cash flow hedge reserves to interest rate movements on a semi-annually basis by assessing the expected reduction in valuation of cash flow hedge due to parallel movements of plus or minus 100bps in all yield curves. These particular exposures form only a part of the Group's overall interest rate risk exposures.

The following table describes the sensitivity of cash flow hedge reported reserves to the stipulated movements in yield curves and the maximum and minimum half year-end figures during the year. The sensitivities are indicative and based on simplified scenarios.

	At 31 December 2017	Maximum impact	Minimum impact
+ 100 basis points parallel move in all yield curves	(114)	(114)	(94)
As a percentage of shareholders' equity at 31 December 2017 (%)	(0.08)	(0.08)	(0.06)
– 100 basis points parallel move in all yield curves	274	274	52
As a percentage of shareholders' equity at 31 December 2017 (%)	0.18	0.18	0.03

	At 31 December 2016	Maximum impact	Minimum impact
+ 100 basis points parallel move in all yield curves	(132)	(136)	(52)
As a percentage of shareholders' equity at 31 December 2016 (%)	(0.09)	(0.10)	(0.04)
– 100 basis points parallel move in all yield curves	35	35	(14)
As a percentage of shareholders' equity at 31 December 2016 (%)	0.02	0.02	(0.01)

(c) Market risk continued

Foreign exchange exposure

(audited)

The Group's foreign exchange exposures mainly comprise foreign exchange dealing by Global Markets and currency exposures originated by its banking business. The latter are transferred to Global Markets where they are centrally managed within foreign exchange position limits approved by the Group's Chief Risk Officer, noting the support of Risk Management Meeting ("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 exchange exposures are managed by the Group's ALCO with the primary objective of ensuring, where practical, that the Group's and the Bank's capital ratios are largely protected from the effect of changes in exchange rates.

At 31 December 2017, the US dollar, Chinese renminbi, Pound sterling and Gold were the currencies in which the Group had non-structural foreign currency positions that were not less than 10% of the total net non-structural position in all foreign currencies. The Group also had a Chinese renminbi structural foreign currency position, which was not less than 10% of the total net structural position in all foreign currencies.

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

Equities exposure

(audited)

The Group's equities exposures in 2017 and 2016 are mainly long-term equity investments which are reported as "Financial investments" set out in note 31 to the financial statements. Equities held for trading purpose are included under "Trading assets" set out in note 27 to the financial statements. These are subject to trading limit and risk management control procedures and other market risk regime.

(d) Insurance risk

(audited)

Risk management objectives and policies for management of insurance risk

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

Group's bancassurance model

We operate an integrated bancassurance model which provides insurance products principally for customers with whom we have a banking relationship. The insurance contracts we sell relate to the underlying needs of our banking customers, which we can identify from our point-of-sale contacts and customer knowledge. The majority of sales are of savings and investment products.

By focusing largely on personal and SME lines of business we are able to optimise volumes and diversify individual insurance risks.

We choose to manufacture these insurance products in a Group subsidiary based on an assessment of operational scale and risk appetite. Manufacturing insurance allows us to retain the risks and rewards associated with writing insurance contracts by keeping part of the underwriting profit and investment income within the Group. It also reduces distribution costs for our products by using our established branch network, and enables us to control the quality of the sale process and the products themselves to ensure our customers receive products which address their specific needs at the best value.

Where we do not have the risk appetite or operational scale to be an effective insurance manufacturer, we engage with a handful of leading external insurance companies in order to provide insurance products to our customers through our banking network and direct channels. These arrangements are generally structured with our exclusive strategic partners and earn the group a combination of commissions, fees and a share of profits. We distribute insurance products in Hong Kong, China and Macau.

Insurance products are sold through all global businesses, but predominantly by RBWM and CMB through our branches and direct channels.

Governance

Insurance risks are managed to a defined risk appetite, which is aligned to the Group risk appetite and enterprise risk management framework (including the three lines of defence model). The Insurance Risk Management Meeting oversees the control framework and is accountable to the Group Risk Management Meeting on risk matters relating to insurance business.

The monitoring of the risks within the insurance operations is carried out by the Insurance Risk teams. Specific risk functions, including wholesale market risk, operational risk, information security risk and financial crime compliance, support Insurance Risk teams in their respective areas of expertise.

Measurement

The risk profile of our insurance manufacturing businesses is measured using an economic capital ("EC") approach. Assets and liabilities are measured on a market value basis and a capital requirement is defined to ensure that there is a less than 1 in 200 chance of insolvency over a one year time horizon, given the risks that the businesses are exposed to. The methodology for the economic capital calculation is largely aligned to the pan-European Solvency II insurance capital regulations. The EC coverage ratio (economic net asset value divided by the economic capital requirement) is a key risk appetite measure. In addition to EC, the regulatory solvency ratio is also a metric used to manage risk appetite on an entity basis.

(d) Insurance risk continued

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

Balance sheet of insurance subsidiaries by type of contract

	Linked contracts[1]	Non-linked contracts[1]	Other assets and liabilities[2]	Total
2017				
Financial assets:				
– financial assets designated at fair value	263	9,050	–	9,313
– derivatives	–	683	–	683
– financial investments	–	92,675	6,563	99,238
– other financial assets	9	5,478	520	6,007
Total financial assets	272	107,886	7,083	115,241
Reinsurance assets	–	8,342	–	8,342
Present value of in-force long-term insurance contracts	–	–	14,574	14,574
Other assets	–	5,687	1,315	7,002
Total assets	272	121,915	22,972	145,159
Liabilities under investment contracts designated at fair value	196	358	–	554
Liabilities under insurance contracts	81	115,464	–	115,545
Deferred tax	–	–	2,378	2,378
Other liabilities	–	1,811	1,706	3,517
Total liabilities	277	117,633	4,084	121,994
Shareholders' equity	–	–	23,165	23,165
Total liabilities and shareholders' equity	277	117,633	27,249	145,159
2016				
Financial assets:				
– financial assets designated at fair value	215	8,308	–	8,523
– derivatives	–	339	–	339
– financial investments	–	84,785	6,331	91,116
– other financial assets	3	7,315	516	7,834
Total financial assets	218	100,747	6,847	107,812
Reinsurance assets	–	7,496	–	7,496
Present value of in-force long-term insurance contracts	–	–	13,664	13,664
Other assets	–	5,435	1,485	6,920
Total assets	218	113,678	21,996	135,892
Liabilities under investment contracts designated at fair value	155	352	–	507
Liabilities under insurance contracts	70	108,256	–	108,326
Deferred tax	–	–	1,899	1,899
Other liabilities	–	3,538	1,271	4,809
Total liabilities	225	112,146	3,170	115,541
Shareholders' equity	–	–	20,351	20,351
Total liabilities and shareholders' equity	225	112,146	23,521	135,892

1 Comprises life insurance contracts and investment contracts
2 Comprises shareholder assets and liabilities

(d) Insurance risk continued

Stress and scenario testing

Stress testing forms a key part of the risk management framework for the Insurance business. We participate in local and group-wide regulatory stress tests.

These have highlighted that a key risk scenario for the Insurance business is a prolonged low interest rate environment. In order to mitigate the impact of this scenario, the insurance operations have a range of strategies that could be employed including the hedging of investment risk, a dynamic approach of re-pricing the products to reflect lower interest rates, diversification of product offerings with less sensitivity to interest rate levels, risk transfer to third parties, and yield enhancement investment strategies to optimise the expected returns against the cost of economic capital.

Key risk types

Market risk (insurance)

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

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

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

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

Our insurance manufacturing subsidiary has market risk mandates which specify the investment instruments in which they are permitted to invest and the maximum quantum of market risk which they may retain. They manage market risk by using, amongst others, some or all of the techniques listed below, depending on the nature of the contracts written:

- for products with DPF, adjusting dividends to manage the liabilities to policyholders. The effect is that a significant portion of the market risk is borne by the policyholders;
- asset and liability matching where asset portfolios are structured to support projected liability cash flows. The Group manages its assets using an approach that considers asset quality, diversification, cash flow matching, liquidity, volatility and target investment return. It is not always possible to match asset and liability durations due to uncertainty over the receipt of all future premiums and the timing of claims; and also because the forecast payment dates of liabilities may exceed the duration of the longest dated investments available. We use models to assess the effect of a range of future scenarios on the values of financial assets and associated liabilities;
- using derivatives to protect against adverse market movements or better match liability cash flows;
- for new products with investment guarantees, considering the cost when determining the level of premiums or the price structure;
- periodically reviewing products identified as higher risk, which contain investment guarantees in savings and investment products;
- designing new products to mitigate market risk, such as those with terminal bonus feature so as to spread out the volatility of return over a longer period of time;
- exiting, to the extent possible, investment portfolios whose risk is considered unacceptable; and
- repricing premiums charged to policyholders.

(d) Insurance risk continued

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

	2017		2016	
	Impact on profit after tax for the year	Impact on shareholders' equity	Impact on profit after tax for the year	Impact on shareholders' equity
+ 100 basis points shift in yield curves	(109)	(273)	(144)	(416)
– 100 basis points shift in yield curves	(50)	136	112	424

	2017		2016	
	Impact on profit after tax for the year	Impact on shareholders' equity	Impact on profit after tax for the year	Impact on shareholders' equity
10 per cent increase in equity prices	290	399	280	282
10 per cent decrease in equity prices	(263)	(371)	(228)	(231)
10% increase in USD exchange rate compared to all currencies	176	176	22	22
10% decrease in USD exchange rate compared to all currencies	(176)	(176)	(22)	(22)

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

Credit risk (insurance)
Credit risk is the risk of financial loss if a customer or counterparty fails to meet their obligation under a contract. It arises in two main areas for our insurance manufacturers:

- risk of default by debt security counterparties after investing premiums to generate a return for policyholders and shareholders; and
- risk of default by reinsurance counterparties and non-reimbursement for claims made after ceding insurance risk.

The amounts outstanding at the balance sheet date in respect of these items are shown in the table on page 71.

(d) Insurance risk continued

Our insurance manufacturing subsidiary is responsible for the credit risk, quality and performance of their investment portfolios. Our assessment of the creditworthiness of issuers and counterparties is based primarily upon internationally recognised credit ratings and other publicly available information. Investment credit exposures are monitored against limits by our local insurance manufacturing subsidiary, and are aggregated and reported to Group Credit Risk. Stress testing is performed on the investment credit exposures using credit spread sensitivities and default probabilities is included in the stress and scenario testing as described above.

We use a number of tools to manage and monitor credit risk. These include a credit report which contains a watch-list of investments with current credit concerns to identify investments which may be at risk of future impairment.

Credit risk on assets supporting unit-linked liabilities is predominantly borne by the policyholders; therefore our exposure is primarily related to liabilities under non-linked insurance and investment contracts and shareholders' funds. The credit quality of these financial assets is included in the table on page 53.

The credit quality of the reinsurers' share of liabilities under insurance contracts is primarily assessed as "strong" or "good" (as defined on page 53), with 100% of the exposure being neither past due nor impaired (2016: 100%).

Liquidity risk (insurance)
Liquidity risk is the risk that an insurance operation, though solvent, either does not have sufficient financial resources available to meet its obligations when they fall due, or can secure them only at excessive cost.

Risk is managed by cashflow matching and maintaining sufficient cash resources; investing in high-credit-quality investments with deep and liquid markets, monitoring investment concentrations and restricting them where appropriate and establishing committed contingency borrowing facilities.

Quarterly liquidity risk reports and annual liquidity contingency plan are prepared and reviewed by management.

The following table shows the expected undiscounted cash flows for insurance contract liabilities at 31 December 2017. The liquidity risk exposure is wholly borne by the policyholder in the case of unit-linked business and is shared with the policyholder for non-linked insurance.

Expected maturity of insurance contract liabilities

	Expected cash flows (undiscounted)				
	Within 1 year	Over 1 year but within 5 years	Over 5 years but within 15 years	Over 15 years	Total
2017					
Non-linked insurance	**15,367**	**46,253**	**72,133**	**78,814**	**212,567**
Linked insurance	**14**	**51**	**86**	**56**	**207**
	15,381	**46,304**	**72,219**	**78,870**	**212,774**
2016					
Non-linked insurance	11,203	40,943	79,720	69,920	201,786
Linked insurance	9	38	89	239	375
	11,212	40,981	79,809	70,159	202,161

The remaining contractual maturity of investment contract liabilities is included in the table on page 169.

(d) Insurance risk continued

Insurance risk

Insurance risk is the loss through adverse experience, in either timing or amount, of insurance underwriting parameters (non-economic assumptions). These parameters include mortality, morbidity, longevity, lapses and unit costs. The principal risk we face is that, over time, the cost of the contract, including claims and benefits may exceed the total amount of premiums and investment income received. The table on page 71 analyses our life insurance risk exposures by type of business.

The Group primarily manages its insurance risk through asset and liability management, product design, pricing and overall proposition management (e.g. lapses management by introducing surrender charges), underwriting policy, claims management process and reinsurance which cedes risks above our acceptable thresholds to an external reinsurer thereby limiting our exposure.

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

In calculating PVIF, expected cash flows are projected after adjusting for a variety of assumptions made by insurance operation to reflect local market conditions and management's judgement of future trends, and after applying risk margins to reflect any uncertainty in the underlying assumptions. Variations in actual experience and changes to assumptions can contribute to volatility in the results of the insurance business.

Actuarial Control Committee meets on a quarterly basis to review and approve assumptions proposed for use in the determination of the PVIF. All changes to non-economic assumptions, economic assumptions that are not observable and model methodology must be approved by the Actuarial Control Committee.

Economic assumptions are either set in a way that is consistent with observable market values or, in certain markets use is made of long-term economic assumptions. Setting such assumptions involves the projection of long-term interest rates and the time horizon over which observable market rates trend towards these long-term assumptions. The assumptions are informed by relevant historical data and by research and analysis performed by internal and external experts, including regulatory bodies. The valuation of PVIF will be sensitive to any changes in these long-term assumptions in the same way that it is sensitive to observed market movements, and the impact of such changes is included in the sensitivities presented below.

The Group sets the risk discount rate applied to the PVIF calculation by starting from a risk-free rate curve and adding explicit allowances for risks not reflected in the best estimate cash flow modelling. Where shareholders provide options and guarantees to policyholders the cost of these options and guarantees is an explicit reduction to PVIF.

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

	2017	2016
+ 100 basis points shift in yield curves	(108)	(141)
– 100 basis points shift in yield curves	188	99

The impact on PVIF shown above, as well as the impact on profit after tax and net assets shown below, are illustrative only and employ simplified scenarios. It should be noted that the effects may not be linear and therefore the results cannot be extrapolated. The sensitivities reflect the established risk sharing mechanism with policyholders for participating products, but do not incorporate other actions that could be taken by management to mitigate effects nor do they take into account the consequential changes in policyholders' behaviour.

(d) Insurance risk continued

Non-economic assumptions

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

	Impact on 2017 results		Impact on 2016 results	
	Profit for the year	Net assets	Profit for the year	Net assets
10 per cent increase in mortality and/or morbidity rates	(43)	(43)	(67)	(67)
10 per cent decrease in mortality and/or morbidity rates	39	39	63	63
10 per cent increase in lapse rates	(29)	(29)	(15)	(15)
10 per cent decrease in lapse rates	32	32	17	17
10 per cent increase in expense rates	(55)	(55)	(56)	(56)
10 per cent decrease in expense rates	53	53	56	56

Mortality and morbidity risk is typically associated with life insurance contracts. The effect on profit of an increase in mortality or morbidity depends on the type of business being written.

Sensitivity to lapse rates depends on the type of contracts being written. In general, for life insurance contracts a policy lapse has two offsetting effects on profits, which are the loss of future income on the lapsed policy and the existence of surrender charge recouped at policy lapse. The net impact depends on the relative size of these two effects which varies with the type of contracts.

Expense rates risk is the exposure to a change in the cost of administering insurance contracts. An increase in expense rates will have a negative effect on our profits.

Process used to determine assumptions for long-term insurance contracts

The process used to determine the assumptions is intended to result in stable and prudent estimates of future outcome. This is achieved by adopting relatively conservative assumptions which can withstand a reasonable range of fluctuation of actual experience. Annual review of the relevant experience is performed to assess the adequacy of margin between the assumptions adopted and the best estimate of future outcome. The assumptions that are considered include expenses and the probability of claims. Both risk discount rate and investment return assumptions are set on active basis with reference to market risk free yields.

For non-linked life business, the policy reserve is generally calculated on a modified net premium basis. The net premium is the level of premium payable over the premium payment period whose discounted value at the outset of the policy would be sufficient to exactly cover the discounted value of the original guaranteed benefits at maturity or at death if earlier. The net premium is then modified to allow for deferral of acquisition costs. The policy reserve is then calculated by subtracting the present value of future modified net premiums from the present value of the benefits guaranteed at maturity or death up to the balance sheet date, subject to a floor of the cash value. The modified net premium basis makes no allowance for voluntary discontinuance by policyholders as this would generally result in a reduced level of policy reserve.

For linked life business, the policy reserve is generally determined as the total account balance of all in-force policies with an additional provision for the unexpired insurance risk.

(d) Insurance risk continued

Assumptions

The principal assumptions underlying the calculation of the long-term insurance business provision are:

(i) Mortality

A base mortality table which is most appropriate for each type of contract is selected. An adjustment is included to reflect the Group's own experience with an annual investigation performed to ascertain the appropriateness of overall assumption.

(ii) Morbidity

The morbidity incidence rates, which mainly cover major illness and disability, are generally derived from the reinsurance costs which also form the pricing basis. A loading is generally added as a provision for adverse deviation. An annual investigation is performed to ascertain the appropriateness with the Group's insurance subsidiary's actual experience.

(iii) Discount rates

Rate of interest

	2017	2016
Policies denominated in HKD	1.8%, 2.22% and 2.55%	1.8%, 2.22%, 2.5% and 2.55%
Policies denominated in USD	3.0% and 3.45%	3.0% and 3.45%
Policies denominated in RMB	2.32%, 2.9%, 3.0%, 3.3% and 3.32% as varies by product	2.32%, 2.9%, 3.0%, 3.3% and 3.32% as varies by product

Under the modified net premium method, the long-term business provision is sensitive to the interest rate used when discounting.

Sensitivity to changes in variables

The Group's insurance company re-runs its valuation models on various bases. An analysis of sensitivity around various scenarios provides an insight to the key risks which the Group's insurance company is exposed to. The table presented below demonstrates the sensitivity of insured liability estimates to particular movements in assumptions used in the estimation process. Certain variables can be expected to impact on life insurance liabilities more than others, and consequently a greater degree of sensitivity to these variables may be expected.

Impact on reported profit to changes in key variable

	Change in variable	Change in liabilities	
	%	2017	2016
Base run		95,348	91,364
Discount rate	+1	(2,583)	(2,624)
Discount rate	–1	11,472	10,980
Mortality/Morbidity	+10	306	336
Mortality/Morbidity	–10	(260)	(290)

The analysis above has been prepared for a change in variable with all other assumptions remaining constant and ignores changes in values of the related assets.

For the sensitivity in discount rate, an absolute +/-1% of the discount rate is used. For the Mortality/Morbidity sensitivity, a relative +/-10% (i.e. multiply the assumption by 110% or 90%) is used.

(e) Operational risk

(audited)

Operational risk is the risk to achieving our strategy or objectives as a result of inadequate or failed internal processes, people and systems or from external events.

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

Operational risk management framework
The Group's Operational Risk Management Framework ("ORMF") is our overarching approach for managing operational risk , the purpose of which is to:

- Identify and manage our operational risks in an effective manner
- Remain within the operational risk appetite, which helps the organisation understand the level of risk it is willing to accept
- Drive forward-looking risk awareness and assist management focus during 2017

Business managers throughout the organisation are responsible for maintaining an acceptable level of internal control commensurate with the scale and nature of operations, and for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The ORMF helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

A centralised database is used to record the results of the operational risk management process. Operational risk and control self-assessments are input and maintained by business units. Business and functional management and business risk and control managers monitor the progress of documented action plans to address shortcomings. To ensure that operational risk losses are consistently reported and monitored at Group level, all Group companies are required to report individual losses when the net loss is expected to exceed USD10,000, and to aggregate all other operational risk losses under USD10,000. Losses are entered into the Group Operational Risk database and are reported to the Risk Management Meeting on a monthly basis.

Activities to strengthen our risk culture and better embed the use of the ORMF was further implemented in 2017. In particular, the use of the activity-based "three lines of defence" model, which sets out roles and responsibilities for managing operational risks on a daily basis.

(e) Operational risk continued

Exposures
(Unaudited)

The Group continues to strengthen those controls that manage our most material risks:

- Further embedding Global Standards to ensure that we know and protect our customers, ask the right questions and escalate concerns.

- Increased monitoring and enhanced detective controls to manage those fraud risks which arise from new technologies and new ways of banking.

- Strengthening security controls to prevent cyber-attacks.

  The cyber threat remains a major concern in the financial industry and it continues to rapidly evolve. Their attacks are becoming increasingly well organised, planned and sophisticated. Cyber criminals seek financial gains through compromising bank and customer information and launch disruption to banking services. Unauthorised access to bank systems by hackers may result in financial and reputational losses, increased regulatory scrutiny which could adversely affect confidence of customers and investors in Hang Seng Bank.

  We have established a governance forum to oversee cyber security to ensure cyber security risks are managed effectively, and to oversee issues and activities related to information security risks. We continue to strengthen and significantly invest in our ability to prevent, detect and respond to the ever-increasing and sophisticated threat of cyber attacks. Specifically, we continue to enhance our capabilities to protect against increasingly sophisticated malware, denial of service attacks and data leakage, as well as enhance security event detection and incident response processes. We participate in intelligence sharing with both law enforcement and industry schemes to help improve our understanding of, and ability to respond to, the evolving threats faced by us and our peers within our industry.

- Improve controls and security to protect customers when using digital channels.

- Enhancing controls associated with IT privileged access.

(audited)

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

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

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

The principal forms of capital are included in the following balances on the consolidated balance sheet: share capital, retained profits, other equity instruments, other reserves and subordinated liabilities. Capital also includes the collectively impairment allowances and regulatory reserve for general banking risks as allowed under Banking (Capital) Rules.

Externally imposed capital requirements

(audited)

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

The Group uses the advanced internal ratings-based approach ("IRB") 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.

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

Basel III

(unaudited)

The Basel III rules set out the minimum capital requirements, to be phased in sequentially from 1 January 2013, becoming fully effective on 1 January 2019 with ultimate CET1 capital ratio and capital conservation buffer minimum requirements at 4.5% and 2.5% respectively. In addition to the criteria detailed in the Basel III proposals, the BCBS issued further minimum requirements in January 2011 to ensure that all classes of capital instruments are able to absorb losses at the point of non-viability before taxpayers are exposed to loss. Instruments issued on or after 1 January 2013 may only be included in regulatory capital if the new requirements are met. The capital treatment of instruments issued prior to this date that meet the grandfathering conditions will be phased out over a 10-year period commencing on 1 January 2013.

The Banking (Capital) (Amendment) Rules 2012, effective on 1 January 2013, signified the first phase of Basel III requirements in Hong Kong. The changes in minimum capital ratio requirements are phased in from 1 January 2013 to 1 January 2019, while the capital treatment for counterparty credit risk is effective from 1 January 2013.

The Banking (Capital) (Amendment) Rules 2014 came into effect on 1 January 2015 to implement the Basel III capital buffer requirements in Hong Kong. The changes include the phasing-in from 2016 to 2019 of the Capital Conservation Buffer ("CCB") which is designed to ensure banks build up capital outside periods of stress of 2.5% of RWAs, the Countercyclical Capital Buffer ("CCyB") which is set on an individual country basis and is built up during periods of excess credit growth to protect against future losses, and the Higher Loss Absorbency ("HLA") requirements for Domestic Systemically Important Banks ("D-SIB"). The CCyB for Hong Kong is 0.625% of RWAs from 1 January 2016, 1.25% from 1 January 2017, 1.875% from 1 January 2018 and 2.5% from 1 January 2019. The increase follows the Basel III phase-in arrangement for the CCyB. On 16 March 2015, the HKMA announced the designation of the Bank as a D-SIB and the HLA requirement to be 1.5% of RWAs which will be phased-in from 0.375% in 2016 to reach the full implementation in 2019. On 31 December 2015, 30 December 2016 and 29 December 2017, the HKMA confirmed the designation of the Bank as a D-SIB as well as the HLA requirements.

Leverage ratio

(unaudited)

The leverage ratio was introduced into the Basel III framework as a non-risk-based backstop limit, to supplement risk-based capital requirements. It aims to constrain the build-up of excess leverage in the banking sector, introducing additional safeguards against model risk and measurement errors. The ratio is a volume-based measure calculated as Basel III tier 1 capital divided by total on- and off-balance sheet exposures. Basel III provides for a transitional period for the introduction of this ratio, comprising a supervisory monitoring period that started in 2011 and a parallel run period from January 2013 to January 2017. The parallel run will be used to assess whether the proposed minimum ratio of 3% is appropriate, with a view to migrating to a Pillar 1 requirement from 1 January 2018.

Capital base

(unaudited)

The following tables show the capital base, RWAs and capital ratios as contained in the "Capital Adequacy Ratio" return required to be submitted to the HKMA by the Bank on consolidated basis as 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 Bank and its subsidiaries maintain a regulatory reserve to satisfy the provisions of the Banking Ordinance and local regulatory requirements for prudential supervision purposes. At 31 December 2017, the effect of this requirement is to restrict the amount of reserves which can be distributed to shareholders by HK$6,018 million (31 December 2016: HK$5,945 million).

The following table sets out the composition of the Group's capital base under Basel III at 31 December 2017 and 31 December 2016. 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.

	2017	2016
Common Equity Tier 1 ("CET1") Capital		
Shareholders' equity	126,241	117,870
– Shareholders' equity per consolidated balance sheet	152,030	140,626
– Additional Tier 1 ("AT1") perpetual capital instrument	(6,981)	(6,981)
– Unconsolidated subsidiaries	(18,808)	(15,775)
Non-controlling interests	–	–
– Non-controlling interests per consolidated balance sheet	49	60
– Non-controlling interests in unconsolidated subsidiaries	(49)	(60)
Regulatory deductions to CET1 capital	(31,783)	(30,103)
– Cash flow hedging reserve	41	48
– Changes in own credit risk on fair valued liabilities	(5)	(14)
– Property revaluation reserves[1]	(24,842)	(23,304)
– Regulatory reserve	(6,018)	(5,945)
– Intangible assets	(408)	(407)
– Defined benefit pension fund assets	(45)	(37)
– Deferred tax assets net of deferred tax liabilities	(211)	(158)
– Valuation adjustments	(295)	(286)
Total CET1 Capital	94,458	87,767
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	101,439	94,748
Tier 2 ("T2") Capital		
Total T2 capital before regulatory deductions	14,723	16,009
– Term subordinated debt	–	2,327
– Property revaluation reserves[1]	11,179	10,487
– Impairment allowances and regulatory reserve eligible for inclusion in T2 capital	3,544	3,195
Regulatory deductions to T2 capital	(915)	(915)
– Significant capital investments in unconsolidated financial sector entities	(915)	(915)
Total T2 Capital	13,808	15,094
Total Capital	115,247	109,842

1 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
(unaudited)

	2017	2016
Credit risk	512,720	470,043
Market risk	7,208	7,354
Operational risk	52,795	50,871
Total	572,723	528,268

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

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

	2017	2016
CET1 capital ratio	16.5%	16.6%
T1 capital ratio	17.7%	17.9%
Total capital ratio	20.1%	20.8%

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 31 December 2017. The pro-forma Basel III end point basis position is a mechanical application of the current rules to the capital base as at 31 December 2017, it is not a projection.

In addition, the capital ratios of all tiers as of 31 December 2017 would be reduced by approximately 1% after the prospective fourth interim dividend payment for 2017. The following table shows the pro-forma basis position of the capital ratios after the prospective interim dividend.

	Pro-forma 2017	Pro-forma 2016
CET1 capital ratio	15.5%	15.6%
T1 capital ratio	16.7%	16.9%
Total capital ratio	19.1%	19.8%

Leverage ratio
(unaudited)

	2017	2016
Leverage ratio	7.3%	7.4%
T1 capital	101,439	94,748
Exposure measure	1,388,288	1,288,039

Detailed breakdown of the Group's leverage exposure measure and a summary comparison table reconciling the assets of the Group's accounting balance sheet with the leverage exposure measure using the standard templates as specified by the HKMA can be viewed in the Banking Disclosure Statement in the Regulatory Disclosures section of our website www.hangseng.com.

Other financial information
Other financial information required under the Banking (Disclosure) Rules can be viewed in the Banking Disclosure Statement that is available in the Regulatory Disclosures section of our website www.hangseng.com.

Corporate Sustainability

Through effective engagement with our stakeholders, we are committed to making our community a better place to live. Improving well-being and contributing to the development of an inclusive, upwardly mobile and environmentally conscious society will support our sustainable growth in the years ahead.

As a bank and a good corporate citizen, we act with integrity and a strong sense of accountability in the provision of services to customers, in the treatment of our staff and in our responsibilities to shareholders, business partners and the wider community.

We team up with trusted local organisations to create corporate sustainability programmes that promote social mobility, entrepreneurism, positive life values and civic pride, particularly among young people.

Since 2008, we have invested nearly HK$274m in community development programmes in Hong Kong, including HK$31m in 2017. We also make non-financial contributions through volunteer service and by providing expertise and practical support to a wide range of social and environmental initiatives.

In testament to our commitment, we have been a constituent member of the FTSE4Good Developed Index since 2001, and of the Hang Seng Sustainability Index Series and the Hong Kong Business Sustainability Index since their establishment in 2010 and 2015 respectively.

A public poll conducted by The University of Hong Kong since 2008 has identified us as having the best corporate social responsibility reputation among local banks and financial institutions for 10 consecutive years and we are the only Hong Kong company included in the '2017 Global 100 Most Sustainable Corporations in the World' list compiled by Corporate Knights. Our 2016 Corporate Sustainability Report received a Silver Award in the international 2016/17 Mercury Awards, which recognise excellence in public relations.

We were the first domestic bank in Hong Kong to gain ISO 14001 certification for its entire network of offices and branches.

Investing in Hong Kong's Future

The aspirations, attitudes and abilities of youngsters in Hong Kong will shape the future direction of our city. Our youth development programmes enhance employability, encourage entrepreneurism and help young people build future skills. Our aim is to empower and inspire younger generations to contribute to creating a compassionate, creative and economically successful society by giving them the tools and confidence to explore their potential and set high goals.

Towards a more compassionate society

Run in partnership with the Hong Kong Family Welfare Society (HKFWS) since 2013, the award-winning Hang Seng – HKFWS Youth Mediation Scheme trains students to use mediation to resolve conflicts, strengthen relationships and enhance communication. More than 1,400 senior primary students from 50 schools have been trained as Peer Mediators over the past five years. To help promote the scheme's key themes to a wider audience, an illustrated storybook was published and distributed to all Hong Kong primary schools in 2016/17. We have continued to build on this initiative in 2017/18 with the introduction of storytelling sessions supported by Bank volunteers.

NURTURING CIVIC-MINDED FUTURE SPORTING STARS

In working with rising table tennis stars, the Hang Seng Table Tennis Academy aims to nurture well-rounded athletes who will serve as good role models and demonstrate civic-minded behaviour as well as perform at the top of their sporting ability. Members of the Hang Seng Elite Cadet Squad participated in various community outreach initiatives with young and elderly people in 2017, including visiting senior citizens during the festive season. Training camps in Shanghai provided members of the Hang Seng Elite Cadet Squad and Hang Seng Regional Squad with opportunities to engage in cultural exchange with their Mainland peers.

Working with St James' Settlement, we launched the Hang Seng Character Master Programme, which encourages well-rounded personal development among children from an early age. Emphasising the four core values of 'Respect, Caring, Integrity and Responsibility', the programme includes social simulation games for young participants as well as sharing sessions and forums on communication and education for teachers and parents.

Creating access and opportunities

The Hang Seng Youth Career Planning Scheme gives young ex-offenders and at-risk youths the opportunity to channel their energies into building a positive future. Leveraging the Hang Seng Youth Entrepreneurship Scheme we launched with The Society of Rehabilitation and Crime Prevention, Hong Kong in 2014, this extended programme gives participants hands-on business experience and the chance to discover new interests and strengths through entrepreneurial training, career guidance and job-shadowing opportunities. Bank executives provide support by serving as guest speakers and providing feedback on business proposals.

Our close to 20-year sponsorship of the Ming Pao Student Reporter Programme has helped over 9,000 students – including 400 from 135 schools in 2017 – to develop greater social awareness, think more critically and enhance their communication skills. We also continue to support the Police in promoting anti-crime messages through our long-term sponsorship of the biennial Hang Seng – Help The Police Fight Youth Crime Competition.

Since 1995, we have allocated more than HK$65m to various scholarship schemes in Hong Kong and mainland China, benefitting over 2,400 students.

Creative ways to encourage greater understanding

Exposure to the arts and opportunities for creative expression provide young people with space to explore social issues, communicate their aspirations and beliefs, and broaden their cultural horizons.

Launched in 2015 with Hong Kong Repertory Theatre, the Hang Seng Call for Young Talent in Theatre programme uses artistic performance as a tool for students to build self-confidence and develop a collaborative spirit. Following an open call that attracted a record 670 applications, 63 primary and secondary school students were selected to take part in the intensive acting, singing and dancing training programme, which concluded with four public performances of the original musical 'Our Time, Our Hong Kong' in August. A number of school performance workshops were also held in 2017 to give students at 10 schools the chance to showcase their talents to their teachers and peers.

Our sponsorship of various student ticket and subsidy schemes helped over 10,000 students and underprivileged children attend performances by the Hong Kong Philharmonic Society and a variety of Hong Kong Arts Festival events in 2017.

Sport for all, fit for success

Participation in sports promotes good health and provides valuable lessons about the benefits and importance of setting goals, perseverance and fair play.

Since 1991, we have worked closely with the Hong Kong Table Tennis Association, donating more than HK$59m to promote table tennis as a healthy and fun activity among people of all ages and backgrounds.

Providing the Tools to Build a Bright Future

Our four-year partnership with The Society for Rehabilitation and Crime Prevention, Hong Kong has provided young people from challenging backgrounds with the chance to build self-confidence while gaining practical business skills and planning for a better future. More than 400 youngsters have benefitted from the Hang Seng Youth Entrepreneurship Scheme since its launch in 2014.

Among individuals who have had their business proposals approved, over 65% have successfully run their businesses for more than six months using start-up funds and professional guidance provided through the scheme. The success of this initiative has inspired us to expand its scope to include career advice and job-shadowing opportunities under the new banner of the Hang Seng Youth Career Planning Scheme.

ARTISTIC ACHIEVEMENT BUILDS SELF-CONFIDENCE

We joined hands with the YMCA of Hong Kong in 2017 to provide special education needs (SEN) students with a creative way to enhance their concentration, coordination and communication skills. With support from Bank volunteers, the Hang Seng – YMCA Balloon Twisting Programme offers SEN youngsters the chance to attend specially tailored classes held by YM Balloon, a local balloon arts social enterprise. The sense of achievement experienced by young participants has helped to increase their confidence and self-esteem. A 2016/17 graduation ceremony was held at a shopping mall to celebrate the students' accomplishments and share their artistic creations with the public.

AN AWARD-WINNING APPROACH TO COMMUNITY ENGAGEMENT

We engage with respected partners to provide long-term support for 'best-in-class' community initiatives that improve social well-being, promote positive life values and generate lasting positive change.

The Hang Seng Call for Young Talent in Theatre programme received the Award for Arts Sponsorship at the Hong Kong Arts Development Council's 2016 Awards for helping young people to develop positive personal attributes.

Established to help young people resolve conflicts in a constructive and non-confrontational way, the Hang Seng – HKFWS Youth Mediation Scheme received the Outstanding Partnership Project Award 2016/17 from the Hong Kong Council of Social Service, and a Silver Award in the corporate social responsibility category at the 3rd Hong Kong Public Relations Awards 2016, organised by the Hong Kong Public Relations Professionals' Association in 2017.

In 2001, we pioneered the establishment of Hang Seng Table Tennis Academy (HSTTA), the first comprehensive programme for a single sport in Hong Kong, which now plays a key role in identifying and training top table tennis talent as well as encouraging participation in sport among the wider community. Close to 350,000 individuals have taken part in more than 6,300 activities organised by HSTTA over the years. Our celebratory programme to mark the Academy's 15th anniversary was recognised with a Silver Award in the corporate social responsibility category at the 13th China Golden Awards for Excellence in Public Relations (China Golden Awards), organised by the China International Public Relations Association (CIPRA).

Other support for table tennis includes sponsoring the 2017 Hang Seng Hong Kong Junior & Cadet Open tournament. Hong Kong athletes Wong Chun-ting, Doo Hoi-kem, Lee Ho-ching and Soo Wai-yun are among the many well-known previous participants in this international event for rising stars. This year's tournament featured more than 150 world-class local and overseas players who demonstrated outstanding sporting skills and a positive competitive spirit. The Hong Kong team put in an excellent performance to win two gold, three silver and nine bronze medals. The success of local athletes at an international level builds civic pride and demonstrates the rewards to be gained from determination, perseverance and good teamwork.

The Public Face of Our Business

We recognise the vital contributions of our employees as stewards of our trusted brand, champions of our values and ambassadors in our relationships with the community. We strive to hire and retain talented individuals by providing attractive compensation and benefits packages, a dynamic and supportive work environment and a good work-life balance.

The number of colleagues and their families and friends participating in Bank-organised recreational and leisure activities increased significantly in 2017 to reach 43,500. Over 4,800 individuals attended our biennial Hang Seng Fun Day to enjoy a variety of fun attractions and performances at a theme park. We also organised bowling, badminton, football, basketball, table tennis and golf competitions under the Hang Seng Cup to encourage good team spirit and more active lifestyles.

Over 400 colleagues joined a series of new lunchtime workshops at our three core office buildings, participating in activities ranging from the creation of festive gifts to fitness classes.

Other initiatives to support employee well-being in 2017 include the enhancement of our annual leave policy and the organisation of workshops and seminars on mental health awareness and handling stress as a working parent.

Deeply Rooted in Our Community

Inclusive, compassionate and progressive communities embrace a culture of service and take steps to support and lift up their vulnerable and underprivileged populations.

As part of our efforts to encourage greater civic participation, our employees are able to take two days of volunteer leave per year to support worthy causes. Bank volunteers took part in a wide variety of community-focused activities in 2017, including outings with underprivileged children, delivering hot meals to the elderly and assisting with environmental clean-up initiatives. Since 2013, our staff and their family members and friends have contributed nearly 90,000 hours in volunteer service.

Various Bank departments also use public service to help reinforce good team spirit and strengthen relationships with the local community. Departmental volunteer activities in 2017 included eco-tours with young people from ethnic minority populations, mural painting in hospitals and museum visits with senior citizens.

RECOGNITION

2017 Global 100 Most Sustainable Corporations in the World
(only Hong Kong corporation included)
CORPORATE KNIGHTS

Constituent stock of FTSE4Good Developed Index (formerly the FTSE4Good Global Index)
(16th consecutive year)
FTSE INDEX

Constituent stock of Hang Seng Corporate Sustainability Index Series
(8th consecutive year)
HANG SENG INDEXES

Constituent stock of Hong Kong Business Sustainability Index
(3rd consecutive year)
THE HONG KONG POLYTECHNIC UNIVERSITY, HONG KONG COUNCIL OF SOCIAL SERVICE AND HONG KONG PRODUCTIVITY COUNCIL

Caring Company
(15th consecutive year)
HONG KONG COUNCIL OF SOCIAL SERVICE

Best Corporate Social Responsibility Reputation among Local Banks and Financial Service Companies
(10th consecutive year)
THE UNIVERSITY OF HONG KONG'S PUBLIC OPINION PROGRAMME

Junzi Corporation
(7th consecutive year)
HANG SENG MANAGEMENT COLLEGE

ENVIRONMENTAL PERFORMANCE

	2017#	2016^	**2017 vs 2016 (% change)**
Greenhouse gas emissions from energy use (kilotonnes CO_2)*	**22.47**	24.27	**-7.39**
Electricity consumption (GWh)	**34.44**	36.65	**-6.03**
Water consumption (000m^3)**	**74.94**	69.80	**7.36**
IT/electrical waste recycled (tonnes)	**20.73**	47.22	**-56.1**

Data coverage: Hang Seng Bank's Hong Kong operations

Key: CO_2: carbon dioxide GWh: gigawatt hours m^3: cubic metres

* The greenhouse gas emissions generated from energy use was calculated based on electricity and fuel consumed as well as their relevant gas emission conversion factors as provided by the relevant electricity companies.

** Hang Seng 113 office building was fully operational in 2017. Fresh water is used for toilet flushing in this building as it is not covered by the Water Supplies Department's seawater supply system.

\# From 1 Oct 2016 to 30 Sep 2017

^ From 1 Oct 2015 to 30 Sep 2016

Our new Mobile Branch reflects our commitment to improving financial inclusion by providing access to banking services at several large housing estates in Hong Kong. To promote greater financial literacy, particularly among young people, the branch will run a series of finance and banking talks and workshops.

We continue to leverage the expertise of our staff to provide financial know-how through the Financial Education programme organised by the Hong Kong Association of Banks and the Hong Kong Council of Social Service, which provides advice on financial management to individuals from low-income groups. We also supported 'Money Month 2017', Hong Kong's first territory-wide financial education campaign, and Junior Achievement China's China Youth Financial Literacy Education Programme in the Pearl River Delta region, which earned us an Honorable Mention in the public service category at CIPRA's 13th China Golden Awards.

Our deep community roots are reflected in the long-term partnerships we have built with local organisations that drive positive change and enhance well-being. Over the past 30 years, we have raised over HK$76m for The Community Chest of Hong Kong, including around HK$24m for The Chest's annual Dress Casual Campaign since its launch in 1994.

Protecting Our Home

Safeguarding the environmental health of our planet is a collective duty that has significant consequences for present and future generations. As one of Hong Kong's largest listed companies, we conduct our business in an environmentally responsible manner and use our public platform to promote good environmental stewardship.

We are working to reduce our consumption of energy and natural resources, reduce waste and use environmentally friendly products and services whenever possible. We use internal channels and volunteer service to raise environmental awareness and communicate green values to our staff. We also encourage our suppliers, business partners and customers to improve their environment performance through our policies, services and community engagement activities.

In 2017, Hang Seng 113 became Hong Kong's first domestic bank office building to be awarded Platinum certification – the highest attainable level – under the US Green Building Council's LEED (Leadership in Energy and Environmental Design) scheme.

Our efforts to be a responsible consumer of energy earned us the Joint Energy Saving Award at the 2017 CLP GREEN PLUS Recognition Award. We also support the green initiatives of NGOs and Government departments, including Friends of the Earth (HK)'s 'Power Smart' Energy Saving Contest, WWF (Hong Kong)'s Earth Hour and the Environmental Bureau's Charter on External Lighting.

In 2017, nearly 28 million e-Statement and e-Advice notices were generated, and over 80% of shareholders have adopted our e-communications services, collectively saving 76.3 million sheets of paper. Since 2001, we have facilitated the charitable giving of more than HK$37m by our customers through our e-Donation channel.

Our Hang Seng Yunnan Low-Carbon Village project in partnership with The Conservancy Association builds on 10 successful years of renewable energy initiatives in rural parts of Yunnan Province. The project aims to reduce dependency on natural resources by installing appliances such as solar heating and biogas facilities, and implementing programmes that help enhance the entrepreneurial skills and economic status of local villagers.

We support the conservation of biodiversity through our financing policies and within our own operations. We stopped serving shark's fin at Bank functions in 2003 and have since removed endangered reef fish species from our menus. We also provide a sustainable seafood menu that is endorsed by WWF (Hong Kong) at our banquet hall.

Corporate Governance Principles and Practices

Hang Seng Bank Limited (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" ("CG-1") under the Supervisory Policy Manual ("SPM") issued by the Hong Kong Monetary Authority ("HKMA"). HKMA issued a revised SPM CG-1 in October 2017 for implementation by 1 January 2018. The Bank has reviewed its governance practices and revised its governance policies so as to bring the Bank in full compliance with the requirements under the revised SPM CG-1. 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 Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("HKEx") (the "Listing Rules"). 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.

Board of Directors

The Board has collective responsibilities for promoting the long-term sustainability and success of the Bank by providing entrepreneurial leadership within a framework of prudent and effective controls. In doing so, the Board commits to high standards of integrity and ethics.

According to the Board's terms of reference, specific matters reserved for the Board's consideration and decision include:

- strategic plan and objectives
- annual operating plan and performance targets
- annual and interim financial reporting
- capital plans and management
- risk appetite statement and profile update
- appointment and oversight of senior management
- internal control and risk management governance structure
- effective audit functions
- corporate values and standards
- policies, practices and disclosure on corporate governance
- policies and practices on compliance with legal and regulatory requirements
- significant policies and plans and subsequent changes
- acquisitions, disposals and purchases above predetermined thresholds

Chairman and Chief Executive

The roles of the Chairman and Chief Executive of the Bank are complementary, but importantly, they are distinct and separate with a clear and well established division of responsibilities. Details of their respective roles are set out in the Board's terms of reference.

The Chairman of the Board, who is an Independent Non-executive Director ("INED"), is responsible for the leadership and effective running of the Board and for ensuring that decisions of the Board are taken on a sound and well-informed basis and in the best interest of the Bank. In addition, as the Chairman of the Board, he is also responsible for ensuring that all Directors are properly briefed on all issues currently on hand and receive adequate, accurate and reliable information in a timely manner. The Chairman possesses the requisite experience, competencies and personal qualities to fulfill these responsibilities.

The Chief Executive, who is an Executive Director ("ED"), is responsible for implementing the strategy and policy as established by the Board. The Chief Executive is also responsible for the management and day-to-day running of the Bank's business and operations, as well as leading and chairing the Executive Committee.

Board Composition

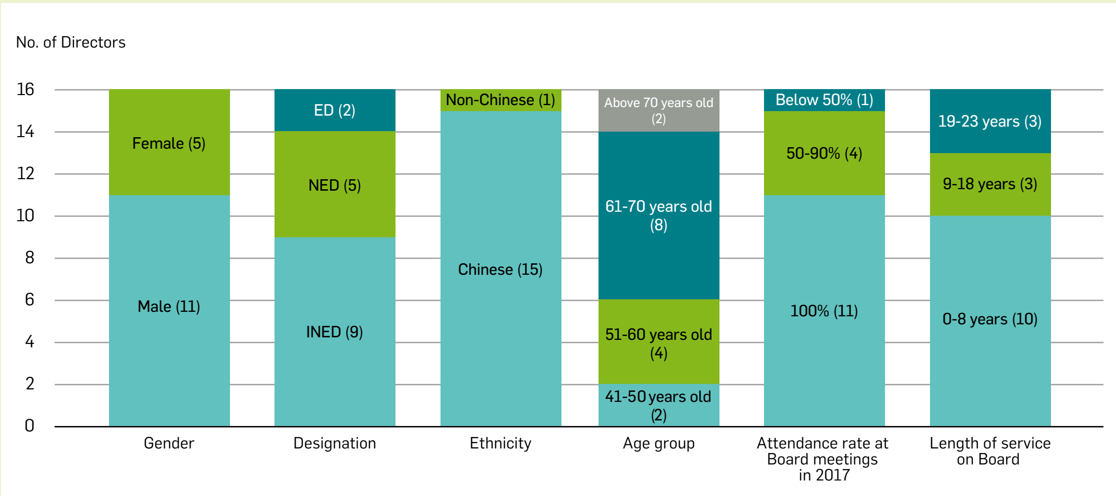
As at the date of this Annual Report, the Board comprises 16 Directors, of whom two are EDs and 14 are Non-executive Directors ("NEDs"). Among the 14 NEDs, nine are INEDs. There is a strong independent element on the Board, to ensure the independence and objectivity of the Board's decision-making process as well as the thoroughness and impartiality of the Board's oversight of the Management.

The Board possesses, both as individual Directors and collectively, appropriate experience, competencies and personal qualities, including professionalism and integrity, to discharge its responsibilities adequately and effectively. In addition, the Board collectively has adequate knowledge and expertise relevant to each of the material business activities that the Bank pursues and the associated risks in order to ensure effective governance and oversight.

Members of the Board, who come from a variety of different backgrounds, have a diverse range of business, banking and professional expertise. Biographical details of the Directors, together with information relating to the relationship among them, are set out in the section "Biographical Details of Directors and Senior Management" in this Annual Report.

The Bank remains committed to meritocracy in the Boardroom, which requires a diverse and inclusive culture where Directors believe that their views are heard, their concerns are attended to and they serve in an environment where bias, discrimination and harassment on any matter are not tolerated. The Board has adopted a Board Diversity Policy which has been made available on the Bank's website (www.hangseng.com) for better transparency and governance. Board appointments are based on merit and candidates are considered against objective criteria, having due regard for the benefits of diversity on the Board including, but not limited to, gender, age, cultural and educational background, ethnicity, professional experience, skills, knowledge and length of service.

An analysis of the Board's current composition is set out in the following chart:



The Bank has maintained on its website (www.hangseng.com) and on the website of HKEx (www.hkexnews.hk) an updated list of its Directors identifying their roles and functions and whether they are INEDs. INEDs are also identified as such in all corporate communications that disclose the names of the Bank's Directors.

Further, the Bank has received from each of the INEDs an annual confirmation of his/her independence. The independence of the INEDs has been assessed in accordance with the guidelines set out in Rule 3.13 of the Listing Rules and the revised SPM CG-1 issued by HKMA. Following such assessment, the Board has affirmed that all the INEDs continue to be independent.

Board Process

Board meetings are held about six times a year and no less than once every quarter. Additional Board meetings, or meetings of a Board committee established by the Board to consider specific matters, can be convened, when necessary.

Schedule for the regular Board meetings in each year, together with the standing agenda for such meetings, are made available to all Directors before the end of the preceding year. In addition, notice of meetings will be given to all Directors at least 14 days before each regular meeting.

Other than regular meetings, the Chairman also meets with NEDs (including INEDs) without the presence of EDs, to facilitate an open and frank discussion among the NEDs on issues relating to the Bank.

The Board also meets with the representatives of HKMA to maintain a regular dialogue with the regulator where HKMA shares with the Board HKMA's overall supervisory assessment of the Bank and their key supervisory focuses on the banking industry in general.

Meeting agenda for regular meetings are set after consultation with the Chairman and the Chief Executive. All Directors are given an opportunity to include matters in the agenda.

Directors make their best efforts to contribute to the formulation of strategy, policies and decision-making by attending the Board meetings in person or via telephone or video-conferencing facilities.

Minutes of Board meetings with details of the matters discussed by the Board and decisions made, including any concerns or views of the Directors, are kept by the Company Secretary and are open for inspection by Directors.

In addition to the regular financial and business performance reports submitted to the Board at its regular meetings, the Board also receives financial and business updates with information on the Bank's latest financial performance and material variance from the Bank's annual operating plan during those months where no Board meetings are held. Directors can therefore have a balanced and comprehensive assessment of the Bank's performance, business operations, financial position and prospects throughout the year.

The Board reviews and evaluates its work process and effectiveness annually, with a view to identifying areas for improvement and further enhancement. The Board also regularly reviews the time commitment required from NEDs.

All Directors have access to the EDs as and when they consider necessary. They also have access to the Company Secretary who is responsible for ensuring that Board procedures, and related rules and regulations, are followed.

Under the Articles of Association of the Bank, a Director shall not vote or be counted in the quorum in respect of any contract, arrangement, transaction or other proposal in which he/she or his/her associate(s), is/are materially interested.

The Board has adopted a Policy on Conflicts of Interest. The Policy identifies the relationships, services, activities or transactions in respect of which conflicts of interest may arise and sets out measures for prevention or management of such conflicts. The Policy also contains an objective compliance process for implementing the Policy, which includes notification by a Director of conflicts or potential conflicts, and a review/approval process. In addition, the Policy also sets out provisions of the Board's approach to dealing with any non-compliance with the Policy.

The Board has been applying technology designed specifically around the Board to help the Directors manage their time more efficiently, while staying connected to the Board and other Directors in order to discharge their responsibilities effectively and securely.

During 2017, the Board held eight meetings (including one meeting with HKMA) and the important matters discussed at Board meetings included:

Strategic Planning

- strategic plan (2018 – 2020)
- annual review of strategic plan (2016 – 2018) with quarterly updates
- impact of regulatory developments both in Hong Kong and the Mainland on the Bank's strategic development

Governance and Risk Management

- global risk appetite framework addendum and risk appetite statement for 2017 with mid year review and quarterly profile update
- enterprise risk management framework implementation and internal control system assessment
- effectiveness of environmental, social and governance risk management and internal control systems
- review of large credit exposures and risk concentrations
- significant policies and plans including, but not limited to, Recovery Plan, Contingency Funding Plan, Liquidity Management Policy, Connected Lending Policy, Capital Management Policy and Large Credit Exposure Policy
- board effectiveness evaluation for 2016
- review of the Bank's implementation of the guiding principles under HKMA's Circulars on "Empowerment of INEDs in the Banking Industry in Hong Kong" and "Bank Culture Reform", and the revised SPM CG-1

Financial and Business Performance, and Capital Planning

- financial statements for the year ended 31 December 2016
- interim financial statements for the six months ended 30 June 2017
- declaration of the fourth interim dividend for year 2016 and first three interim dividends for year 2017
- annual operating plan and capital plan for year 2017
- reports on financial and business performance
- internal capital adequacy assessment process
- individual liquidity adequacy assessment
- redemption of tier 2 subordinated loan
- review of the Bank's Disclosure Policy

Human Resources and Remuneration

- annual review of the remuneration policy and remuneration system
- annual review of alignment of risk and remuneration
- pay review for 2017 and variable pay for 2016
- review of fees payable to Directors and Board Committee Chairmen/Members of the Bank and its subsidiaries
- succession planning for the Board and senior management
- appointments to the Board and senior management
- performance management relating to senior management
- re-election of Directors
- terms of appointment of NEDs
- review of independence of INEDs
- annual review of the implementation of corporate values and business principles

Appointment and Re-election of Directors

The Bank uses a formal, considered and transparent procedure for the appointment of new Directors. Before a prospective Director's name is formally proposed, opinions of the existing Directors (including the INEDs) will be solicited. The proposed appointment will first be reviewed by the Nomination Committee, taking into account the balance of skills, knowledge and experience on the Board. Upon recommendation of the Nomination Committee, the proposed appointment will then be reviewed and, if thought fit, approved by the Board after due deliberation.

Pursuant to Group policy, the Bank will conduct enhanced vetting for non-employee NEDs before his/her appointment and thereafter once every three years, as one of the measures to verify the continual fitness and propriety of the NEDs.

In accordance with the requirement under the Banking Ordinance, approval from HKMA will also be obtained for appointment of new Directors.

The Bank issues appointment letters to each of the NEDs, setting out the terms and conditions of their appointments, including the time commitment expected of them. Additional time commitment is necessary if the NEDs also serve on committee(s) of the Board.

All new Directors are subject to election by shareholders at the next Annual General Meeting ("AGM") after their appointments have become effective. Further, the Bank's Articles of Association provide that all Directors shall be subject to retirement by rotation at least once every three years. Retiring Directors are eligible for re-election at AGMs of the Bank.

According to the policy on the term of appointment of NEDs, term of appointment of each NED is three years except that where a NED has served on the Board for more than nine years, then his/her term of appointment is one year. In renewing the term of appointment of each NED, the Board reviews whether such NED remains qualified for his/her position.

Responsibilities of Directors

Directors have full and timely access to all relevant information about the Bank so that they can discharge their duties and responsibilities as Directors. In particular, through regular Board meetings and receipt of regular financial and business updates, all Directors are kept abreast of the conduct, business activities and development, as well as regulatory updates applicable to the Bank.

There are established procedures for Directors to seek independent professional advice on matters relating to the Bank where appropriate. All costs associated with obtaining such advice will be borne by the Bank. In addition, each Director has separate and independent access to the Bank's Management.

The Bank has adopted a Code for Securities Transactions by Directors on terms no less exacting than the required standards set out in the Model Code for Securities Transactions by Directors of Listed Issuers (set out in Appendix 10 to the Listing Rules) with periodic review. 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 year 2017.

Directors' interests in securities of the Bank and HSBC Group as at 31 December 2017 have been disclosed in the Report of the Directors set out in this Annual Report.

Appropriate Directors' liability insurance cover has also been arranged to indemnify the Directors against liabilities arising out of the discharge of their duties and responsibilities as the Bank's Directors. The coverage and the sum insured under the policy are reviewed annually. Further, the Bank's Articles of Association provide that Directors are entitled to be indemnified out of the Bank's assets against claims from third parties in respect of certain liabilities.

Induction and Training for Directors

Induction programmes on the following key areas will be arranged for newly appointed Directors so that they can discharge their responsibilities to the Bank properly and effectively:

- directors' duties and responsibilities
- business operations and financial position
- risk management framework
- governance structure and practices
- control and support functions

Further, all Directors are provided with briefings and trainings on an on-going basis as necessary to ensure that they have a proper understanding of the Bank's operations and business, and are fully aware of their responsibilities under the applicable laws, rules and regulations. Such briefings and trainings are provided at the Bank's expense. The Bank maintains proper records of the briefings and trainings provided to and received by its Directors.

In addition, all Directors are provided with a "Memorandum of Directors", which sets out the scope and nature of Directors' duties and liabilities, particulars of Group policies and local regulatory and statutory requirements of which the Directors must be aware. Such memorandum is updated from time to time so as to reflect the latest internal policies/guidelines, regulatory/statutory requirements, and best practices.

During the year, Directors received briefings and trainings on the following topics:

- HKMA Development Programme – 2017 Independent Non-executive Directors Conference
- Supervisory focuses in 2018 and review on prominent risks of authorised institutions
- "Are Independent Non-executive Directors in Hong Kong performing their roles effectively?"
- Corporate Governance - Compliance and Beyond
- "All an Authorised Institution director needs to know about Trade-based Anti-money Laundering"
- Fighting corruption: challenges confronting bank directors
- Cyber security update
- Digital technology and innovation initiatives
- Machine learning and artificial intelligence
- Site visit to HSBC-ASTRI Research & Development Innovation Laboratory
- Common Reporting Standards
- Implementation of IFRS9

To summarise, Directors received briefings and trainings on the following key areas to update and develop their skills and knowledge during the year:

Directors	Training areas		
	Governance matters	Regulatory matters	Business/Management
INEDs			
Dr Raymond K F Ch'ien	√	√	√
Dr John C C Chan	√	√	√
Dr Henry K S Cheng	√	√	√
Ms L Y Chiang	√	√	√
Dr Fred Zuliu Hu	√	√	√
Ms Irene Y L Lee	√	√	√
Dr Eric K C Li	√	√	√
Mr Richard Y S Tang	√	√	√
Mr Michael W K Wu	√	√	√
NEDs			
Mr Nixon L S Chan	√	√	√
Ms Sarah C Legg	√	√	√
Dr Vincent H S Lo	√	√	√
Mr Kenneth S Y Ng	√	√	√
Mr Peter T S Wong	√	√	√
EDs			
Ms Louisa Cheang [Note 1]	√	√	√
Ms Margaret W H Kwan [Note 2]	√	√	√

Note 1 Ms Louisa Cheang was appointed as Vice-Chairman and Chief Executive with effect from 1 July 2017.

Note 2 Ms Margaret W H Kwan was appointed as ED with effect from 13 May 2017.

Delegation by the Board

Board Committees

The Board has set up five Committees, namely, Executive Committee, Audit Committee, Risk Committee, Remuneration Committee and Nomination Committee, to assist it in carrying out its responsibilities.

The current composition of the Board Committees is as follows:

Board

Executive Committee	Audit Committee	Risk Committee	Remuneration Committee	Nomination Committee
Ms Louisa Cheang [Note 3] (Chairman)	Dr Eric K C Li* (Chairman)	Ms Irene Y L Lee* (Chairman)	Dr John C C Chan* (Chairman)	Dr Raymond K F Ch'ien* (Chairman)
Mrs Eunice Chan	Ms Irene Y L Lee*	Dr Fred Zuliu Hu*	Ms L Y Chiang*	Dr John C C Chan*
Ms Ivy S P Chan	Mr Richard Y S Tang*	Dr Eric K C Li*	Dr Raymond K F Ch'ien*	Ms Louisa Cheang [Note 3]
Mr Walter S W Cheung	Mr Michael W K Wu*			Mr Peter T S Wong#
Ms Liz T L Chow [Note 4]				Mr Michael W K Wu*
Ms Margaret W H Kwan				
Mr Donald Y S Lam				
Mr Gordon W C Lam				
Mr Gilbert M L Lee [Note 5]				
Mr Sai Kit Lee				
Mr Andrew W L Leung				
Mr Godwin C C Li				
Mr Thomas C M Tsui [Note 4]				
Ms Elaine Y N Wang				
Ms Katie K C Yip				

* INED

\# NED

Note 3 Ms Louisa Cheang was appointed as Executive Committee Chairman and Nomination Committee member with effect from 1 July 2017.

Note 4 Ms Liz T L Chow and Mr Thomas C M Tsui were appointed as Executive Committee members with effect from 26 July 2017.

Note 5 Mr Gilbert M L Lee was appointed as Executive Committee member with effect from 14 February 2018.

Each of these Committees has specific written terms of reference, which set out in detail their respective authorities and responsibilities. Each Committee reviews its terms of reference and effectiveness annually. The terms of reference of all the Non-executive Board Committees have been made available on the Bank's website (www.hangseng.com). All Committees, except the Executive Committee and Nomination Committee, comprise solely of INEDs. Majority of the Nomination Committee members are INEDs while the Executive Committee comprises the Bank's EDs and senior executives.

All Committees adopt the same governance processes as the Board as far as possible and report back to the Board on their decisions and recommendations on a regular basis.

Executive Committee

The Executive Committee usually meets once a month and operates as a general management committee under the direct authority of the Board. It exercises the powers, authorities and discretions as delegated by the Board in so far as they concern the management and day-to-day running of the Bank in accordance with its terms of reference and such other policies and directives as the Board may determine from time to time. The Executive Committee also sub-delegates credit, investment and capital expenditure authorities to its members and senior executives.

To further enhance the Bank's risk management framework and in line with best practices, the Bank has set up a Risk Management Meeting, a risk meeting of the Executive Committee, to provide recommendations and advice to the Bank's Chief Risk Officer on enterprise-wide management of all risks, policies and guidelines for the management of risk within the HASE Group. Risk Management Meetings are usually held monthly. Minutes of Risk Management Meetings are provided to the Executive Committee and the Risk Committee for review and oversight purpose.

Audit Committee

The Audit Committee meets at least four times a year with the Bank's executives including the Chief Executive, Chief Financial Officer, Chief Risk Officer, Head of Audit, and representatives from the Bank's external auditor. The Committee reviews, among other things, the Bank's financial reporting, the nature and scope of audit reviews, and the effectiveness of the systems of internal control and compliance relating to financial reporting. The Audit Committee is also responsible for making recommendations to the Board on the appointment, re-appointment, removal and remuneration of the Bank's external auditor. In addition, the Audit Committee has established a "Policy for the Reporting of Improprieties" to provide a secured and confidential channel through which all staff members may report incidents of improprieties on a strictly confidential basis so that the same can be timely and thoroughly investigated and appropriate actions can be taken promptly.

The Audit Committee reports to the Board following each Audit Committee meeting, drawing the Board's attention to significant issues or matters of which the Board should be aware, identifying any matters in respect of which it considers that action or improvement is needed, and making relevant recommendations.

During the year, the Audit Committee held five meetings and the major work performed by the Committee was as follows:

- reviewed the financial statements for the year ended 31 December 2016 and the related documents, and internal control recommendations and audit issues noted by the Bank's external auditor
- reviewed the interim financial statements for the six months ended 30 June 2017 and the related documents, and the issues noted by the Bank's external auditor
- reviewed and approved the quarterly banking disclosure statements for reporting periods ended 31 March, 30 June and 30 September 2017
- reviewed the annual operating plan and capital plan for year 2017
- reviewed the balance sheet management position
- reviewed the revised accounting standards and prospective changes to accounting standards, in particular, the update on IFRS9 implementation, and the impact on the Bank's financial reporting
- reviewed the significant policies and plans including, but not limited to, the Bank's Recovery Plan and revised Disclosure Policy
- reviewed the internal audit reports and discussed the same with the Management and Head of Audit
- reviewed and adopted the revised Internal Audit Charter and enhanced Global Internal Audit Standards Manual
- reviewed the update on internal audit plan for 2017 and approved the internal audit plan for 2018
- reviewed the update on Sarbanes-Oxley Act (SOX) implementation and internal control system assessment as at 31 December 2016 and 30 June 2017
- reviewed the adequacies of resources, qualifications and experience of staff of the Accounting and Financial Reporting function and Internal Audit function, and their training programmes and budgets
- reviewed the re-appointment, remuneration and engagement letter of the Bank's external auditor, its independence and objectivity, and the effectiveness of the audit process
- reviewed the incidents reported under the Policy for the Reporting of Improprieties during the year
- reviewed the Audit Committee's independence and effectiveness in discharging its role and responsibilities, and its terms of reference
- reviewed and adopted the revised approach for the governance and interaction with the audit committees of the Bank's subsidiaries, and exercised oversight over such committees
- endorsed the appointment of an audit committee chairman of the Bank's subsidiary in Mainland China

The Audit Committee also meets annually with the representatives of the Bank's Head of Audit and external auditor without the presence of the Management in accordance with its terms of reference.

Risk Committee

The Risk Committee meets at least four times a year with the Bank's executives including the Chief Executive, Chief Financial Officer, Chief Risk Officer, Head of Audit, Head of Regulatory Compliance, Head of Financial Crime Compliance, and representatives from the Bank's external auditor. The Committee is responsible for, among other things, the Bank's high level risk related matters, risk appetite and tolerance, risks associated with proposed strategic acquisitions or disposals, risk management reports from the Management, effectiveness of the enterprise risk management framework and systems of internal control and compliance (other than that regarding financial reporting), and appointment and removal of the Chief Risk Officer.

Following the issuance of HKMA's Circular on "Bank Culture Reform" in March 2017, the Board has also delegated to the Risk Committee to encompass culture-related responsibilities. Such responsibilities include actions to approve, review and assess, at least annually, the adequacy of any relevant statement which sets out the Bank's culture and behavioural standard.

The Risk Committee reports to the Board following each Risk Committee meeting, drawing the Board's attention to significant issues or matters of which the Board should be aware, identifying any matters in respect of which it considers that action or improvement is needed, and making relevant recommendations.

During the year, the Risk Committee held five meetings and the major work performed by the Committee was as follows:

– reviewed the routine risk reports submitted by the Management including, but not limited to, enterprise risk management framework, internal control system assessment, global risk appetite framework addendum and risk appetite statement with mid year review and profile update, risk maps, top and emerging risks, annual plan and progress update relating to financial crime compliance, regulatory compliance and internal control, and summary of HKMA's regulatory on-site examinations
– reviewed the internal capital adequacy assessment process, individual liquidity adequacy assessment, and other significant policies and plans including, but not limited to, the Bank's Recovery Plan, Contingency Funding Plan, Liquidity Management Policy, Connected Lending Policy, Capital Management Policy and Large Credit Exposure Policy
– reviewed the report on the alignment of risk and remuneration, and outcome of incentivising compliance for the pay review of performance year 2016
– reviewed the internal control recommendations and audit issues noted by the Bank's external auditor in the annual audit
– reviewed the revised Internal Audit Charter, the enhanced Global Internal Audit Standards Manual, and internal audit reports insofar as the same give rise to any risk-related issues
– reviewed the adequacies of resources, qualifications and experience of staff of the Risk and Compliance function, and their training programmes and budgets
– reviewed the incidents reported under the Policy for the Reporting of Improprieties during the year
– reviewed the update of cyber security risk and the revised accounting standards and prospective changes to accounting standards, in particular, the update on IFRS9 implementation, and the impact on the Bank insofar as the same give rise to any risk-related issues
– reviewed the Risk Committee's independence and effectiveness in discharging its role and responsibilities, and its terms of reference
– reviewed and adopted the revised approach for the governance and interaction with the risk committees of the Bank's subsidiaries, and exercised oversight over such committees
– endorsed the appointment of a risk committee member of the Bank's subsidiary in Mainland China

The Risk Committee also meets annually with the Bank's Chief Risk Officer and Head of Audit separately without the presence of the Management in accordance with its terms of reference.

Remuneration Committee

The Remuneration Committee normally meets twice a year with the Bank's Head of Human Resources. The Committee considers and provides advice to the Board on the remuneration policy and structure in order to attract, motivate and retain quality personnel. Pursuant to delegation by the Board, the Committee also determines and proposes for the Board's approval the remuneration policy, and the specific remuneration packages of all EDs, senior management and key personnel. In addition, it reviews at least annually and independently of the Management, the adequacy and effectiveness of the Bank's remuneration policy and its implementation, to ensure that the Bank's remuneration policy is consistent with relevant regulatory requirements and promotes effective risk management.

In determining the bank-wide remuneration policy, the Remuneration Committee will take into account the Bank's business objective, people strategy, short-term and long-term performance, business and economic conditions, market practices, conduct, compliance and risk control, in order to ensure that the remuneration aligns with business and individual performance, promotes effective risk management, facilitates retention of quality personnel and is competitive in the market. The Committee may invite any Director, executive, consultant or other relevant party to provide advice in this respect, if necessary. In 2017, the Committee has requested to seek advice from external consultant on matters relating to remuneration.

The Remuneration Committee reports to the Board following each Committee meeting, drawing the Board's attention to significant issues or matters of which the Board should be aware, identifying any matters in respect of which it considers that action or improvement is needed, and making relevant recommendations.

During the year, the Remuneration Committee held four meetings and the major work performed by the Committee was as follows:

- reviewed the fees payable to the Bank's Chairman, and the Directors and Board Committee chairmen/members of the Bank and its subsidiaries, and made its recommendation to the Board
- determined the remuneration packages of EDs, senior management and key personnel of the Bank
- reviewed the proposed variable pay for 2016 and pay review proposal for 2017, and recommended the same to the Board for approval
- reviewed the report on the alignment of risk and remuneration, and outcome of incentivising compliance for the pay review of performance year 2016
- reviewed and updated the remuneration policy and the list of the Bank's material risk takers to further strengthen the governance in response to tightened regulatory requirements
- reviewed the outcome of the independent review by the Internal Audit function of the Bank's remuneration policy and remuneration system, and the adequacy and effectiveness of its implementation
- reviewed the Remuneration Committee's effectiveness in discharging its role and responsibilities, and its terms of reference

Nomination Committee

The Nomination Committee meets at least twice a year. It leads the process for Board appointments and identifies and nominates candidates for appointment to the Board, for the Board's approval. The Committee also considers, among other things, the structure, size and composition of the Board and Non-executive Board Committees, independence of INEDs, re-election of Directors, term of appointment of NEDs, time commitment required from NEDs, and appointment to Board Committees.

The Nomination Committee reports to the Board following each Committee meeting, drawing the Board's attention to significant issues or matters of which the Board should be aware, identifying any matters in respect of which it considers that action or improvement is needed, and making relevant recommendations.

During the year, the Nomination Committee held three meetings and the major work performed by the Committee was as follows:

- reviewed and recommended the proposed appointment of Vice-Chairman and Executive Directors to the Board for approval
- reviewed the structure, size and composition of the Board and Non-executive Board Committees
- reviewed the succession planning for the Board
- reviewed the independence of INEDs
- reviewed the time commitment required from NEDs
- recommended the renewal of terms of appointment of NEDs to the Board for approval
- recommended the re-election of Directors to the Board for endorsement
- reviewed the Nomination Committee's effectiveness in discharging its role and responsibilities, and its terms of reference

Attendance Records

The attendance records of Board and Board Committee meetings held in 2017 are as follows:

	Meetings held in 2017						
	AGM	Board	Executive Committee	Audit Committee	Risk Committee	Remuneration Committee	Nomination Committee
Number of Meetings	1	8	12	5	5	4	3
Directors							
Dr Raymond K F Ch'ien* *(Chairman)*	1/1	8/8	–	–	–	4/4	3/3
Ms Louisa Cheang Note 6 *(Vice-Chairman and Chief Executive)*	–	4/4	6/6	–	–	–	1/1
Ms Rose W M Lee Note 7	1/1	4/4	6/6	–	–	–	2/2
Dr John C C Chan*	1/1	8/8	–	–	–	4/4	3/3
Mr Nixon L S Chan#	1/1	8/8	–	–	–	–	–
Mr Patrick K W Chan Note 8	–	2/4	3/4	–	–	–	–
Dr Henry K S Cheng* Note 9	0/1	1/8	–	–	–	–	–
Ms L Y Chiang*	1/1	8/8	–	–	–	4/4	–
Mr Andrew H C Fung Note 10	1/1	4/4	4/6	–	–	–	–
Dr Fred Zuliu Hu*	1/1	6/8	–	–	4/5	–	–
Ms Margaret W H Kwan Note 11	–	4/4	11/12	–	–	–	–
Ms Irene Y L Lee*	1/1	8/8	–	5/5	5/5	–	–
Ms Sarah C Legg#	1/1	8/8	–	–	–	–	–
Dr Eric K C Li*	1/1	8/8	–	5/5	5/5	–	–
Dr Vincent H S Lo#	0/1	6/8	–	–	–	–	–
Mr Kenneth S Y Ng#	1/1	8/8	–	–	–	–	–
Mr Richard Y S Tang*	1/1	8/8	–	5/5	–	–	–
Mr Peter T S Wong#	1/1	5/8	–	–	–	–	1/3
Mr Michael W K Wu*	1/1	7/8	–	4/5	–	–	3/3
Senior Management							
Mrs Eunice Chan	–	–	11/12	–	–	–	–
Ms Ivy S P Chan	–	–	11/12	–	–	–	–
Mr Walter S W Cheung	–	–	10/12	–	–	–	–
Ms Liz T L Chow Note 12	–	–	5/5	–	–	–	–
Mr Donald Y S Lam	–	–	11/12	–	–	–	–
Mr Gordon W C Lam	–	–	11/12	–	–	–	–
Mr S K Lee	–	–	12/12	–	–	–	–
Mr Andrew W L Leung	–	–	12/12	–	–	–	–
Mr Godwin C C Li	–	–	11/12	–	–	–	–
Mr Thomas C M Tsui Note 12	–	–	5/5	–	–	–	–
Ms Elaine Y N Wang	–	–	12/12	–	–	–	–
Ms Katie K C Yip	–	–	8/12	–	–	–	–
Average Attendance Rate	88%	88%	93%	95%	93%	100%	87%

* INEDs

\# NEDs

Note 6 Ms Louisa Cheang was appointed as Vice-Chairman and Chief Executive, Executive Committee Chairman and Nomination Committee member with effect from 1 July 2017.

Note 7 Ms Rose W M Lee retired as Vice-Chairman and Chief Executive, Executive Committee Chairman and Nomination Committee member with effect from 1 July 2017.

Note 8 Mr Patrick K W Chan resigned as ED and Head of Greater China, and ceased to be Executive Committee member with effect from 1 May 2017.

Note 9 Dr Henry K S Cheng was unable to attend meetings due to health reasons.

Note 10 Mr Andrew H C Fung retired as ED and Head of Global Banking and Markets, and ceased to be Executive Committee member with effect from 4 July 2017.

Note 11 Ms Margaret W H Kwan was appointed as ED with effect from 13 May 2017.

Note 12 Ms Liz T L Chow and Mr Thomas C M Tsui were appointed as Executive Committee members with effect from 26 July 2017.

Remuneration of Directors, Senior Management and Key Personnel

The Bank's policy on remuneration is to maintain fair and competitive packages based on business needs and industry practice.

Remuneration of Directors

The level of fees paid to NEDs is determined by reference to factors including Directors' responsibilities and commitment, and fees paid by comparable institutions.

As regards EDs, the following factors are considered when determining their remuneration packages:

- business objectives
- general business and economic conditions
- changes in appropriate markets such as supply/demand fluctuations and changes in competitive conditions
- individual contributions to results as confirmed in the performance appraisal process
- retention consideration and individual potential

No individual Director will be involved in decisions relating to his/her own remuneration.

The current scale of Director's fees, and fees for chairmen and members of the Non-executive Board Committees, namely, Audit Committee, Risk Committee, Remuneration Committee and Nomination Committee, are set out below:

	(HK$)		(HK$)
Board of Directors Note 13		**Remuneration Committee/Nomination Committee**	
Chairman	650,000	Chairman	90,000
Non-executive Directors	500,000	Members	60,000
Audit Committee/Risk Committee			
Chairman	260,000		
Members	160,000		

Note 13 In line with the remuneration policy of HSBC Group, no Director's fee is payable to those Directors who are full time employees of the Bank and its subsidiaries.

Information relating to the remuneration of Directors on a named basis for the year ended 31 December 2017 is set out in Note 16 to the Bank's 2017 Financial Statements.

Remuneration of Senior Management and Key Personnel

According to HKMA's SPM CG-5 "Guideline on a Sound Remuneration System", authorised institutions are required to make disclosures in relation to their remuneration systems as appropriate. The Bank has fully complied with HKMA's disclosure requirements set out in Part 3 of the said Guideline.

There are 17 employees being classified as Senior Management [Note 14] and three employees identified as Key Personnel [Note 15] during the year. The aggregate amount of remuneration [Note 16] of the Senior Management and Key Personnel during the year, split into fixed and variable remuneration, is set out below:

	2017 [Note 17] (20 employees)		2016 [Note 17] (19 employees)	
Amount (HK$ '000)	Non-deferred	Deferred	Non-deferred	Deferred
Fixed remuneration				
Cash	68,947	–	53,152	–
Shares	–	–	–	–
Variable remuneration				
Cash	16,905	7,422	19,319	6,429
Shares	7,973	9,993	7,063	9,928

Note 14 Senior Management refers to those executives who are (a) EDs of the Bank; (b) Alternate Chief Executives of the Bank; (c) Members of the Executive Committee of the Bank; and (d) Head(s) of the Bank's principal subsidiary/subsidiaries with offshore operations and with total assets representing more than 5% of the Bank's total assets.

Note 15 Key Personnel refers to employees classified as "Identified Staff and Material Risk Takers" under the UK Prudential Regulation Authority Remuneration Code.

Note 16 Remuneration refers to all remuneration payable to employees during the year with reference to their tenure as Senior Management and Key Personnel. The forms of variable remuneration and the proportion deferred are based on the seniority, role and responsibilities of employees and their level of total variable compensation. As the total number of Senior Management and Key Personnel involved is relatively small, to avoid individual figures being deduced from the disclosure, aggregate figures are disclosed in this section.

Note 17 No deferred variable remuneration had been reduced through performance adjustments in 2017 and 2016. No Senior Management or Key Personnel has been awarded or paid guaranteed bonus and new sign-on during the years of 2017 and 2016. In 2017, a total payment of HK$11,433,000 (Highest payment: HK$8,368,000) in respect of the termination of services had been paid to two Senior Management, who were Directors, of the Bank. No Senior Management or Key Personnel has been awarded or paid for the termination of services in 2016.

The aggregate amount of deferred variable remuneration, split into (a) vested and paid during the year and (b) outstanding and unvested at the end of the year, is set out below:

	2017		2016	
Amount (HK$ '000)	Awarded for Performance Year 2017	Awarded for Prior Performance Years	Awarded for Performance Year 2016	Awarded for Prior Performance Years
Vested and paid out during the year [Note 19]				
Cash	–	7,577	–	2,864
Shares	–	24,465	–	7,043
Outstanding and unvested at the end of the year [Notes 18 & 20]				
Cash	7,422	18,409	6,429	10,464
Shares [Note 21]	9,993	52,648	9,928	29,258

Note 18 Outstanding, unvested, deferred remuneration is exposed to ex post explicit adjustments via malus.

Note 19 Paid and vested variable pay made to Material Risk Takers is subject to clawback.

Note 20 There is no reduction of deferred remuneration and retained remuneration exposed due to ex post explicit adjustments during 2017 and 2016 via the application of malus and/or clawback.

Note 21 Outstanding, unvested, deferred shares are exposed to ex post implicit adjustments. The total value of these shares in 2017 and 2016 was calculated based on the closing market share price of HSBC Holding plc (London) as at 31 December of the respective financial years. HSBC's share price was 16.7% higher as at 31 December 2017 when compared to that of 31 December 2016.

Other relevant remuneration disclosures are set out in Notes 15, 16 and 54(b) to the Bank's 2017 Financial Statements.

Accountability and Audit

Financial Reporting

The Board aims at making a balanced, clear and comprehensive assessment of the Bank's performance, position and prospects. An annual operating plan is reviewed and approved by the Board on an annual basis. Reports on financial results, business performance and variances against the approved annual operating plan are made available to the Board for review and monitoring on a monthly basis.

Strategic planning cycles are generally from three to five years. The Bank's strategic plan for 2018 – 2020 was approved by the Board in November 2017. Progress of the implementation of the key initiatives in the strategic plan is reported to and reviewed by the Board and Executive Committee on a quarterly basis.

The annual and interim results of the Bank are announced in a timely manner within three months and two months respectively after the end of the relevant year or period.

Pursuant to the revised Pillar 3 disclosure requirements published by Basel Committee on Banking Supervision in January 2015, HKMA's consultation paper on "Implementation of Revised Pillar 3 Disclosure Requirements" in December 2015, and the Banking (Disclosure) (Amendment) Rules in October 2016, the Bank revised its Disclosure Policy in May 2017 to enhance the disclosure frequency from bi-annually to quarterly, and to put in place a robust governance on collation of information and attestation of disclosure.

The Directors acknowledge their responsibilities for preparing the accounts of the Bank. As at 31 December 2017, the Directors were not aware of any material uncertainties relating to events or conditions which may cast significant doubt upon the Bank's ability to continue as a going concern. Accordingly, the Bank's Directors have prepared the financial statements of the Bank on a going-concern basis.

The responsibilities of the external auditor with respect to financial reporting are set out in the "Independent Auditor's Report" attached to the Bank's 2017 Financial Statements.

Internal Controls

System and Procedures

The Board is responsible for internal control of the Bank and its subsidiaries and for reviewing its effectiveness.

The Bank's internal control system comprises a well-established organisational structure and comprehensive policies and standards. Areas of responsibilities for each business and functional unit are clearly defined to ensure effective checks and balances.

Procedures have been designed for safeguarding assets against unauthorised use or disposition; for maintaining proper accounting records; and for ensuring the reliability of financial information used within the business or for publication. The procedures provide reasonable but not absolute assurance against material errors, losses or fraud. Procedures have also been designed to ensure compliance with applicable laws, rules and regulations.

Systems and procedures are in place in the Bank to identify, control and report on the major types of risks the Bank encounters. Business and functional units are responsible for the assessment of individual types of risk arising under their areas of responsibilities, the management of the risks in accordance with risk management procedures and the reporting on risk management. The Bank maintains an effective risk management framework through the setting up of specialised management committees for the oversight and monitoring of major risk areas and the establishment of risk management departments under the relevant control functions of the Bank. Relevant risk management reports are submitted to Asset and Liability Management Committee, Risk Management Meeting, Executive Committee and Risk Committee, and ultimately to the Board for oversight and monitoring of the respective types of risk. The Bank's risk management policies and major control limits are approved by the Board or its delegated committees, and are monitored and reviewed regularly according to established policies and procedures.

More detailed discussion on the policies and procedures for management of each of the major types of risk the Bank encounters is set out in the sections "Risk Management" and "Capital Management" of the "Management Discussion and Analysis" in this Annual Report.

Annual Assessment

A review of the effectiveness of the Bank's internal control system covering all material controls, including financial, operational, compliance, and risk management controls, is conducted annually. The review at the end of 2017 was conducted with reference to the COSO (The Committee of Sponsoring Organisations of the Treadway Commission) internal control framework, which assesses the Bank's internal control system against the five elements of control environment, risk assessment, control activities, information and communication, and monitoring. The review results have been reported to the Audit Committee, Risk Committee and the Board. The Board is satisfied that such system is effective and adequate. In addition, the Bank, through the Audit Committee, has also reviewed the adequacy of resources, qualifications and experience of staff of the Accounting and Financial Reporting functions, and their training programmes and budget.

Framework for Disclosure of Inside Information

The Bank has put in place a robust framework for the disclosure of inside information in compliance with the Securities and Futures Ordinance. The framework sets out the procedures and internal controls for the handling and dissemination of inside information in a timely manner so as to allow all the stakeholders to apprehend the latest position of the Bank and its subsidiaries. The framework and its effectiveness are subject to review on a regular basis according to established procedures.

Internal Audit

The primary role of the Internal Audit function is to help the Board and the Management to protect the assets, reputation and sustainability of the Bank. The Internal Audit function provides independent and objective assurance as to whether the design and operational effectiveness of the Bank's framework of risk management, control and governance processes, as designed and represented by the Management, is adequate.

The Bank has adopted a risk management and internal control structure, referred to as the "Three Lines of Defence", to ensure it achieves its commercial aims while meeting regulatory and legal requirements, and its responsibilities to shareholders, customers and staff. The Internal Audit function's role as the third line of defence is independent of the first and second lines of defence. The Bank's Head of Audit reports to the Chairman and the Audit Committee.

An Internal Audit Charter is reviewed and approved by the Audit Committee periodically which has detailed the purpose, authority, independence and objectivity, accountabilities and scope of work, and standards of audit practices to govern the work of the Internal Audit function. Further, the Internal Audit function also maintains a quality assurance and improvement programme that covers all aspects of internal audit activity, including conformance with The Institute of Internal Auditors' (IIA) Standards, applicable regulatory guidance and internal audit policies and procedures.

Results of audit work together with an assessment of the overall risk management and control framework are reported to the Audit Committee and the Risk Committee as appropriate. The Internal Audit function also reviews the Management's action plans in relation to audit findings and verifies the adequacy and effectiveness of the mitigating controls before formally closing the issue.

External Auditor

PricewaterhouseCoopers is the Bank's external auditor. The Audit Committee is responsible for making recommendations to the Board on the appointment, re-appointment, removal and remuneration of the external auditor. The external auditor's independence and objectivity, and the effectiveness of the audit process are also reviewed and monitored by the Audit Committee on a regular basis.

During 2017, fees paid to the Bank's external auditor for audit services amounted to HK$20.6 million, compared with HK$13.4 million in 2016. For non-audit services, the fees paid to the Bank's external auditor amounted to HK$8.9 million, compared with HK$9.1 million in 2016. In 2017, the non-audit service assignments covered by these fees included the following:

Nature of service	Fees paid (HK$ million)
Other assurance services	7.9
Tax services	1.0
	8.9

Audit Committee

The Audit Committee assists the Board in meeting its responsibilities for ensuring effective systems of internal control and compliance relating to financial reporting, and in meeting its financial reporting obligations.

Risk Committee

The Risk Committee assists the Board in meeting its responsibilities for ensuring effective systems of risk management, internal control and compliance (other than that relating to financial reporting), and in meeting its risk governance obligations.

Communication with Shareholders

Effective Communication

The Bank attaches great importance to communication with shareholders. To this end, a number of means are used to promote greater understanding and dialogue with the investment community. The Bank holds group meetings with analysts in connection with the Bank's annual and interim results. The results announcements are also broadcast live via webcast. Apart from the above, designated senior executives maintain regular dialogue with institutional investors and analysts to keep them abreast of the Bank's development, subject to compliance with the applicable laws and regulations. Including the two results announcements, around a hundred meetings with analysts and fund managers were held in 2017. In addition, the Bank's Vice-Chairman and Chief Executive, and Chief Financial Officer also made presentations and held group meetings with investors at investor forums.

Further, the Bank's website (www.hangseng.com) offers timely access to the Bank's financial information, announcements, circulars to shareholders and information on the Bank's corporate governance structure and practices. For efficient communication with shareholders and in the interest of environmental preservation, shareholders are encouraged to browse the Bank's corporate communications on the Bank's website, in the place of receiving printed copies of the same.

The AGM provides a useful forum for shareholders to exchange views with the Board. The Bank's Chairman, EDs, Chairmen of the Board Committees and NEDs are available at the AGM to answer questions from shareholders about the business and performance of the Bank. In addition, the Bank's external auditor is also invited to attend the AGM to answer questions about the conduct of the audit, and the preparation and contents of the auditor's report. Separate resolutions are proposed at general meetings for each substantial issue, including the re-election and election (as the case may be) of individual Directors. An explanation of the detailed procedures of conducting a poll will be provided to shareholders at the AGM, to ensure that shareholders are familiar with such procedures.

The Bank's last AGM was held on Friday, 12 May 2017 at Hang Seng Bank Headquarters, 83 Des Voeux Road Central, Hong Kong. All the resolutions proposed at that meeting were approved by the shareholders by poll voting. Details of the poll results are available under the section "Investor Relations" of the Bank's website (www.hangseng.com).

The next AGM will be held on Thursday, 10 May 2018, the notice of which will be sent to shareholders at least 20 clear business days before the said meeting. Shareholders may refer to the section "Corporate Information and Calendar" in this Annual Report for information on other important dates for shareholders in year 2018.

Calling an Extraordinary General Meeting

Shareholder(s) holding not less than five percent of the total voting rights of all the members having a right to vote may request to call an Extraordinary General Meeting of the Bank.

The requisition (a) must state the general nature of the business to be dealt with at the meeting, (b) must be signed by the requisitionist(s), and (c) may either be deposited at the Bank's registered office at 83 Des Voeux Road Central, Hong Kong in hard copy form or sent by email to egmrequisition@hangseng.com. If the resolution is to be proposed as a special resolution, the requisition should include the text of the resolution and specify the intention to propose the resolution as a special resolution. The requisition may consist of several documents in like form, each signed by one or more requisitionist(s).

The requisition must also state (a) the name(s) of the requisitionist(s), (b) the contact details of the requisitionist(s), and (c) the number of ordinary shares of the Bank held by the requisitionist(s).

The Directors must proceed to convene an Extraordinary General Meeting within 21 days from the date of receipt of the requisition. Such meeting should be held on a date not more than 28 days after the date on which the notice convening the meeting is given.

If the Directors fail to convene the Extraordinary General Meeting as aforesaid, the requisitionist(s), or any of them representing more than one-half of the total voting rights of all of them, may themselves convene the meeting. Any meeting so convened shall not be held after the expiration of three months from the date of the deposit of the requisition.

A meeting so convened by the requisitionist(s) shall be convened in the same manner, as nearly as possible, as that in which meetings are to be convened by the Directors.

Any reasonable expenses incurred by the requisitionist(s) by reason of the failure of the Directors to convene a meeting shall be reimbursed to the requisitionist(s) by the Bank.

Putting Forward Proposals at General Meetings

Shareholders representing at least 2.5 percent of the total voting rights of all the members having a right to vote, or, at least 50 shareholders who have a relevant right to vote, may:

- put forward proposal at general meeting
- circulate to other shareholders written statement with respect to matter to be dealt with or other business to be dealt with at general meeting

For further details on shareholder qualifications, and the procedures and timeline, in connection with the above, shareholders are kindly requested to refer to Sections 580 and 615 of the Companies Ordinance (Cap 622, Laws of Hong Kong).

Further, a shareholder may propose a person other than a retiring Director of the Bank for election as a Director of the Bank at a general meeting. For such purpose, the shareholder must send to the Bank's registered address (for the attention of the Bank's Company Secretary) a written notice which identifies the candidate and includes a notice in writing by that candidate of his/her willingness to be so elected. Such notice must be sent within the seven-day period commencing on the day after the despatch of the notice of the meeting, or such other period as may be determined by the Directors from time to time, and ending no later than seven days prior to the date appointed for such meeting. Procedures for shareholders to propose candidates for election as Director of the Bank are also available on the website of the Bank (www.hangseng.com).

Putting Enquiries to the Board

Shareholders may send their enquiries requiring the Board's attention to the Bank's Company Secretary at the Bank's registered address. Questions about the procedures for convening or putting forward proposals at an AGM or Extraordinary General Meeting may also be put to the Company Secretary by the same means.

Shareholders Communication Policy

The Bank has established a Shareholders Communication Policy to set out the Bank's processes to provide shareholders and the investment community with ready, equal and timely information on the Bank for them to make informed assessments of the Bank's strategy, operations and financial performance, and to engage actively with the Bank. The said policy is available on the Bank's website (www.hangseng.com).

Material Related Party Transactions

Material Related Party Transactions and Contracts of Significance

The Bank's material related party transactions are set out in Note 54 to the 2017 Financial Statements. These transactions include those that the Bank has entered into with its immediate holding company and fellow subsidiary companies in the ordinary course of its interbank activities, including the acceptance and placement of interbank deposits, corresponding banking transactions, off-balance sheet transactions, and the provision of other banking and financial services.

The Bank uses the information technology services of, and shares an automated teller machine network with, The Hongkong and Shanghai Banking Corporation Limited, its immediate holding company. The Bank also shares information technology and certain processing services with fellow subsidiaries on a cost recovery basis. In 2017, the Bank's share of the costs included HK$434 million for system development, HK$438 million for data processing, and HK$263 million for administrative services.

The Bank maintains a staff retirement benefit scheme for which a fellow subsidiary company acts as insurer and administrator. As part of its ordinary course of business with other financial institutions, the Bank also markets Mandatory Provident Fund and life insurance products and distributes retail investment funds for fellow subsidiaries, with a fee income of HK$159 million and HK$77 million respectively in 2017. Hang Seng Investment Management Limited, a wholly owned subsidiary of the Bank, manages, in the ordinary course of its business, a fund administered by a fellow subsidiary, to which management fee rebates were made. The rebate for 2017 amounted to HK$126 million.

These transactions were entered into by the Bank in the ordinary and usual course of business on normal commercial terms, and in relation to those which constituted connected transactions under the Listing Rules, they also complied with applicable requirements under the Listing Rules. The Bank regards its usage of the information technology services of The Hongkong and Shanghai Banking Corporation Limited (amount of information technology services cost incurred for 2017: HK$251 million) as contracts of significance for 2017.

Continuing Connected Transactions

(a) On 21 June 2016, Hang Seng Insurance Company Limited ("HSIC"), a wholly-owned subsidiary of the Bank, entered into the following agreements:

(i) A management services agreement ("Management Services Agreement") with HSBC Life (International) Limited ("INHK") for a term of three years, pursuant to which INHK, directly or through one or more of its affiliates, provides certain management services to HSIC.

INHK charged HSIC for the provision of the services on a fully absorbed cost basis plus a mark-up of 10% for actuarial and risk analytics services and a mark-up of 6% for all other services. These charges were determined following negotiation on an arm's length basis and in accordance with the policy of the HSBC Group, which took into account the transfer pricing guidelines of the Organisation for Economic Co-operation and Development.

(ii) An investment management agreement ("Investment Management Agreement") with HSBC Global Asset Management (Hong Kong) Limited ("AMHK") for a term of three years, pursuant to which AMHK acts as investment manager in respect of certain of HSIC's assets held from time to time. AMHK has delegated to HSBC Alternative Investments Limited ("HAIL") the management of part of such assets by way of a bespoke portfolio.

HSIC paid to AMHK, on a quarterly basis, a fee of between 0.05% and 0.35% per annum of the mean value of the assets under management. HSIC also paid to HAIL a fee of 0.5% per annum of the aggregate value of assets under management in a bespoke portfolio together with a performance fee of 10% per annum in respect of the amount by which the return of such portfolio exceeded a benchmark return of 8% per annum. The above fees were determined on an arm's length basis. Subject to the caps under the Investment Management Agreement not being exceeded, HSIC and AMHK may subsequently agree to vary the above fees.

(iii) A private equity investment management agreement ("PE Investment Management Agreement") with HAIL for a term of 11 years, pursuant to which HAIL acts as investment manager in respect of certain private equity fund investments made by HAIL on behalf of HSIC.

HSIC paid HAIL a fee of between 0.1% and 0.75% per annum of the aggregate value of assets under management as an annual retainer fee and an annual management fee on an aggregate basis. On top of the aforesaid, a performance fee of 15% carried interest will be paid if certain hurdle rates of return are achieved for HSIC in respect of the investments made in each year of the investment period under the PE Investment Management Agreement. The above fees have been determined on an arm's length basis.

Pursuant to the Listing Rules, the term of an agreement for a continuing connected transaction of a listed company must not exceed three years except in special circumstances. As the term of the PE Investment Management Agreement is 11 years, the Bank, in compliance with the Listing Rules requirement, appointed an independent financial adviser to explain why the PE Investment Management Agreement requires a term that is longer than three years and to confirm that it is normal business practice for investment management agreements relating to private equity investments to be of such duration. The explanation and confirmation by the independent financial adviser were set out in the Bank's announcement of 21 June 2016.

The Bank considered that due to the similarity of the services provided under the Investment Management Agreement, the PE Investment Management Agreement, and the fund monitoring agreement entered into between HSIC and HAIL on 12 December 2013 ("Previous Fund Monitoring Agreement"), the fees payable by HSIC under these three agreements should be aggregated for the purpose of the Listing Rules. The Previous Fund Monitoring Agreement, on a standalone basis, was a "de minimis" continuing connected transaction which was fully exempt from any reporting, announcement, shareholders' approval and annual review requirements under the Listing Rules.

Details of the terms of the Management Services Agreement, the Investment Management Agreement, the PE Investment Management Agreement and the Previous Fund Monitoring Agreement, and the relevant annual caps and fee caps were announced by the Bank on 21 June 2016.

(b) Upon expiry of the Previous Fund Monitoring Agreement, a new fund monitoring agreement ("Current Fund Monitoring Agreement") was entered into between HSIC and HAIL on 12 December 2016 for a term of three years, pursuant to which HAIL provides fund monitoring and reporting services for certain private equity investments made by HSIC. HSIC has agreed to pay HAIL a fee of 0.04% per annum on the aggregate USD commitments in such investments, which is the same as the Previous Fund Monitoring Agreement, subject to an annual cap of US$75,000 (approximately HK$585,000). The above fee was determined on an arm's length basis.

The Current Fund Monitoring Agreement, on a standalone basis, is a "de minimis" continuing connected transaction which is fully exempt from any reporting, announcement, shareholders' approval and annual review requirements under the Listing Rules. However, the Bank considers that the fee payable by HSIC under the Current Fund Monitoring Agreement should be aggregated with the Investment Management Agreement and the PE Investment Management Agreement for the purpose of the Listing Rules, and it is therefore subject to the annual review requirements under the Listing Rules together with those agreements.

INHK, AMHK and HAIL are all indirect wholly-owned subsidiaries of HSBC Group, the ultimate controlling shareholder of the Bank, and therefore are connected persons of the Bank. Accordingly, all the aforesaid agreements constituted continuing connected transactions of the Bank. The Bank has complied with the disclosure requirements in accordance with Chapter 14A of the Listing Rules.

For the year ended 31 December 2017, the aggregate amount paid under the Management Services Agreement was HK$77 million, whereas the aggregate amount paid under the Investment Management Agreement was HK$33 million, both of which were within the annual caps for the year ended 31 December 2017 of HK$242 million and HK$91 million, respectively. The retainer fee of approximately US$62,750 (equivalent to HK$490,432), the management fee of approximately US$558,372 (equivalent to HK$4,364,043) and no performance fee were payable under the PE Investment Management Agreement for the year ended 31 December 2017. Such fees were within the annual cap on retainer fee of US$300,000 (approximately HK$2,325,000), and the annual cap on management fee of US$2,000,000 (approximately HK$15,500,000) respectively. Further, for the year ended 31 December 2017, the aggregate amount paid under the Current Fund Monitoring Agreement was approximately US$48,606 (equivalent to HK$379,887), which was within the annual cap of US$75,000 (approximately HK$585,000).

In respect of all the aforesaid agreements which constituted the Bank's continuing connected transactions, all the INEDs of the Bank have reviewed the said transactions and confirmed that the said transactions have been entered into:

(a) in the ordinary and usual course of business of the Bank and its subsidiaries;

(b) on normal commercial terms or better; and

(c) in accordance with the relevant agreements governing the same on terms that are fair and reasonable and in the interests of the shareholders of the Bank as a whole.

Further, the Bank engaged its external auditor to report on the continuing connected transactions of the Bank and its subsidiaries in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised) "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by the Hong Kong Institute of Certified Public Accountants. The Directors confirmed that the external auditor had issued an unqualified letter containing their findings and conclusions in respect of the continuing connected transactions set out in the preceding paragraphs in accordance with Rule 14A.56 of the Listing Rules. A copy of the auditor's letter has been provided by the Bank to The Stock Exchange of Hong Kong Limited.

Culture

Business Principles and Values

The Bank has a set of clear business principles and corporate values guiding staff to keep the highest standards of integrity as well as to comply with the spirit and letter of all laws and regulations when conducting business. "Courageous Integrity" is the guiding principle for staff to speak up and to do the right thing with no compromises to the ethical standards and integrity, and behave in a "Dependable, Open and Connected" way in everyday work. The Bank promotes staff awareness of and commitment to the corporate values, and empowers leaders and managers to drive values-aligned behaviour in the workplace.

Three values-aligned behaviours (Accountability, Good Judgment and Speaking Up) are identified to support effective financial crime risk management culture and good conduct outcomes. Ongoing management effort is made to embed the corporate values and good conduct through (a) purpose and strategy; (b) reward and recognitions; (c) communications; (d) process, policies, and governance; and (e) people.

Staff Code of Conduct

To ensure the Bank operates according to the highest standards of ethical conduct and professional competence, all staff are required to strictly follow the Staff Code of Conduct documented in the Bank's Staff Handbook. With reference to applicable regulatory guidelines and other industry best practices, the Code sets out ethical standards and values to which all the Bank's staff are required to adhere and covers various legal, regulatory and ethical issues. Topics including, but not limited to, the prevention of bribery, use of information, insider dealing and personal dealings, personal benefits, outside directorships/employment, and equal opportunities policy, are covered in the Code.

The Bank uses various communication channels to periodically remind staff of the requirement to adhere to the rules and ethical standards set out in the Staff Code of Conduct.

Avoidance of Conflicts of Interest

The Bank has set standards and established policies and procedures to manage actual or potential conflicts of interest of its staff. Robust organisational structure has been designed to ensure adequate segregation of duties and avoid conflicts of interest. Staff working in sensitive or high-risk areas are required to adhere to job-specific rules and undergo training on the avoidance of conflicts of interest in carrying out their duties.

Human Resources

The human resources policies of the Bank are designed to attract people of the highest calibre and to motivate them to excel in their careers, as well as uphold the Bank's brand equity, corporate values and culture of service excellence.

Employee Statistics

As at 31 December 2017, the Bank's total headcount was 9,929 representing an increase of 256, or +2.6%, compared with a year earlier. The total headcount comprised 2,556 executives, 4,406 officers and 2,967 clerical and non-clerical staff.

Employee Remuneration

The quality and engagement of employees are fundamental to the Bank's success and the Bank aims to attract, motivate and retain the best people. The Bank's reward strategy supports this objective through rewarding those who are committed to maintaining a long-term career with the Bank with good sustainable performance.

The Remuneration Committee oversees the Bank's overall remuneration strategy and ensures all the reward policies are carefully considered in the context of business objective, people strategy, commercial competitiveness, alignment of risk and reward and regulatory guidance. The fundamental principles, philosophies and processes are documented in the Bank's remuneration policy.

The Bank adopts a Total Compensation Approach. In determining the total remuneration for employees, fixed and discretionary variable pay are looked at together and differentiated by performance and adherence to corporate values. The Bank will make reference to individual's responsibility, capability and risk profile of the job to ensure an appropriate balance between the fixed pay and variable pay.

Fixed pay is determined by taking into account relevant level and composition of pay in the markets in which the Bank operates. Salaries are reviewed in the context of business performance, individual potential and performance, market practice, internal relativities and regulatory requirements.

Bank-wide variable pay budgets are determined in consideration of the Bank's business performance, people strategy, risk appetite statement and risk metrics including conduct risks. This helps to ensure that the variable pay pool is shaped by risk considerations and the Bank's performance is sustainable in the long-term. The ex-ante risk adjustment of remuneration within the Bank is achieved in the way that the Risk Committee of the Bank will advise the Board and/or the Remuneration Committee, as appropriate, on the alignment of risk appetite with performance objectives set in the context of variable incentive and on whether any adjustments for risk need to be applied when considering performance objectives and actual performance. In addition, the overall variable pay funding proposal is refined with reference to the advice of Chief Financial Officer and Chief Risk Officer in respect of the Bank's financial position and performance against its risk appetite profile.

Variable pay plans takes into account a combination of corporate and/or business results as well as the individual's performance. They reward financial quantitative measures and non-financial qualitative measures including compliance to Group values, management of risks, service standards, ethical behaviour and responsible selling. To embed a values-led, high performance culture, the variable pay plans are designed to recognise and reward positive behaviours while discourage negative behaviours that put the Bank under unnecessary financial, regulatory or reputational risk via the application of consequence management, malus and clawback policies.

Variable pay consists of deferred and non-deferred components in the forms of cash and share award. The Bank adopts a progressive deferral mechanism with higher deferral rates and different forms of deferral by reference to (a) the employee's seniority, role, responsibilities and the potential risks that their activities may create for the Bank; and (b) the total amount of variable remuneration exceeding the prescribed thresholds. The deferred award has a vesting period of three to seven years and is subject to malus and clawback.

The principles of the remuneration policy are applicable to the Bank and its subsidiaries, subject to the local legislative requirements and market practices, and are proportionate to the scope and complexity of the local business.

Employee Engagement

The Bank aims to create a work environment that promotes employee engagement, champions diversity and an inclusive culture, and empowers our employees to perform at their best by providing training, performance coaching and career development opportunities.

To foster an open and dynamic culture, employees are encouraged to engage in two-way communications with senior management and colleagues at all levels.

Information on the Bank's direction and strategies, policy updates and employment matters is conveyed to employees through business briefings, town hall meetings, the Bank's intranet, morning broadcasts, circulars and e-mails. The Bank encourages employees to provide suggestions, comments and feedback through employee surveys, exchange sessions, thematic focus groups and other channels. The Bank also gauges the sentiments and behaviours of its staff to inform training, communication and staff engagement plans with the aim of facilitating staff integration into the corporate culture.

An annual Bank-wide employee survey was conducted in May 2017 and subsequent surveys have been carried out on a regular basis to gather employee insights in a timely manner. The results of the 2017 annual survey indicate that employee confidence regarding the Bank's strategy and the level of trust between employees and senior leadership are both high. Employees are positive about the Bank's 'speak-up' culture, and perceptions of the Bank as being a great place to work have risen compared with 2016, with a high percentage of employees saying that they are proud to work at Hang Seng.

Growth and Development

The Bank is committed to ensuring the competence and ethical behaviour of staff members with due regard to the principles set out in HKMA's SPM CG-6 on "Competence and Ethical Behaviour". The Bank has established policies and procedures for monitoring, developing and maintaining the competence level and ethical behaviour of staff members. These include clear guidance as set out in various policy manuals, robust performance management system, training and development solutions provided on a regular and need basis.

In order to fully develop staff competence and potential and to help them quickly integrate into the Bank, new joiners are provided with a comprehensive induction programme that enhances their understanding of the Bank's history, vision, culture, values, risk management and corporate governance. To equip staff members with necessary skills and knowledge to meet future challenges and professional requirements, especially those who are involved in regulated businesses and activities, the Bank offers a wide range of training and development programmes in the areas of sales and relationship management, products, operations, compliance, credit and risk. Apart from these programmes, the Bank has launched a series of anti-money laundering, conduct, anti-bribery and corruption training programmes to strengthen the financial crime risk management culture. The Bank also offers Professional Qualifications and Education Award Scheme to support staff members to pursue professional or academic qualifications. On average, the Bank's staff members received five days of training in 2017.

The Bank focuses on the development of leadership pipeline and supports the personal growth of staff by providing a broad range of leadership and management development solutions. To ensure sustainability, the Bank has strategies, measures and analytics to plan and manage succession to key roles, and to prepare high-potential talents for their succession to key roles. Businesses/functions supported by the Human Resources take actions to accelerate the development of successors and high potential talents through feedback and coaching, planned job moves for development including cross fertilisation between businesses/functions, and implementing individual development plans.

Recruitment and Retention

Robust recruitment activities continued throughout 2017 to support the Bank's execution of the business strategy and to replace out-going staff, including front line sales positions, experienced professionals and specialists.

Young talents are developed through well-structured onboarding and development programmes. Trainee programmes in selected business areas are in place to develop professional competence and to build future talents for key roles. Staff engagement and retention focus on people managers' roles in everyday performance and development conversations with their staff, offer of career advancement opportunities and market competitive remuneration.

In addition, the Bank also participated in the first FinTech Internship programme co-launched by HKMA and the Applied Science and Technology Research Institute. The Bank sponsored 16 interns for six to twelve-month placements to support talent pipeline building for FinTech development in Hong Kong.

Other Information

Organisational Structure

Under the Bank's current organisational structure, the Bank's businesses and functions are set out as follows:

Businesses	Functions	
Retail Banking and Wealth Management	Audit	Human Resources
Commercial Banking	Communications	Legal
Global Banking	Company Secretarial Services	Marketing
Global Markets	Corporate Sustainability	Risk and Compliance
	Financial Control	Operations, Services and Technology
	Financial Crime Compliance	Strategic Planning and Corporate Development

Health and Safety

The Bank has a demonstrated commitment to occupational health and safety ("OH&S") in the workplace with employee engagement through committees, forums and working groups in the development of an OH&S Policy and Management System. By successfully implementing the certified BS OHSAS 18001:2007-compliant Safety Management System, the Bank marks its achievement to be the first bank world-wide to conform to this internationally acclaimed best practice aiming at reducing the exposure of the Bank's staff, contractors and customers to OH&S risks associated with its business activities at premises over which it has control.

The Bank provides a range of training and activities to enhance the knowledge of its staff in OH&S, fire safety, manual operation, and office safety. A number of staff have acquired Qualified First Aider status so as to offer prompt assistance to their colleagues and customers in the event of a medical emergency or accident whilst awaiting the arrival of the ambulance. Some Qualified First Aiders have also been trained to operate the Automated External Defibrillators installed in the Bank premises.

The Bank implements a Contingency Plan for Communicable Disease, which sets out the key issues to be addressed and the actions to be taken by various units in response to the occurrence of a serious communicable disease, and the keeping of adequate stock of face masks to cater for the needs of its staff in response to an outbreak of influenza pandemic. Staff have been made aware through the Bank-wide intranet of the importance of personal hygiene and health, and the contingency measures to be adopted, to enable the Bank to continue with its services to the community during an outbreak of a serious communicable disease.

The Bank also places strong importance on all aspects of health and safety in maintaining workplace safety and comfort for its staff. The Bank also organised a series of promotional activities in 2017, including workshops and seminars to provide information and support to its working parents with an aim to helping them to achieve a balance between work and family and also to better understand their preferences when raising their children. Mental health is a state of well-being and being able to achieve and maintain a mentally healthy workplace is very important for staff and customers. In October 2017, the Bank also promoted a "Mental Health Month" through activities, such as workshops and massage therapy sessions to raise awareness and encourage positive mental health with an aim to reducing the risks of mental illnesses and related disorders. The activities and programs were well received by staff.

Biographical Details of Directors and Senior Management

Board of Directors

Dr Raymond CH'IEN Kuo Fung GBS, CBE, JP INDEPENDENT NON-EXECUTIVE CHAIRMAN AGED 66

JOINED THE BOARD SINCE AUGUST 2007

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
– Chairman of Nomination Committee; Member of Remuneration Committee

Other major appointments

Justice of the Peace

^ China Resources Power Holdings Company Limited
– Independent Non-executive Director

Economic Development Commission of HKSAR Government
– Non-official Member

Federation of Hong Kong Industries – Honorary President

Hong Kong CPPCC (Provincial) Members Association Limited
– Deputy Director of One Belt One Road and Guangdong-Hong Kong-Macau Greater Bay Area Construction Advisory Committee

Swiss Re Asia Pte. Ltd.
– Independent Non-executive Director *(Note 1)*

^ Swiss Re Limited – Independent Non-executive Director

The Hongkong and Shanghai Banking Corporation Limited
– Independent Non-executive Director

Past major appointments

The Tianjin Municipal Committee of the Chinese People's Political Consultative Conference
– Member of Standing Committee (2008-2018) *(Note 1)*

University of Pennsylvania, USA – Trustee (2006-2016)

^ MTR Corporation Limited
– Non-executive Chairman (2003-2015)

^ The Wharf (Holdings) Limited
– Independent Non-executive Director (2002-2015)

^ UGL Limited – Non-executive Director (2012-2014)

^ Convenience Retail Asia Limited
– Independent Non-executive Director (2001-2014)

Hong Kong Mercantile Exchange Limited
– Independent Non-executive Director (2009-2013)

^ China.com Inc – Chairman (1999-2013)

Ascendas China Commercial Fund Management Limited
– Chairman (2011-2012)

^ CDC Software Corporation – Director (2009-2012)

The Hong Kong/European Union Business Cooperation Committee
– Chairman (2005-2012)

^ CDC Corporation – Chairman (1999-2011)

HSBC Private Equity (Asia) Limited – Chairman (1997-2010)

The APEC Business Advisory Council
– Hong Kong Member (2004-2009)

^ Inchcape plc
– Independent Non-executive Director (1997-2009)

^ HSBC Holdings plc
– Independent Non-executive Director (1998-2007)

Independent Commission Against Corruption
– Chairman of Advisory Committee on Corruption (1998-2006)

Executive Council of HKSAR Government – Member (1997-2002)

Executive Council of Hong Kong, then under British Administration
– Member (1992-1997)

Qualification

Doctoral Degree in Economics – University of Pennsylvania, USA

Major awards

Chevalier de l'Ordre du Merite Agricole of France (2008)

Gold Bauhinia Star (1999)

Commander in the Most Excellent Order of the British Empire (1994)

Ms Louisa CHEANG Wai Wan VICE-CHAIRMAN AND CHIEF EXECUTIVE AGED 54

JOINED THE BOARD SINCE JULY 2017

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
– Chairman of Executive Committee; Member of Nomination Committee

Hang Seng Bank (China) Limited
– Chairman; Chairman of Nomination Committee *(Note 1)*

Hang Seng Indexes Company Limited
– Chairman of Hang Seng Index Advisory Committee

Chairman of other subsidiaries in Hang Seng Group

Other major appointments

China Union Pay – International Advisor

Ho Leung Ho Lee Foundation – Member of Board of Trustees

HSBC Amanah Malaysia Berhad
– Non-Independent Executive Director

^ HSBC Holdings plc – Group General Manager

Qianhai & Shekou Area of Shenzhen, China (Guangdong) Pilot Free Trade Zone, and Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone of Shenzhen
– Member of the Consulting Committee *(Note 1)*

The Community Chest of Hong Kong – Board Member *(Note 1)*

The Hongkong and Shanghai Banking Corporation Limited
– Director *(Note 1)*

The Hong Kong Institute of Bankers – Vice President *(Note 1)*

The Twelfth Jiangsu Provincial Committee of the Chinese People's Political Consultative Conference
– Member *(Note 1)*

Past major appointments

HSBC – Group Head of Retail Banking (2014-2017)

The Hongkong and Shanghai Banking Corporation Limited
– Alternate Chief Executive (2009-2014)
Regional Head of Retail Banking and Wealth Management, Asia Pacific (2010-2014)
Regional Director of Personal Financial Services, Asia Pacific (2009-2010)
Head of Personal Financial Services, Hong Kong (2007-2009)
Head of Marketing, Asia Pacific (2004-2007)
Head of Marketing, Hong Kong (2002-2003)
Senior Manager Product and Marketing (2000-2001)
Senior Manager Credit Card Product Development (1999-2000)

Qualifications

Bachelor of Social Sciences – The University of Hong Kong

Honorary Certified Financial Management Planner
– The Hong Kong Institute of Bankers

Dr John CHAN Cho Chak GBS, JP INDEPENDENT NON-EXECUTIVE DIRECTOR AGED 74

JOINED THE BOARD SINCE AUGUST 1995

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
– Chairman of Remuneration Committee; Member of Nomination Committee

Other major appointments

Justice of the Peace

^ Guangdong Investment Limited
– Independent Non-executive Director

Long Win Bus Company Limited – Non-executive Director

The Hong Kong University of Science and Technology
– Chairman of the Court

The Kowloon Motor Bus Company (1933) Limited
– Non-executive Director

^ Transport International Holdings Limited
– Deputy Chairman and Independent Non-executive Director

Past major appointments

^ RoadShow Holdings Limited
– Chairman and Non-executive Director (2001-2017) *(Note 1)*

^ Swire Properties Limited
– Independent Non-executive Director (2010-2017)

The Community Chest of Hong Kong
– Board Member (2011-2017)
Member of Executive Committee (2014-2017)
Third Vice President;
Chairman of Public Relations Committee (2014-2015)

Hong Kong Monetary Authority
– Member of The Exchange Fund Advisory Committee (2008-2014)

Sir Edward Youde Memorial Fund
– Chairman of the Council (2007-2013)

The Hong Kong Jockey Club – Chairman (2006-2010)

HKSAR Commission on Strategic Development
– Non-Official Member (2005-2009)

^ Hong Kong Exchanges and Clearing Limited
– Independent Non-executive Director (2000-2003)

Hong Kong Civil Service
– Private Secretary to the Governor;
Deputy Secretary (General Duties);
Director of Information Services;
Deputy Chief Secretary;
Secretary for Trade and Industry;
Secretary for Education and Manpower
(1964-1978; 1980-1993)

Qualifications

Degree of Doctor of Social Sciences (honoris causa)
– Lingnan University; The University of Hong Kong; The Hong Kong University of Science and Technology

Degree of Doctor of Business Administration (honoris causa)
– International Management Centres

Diploma in Management Studies – The University of Hong Kong

Honours Degree in English Literature
– The University of Hong Kong

Major award

Gold Bauhinia Star (1999)

Mr Nixon CHAN Lik Sang NON-EXECUTIVE DIRECTOR AGED 65

JOINED THE BOARD SINCE JANUARY 2014

Other major appointment

Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Review Tribunal
– Member

Past major appointments

Employers' Federation of Hong Kong
– Chairman of Banking and Financial Services Group (2013-2016)

EPS Company (Hong Kong) Limited – Director (2011-2016)

^ Hang Seng Bank Limited
– Executive Director (2014-2016)
Head of Retail Banking and Wealth Management (2011-2016)
Member of Executive Committee (2009-2016)
Head of Corporate and Commercial Banking (2009-2011)

Hang Seng Management College – Governor (2010-2016)

Hang Seng School of Commerce – Director (2009-2016)

TransUnion Limited – Director (2011-2016)

MasterCard Asia/Pacific Advisory Board – Director (2012-2015)

Small and Medium Enterprises Committee
– Member (2009-2014)

The Hongkong and Shanghai Banking Corporation Limited
– Senior Executive, Commercial Banking (2005-2009)
Held various senior positions in commercial banking and personal financial services (1993-2005)

Qualification

Bachelor's Degree in Business Administration
– The University of Hawaii, USA

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

Dr Henry CHENG Kar Shun GBM INDEPENDENT NON-EXECUTIVE DIRECTOR AGED 71

JOINED THE BOARD SINCE MAY 2014

Other major appointments

^ Chow Tai Fook Jewellery Group Limited
 – Chairman and Executive Director

^ FSE Engineering Holdings Limited
 – Chairman and Non-executive Director

^ HKR International Limited
 – Independent Non-executive Director

^ i-CABLE Communications Limited
 – Vice-chairman and Non-executive Director *(Note 1)*

New World China Land Limited
 – Chairman and Managing Director

^ New World Department Store China Limited
 – Chairman and Non-executive Director

^ New World Development Company Limited
 – Chairman and Executive Director

^ Newton Resources Ltd
 – Chairman and Non-executive Director

^ NWS Holdings Limited – Chairman and Executive Director

^ SJM Holdings Limited – Non-executive Director

The Better Hong Kong Foundation
 – Chairman of the Advisory Council

The Twelfth National Committee of Chinese People's Political Consultative Conference
 – Standing Committee Member

Past major appointments

^ International Entertainment Corporation
 – Chairman and Executive Director (2004-2017)

^ Lifestyle International Holdings Limited
 – Non-executive Director (2004-2015)

Qualifications

Honorary Doctor of Business Administration in Hospitality Management
 – The Johnson & Wales University, USA

Honorary Doctor of Laws
 – The University of Western Ontario, Canada

Doctor of Social Sciences (honoris causa)
 – The University of Hong Kong

Major awards

Grand Bauhinia Medal (2017)

Gold Bauhinia Star (2001)

Ms CHIANG Lai Yuen JP INDEPENDENT NON-EXECUTIVE DIRECTOR AGED 52

JOINED THE BOARD SINCE SEPTEMBER 2010

Other position held within Hang Seng Group

^ Hang Seng Bank Limited
 – Member of Remuneration Committee

Other major appointments

Justice of the Peace

Aviation Development and Three-runway System Advisory Committee – Member

^ Chen Hsong Holdings Limited
 – Executive Director; Chief Executive Officer

Chen Hsong Investments Limited – Director

China Shenzhen Machinery Association – Vice-President

Federation of Shenzhen Industries – Vice-Chairman

The Hong Kong University of Science and Technology
 – Member of the Court

The Shenzhen Committee of the Chinese People's Political Consultative Conference
 – Member of Standing Committee

The Toys Manufacturers' Association of Hong Kong
 – Vice-President

Past major appointments

Hospital Authority – Board Member (2011-2017)

Directorate Salaries and Conditions of Service of HKSAR Government
 – Member of Standing Committee (2008-2014)

The Hong Kong University of Science and Technology
 – Member of the Council (2006-2012)

The Open University of Hong Kong
 – Member of the Council (2006-2012)

Disciplined Services Salaries and Conditions of Service of HKSAR Government
 – Member of Standing Committee (2005-2010)

Qualification

Bachelor Degree of Arts – Wellesley College, USA

Major award

"Young Industrialist Awards of Hong Kong" by the Federation of Hong Kong Industries (2004)

Dr HU Zuliu, Fred INDEPENDENT NON-EXECUTIVE DIRECTOR AGED 54

JOINED THE BOARD SINCE MAY 2011

Other position held within Hang Seng Group

^ Hang Seng Bank Limited – Member of Risk Committee

Other major appointments

China Medical Board – Trustee

^ Dalian Wanda Commercial Properties Co., Ltd.
 – Independent Non-executive Director

^ Hong Kong Exchanges and Clearing Limited
 – Independent Non-executive Director;
 Member of Investment Advisory Committee;
 Member of Project Oversight Committee;
 Member of Remuneration Committee

National Center for Economic Research at Tsinghua University
 – Director and Professor

Primavera Capital Limited – Founder and Chairman

The Nature Conservancy Asia Pacific Region – Co-Chairman

^ YUM China Holdings, Inc.
 – Non-executive Chairman;
 Chairman of Nominating and Governance Committee

Past major appointments

^ Hong Kong Exchanges and Clearing Limited
 – Member of Nomination Committee (2015-2017)

^ Great Wall Pan Asia Holdings Limited (formerly known as "Armada Holdings Limited")
 – Independent Non-executive Director (2010-2016)

Yale-China Association – Trustee (2010-2016)

^ Shanghai Pudong Development Bank Co., Ltd.
 – External Supervisor (2008-2016)
 Independent Director (2002-2008)

Securities and Futures Commission
 – Member of Advisory Committee (2009-2011)

Goldman Sachs Group Inc.
 – Chairman of Greater China (2008-2010)
 Managing Director (2000-2010)

HKSAR Commission on Strategic Development
 – Member (2007-2009)

Qualifications

Master of Arts and Doctor of Philosophy in Economics
 – Harvard University, USA

Master of Science in Engineering Science
 – Tsinghua University, PRC

Ms Margaret KWAN Wing Han EXECUTIVE DIRECTOR AND HEAD OF RETAIL BANKING AND WEALTH MANAGEMENT AGED 58

JOINED THE BOARD SINCE MAY 2017

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
– Member of Executive Committee

Hang Seng Bank (Trustee) Limited – Director

Hang Seng Credit Limited – Director

Hang Seng Finance Limited – Director

Hang Seng Futures Limited – Director

Hang Seng Indexes Company Limited
– Member of Hang Seng Index Advisory Committee

Hang Seng Insurance Company Limited – Director

Hang Seng Investment Management Limited – Director

Hang Seng Securities Limited – Director

Hang Seng Security Management Limited – Director

Haseba Investment Company Limited – Director

Other major appointment

Employers' Federation of Hong Kong
– Elected Member of General Committee

Past major appointments

^ Hang Seng Bank Limited
– Head of Consumer Assets (2013-2016)
Head of Unsecured Loans (2005-2013)
Senior Marketing and Business Development Manager, Unsecured Lending (2002-2005)
Senior Marketing Communications Manager (2001-2002)
Manager, Marketing Communications (1995-2001)

^ Standard Chartered Bank
– Advertising Manager (1990-1994)

Qualification

Bachelor of Social Sciences in Business Studies
– The University of Hong Kong

Ms Irene LEE Yun Lien INDEPENDENT NON-EXECUTIVE DIRECTOR AGED 64

JOINED THE BOARD SINCE MAY 2014

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
– Chairman of Risk Committee; Member of Audit Committee

Other major appointments

^ Cathay Pacific Airways Limited
– Independent Non-executive Director;
Chairman of Audit Committee and Remuneration Committee

^ CLP Holdings Limited
– Independent Non-executive Director;
Member of Audit Committee,
Finance & General Committee, and Sustainability Committee

^ Hysan Development Company Limited
– Executive Chairman;
Chairman of Nomination Committee and Strategy Committee

^ HSBC Holdings plc – Independent Non-executive Director

The Hongkong and Shanghai Banking Corporation Limited
– Independent Non-executive Director;
Member of Audit Committee;
Member of Risk Committee

Past major appointments

^ Noble Group Limited
– Independent Non-executive Director;
Member of Audit Committee;
Member of Investment and Capital Markets Committee (2012-2017)
Member of Nominating Committee (2013-2017)
Member of Risk Committee (2014-2017)

JP Morgan Australia
– Member of Advisory Council (2005-2013)

^ QBE Insurance Group Limited
– Non-executive Director (2002-2013)

^ Keybridge Capital Limited
– Non-executive Chairman (2009-2012)
Executive Chairman (2006-2009)

The Myer Family Company Pty Limited
– Non-executive Director (2009-2011)

ING Bank (Australia) Limited
– Non-executive Director (2005-2011)

Australian Government Takeovers Panel
– Member (2001-2010)

Sealcorp Holdings Limited
– Chief Executive Officer (1998-1999)

^ Commonwealth Bank of Australia
– Head of Corporate Finance (1993-1998)

Citicorp Investment Bank Limited in New York, London and Sydney
– Executive Director (1977-1987)

Qualifications

Bachelor of Arts Degree – Smith College, USA

Barrister-at-Law in England and Wales

Member – The Honourable Society of Gray's Inn, UK

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

Ms Sarah Catherine LEGG NON-EXECUTIVE DIRECTOR AGED 50

JOINED THE BOARD SINCE FEBRUARY 2011

Other major appointments

^ HSBC Holdings plc
- Group General Manager; Group Financial Controller

The Hong Kong Society for Rehabilitation
- Honorary Vice-President

Past major appointments

The Hong Kong Association of Banks
- Acting Chairman (2015)
  Chairman of the Basel Implementation Committee (2012 and 2015)

The Hong Kong Society for Rehabilitation
- Honorary Treasurer (2006-2015)

The Hongkong and Shanghai Banking Corporation Limited
- Alternate Chief Executive; Chief Financial Officer (2010-2015)
  Chief Accounting Officer (2006-2010)

HSBC Bank (Taiwan) Limited – Director (2011-2015)

HSBC Securities Investments (Asia) Limited
- Director (2006-2015)

HSBC Bank Bahamas Limited – President (2010-2014)

HSBC Markets (Bahamas) Limited – President (2010-2014)

HSBC Asia Holdings BV – Director (2011-2013)

^ HSBC Holdings plc
- Senior Manager, Finance Transformation (2003-2006)

HSBC Bank plc
- Head of Product Control, Global Banking and Markets (1999-2003)

Qualifications

Master of Arts – King's College, Cambridge University, UK

Fellow – Chartered Institute of Management Accountants

Fellow – Association of Corporate Treasurers

Dr Eric LI Ka Cheung GBS, OBE, JP INDEPENDENT NON-EXECUTIVE DIRECTOR AGED 64

JOINED THE BOARD SINCE FEBRUARY 2000

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
- Chairman of Audit Committee; Member of Risk Committee

Other major appointments

Justice of the Peace

^ China Resources Beer (Holdings) Company Limited
- Independent Non-executive Director;
  Chairman of Audit Committee

Home Affairs Bureau
- Member of the Board of Trustees of the Sir Edward Youde Memorial Fund

Hong Kong Children Foundation Limited
- Honorary Chairman *(Note 1)*

Independent Commission on Remuneration for the Members of the District Councils of HKSAR Government
- Chairman

Legal Aid Services Council – Chairman

Li, Tang, Chen & Co, Certified Public Accountants
- Senior Partner

Long Win Bus Company Limited – Director

^ SmarTone Telecommunications Holdings Limited
- Independent Non-executive Director;
  Chairman of Audit Committee

^ Sun Hung Kai Properties Limited
- Independent Non-executive Director;
  Chairman of Audit Committee

The Education University of Hong Kong Foundation
- Member of the Board of Stewards

The Financial Reporting Council
- Member of Honorary Advisory Panel

The Hong Kong Jockey Club
- Steward; Chairman of Audit Committee

The Kowloon Motor Bus Company (1933) Limited – Director

The Twelfth National Committee of the Chinese People's Political Consultative Conference
- Member

^ Transport International Holdings Limited
- Independent Non-executive Director;
  Chairman of Audit Committee

^ Wong's International Holdings Limited
- Independent Non-executive Director;
  Chairman of Audit Committee

Past major appointments

^ RoadShow Holdings Limited
- Independent Non-executive Director (2004-2017) *(Note 1)*
  Chairman of Audit Committee (2005-2017) *(Note 1)*

The Education University of Hong Kong
- Chairman of Finance Committee;
  Treasurer of the Council (2009-2015)

The Presidium of the Election of Deputies of the Hong Kong Special Administrative Region to the Twelfth National People's Congress
- Member (2013)

^ Bank of Communications Co., Ltd.
- Independent Non-executive Director;
  Chairman of Audit Committee (2007-2013)

The Financial Reporting Council
- Convenor and Member of Financial Reporting Review Committee (2007-2013)

HKSAR Commission on Strategic Development
- Member (2007-2013)

Hong Kong Monetary Authority
- Chairman of Process Review Committee (2004-2010)

Meadville Holdings Limited
- Independent Non-executive Director;
  Chairman of Remuneration Committee (2007-2010)

The International Federation of Accountants
- Board Member (2004-2006)

The Legislative Council of Hong Kong
- Member (1991-2004)
  Chairman of Public Accounts Committee (1995-2004)

Qualifications

BA (Economics) Honours Degree
- University of Manchester, UK

Fellow
- Hong Kong Institute of Certified Public Accountants (Practising)

Hon Doctor of Laws – University of Manchester, UK

Hon Doctor of Social Sciences – Hong Kong Baptist University

Hon Doctor of Social Sciences
- The Education University of Hong Kong

Hon Fellow – The Chinese University of Hong Kong

Hon Fellow – The Hong Kong Polytechnic University

Major awards

Gold Bauhinia Star (2003)

Officer of the Most Excellent Order of the British Empire (1996)

Dr Vincent LO Hong Sui GBM, JP NON-EXECUTIVE DIRECTOR AGED 69

JOINED THE BOARD SINCE FEBRUARY 1999

Other major appointments

Justice of the Peace

Business and Professionals Federation of Hong Kong
– Honorary Life President

Chongqing Municipal Government – Economic Adviser

Council for the Promotion and Development of Yangtze
– President

^ Great Eagle Holdings Limited – Non-executive Director

Hong Kong Trade Development Council – Chairman

Shanghai Tongji University; Shanghai University
– Advisory Professorship

Shui On Group – Chairman

^ Shui On Land Limited – Chairman

^ SOCAM Development Limited – Chairman

The Hong Kong University of Science and Technology
– Honorary Court Chairman

The Twelfth National Committee of the Chinese People's Political Consultative Conference
– Member

Past major appointments

Airport Authority Hong Kong
– Chairman (2014-2015)
Board Member (2013-2015)

Lantau Development Advisory Committee of HKSAR Government
– Non-official Member (2014-2015)

APEC Business Advisory Council
– Hong Kong's Representative (2010-2014)

^ Shui On Land Limited – Chief Executive Officer (2004-2011)

^ China Telecom Corporation Limited
– Independent Non-executive Director (2002-2008)

^ New World China Land Limited
– Independent Non-executive Director (1999-2004)

The Hong Kong University of Science and Technology
– Chairman of the Council (1999-2002)

Hong Kong General Chamber of Commerce
– Chairman (1991-1992)

Basic Law Consultative Committee
– Executive Committee Member (1985-1990)

Qualifications

Doctorate in Business Administration (honoris causa)
– The Hong Kong University of Science and Technology

Doctor of Business (honoris causa)
– The University of New South Wales, Australia

Major awards

Grand Bauhinia Medal (2017)

Lifetime Achievement Award for Leadership in Property Sector by the 4th World Chinese Economic Forum (2012)

"Ernst & Young Entrepreneur Of The Year 2009" in the China Real Estate Sector (2009)

Ernst & Young China Entrepreneur Of The Year 2009 (2009)

Chevalier des Arts et des Lettres by the French Government (2005)

Director of the Year in the category of Listed Company Executive Directors by The Hong Kong Institute of Directors in 2002 (2002)

Businessman of the Year award in the Hong Kong Business Awards 2001 (2001)

Gold Bauhinia Star (1998)

Mr Kenneth NG Sing Yip NON-EXECUTIVE DIRECTOR AGED 67

JOINED THE BOARD SINCE MARCH 2014

Other major appointments

Hong Kong General Chamber of Commerce
– Vice Chairman of Legal Committee

HSBC Bank (China) Company Limited
– Non-executive Director

HSBC Bank (Vietnam) Ltd. – Chairman of Board of Supervision

The University of Hong Kong
– Member of Asian Institute of International Financial Law Advisory Board of the Faculty of Law

Past major appointments

Competition Tribunal Users' Committee of HKSAR Government
– Member (2014-2017) *(Note 1)*

Standing Committee on Company Law Reform
– Member (2011-2017)

The Law Society of Hong Kong – Council Member (2002-2016)

The Hongkong and Shanghai Banking Corporation Limited
– General Counsel, Asia Pacific (1998-2016)
Deputy Head of Legal and Compliance Department (1993-1998)
Assistant Group Legal Adviser (1987-1993)

Board of Review of Inland Revenue Ordinance of HKSAR Government
– Member (2008-2014)

^ Ping An Insurance (Group) Company of China, Ltd.
– Non-executive Director (2006-2013)

Qualifications

Bachelor's Degree and Master's Degree in Laws (L.L.B. and L.L.M.)
– University of London, UK

Bachelor's Degree in Laws (L.L.B.) – Beijing University, PRC

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

Mr Richard TANG Yat Sun SBS, JP INDEPENDENT NON-EXECUTIVE DIRECTOR AGED 65

JOINED THE BOARD SINCE AUGUST 1995

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited – Member of Audit Committee
Hang Seng Bank (China) Limited – Supervisor

Other major appointments

Justice of the Peace
China Overseas Friendship Association
– Executive Director-General
Customs and Excise Service Children's Education Trust Fund
– Chairman of Investment Advisory Board
Fight Crime Committee – Member
Hong Kong Commercial Broadcasting Company Limited
– Director
Hong Kong Institute of Certified Public Accountants
– Member of Investigation Panel A
^ King Fook Holdings Limited – Chairman
^ Miramar Hotel & Investment Company, Limited – Director
Richcom Company Limited – Chairman and Managing Director
Tang Shiu Kin and Ho Tim Charitable Fund – Advisor
The Twelfth National Committee of the Chinese People's Political Consultative Conference
– Member
^ Wheelock and Company Limited
– Independent Non-executive Director

Past major appointments

Steering Committee of HKSAR Government Scholarship Fund
– Member (2008-2014)
Customs and Excise Service Children's Education Trust Fund Committee
– Chairman (2006-2012)
Hong Kong Institute of Certified Public Accountants
– Member of Disciplinary Panel A (2006-2012)
Correctional Services Children's Education Trust
– Chairman of Investment Advisory Board (2006-2011)

Qualifications

Bachelor of Science Degree in Business Administration
– Menlo College, California, USA
Master's Degree in Business Administration
– University of Santa Clara, California, USA

Major awards

Silver Bauhinia Star (2016)
Bronze Bauhinia Star (2000)

Mr Peter WONG Tung Shun JP NON-EXECUTIVE DIRECTOR AGED 66

JOINED THE BOARD SINCE MAY 2005

Other position held within Hang Seng Group

^ Hang Seng Bank Limited
– Member of Nomination Committee

Other major appointments

Justice of the Peace
^ Bank of Communications Co., Ltd.
– Vice Chairman and Non-executive Director
^ Cathay Pacific Airways Limited
– Independent Non-executive Director
Chongqing Mayor's International Economic Advisory Council
– Member
Economic Development Commission of HKSAR Government
– Non-official Member
Hong Kong General Chamber of Commerce
– Vice Chairman; Member of General Committee
Hong Kong Monetary Authority
– Member of The Exchange Fund Advisory Committee
HSBC Bank (China) Company Limited
– Chairman and Non-executive Director;
Chairman of Nomination Committee;
Member of Remuneration Committee
HSBC Bank Malaysia Berhad
– Non-Independent Executive Director
^ HSBC Holdings plc
– Group Managing Director;
Member of Group Management Board
International Consultative Conference on the Future Economic Development of Guangdong Province
– Economic Advisor to the Governor of Guangdong Province of the People's Republic of China
Our Hong Kong Foundation Limited
– Special Counsellor
Qianhai & Shekou Area of Shenzhen, China (Guangdong) Pilot Free Trade Zone, and Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone of Shenzhen
– Member of the Consulting Committee
The Community Chest of Hong Kong
– Board Member; First Vice President;
Chairman of Executive Committee
The Hongkong and Shanghai Banking Corporation Limited
– Deputy Chairman and Chief Executive; Executive Director
The Hong Kong Institute of Bankers – President
The Twelfth National Committee of the Chinese People's Political Consultative Conference
– Member

Past major appointments

The Eleventh Hubei Provincial Committee of the Chinese People's Political Consultative Conference
– Member (2012-2018) *(Note 1)*
Member of Standing Committee (2013-2018) *(Note 1)*
International Advisor to the Mayor of Tianjin (2010-2013)
Greater Pearl River Delta Business Council
– Member (2006-2013)
HSBC Bank (Vietnam) Ltd
– Vice-Chairman and Non-executive Director (2010-2012)
^ Ping An Insurance (Group) Company of China, Ltd.
– Non-executive Director (2006-2012)
Hong Kong Institute for Monetary Research
– Member of the Board of Directors (2010-2011)
HSBC Bank Australia Limited
– Non-executive Director (2010-2011)
^ Hong Kong Exchanges and Clearing Limited
– Member of Risk Management Committee (2010)
Hong Kong Trade Development Council
– Chairman of Financial Services Advisory Committee (2006-2010)
Hong Kong Monetary Authority
– Member of Banking Advisory Committee (2005-2010)
The Hong Kong Association of Banks
– Chairman (2001, 2004, 2006 and 2009)

Qualifications

Bachelor's Degree in Computer Science; MBA in Marketing and Finance; MSc in Computer Science
– Indiana University, USA
Fellow – The Hong Kong Management Association

Mr Michael WU Wei Kuo INDEPENDENT NON-EXECUTIVE DIRECTOR AGED 47

JOINED THE BOARD SINCE SEPTEMBER 2010

Other positions held within Hang Seng Group

^ Hang Seng Bank Limited
– Member of Audit Committee;
Member of Nomination Committee

Other major appointments

Hongkong Caterers Limited
– Executive Director and Company Secretary

^ Hongkong Land Holdings Limited – Non-executive Director

^ Jardine Matheson Holdings Limited
– Non-executive Director

Maxim's Caterers Limited – Chairman and Managing Director

The Community Chest of Hong Kong
– Board Member; Member of Executive Committee

Past major appointment

The Hong Kong University of Science and Technology
– Member of the Council (2011-2017) *(Note 1)*

Qualification

Bachelor of Science in Applied Mathematics and Economics
– Brown University, USA

Major awards

"Ernst & Young Entrepreneur of The Year 2012 China"
– Category Winner (Services) and Country Winner (Hong Kong/Macau Regions) (2012)

Executive Award of the DHL/SCMP Hong Kong Business Awards (2008)

Notes:

1 New appointments or cessation of appointments since the date of the Bank's 2017 Interim Report.

2 The interests of Directors in shares of the Bank, if any, within the meaning of Part XV of the Securities and Futures Ordinance ("SFO") as at 31 December 2017 are disclosed in the section "Directors' and Alternate Chief Executives' Interests" of the Report of the Directors attached to the Bank's 2017 Annual Report.

3 Some Directors (as disclosed in the section "Biographical Details of Directors and Senior Management – Board of Directors" of the Bank's 2017 Annual Report) are also Directors of HSBC Holdings plc ("HSBC") and/or its subsidiaries. HSBC, through its wholly owned subsidiaries, has an interest in the shares of the Bank under the provisions of Divisions 2 and 3 of Part XV of the SFO, the details of which are disclosed in the section "Substantial Interests in Share Capital" of the Report of the Directors attached to the Bank's 2017 Annual Report.

4 Save as disclosed in the section "Biographical Details of Directors and Senior Management – Board of Directors" of the Bank's 2017 Annual Report, the Directors (a) have not held any directorships in other publicly listed companies, whether in Hong Kong or overseas, during the last 3 years; (b) do not hold any other positions in the Bank and its subsidiaries; and (c) do not have any other relationships with any Directors, senior management or substantial or controlling shareholders of the Bank, except that Mr Michael W K Wu's spouse is the niece of Dr Vincent H S Lo, a Non-executive Director of the Bank.

5 All Directors (except those Directors who are full time employees of the Bank or its subsidiaries) will receive Directors' fees in the amounts approved from time to time by shareholders at the Annual General Meetings of the Bank. The current amounts of Directors' fees have been determined with reference to market rates, directors' workload and required commitment. A Director will also receive a fee for duties assigned to and services provided by him/her as Chairman or member of various Committees of the Bank. Such fees have been determined with reference to the remuneration policy of the Bank.

6 No Directors' fees are payable to those Directors who are full time employees of the Bank or its subsidiaries. The salary packages of such Directors have been determined with reference to the remuneration policy of the Bank. Such Directors are also entitled to discretionary bonus.

7 The details of the emoluments of the Directors on a named basis are disclosed in Note 16 of the Bank's Financial Statements as contained in the Bank's 2017 Annual Report.

8 None of the Directors, except Ms Margaret W H Kwan, has signed service contract with the Bank. The term of appointment of Non-executive Directors (including Independent Non-executive Directors) is three years except that where a Non-executive Director (or an Independent Non-executive Director) has served on the Board for more than nine years, then his/her term of appointment is one year.

9 Biographical details of Directors of the Bank are also available on the website of the Bank at www.hangseng.com.

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

Senior Management

FROM LEFT TO RIGHT

Mr Donald Y S Lam
Mr Andrew W L Leung
Ms Louisa W W Cheang
Ms Liz T L Chow
Ms Margaret W H Kwan
Mr Thomas C M TSUI

Ms Louisa CHEANG Wai Wan VICE-CHAIRMAN AND CHIEF EXECUTIVE

(Biographical details are set out on page 116)

Ms Margaret KWAN Wing Han EXECUTIVE DIRECTOR AND HEAD OF RETAIL BANKING AND WEALTH MANAGEMENT

(Biographical details are set out on page 119)

Mrs Eunice CHAN CHIEF OPERATING OFFICER AGED 55

JOINED THE BANK SINCE MARCH 2016

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Chief Operating Officer; Member of Executive Committee

Hang Seng Investment Management Limited – Director

Hang Seng Investment Services Limited – Director

Hang Seng Real Estate Management Limited – Director

Hang Seng Securities Limited – Director

Hang Seng Security Management Limited – Director

Past major positions

The Hongkong and Shanghai Banking Corporation Limited
– Head of Operations Asia Pacific (2015-2016)
Regional Head of Service Delivery Asia Pacific (2012-2015)
Head of Service Delivery Hong Kong (2011-2012)
Head of Securities Operations Centre (2007-2011)
Senior Manager, Network Services Centre Operations (2004-2007)
Manager, Implementation (Payment and Cash Management) (2001-2004)

Qualification

Bachelor of Arts (Major in Economics)
– University of Brandon, Canada

Ms Ivy CHAN Shuk Pui CHIEF RISK OFFICER AGED 52

JOINED THE BANK SINCE JULY 2014

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Chief Risk Officer; Member of Executive Committee

Hang Seng Investment Management Limited – Director

Hang Seng Investment Services Limited – Director

Hang Seng Securities Limited – Director

Hang Seng Security Management Limited – Director

Past major positions

The Hongkong and Shanghai Banking Corporation Limited
– Chief Risk Officer, HSBC Bank (Taiwan) Limited (2010-2014)
Senior Manager of Credit Risk Management Department (2005-2010)
Senior Relationship Manager of Credit Risk Management Department (2002-2005)
Treasury Credit Risk Manager (1997-2001)
Various positions in HSBC in the areas of Trade Services, Retail Banking, Corporate Banking Relationship Manager, Credit Operations (1988-1997)

Qualification

Professional Diploma in Company Secretaryship and Administration
– The Hong Kong Polytechnic University

Mr Walter CHEUNG Shu Wai HEAD OF COMMUNICATIONS AND CORPORATE SUSTAINABILITY AGED 60

JOINED THE BANK SINCE SEPTEMBER 1994

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Head of Communications and Corporate Sustainability; Member of Executive Committee

Past major positions

Hong Kong Baptist University School of Communication Advisory Committee
– Chairman (2000-2006)

TVBI Company Limited
– Senior Marketing Manager (1993-1994)

Digital Equipment Corporation
– Regional Marketing Communications Manager (1989-1993)

City University of Hong Kong (formerly known as "City Polytechnic of Hong Kong")
– Senior Information Officer (1987-1989)

South China Morning Post
– Reporter; Deputy News Editor (1979-1987)

Qualifications

Bachelor of Social Science
– The Chinese University of Hong Kong

Diploma in Marketing and International Business
– The Chinese University of Hong Kong

Diploma in Finance – The Chinese University of Hong Kong

Ms Liz CHOW Tan Ling HEAD OF GLOBAL MARKETS AGED 44

JOINED THE BANK SINCE OCTOBER 2006

Major positions held within Hang Seng Group

Hang Seng Bank Limited
- Head of Global Markets; Member of Executive Committee

Past major positions

Hang Seng Bank Limited
- Head of Global Markets Corporate Treasury and Business Management (2011-2015)
  Head of Corporate Treasury Services Greater China (2011)
  Various positions in the area of corporate treasury in Treasury Division (2006-2011)

DBS Bank Limited, Hong Kong
- VP Treasury & Markets (2002-2006)

Commonwealth Bank of Australia, Hong Kong
- Executive Capital Markets (2000-2002)

Qualifications

Bachelor of Business Administration
- The Chinese University of Hong Kong

Bachelor of Laws – University of London, UK

Mr Donald LAM Yin Shing HEAD OF COMMERCIAL BANKING AGED 54

JOINED THE BANK SINCE MARCH 2003

Major positions held within Hang Seng Group

Hang Seng Bank Limited
- Head of Commercial Banking;
  Member of Executive Committee

Hang Seng Insurance Company Limited – Director

Past major positions

Hang Seng Bank Limited
- Head of Commercial Banking Relationship Management (2005-2006)
  Deputy Head of Commercial Banking Relationship Management (2004-2005)
  Department Head, Commercial Banking Relationship Management Department A (2003-2004)

Playmates Holdings Limited
- Executive Director and Chief Financial Officer (2001-2003)

The Hongkong and Shanghai Banking Corporation Limited
- Senior Marketing and Planning Manager (1999-2001)
  Held various senior positions in Corporate and Commercial Banking (1987-1999)

Qualifications

Associate – The Hong Kong Institute of Bankers

Bachelor of Social Science (1st Class Honor)
- The University of Hong Kong

Master of Business Administration
- The Chinese University of Hong Kong

Master of Science in e-Commerce
- The Chinese University of Hong Kong

Mr Gordon LAM Wai Chung VICE-CHAIRMAN AND CHIEF EXECUTIVE OF HANG SENG BANK (CHINA) LIMITED AGED 58

JOINED THE BANK SINCE OCTOBER 2012

Major positions held within Hang Seng Group

Hang Seng Bank Limited – Member of Executive Committee

Hang Seng Bank (China) Limited
- Vice-Chairman and Chief Executive;
  Chairman of Executive Committee;
  Member of Nomination Committee

Past major positions

Hang Seng Bank (China) Limited
- First Deputy Chief Executive and Head of Network (2012-2013)
  Deputy Chief Executive, Head of Business Development, Corporate and Commercial Banking (2012)

HSBC Bank (China) Company Limited
- Managing Director and Head of Global Banking (2007-2011)
  Chief Credit Officer (2003-2007)

China Banking Regulatory Commission Shanghai Office
- Leader of the Foreign Bank Basel ll Working Committee (2007)

The Hong Kong Association of Banks
- Chairman of Preparatory Committee for Hong Kong Commercial Credit Reference Agency (2003)

The Hongkong and Shanghai Banking Corporation Limited
- Senior Manager, Credit Risk Management, Asia Pacific (1988-2003)

Hong Kong Chamber of Commerce in China
- One of Founding members (1993-1994)

Qualification

Bachelor of Business Administration
- The Chinese University of Hong Kong

Note: Definition of senior management is set out in the "Corporate Governance Report" section in this Annual Report.

Mr Gilbert LEE Man Lung HEAD OF STRATEGY AND PLANNING AGED 40

JOINED THE BANK SINCE AUGUST 2014

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Head of Strategy and Planning; Member of Executive Committee

Past major positions

Wells Fargo Bank, N.A.
– Senior Vice President, Cross-Border Governance & Strategic Initiatives Leader – Asia (2013–2014)

Booz & Company
– Senior Associate, Co-Lead of Financial Services Practice, Greater China (2007–2013)

Bank of America, N.A.
– Assistant Vice President, Special Assets Group, Asia (2006)

Citibank, N.A.
– Various positions in the areas of Corporate Banking and Risk Management (2000 – 2005)

Qualifications

Chartered Financial Analyst

Master of Business Administration – INSEAD, France

Master of Science in Business Economics
– The Chinese University of Hong Kong

Bachelor of Finance – The University of Hong Kong

Fellow of Asia Pacific Leadership Programme
– East-West Centre, The University of Hawaii, USA

Mr LEE Sai Kit HEAD OF FINANCIAL CRIME COMPLIANCE AGED 43

JOINED THE BANK SINCE OCTOBER 2014

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Head of Financial Crime Compliance; Member of Executive Committee

Hang Seng Investment Management Limited – Director

Hang Seng Investment Services Limited – Director

Hang Seng Securities Limited – Director

Past major positions

Standard Chartered Bank (Hong Kong) Limited
– Head of Compliance, Retail Clients (2006-2014)

Hong Kong Monetary Authority
– Banking Supervision Manager (1996-2006)

Qualifications

Associate Anti-Money Laundering Professional
– Hong Kong Institute of Bankers

Bachelor of Arts (Hons) in Public and Social Administration
– City University of Hong Kong

Bachelor of Laws – Manchester Metropolitan University, UK

Certified Anti-Money Laundering Specialist
– Association of Certified Anti-Money Laundering Specialists

Master of Arts – The University of Hong Kong

Master of Science in Banking – City University of Hong Kong

Member – Hong Kong Securities and Investment Institute

Mr Andrew LEUNG Wing Lok CHIEF FINANCIAL OFFICER AGED 55

JOINED THE BANK IN JULY 1997 (LEFT IN 2006) AND REJOINED IN JULY 2009

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Chief Financial Officer; Member of Executive Committee

Hang Seng Bank (China) Limited
– Director; Member of Remuneration Committee

Hang Seng Insurance Company Limited – Director

Hang Seng Investment Management Limited – Chairman

Hang Seng Investment Services Limited – Director

Hang Seng Securities Limited – Director

Past major positions

Bank of China (Hong Kong) Limited
– Deputy General Manager, Financial Management (2007-2009)

Hang Lung Properties Limited
– Senior Manager, Corporate Finance (2006-2007)

Hang Seng Bank Limited
– Senior Manager and Deputy Head of China Business (2005-2006)
Senior Manager and Deputy Head of Greater China Business (2003-2005)
Senior Manager of Corporate Banking (2001-2003)
Senior Manager and Deputy Head of Financial Control (1997-2001)

Qualifications

Associate – The Hong Kong Institute of Chartered Secretaries

Associate
– The Institute of Chartered Secretaries and Administrators, UK

Bachelor of PRC Law – Peking University, PRC

Bachelor of Social Sciences (Major in Management)
– The University of Hong Kong

Chartered Professional Accountant, Canada (CPA (Canada), CMA)

Fellow – The Association of Chartered Certified Accountants, UK

Fellow – The Hong Kong Institute of Certified Public Accountants

Master of Science, Data processing – University of Ulster, UK

Master of Science in Electronic Commerce and Internet Computing
– The University of Hong Kong

Mr Godwin LI Chi Chung COMPANY SECRETARY AND GENERAL COUNSEL AGED 53

JOINED THE BANK SINCE MAY 1995

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Company Secretary and General Counsel; Member of Executive Committee

Hang Seng Bank (Trustee) Limited – Director

Hang Seng (Nominee) Limited – Director

Past major positions

Hang Seng Bank Limited
– Assistant Company Secretary, Senior Manager and Legal Advisor (1995-2005)

Guoco Group Limited – Assistant Legal Counsel (1993-1995)

Qualification

Bachelor of Laws – The University of Hong Kong

Mr Thomas TSUI Chun Man HEAD OF GLOBAL BANKING AGED 56

JOINED THE BANK IN OCTOBER 1994 (LEFT IN 1996) AND REJOINED IN JUNE 1997

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Head of Global Banking; Member of Executive Committee

Hang Seng Finance Limited – Director

Hang Seng Indexes Company Limited – Director

HSI International Limited – Director

Past major positions

Hang Seng Bank Limited
– Assistant General Manager and Head of Business Banking (2002-2011)
Assistant General Manager and Head of Retail Sales and Services (1999-2002)
Senior Manager and Head of Retail Planning and Development (1997-1999)
Senior Manager, Retail Planning of Retail Banking Division (1994–1996)

Standard Chartered Bank
– Regional Head of Personal Banking Africa (1996-1997)

Qualifications

Associate – The Hong Kong Institute of Bankers

Member – Institute of Financial Planners of Hong Kong

Bachelor of Social Sciences – The University of Hong Kong

Master of Business Administration – Brunel University, UK

Ms Elaine WANG Yee Ning HEAD OF HUMAN RESOURCES AGED 56

JOINED THE BANK SINCE JUNE 2016

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Head of Human Resources; Member of Executive Committee

Past major positions

The Hongkong and Shanghai Banking Corporation Limited
– Regional Head of Development and Regional Head of Talent (2014-2016)
Regional Head of Human Resources, Retail Banking and Wealth Management, Asia Pacific (2011-2014)
Head of Human Resources, HSBC China (2009-2011)

BP Asia Limited
– Vice President, Human Resources China & Gas Asia Pacific Business Unit (2005-2008)
Regional Human Resources Manager (2002-2004)
Head of Human Resources, BP Amoco Chemicals Asia Pacific (1992-2001)

Qualifications

Master of Health Services Management
– The University of New South Wales, Australia

Bachelor of Applied Science
– The University of Sydney, Australia

Ms Katie YIP Kay Chun HEAD OF REGULATORY COMPLIANCE AGED 56

JOINED THE BANK SINCE FEBRUARY 2005

Major positions held within Hang Seng Group

Hang Seng Bank Limited
– Head of Regulatory Compliance; Member of Executive Committee

Hang Seng Investment Management Limited – Director

Hang Seng Investment Services Limited – Director

Hang Seng Securities Limited – Director

Past major positions

Standard Chartered Bank
– Regional Head of Legal & Compliance, North East Asia (2004)
Various positions in the area of Legal & Compliance (1992-2004)

Johnson Stokes & Master – Assistant Solicitor (1990-1992)

Baker & McKenzie – Associate (1987-1990)

Qualifications

Practising Solicitor in Hong Kong

Master of Arts in Jurisprudence
– Wadham College Oxford University, UK

Note: Definition of senior management is set out in the "Corporate Governance Report" section in this Annual Report.

Report of the Directors

The Directors have pleasure in presenting their report together with the audited financial statements for the year ended 31 December 2017.

Principal Place of Business

The Bank is incorporated and domiciled in Hong Kong and has its registered office and principal place of business at 83 Des Voeux Road Central, Hong Kong.

Principal Activities and Business Review

The Bank and its subsidiaries (the "Group") are engaged in the provision of banking and related financial services. Further discussion and analysis of these activities as required by Schedule 5 to the Hong Kong Companies Ordinance, including a fair review of the business and a discussion of the principal risks and uncertainties facing the Group, particulars of important events affecting the Group that have occurred since the end of the financial year 2017, an indication of likely future development in the Group's business, a discussion of the Group's environmental policies and performance, and its compliance with the relevant laws and regulations that have a significant impact on the Group and an account of the Group's key relationships with its employees, customers and suppliers that have a significant impact on the Group can be found in the sections "Five-Year Financial Summary", "Chairman's Statement", "Chief Executive's Report", "Management Discussion and Analysis", "Corporate Sustainability" and "Corporate Governance Report" of this Annual Report. The aforesaid form part of this report.

Profits and Dividends

The consolidated profit of the Bank and its subsidiaries and associates for the year is set out under the consolidated income statement of this Annual Report.

The Directors declared and paid the first to third interim dividends of HK$3.60 (2016: HK$3.30) per share totalling HK$6,882m (2016: HK$6,309m) during the year. The Directors also declared the fourth interim dividend of HK$3.10 per share totalling HK$5,927m (2016: HK$2.80 per share totalling HK$5,353m), which will be paid on 23 March 2018.

Major Customers

The Directors believe that the five largest customers of the Bank accounted for less than 30% of the total interest income and other operating income of the Bank for the year.

Subsidiaries

Particulars of the Bank's principal subsidiaries as at 31 December 2017 are set out in note 33 to the financial statements for the year ended 31 December 2017.

Share Capital

Details of share capital of the Bank during the year are set out in note 47 to the financial statements for the year ended 31 December 2017.

Equity-linked Agreements

For the year ended 31 December 2017, the Bank has not entered into any equity-linked agreement.

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 year.

Reserves

Profit attributable to shareholders, before dividends, of HK$20,018m (2016: 16,212m) has been transferred to reserves. Distributable reserve of the Bank as at 31 December 2017 amounted to HK$78,463m (2016: HK$72,270m). Other movements in reserves are set out in the consolidated statement of changes in equity of this Annual Report.

Donations

Charitable donations made by the Bank and its subsidiaries during the year amounted to HK$28m. For further details of the Bank's corporate social responsibility activities and expenditures, please refer to the section "Corporate Sustainability" of this Annual Report.

Directors

The Directors of the Bank, who were in office on the date of this report, were Dr Raymond K F Ch'ien, Ms Louisa Cheang, Dr John C C Chan, Mr Nixon L S Chan, Dr Henry K S Cheng, Ms L Y Chiang, Dr Fred Zuliu Hu, Ms Margaret W H Kwan, Ms Irene Y L Lee, Ms Sarah C Legg, Dr Eric K C Li, Dr Vincent H S Lo, Mr Kenneth S Y Ng, Mr Richard Y S Tang, Mr Peter T S Wong and Mr Michael W K Wu.

Ms Rose W M Lee, Mr Andrew H C Fung and Mr Patrick K W Chan stepped down from the Board with effect from 1 July, 4 July and 1 May 2017 respectively.

Save for Ms Louisa Cheang, who was appointed as Vice-Chairman and Chief Executive with effect from 1 July 2017, and Ms Margaret W H Kwan, who was appointed as Executive Director with effect from 13 May 2017, all the other Directors, who were in office on the date of this report, had served on the Board of the Bank throughout the year. Both of Ms Cheang and Ms Kwan will retire under the provisions of the Bank's Articles of Association and, being eligible, offer themselves for election at the Bank's 2018 Annual General Meeting ("2018 AGM") to be held on 10 May 2018.

The Directors retiring by rotation in accordance with the Bank's Articles of Association are Dr Henry K S Cheng, Dr Fred Zuliu Hu, Ms Irene Y L Lee, Mr Richard Y S Tang and Mr Peter T S Wong. Dr Cheng has informed the Board of his intention of not seeking re-election at the 2018 AGM, in order to devote more time to his own business.

No Director proposed for election or re-election at the forthcoming AGM has a service contract with the Bank which is not determinable by the Bank within one year without payment of compensation (other than statutory compensation).

The biographical details of the Directors of the Bank are set out in the section "Biographical Details of Directors and Senior Management" of this Annual Report.

Directors of Subsidiaries

The names of all Directors who have served on the boards of the Bank's subsidiaries during the period from 1 January 2017 to the date of this report (unless otherwise stated) are provided in the section "Directors of Subsidiaries" of this Annual Report.

Status of Independent Non-executive Directors

The Bank has received from each Independent Non-executive Director an annual confirmation of his/her independence pursuant to Rule 3.13 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") (the "Listing Rules"). The Bank still considers all the Independent Non-executive Directors to be independent.

Directors' and Alternate Chief Executives' Interests

As at 31 December 2017, 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	58,572	–	–	–	58,572	0.00
Ms Louisa Cheang	277,707	–	–	246,178[3]	523,885	0.00
Dr John C C Chan	24,605[1]	–	–	–	24,605	0.00
Mr Nixon L S Chan	132,010	–	–	24,800[3]	156,810	0.00
Ms Margaret W H Kwan	22,205	–	–	9,411[3]	31,616	0.00
Ms Irene Y L Lee	10,588	–	–	–	10,588	0.00
Ms Sarah C Legg	161,853	2,695	–	115,650[3]	280,198	0.00
Dr Eric K C Li	–	57,616	–	–	57,616	0.00
Mr Kenneth S Y Ng	422,722	–	–	19,582[3]	442,304	0.00
Mr Peter T S Wong	1,273,825	24,398	–	1,599,181[3]	2,897,404	0.02
Alternate Chief Executives:						
Mrs Eunice L C Y Chan	27,267	–	–	13,356[3]	40,623	0.00
Mr Donald Y S Lam	101,841	–	–	19,263[3]	121,104	0.00
Mr Andrew W L Leung	12,628	–	–	21,198[3]	33,826	0.00
Number of perpetual non-cumulative preference shares of US$0.01 each in HSBC Holdings plc						
Director:						
Ms Margaret W H Kwan	–	15,000[2]	–	–	15,000	0.02

Interests in debentures of associated corporation of the Bank

	Personal Interests (held as beneficial owner)	Family Interests (interests of spouse or child under 18)	Corporate Interests (interests of controlled corporation)	Other Interests	Total Interests
8.125% perpetual subordinated capital securities issued by HBSC Holdings plc					
Director:					
Ms Margaret W H Kwan	–	US$375,000[(2)]	–	–	US$375,000

Notes:

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

(2) Ms Margaret W H Kwan's spouse had interests in the total principal amount of US$375,000 of the 8.125% perpetual subordinated capital securities. These perpetual subordinated capital securities were exchangeable at the option of HSBC Holdings plc to 15,000 perpetual non-cumulative preference shares of US$0.01 each in HSBC Holdings plc. Ms Kwan's interests set out in the table under "Interests in shares" and the table under "Interests in debentures of associated corporation of the Bank" represented the same interests.

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

Conditional Awards of Shares

During the year, the Directors and Alternate Chief Executives as set out below were eligible to be granted conditional awards over ordinary shares of US$0.50 each in HSBC Holdings plc by that company (being the ultimate holding company of the Bank) under various HSBC Share Plans. The details of the interests of the Directors and Alternate Chief Executives in the conditional awards of ordinary shares in HSBC Holdings plc under the HSBC Share Plans, as at 31 December 2017, were as follows:

	Awards held as at 1 January 2017	Awards made during the Director's/ Alternate Chief Executive's term of office in 2017	Awards released during the Director's/ Alternate Chief Executive's term of office in 2017	Awards held as at 31 December 2017
Directors:				
Ms Louisa Cheang	238,514[(2)]	–	–	246,178[(1)]
Mr Nixon L S Chan	33,495	15,795	26,480	24,800[(1)]
Ms Margaret W H Kwan	4,590	6,476	2,066	9,411[(1)]
Ms Sarah C Legg	105,007	49,670	45,359	115,650[(1)]
Mr Kenneth S Y Ng	39,219	–	21,269	19,582[(1)]
Mr Peter T S Wong	1,315,716	174,520	493,753	1,063,868[(1)]
Alternate Chief Executives:				
Mrs Eunice L C Y Chan	13,613	5,686	6,712	13,356[(1)]
Mr Donald Y S Lam	18,727	20,218	20,768	19,263[(1)]
Mr Andrew W L Leung	22,942	6,950	9,951	21,198[(1)]

Notes:

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

(2) This represented the awards held by Ms Louisa Cheang on 1 July 2017 when she was appointed as Vice-Chairman and Chief Executive of the Bank.

During the year, 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 31 December 2017, 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.

Save as disclosed in the preceding paragraphs, neither the Bank nor any of its holding companies or its subsidiaries or fellow subsidiaries was a party to any arrangement to enable the Directors of the Bank to acquire benefits by means of the acquisition of shares in or debentures of the Bank or any other body corporate as at the end of the year or at any time during the year.

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 year ended 31 December 2017.

Directors' Interests in Transactions, Arrangements or Contracts

No transaction, arrangement or contract (that is significant in relation to the Bank's business), to which the Bank or any of its holding companies or any of its subsidiaries or fellow subsidiaries was a party and in which a Director of the Bank or an entity connected with a Director had, directly or indirectly, a material interest, subsisted as at the end of the year or at any time during the year.

Management Contracts

Save for service contracts, no other contracts, relating to the management and/or administration of the whole or any substantial part of the business of the Bank were entered into or subsisting during the year.

Directors' Interests in Competing Businesses

Pursuant to Rule 8.10 of the Listing Rules, as at the date of this report, the following Directors had declared interests in the following entities which compete or are likely to compete, either directly or indirectly, with the businesses of the Bank:

Ms Louisa Cheang is a Group General Manager of HSBC Holdings plc and a Director of The Hongkong and Shanghai Banking Corporation Limited. She is also a Non-Independent Executive Director of HSBC Amanah Malaysia Berhad, an indirect wholly-owned subsidiary of The Hongkong and Shanghai Banking Corporation Limited.

Ms Sarah C Legg is a Group General Manager and Group Financial Controller of HSBC Holdings plc.

Mr Kenneth S Y Ng is a Director of HSBC Bank (China) Company Limited and the Chairman of the Board of Supervision of HSBC Bank (Vietnam) Ltd. Both companies are wholly-owned subsidiaries of The Hongkong and Shanghai Banking Corporation Limited.

Mr Peter T S Wong is a Group Managing Director and a member of Group Management Board of HSBC Holdings plc. He is also the Deputy Chairman, Chief Executive and Executive Director of The Hongkong and Shanghai Banking Corporation Limited; Chairman and Non-executive Director of HSBC Bank (China) Company Limited; and Non-Independent Executive Director of HSBC Bank Malaysia Berhad. Both HSBC Bank (China) Company Limited and HSBC Bank Malaysia Berhad are wholly-owned subsidiaries of The Hongkong and Shanghai Banking Corporation Limited. He is the Vice-Chairman and Non-executive Director of Bank of Communications Co., Ltd., which conducts general banking business.

HSBC Holdings plc, through its subsidiaries and associated undertakings, including The Hongkong and Shanghai Banking Corporation Limited, the immediate holding company of the Bank, is engaged in providing a comprehensive range of banking, insurance and related financial services.

The entities in which the Directors have declared interests are managed by separate boards of directors and management, which are accountable to their respective shareholders.

The Board of the Bank includes nine Independent Non-executive Directors whose views carry significant weight in the Board's decisions. The Audit Committee and Risk Committee of the Bank, which consist of four and three Independent Non-executive Directors respectively, meet regularly to assist the Board of Directors in reviewing the financial performance, internal control and risk management systems of the Bank and its subsidiaries. The Bank is, therefore, capable of carrying on its businesses in the best interests of all shareholders as a whole and has put in place adequate mechanisms to ensure that the Directors discharge their duties vis-a-vis all shareholders, including in respect of the Bank's dealings with the businesses in which Directors have declared interests.

Directors' Emoluments

The emoluments of the Directors of the Bank on a named basis are set out in note 16 to the financial statements for the year ended 31 December 2017.

Indemnity Provision

Details of the Bank's permitted indemnity provision are set out in the section "Corporate Governance Report" of this Annual Report.

Substantial Interests in Share Capital

The register maintained by the Bank pursuant to the SFO recorded that, as at 31 December 2017, 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 31 December 2017, 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.

Public Float

As at the date of this report, the Bank has maintained the prescribed public float under the Listing Rules, based on the information that is publicly available to the Bank and within the knowledge of the Directors of the Bank.

Corporate Governance Principles and Practices

Details of the Bank's corporate governance practices are set out in the section "Corporate Governance Report" in this Annual Report.

Auditor

The financial statements for the year ended 31 December 2017 have been audited by PricewaterhouseCoopers who will retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of PricewaterhouseCoopers as auditor of the Bank will be proposed at the 2018 AGM.

On behalf of the Board

Raymond Ch'ien
Chairman
Hong Kong, 20 February 2018

2017 Financial Statements

Consolidated Income Statement

for the year ended 31 December 2017
(Expressed in millions of Hong Kong dollars)

	note	2017	2016
Interest income	4	**29,221**	26,493
Interest expense	4	**(4,644)**	(4,239)
Net interest income		**24,577**	22,254
Fee income		**9,209**	8,042
Fee expense		**(2,454)**	(2,103)
Net fee income	5	**6,755**	5,939
Net trading income	6	**2,384**	1,685
Net income from financial instruments designated at fair value	7	**1,773**	73
Gains less losses from financial investments	8	**48**	105
Dividend income	9	**188**	190
Net insurance premium income	10	**12,817**	11,059
Other operating income	11	**1,534**	2,828
Total operating income		**50,076**	44,133
Net insurance claims and benefits paid and movement in liabilities to policyholders	12	**(14,719)**	(13,534)
Net operating income before loan impairment charges and other credit risk provisions		**35,357**	30,599
Loan impairment charges and other credit risk provisions	13	**(1,042)**	(1,313)
Net operating income		**34,315**	29,286
Employee compensation and benefits		**(5,122)**	(4,807)
General and administrative expenses		**(4,310)**	(4,226)
Depreciation of premises, plant and equipment		**(1,229)**	(1,114)
Amortisation of intangible assets		**(107)**	(105)
Operating expenses	14	**(10,768)**	(10,252)
Operating profit		**23,547**	19,034
Net surplus/(deficit) on property revaluation	18	**141**	(37)
Share of profits/(losses) of associates		**(14)**	93
Profit before tax		**23,674**	19,090
Tax expense	19	**(3,671)**	(2,886)
Profit for the year		**20,003**	16,204
Attributable to:			
Shareholders of the company		**20,018**	16,212
Non-controlling interests		**(15)**	(8)
(Figures in HK$)			
Earnings per share – basic and diluted	20	**10.30**	8.30

The notes on pages 144 to 216 form part of these financial statements.

Consolidated Statement of Comprehensive Income

for the year ended 31 December 2017
(Expressed in millions of Hong Kong dollars)

	2017	2016
Profit for the year	**20,003**	16,204
Other comprehensive income		
Items that will be reclassified subsequently to the income statement when specific conditions are met:		
Available-for-sale investment reserve:		
– fair value changes taken to equity:		
– on debt securities	**(101)**	(549)
– on equity shares	**396**	(127)
– fair value changes transferred to income statement:		
– on hedged items	**230**	398
– on disposal	**(48)**	(105)
– deferred taxes	**7**	57
– exchange difference and others	**198**	(179)
Cash flow hedging reserve:		
– fair value changes taken to equity	**(1,914)**	781
– fair value changes transferred to income statement	**1,949**	(924)
– deferred taxes	**(6)**	24
Exchange differences on translation of:		
– financial statements of overseas branches, subsidiaries and associates	**868**	(762)
Items that will not be reclassified subsequently to the income statement:		
Change in fair value of financial liabilities designated at fair value arising from changes in own credit risk[1]	**(4)**	–
Premises:		
– unrealised surplus on revaluation of premises	**2,285**	853
– deferred taxes	**(381)**	(144)
– exchange difference	**16**	(11)
– other	**3**	–
Defined benefit plans:		
– actuarial gains on defined benefit plans	**564**	127
– deferred taxes	**(93)**	(21)
Other comprehensive income for the year, net of tax	**3,969**	(582)
Total comprehensive income for the year	**23,972**	15,622
Total comprehensive income for the year attributable to:		
– shareholders of the company	**23,987**	15,630
– non-controlling interests	**(15)**	(8)
	23,972	15,622

1 On 1 January 2017, the Group adopted the requirements of Hong Kong Financial Reporting Standard ("HKFRS") 9 relating to the presentation of gains and losses on financial liabilities designated at fair value. As a result, the effect of changes in fair value of those liabilities arising from changes in own credit risk is presented in other comprehensive income. As permitted by the transitional requirements of HKFRS 9, comparatives have not been restated.

Consolidated Balance Sheet

at 31 December 2017
(Expressed in millions of Hong Kong dollars)

	note	2017	2016
ASSETS			
Cash and sight balances at central banks	25	**21,718**	23,299
Placings with and advances to banks	26	**103,113**	103,460
Trading assets	27	**53,704**	44,427
Financial assets designated at fair value	28	**9,313**	8,523
Derivative financial instruments	29	**10,836**	16,695
Loans and advances to customers	30	**806,573**	698,992
Financial investments	31	**385,261**	398,137
Interest in associates	34	**2,170**	2,274
Investment properties	35	**10,166**	9,960
Premises, plant and equipment	36	**28,499**	26,772
Intangible assets	37	**15,354**	14,443
Other assets	38	**31,711**	30,260
Total assets		**1,478,418**	1,377,242
LIABILITIES AND EQUITY			
Liabilities			
Current, savings and other deposit accounts	39	**1,074,837**	989,539
Repurchase agreements – non-trading		**2,389**	1,805
Deposits from banks		**3,676**	14,075
Trading liabilities	40	**88,270**	68,124
Financial liabilities designated at fair value	41	**1,047**	3,991
Derivative financial instruments	29	**11,169**	13,303
Certificates of deposit and other debt securities in issue	42	**600**	5,116
Other liabilities	43	**22,222**	24,765
Liabilities under insurance contracts	44	**115,545**	108,326
Current tax liabilities	45	**568**	25
Deferred tax liabilities	45	**6,016**	5,160
Subordinated liabilities	46	**–**	2,327
Total liabilities		**1,326,339**	1,236,556
Equity			
Share capital	47	**9,658**	9,658
Retained profits		**113,646**	105,204
Other equity instruments	48	**6,981**	6,981
Other reserves		**21,745**	18,783
Total shareholders' equity		**152,030**	140,626
Non-controlling interests		**49**	60
Total equity		**152,079**	140,686
Total equity and liabilities		**1,478,418**	1,377,242

Louisa Cheang *Vice-Chairman and Chief Executive*
John C C Chan *Director*
Richard Y S Tang *Director*

Andrew W L Leung *Chief Financial Officer*

The notes on pages 144 to 216 form part of these financial statements.

Consolidated Statement of Changes in Equity

for the year ended 31 December 2017
(Expressed in millions of Hong Kong dollars)

	Share capital	Other equity instruments	Retained profits[1]	Other reserves: Premises revaluation reserve	Available-for-sale investment reserve	Cash flow hedge reserve	Foreign exchange reserve	Others	Total share-holders' 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 year	**–**	**–**	**20,018**	**–**	**–**	**–**	**–**	**–**	**20,018**	**(15)**	**20,003**
Other comprehensive income (net of tax)	**–**	**–**	**471**	**1,923**	**682**	**29**	**868**	**(4)**	**3,969**	**–**	**3,969**
Available-for-sale investments	**–**	**–**	**–**	**–**	**682**	**–**	**–**	**–**	**682**	**–**	**682**
Cash flow hedges	**–**	**–**	**–**	**–**	**–**	**29**	**–**	**–**	**29**	**–**	**29**
Change in fair value of financial liabilities designated at fair value arising from changes in own credit risk[2]	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(4)**	**(4)**	**–**	**(4)**
Property revaluation	**–**	**–**	**–**	**1,923**	**–**	**–**	**–**	**–**	**1,923**	**–**	**1,923**
Actuarial gains on defined benefit plans	**–**	**–**	**471**	**–**	**–**	**–**	**–**	**–**	**471**	**–**	**471**
Exchange differences and others	**–**	**–**	**–**	**–**	**–**	**–**	**868**	**–**	**868**	**–**	**868**
Total comprehensive income for the year	**–**	**–**	**20,489**	**1,923**	**682**	**29**	**868**	**(4)**	**23,987**	**(15)**	**23,972**
Dividends paid	**–**	**–**	**(12,235)**	**–**	**–**	**–**	**–**	**–**	**(12,235)**	**–**	**(12,235)**
Coupon paid to holder of AT1 capital instrument	**–**	**–**	**(389)**	**–**	**–**	**–**	**–**	**–**	**(389)**	**–**	**(389)**
Movement in respect of share-based payment arrangements	**–**	**–**	**(4)**	**–**	**–**	**–**	**–**	**(19)**	**(23)**	**–**	**(23)**
Others	**–**	**–**	**64**	**–**	**–**	**–**	**–**	**–**	**64**	**4**	**68**
Transfers	**–**	**–**	**517**	**(526)**	**–**	**–**	**–**	**9**	**–**	**–**	**–**
At 31 December 2017	**9,658**	**6,981**	**113,646**	**18,379**	**2,116**	**(99)**	**706**	**643**	**152,030**	**49**	**152,079**
At 1 January 2016	9,658	6,981	105,363	16,777	1,939	(9)	600	672	141,981	–	141,981
Profit for the year	–	–	16,212	–	–	–	–	–	16,212	(8)	16,204
Other comprehensive income (net of tax)	–	–	106	698	(505)	(119)	(762)	–	(582)	–	(582)
Available-for-sale investments	–	–	–	–	(505)	–	–	–	(505)	–	(505)
Cash flow hedges	–	–	–	–	–	(119)	–	–	(119)	–	(119)
Property revaluation	–	–	–	698	–	–	–	–	698	–	698
Actuarial gains on defined benefit plans	–	–	106	–	–	–	–	–	106	–	106
Exchange differences and others	–	–	–	–	–	–	(762)	–	(762)	–	(762)
Total comprehensive income for the year	–	–	16,318	698	(505)	(119)	(762)	–	15,630	(8)	15,622
Dividends paid	–	–	(16,633)	–	–	–	–	–	(16,633)	–	(16,633)
Coupon paid to holder of AT1 capital instrument	–	–	(346)	–	–	–	–	–	(346)	–	(346)
Movement in respect of share-based payment arrangements	–	–	9	–	–	–	–	(15)	(6)	–	(6)
Others	–	–	–	–	–	–	–	–	–	68	68
Transfers	–	–	493	(493)	–	–	–	–	–	–	–
At 31 December 2016	9,658	6,981	105,204	16,982	1,434	(128)	(162)	657	140,626	60	140,686

1 Retained profits are the cumulative net earnings of the Group that have not been paid out as dividends, but retained to be reinvested in the business. To satisfy the provisions of the Hong Kong Banking Ordinance and local regulatory requirements for prudential supervision purposes, the Group has earmarked a "regulatory reserve" from retained profits. Movements in the reserve are made directly through retained earnings. As at 31 December 2017, the effect of this requirement is to restrict the amount of reserves which can be distributed by the Group to shareholders by HK$6,018m (2016: HK$5,945m).

2 On 1 January 2017, the Group adopted the requirements of HKFRS 9 relating to the presentation of gains and losses on financial liabilities designated at fair value. As a result, the effect of changes in fair value of those liabilities arising from changes in own credit risk is presented in other reserve. As permitted by the transitional requirements of HKFRS 9, comparatives have not been restated.

Consolidated Statement of Cash Flows

for the year ended 31 December 2017
(Expressed in millions of Hong Kong dollars)

	2017	2016 *(Re-presented)*
Profit before tax	**23,674**	19,090
Adjustments for non-cash items:		
Depreciation	**1,229**	1,114
Amortisation of intangible assets	**107**	105
Net interest income	**(24,577)**	(22,254)
Dividend income	**(188)**	(190)
Gains less losses from financial investments	**(48)**	(105)
Share of profits/(losses) in associates	**14**	(93)
Net surplus/(deficit) on property revaluation	**(141)**	37
Loan impairment charges and other credit risk provisions	**1,042**	1,313
Loans and advances written off net of recoveries	**(1,306)**	(974)
Movement in present value of in-force long-term insurance business ("PVIF")	**(910)**	(2,233)
Interest received	**23,816**	21,670
Interest paid	**(4,370)**	(4,437)
Elimination of exchange differences and other non-cash items	**(12,003)**	9,656
Changes in operating assets and liabilities		
Change in financial assets designated at fair value	**(390)**	(1,690)
Change in trading assets	**(11,322)**	5,397
Change in derivative financial instruments	**3,725**	(1,785)
Change in placings with and advances to banks maturing after one month	**18,469**	(5,224)
Change in loans and advances to customers	**(108,509)**	(10,739)
Change in other assets	**(1,149)**	(2,506)
Change in current, savings and other deposit accounts	**85,298**	30,311
Change in deposits from banks	**(10,399)**	(4,705)
Change in repurchase agreements – non-trading	**584**	(510)
Change in certificates of deposit and other debt securities in issue	**(4,516)**	(75)
Change in financial liabilities designated at fair value	**(2,944)**	(3)
Change in trading liabilities	**20,146**	5,207
Change in liabilities under insurance contracts	**7,219**	6,509
Change in other liabilities	**(422)**	554
Interest received from available-for-sale investments	**5,009**	5,219
Dividends received from available-for-sale investments	**187**	184
Tax paid	**(2,522)**	(3,034)
Net cash from operating activities	**4,803**	45,809

	2017	2016 *(Re-presented)*
Purchase of available-for-sale investments	**(480,946)**	(514,564)
Purchase of held-to-maturity debt securities	**(15,183)**	(11,187)
Proceeds from sale or redemption of available-for-sale investments	**516,117**	479,810
Proceeds from redemption of held-to-maturity debt securities	**8,147**	6,307
Proceeds from sale of fixed assets and assets held for sale	**12**	–
Purchase of property, plant and equipment and intangible assets (excluding PVIF)	**(721)**	(899)
Net cash inflow from the sales of loan portfolio	**1,141**	389
Net cash from investing activities	**28,567**	(40,144)
Interest paid for subordinated liabilities	**(118)**	(112)
Dividends paid	**(12,235)**	(16,633)
Coupon paid to holder of AT1 capital instrument	**(389)**	(346)
Redemption of subordinated liabilities	**(2,327)**	–
Net cash from financing activities	**(15,069)**	(17,091)
Net increase/(decrease) in cash and cash equivalents	**18,301**	(11,426)
Cash and cash equivalents at 1 Jan	**88,592**	105,776
Exchange differences in respect of cash and cash equivalents	**3,780**	(5,758)
Cash and cash equivalents at 31 Dec	**110,673**	88,592
Cash and cash equivalents comprise[1]:		
– cash and sight balances at central banks	**21,718**	23,299
– balances with banks	**5,182**	7,456
– items in the course of collection from other banks	**6,464**	6,354
– placings with and advances to banks maturing within one month	**56,795**	36,399
– treasury bills	**29,501**	26,360
– less: items in the course of transmission to other banks	**(8,987)**	(11,276)
	110,673	88,592

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$17,462m at 31 December 2017 (31 December 2016: HK$17,652m).

In 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. Comparatives have been re-presented accordingly.

Notes to the Financial Statements

For the year ended 31 December 2017
(Figures expressed in millions of Hong Kong dollars unless otherwise indicated)

1. Basis of preparation

(a) Compliance with Hong Kong financial reporting standards

The consolidated financial statements comprise the financial statements of Hang Seng Bank Limited ("the Bank") and its subsidiaries ("the Group") made up to 31 December 2017. These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRS"), the provisions of the Hong Kong Companies Ordinance and accounting principles generally accepted in Hong Kong. HKFRS comprises Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKAS"), and interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). In addition, these financial statements comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. A summary of the significant accounting policies adopted by the Group is set out in note 3.

Standards adopted during the year ended 31 December 2017

The Group has adopted the requirements of HKFRS 9 *"Financial Instruments"* relating to the presentation of gains and losses on financial liabilities designated at fair value from 1 January 2017. As a result, the effect of changes in fair value of those liabilities arising from changes in own credit risk is presented in other comprehensive income with the remaining effect presented in profit or loss. As permitted by the transitional requirements of HKFRS 9, comparatives have not been restated. The adoption increased profit after tax by HK$4 million with the opposite effect on other comprehensive income and no effect on net assets for the year ended 31 December 2017.

There were no other new standards applied in 2017. However, during 2017, the Group adopted a number of amendments to standards which had an insignificant effect on the consolidated financial statements of the Group.

(b) Presentation of information

The following have been included in the audited sections of the "Management Discussion and Analysis" ("MD&A"):

– Disclosure under HKFRS 4 *"Insurance Contracts"* and HKFRS 7 *"Financial Instruments: Disclosures"* concerning the nature and extent of risks relating to insurance contracts and financial instruments on pages 40 to 43.

– Capital disclosures under HKAS 1 *"Presentation of Financial Statements"* on pages 80 to 83.

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

(c) Consolidation

The Group controls and consequently consolidates an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Control is initially assessed based on consideration of all facts and circumstances, and is subsequently reassessed when there are significant changes to the initial setup.

Where an entity is governed by voting rights, the Group would consolidate when it holds, directly or indirectly, the necessary voting rights to pass resolutions by the governing body. In all other cases, the assessment of control is more complex and requires judgement of other factors, including having exposure to variability of returns, power over relevant activities or holding the power as agent or principal.

All intra-group transactions are eliminated on consolidation.

The consolidated financial statements also include the attributable share of the results and reserves of associates based on the financial statements prepared at dates not earlier than three months prior to 31 December 2017.

(d) Future accounting developments

The HKICPA has issued a number of amendments and new standards which are not yet effective for the year ended 31 December 2017 and which have not been adopted in the financial statements, except the requirements of HKFRS 9 *"Financial Instruments"* relating to the presentation of gains and losses on financial liabilities designated at fair value, which was adopted from 1 January 2017. Key changes of new standards are summarised as follows:

HKFRS 9 "Financial Instruments"

In September 2014, the HKICPA issued the HKFRS 9 *"Financial Instruments"*, which is the comprehensive standard to replace HKAS 39 *"Financial Instruments: Recognition and Measurement"*, and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

Classification and measurement

The classification and measurement of financial assets will depend on how these are managed (i.e the entity's business model) and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income ("FVOCI") or fair value through profit or loss ("FVTPL"). The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of financial assets measured at amortised cost or fair value compared with HKAS 39.

1. Basis of preparation continued

(d) Future accounting developments continued

HKFRS 9 "Financial Instruments" continued

Impairment

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, lease receivables, certain loan commitments and financial guarantee contracts. At initial recognition, impairment allowance (or provision in the case of commitments and guarantees) is required for expected credit losses ("ECL") resulting from default events that are possible within the next 12 months ("12-month ECL"). In the event of a significant increase in credit risk, an 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".

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under HKAS 39, and the resulting impairment charge will tend to be more volatile. HKFRS 9 will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with HKAS 39.

Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks. However, they do not explicitly address macro hedge accounting strategies, which are particularly important for banks. As a result, HKFRS 9 includes an accounting policy choice to remain with HKAS 39 hedge accounting.

Transition impact

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 requirements of HKFRS 9 *"Financial Instruments"* will be adopted from 1 January 2018. HKFRS 9 includes an accounting policy choice to continue with HKAS 39 hedge accounting, which the Group has exercised, although it will implement the revised hedge accounting disclosures required by the related amendments to HKFRS 7 *"Financial Instruments: Disclosures"*. The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The Group does not intend to restate comparatives.

The adoption of HKFRS 9 is expected to reduce net assets at 1 January 2018 by HK$854 million, with the classification and measurement changes increasing net assets by HK$46 million and additional impairment reducing net assets by HK$1,078 million, net of deferred tax of HK$178 million. There is no material impact on the Group's capital resources.

HKFRS 15 "Revenue from Contracts with Customers"

In July 2014, the HKICPA issued HKFRS 15 *"Revenue from Contracts with Customers"* and it is effective for annual periods beginning on or after 1 January 2018. HKFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue obligations as they are satisfied. The Group will adopt the standard on its mandatory effective date, and the standard will be applied on a retrospective basis, recognising the cumulative effect, if any, of initially applying the standard as an adjustment to the opening balance of retained earnings.

The Group has assessed the impact of HKFRS 15 and expects that the standard will not have significant impact, when applied, on the consolidated financial statements of the Group.

HKFRS 16 "Leases"

In May 2016, the HKICPA issued HKFRS 16 *"Leases"* with an effective date of annual periods beginning on or after 1 January 2019. HKFRS 16 results in lessee 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 asset will be amortised over the length of the lease and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as in HKAS 17.

The Group is currently assessing the impact of HKFRS 16 and it is not practicable to quantify the effect as at the date of the publication of these financial statements.

HKFRS 17 "Insurance Contracts"

In January 2018, HKICPA issued HKFRS 17 *"Insurance contracts"* 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 in the process of considering its impact.

2. Critical accounting estimates and judgements in applying accounting policies

The results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of the consolidated financial statements. The significant accounting policies are described in Note 3 to the financial statements.

The accounting policies that are deemed critical to our results and financial position, in terms of the materiality of the items to which the policies are applied and the high degree of judgement involved, including the use of assumptions and estimation, are discussed below.

(i) Loan impairment charges

Application of the Group's methodology for assessing loan impairment, as set out in note 3(e), involves considerable judgement and estimation.

For individually assessed loans, judgement is required in determining whether there are indications that an impairment loss may already have been incurred and then estimating the amount and timing of expected cash flows, which form the basis of the impairment loss calculation.

For collectively assessed loans, judgement is involved in selecting and applying the criteria for grouping together loans with similar credit characteristics, as well as in selecting and applying statistical and other models used to estimate the losses incurred for each group of loans in the reporting period. The benchmarking of loss rates, the assessment of the extent to which historical losses are representative of current conditions and the ongoing refinement of modelling methodologies provide a means of identifying changes that may be required, but the process is inherently an estimation.

(ii) Valuation of financial instruments

The best evidence of fair value is a quoted price in an actively traded principal market. In the event that the market for a financial instrument is not active, and the valuation technique uses only observable market data, the reliability of the fair value measurement is high. However, when valuation techniques include one or more significant unobservable inputs, they rely to a greater extent on management judgement and the fair value derived becomes less reliable. In absence of observable valuation inputs, due to lack of or a reduced volume of similar transactions, management judgement is required to assess the price at which an arm's length transaction would occur under normal business conditions, in which case management may rely on historical prices for that particular financial instrument or on recent prices for similar instruments.

The main assumptions and estimates which management consider when applying a model with valuation techniques are:

- the likelihood and expected timing of future cash flows on the instrument. Judgement may be required to assess the counterparty's ability to service the instrument in accordance with its contractual terms. Future cash flows may be sensitive to changes in market rates;
- selecting appropriate discount rate for the instrument. Judgement is required to assess what a market participant would regard as the appropriate spread of the rate for an instrument over the appropriate risk-free rate; and
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivatives.

When applying a model with observable inputs, estimates are made to reflect uncertainties in fair values resulting from a lack of market data inputs, for example, as a result of illiquidity in the market. For these instruments, the fair value measurement is less reliable. Inputs into valuations based on observable data are inherently uncertain because there is little or no current market data available from which to determine the level at which an arm's length transaction would occur under normal business conditions. However, in most cases there is some market data available on which to base a determination of fair value, for example historical data, and the fair values of most financial instruments are based on some market observable inputs even when observable inputs are significant.

The Group's accounting policy for valuation of financial instruments is included in note 3(j) and is discussed further within note 55 "Fair value of financial instruments".

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

Judgement is required in determining whether or not a decline in fair value of an available-for-sale financial investment below its original cost is of such a nature as to constitute impairment, and thus whether an impairment loss needs to be recognised under HKAS 39.

(iv) Held-to-maturity investments

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

2. Critical accounting estimates and judgements in applying accounting policies continued

(v) Insurance contracts

Classification

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

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

The value of PVIF, which is recorded as an intangible asset, depends upon assumptions regarding future events. These are described in more detail in note 37(a). The assumptions are reassessed at each reporting date and changes in the estimates which affect the value of PVIF are reflected in the income statement.

Insurance liabilities

The estimation of insurance liabilities involves selecting statistical models and making assumptions about future events which need to be frequently calibrated against experience and forecasts. The sensitivity of insurance liabilities to potential changes in key assumptions is set out in the MD&A.

3. Significant accounting policies

(a) Interest income and expense

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

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

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

(b) Non-interest income

(i) Fee income

Fee income is earned from a diverse range of services provided by the Group to its customers and is accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party); and
- income earned from the provision of services is recognised as revenue when the services are provided (for example, asset management services).

(ii) Net trading income

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading and dividend income from equities held for trading. Gains or losses arising from changes in fair value of derivatives are recognised in Net trading income to the extent as described in the accounting policy set out in note 3(g). Gains and losses on foreign exchange trading and other transactions are also reported as Net trading income except for those gains and losses on translation of foreign currencies recognised in other comprehensive income and accumulated separately in equity in the foreign exchange reserve in accordance with the accounting policy set out in note 3(w).

(iii) Net income/(expense) from financial instruments designated at fair value

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

3. Significant accounting policies continued

(b) Non-interest income continued

(iv) Dividend income

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

(v) Rental income from operating lease

Rental income, net of incentives, under an operating lease is recognised in "Other operating income" in equal instalments over the reporting periods covered by the lease term.

(c) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of change in value. Such investments comprise cash and sight balances at central banks maturing within one month, treasury bills and certificates of deposit with less than three months' maturity from the date of acquisition and items in the course of collection from or in transmission to other banks.

(d) Loans and advances to customers and placings with and advances to banks

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

(e) Impairment of loans and advances

Losses for impaired loans and advances are recognised when there is objective evidence that impairment of a loan or portfolio of loans has occurred.

(i) Individually assessed loans and advances

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

- known cash flow difficulties experienced by the borrower;
- contractual payments of either principal or interest being past due for more than 90 days;
- the probability that the borrower will enter bankruptcy or other financial realisation;
- a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in the forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and
- a significant downgrading in credit rating by an external rating agency.

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

- the Group's aggregate exposure to the borrower;
- the viability of the borrower's business model and its capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors' commitments ranking ahead of, or pari passu with, the Group and the likelihood of other creditors continuing to support the borrower;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of collateral (or other credit mitigants) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding;
- the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and
- where available, the secondary market price for the debt.

3. Significant accounting policies continued

(e) Impairment of loans and advances continued

(i) Individually assessed loans and advances continued

The realisable value of collateral is based on the most recently updated market value at the time the impairment assessment is performed. The value is not adjusted for expected future changes in market prices, though adjustments are made to reflect local conditions such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at its original effective interest rate and comparing the resultant present value with the loan's current carrying amount.

(ii) Collectively assessed loans and advances

Impairment allowances are calculated on a collective basis to cover losses which have been incurred but have not yet been identified:

- on loans subject to individual assessment; or
- for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

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

- historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between a loss occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and
- management's judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses at the reporting date is likely to be greater or less than that suggested by historical experience.

Homogeneous groups of loans and advances

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

(iii) Write-off of loans and advances

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

(iv) Reversals of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognised in the income statement.

(v) Repossessed assets

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

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

3. Significant accounting policies continued

(e) Impairment of loans and advances continued

(vi) Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as new loans for measurement purposes once the minimum number of payments required under the new arrangements has been received. A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument. These renegotiated loans are segregated from other parts of the loan portfolio for the purposes of collective impairment assessment, to reflect their risk profile. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired. The carrying amounts that have been classified as renegotiated loans retain this classification until maturity or derecognition.

(f) Financial instruments designated at fair value

A financial instrument is classified in this category if it meets any one of the criteria set out below, and is so designated irrevocably on initial recognition:

– eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial instruments or recognising the gains and losses on them on different bases.

– applies to a group of financial instruments that is managed and its performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and where information about that group of financial instruments is provided internally on that basis to key management personnel.

  Under this criterion, certain liabilities under investment contracts and financial assets held to meet liabilities under insurance and investment contracts are the main classes of financial instruments so designated.

– relates to financial instruments containing one or more embedded derivatives, and which would otherwise be required to be accounted for separately.

Designated financial instruments are recognised at fair values when the Group enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequent changes in fair values are recognised in the income statement within "Net income from financial instruments designated at fair value".

(g) Derivative financial instruments and hedge accounting

Derivatives are recognised initially, and are subsequently remeasured, at fair values, with changes in fair value generally recorded in the income statement. Fair values of derivatives are obtained either from quoted market prices or by using valuation techniques.

Derivatives are classified as assets when their fair values are positive, or as liabilities when their fair values are negative. Derivative assets and liabilities arising from different transactions are only offset for accounting purposes if the offsetting criteria are met, i.e. the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

The method of recognising fair value gains or losses depends on whether the derivative is held for trading, or is designated as a hedging instrument, and if the latter, the nature of the risk being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement.

The Group designates certain derivatives as either (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ("fair value hedge"); or (ii) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ("cash flow hedge").

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

(i) Fair value hedge

Changes in the fair value of derivatives that are designated and qualified as fair value hedging instruments are recorded in the income statement within "Net trading income", along with changes in the fair value of the hedged assets or liabilities attributable to the hedged risk.

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

3. Significant accounting policies continued

(g) Derivative financial instruments and hedge accounting continued

(ii) Cash flow hedge

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

The accumulated gains and losses recognised in other comprehensive income are recycled to the income statement in the periods in which the hedged item will affect profit or loss.

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

(iii) Hedge effectiveness testing

To qualify for hedge accounting, the Group requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness), and demonstrate actual effectiveness (retrospective effectiveness) on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed and the method adopted by the Group to assess hedge effectiveness depends on its risk management strategy.

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

For prospective effectiveness, the hedging instrument is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For retrospective effectiveness, the change in fair value or cash flows must offset each other in the range of 80% to 125%. Hedge ineffectiveness is recognised in the income statement in "Net trading income".

(iv) Derivatives that do not qualify for hedge accounting

Non-qualifying hedges are economic hedges entered into as part of documented interest rate management strategies for which hedge accounting is not applied. Changes in fair value of non-qualifying hedges do not alter the cash flows expected as part of the documented management strategies for both the non-qualifying hedge instruments and the related assets and liabilities. All gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in the income statement.

(h) Sale and repurchase agreements

Where securities are sold subject to commitment to repurchase them at a pre-determined price ("repos"), they remain on the balance sheet and a liability is recorded in respect of the consideration received in "Repurchase agreements-non-trading". Conversely, securities purchased under analogous commitments to resell ("reverse repos") are not recognised on the balance sheet and the consideration paid is recorded in "Reverse repurchase agreements-non-trading". The difference between the sale and repurchase price is treated as interest income and recognised over the life of the agreement.

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. The transfer of securities to counterparties under these agreements is not normally reflected on the balance sheet. Cash collateral advanced or received is recorded as an asset or a liability respectively.

(i) Financial investments

Financial instruments intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale or held-to-maturity.

(i) Available-for-sale financial assets

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

(ii) Held-to-maturity investments

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

3. Significant accounting policies continued

(j) Valuation of financial instruments

All financial instruments are recognised initially 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 fair value of a financial instrument on initial recognition is generally its transaction price (that is the fair value of the consideration given or received). However, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Group recognises a trading gain or loss on day 1, being the difference between the transaction price and the fair value. When significant unobservable parameters are used, the entire day 1 gain or loss is deferred and is recognised in the income statement over the life of the transaction until the transaction matures, is closed out, the valuation inputs become observable, or when the Group enters into an offsetting transaction.

The fair value of financial instruments is generally measured on an individual basis. However, in cases where the Group manages a group of financial assets and liabilities according to its net market or credit risk exposure, the Group measures the fair value of the group of financial instruments on a net basis but presents the underlying financial assets and liabilities separately in the financial statements, unless they satisfy the HKFRS offsetting criteria.

(k) Impairment of assets

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

The accounting policies on impairment losses on loans and receivables and goodwill are set out in notes 3(e) and 3(o) respectively.

(i) Held-to-maturity investments

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

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

(ii) Available-for-sale financial assets

At each reporting date, an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset or group of assets.

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

Available-for-sale debt securities

When assessing available-for-sale debt securities for objective evidence of impairment at the reporting date, the Group considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows.

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

Available-for-sale equity securities

A significant or prolonged decline in the fair value of the asset below its cost is also objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the period in which the fair value of the asset has been below its original cost at initial recognition.

All subsequent increases in the fair value of the instrument are treated as a revaluation and recognised in other comprehensive income Subsequent decreases in the fair value of the available-for-sale equity security are recognised in the income statement to the extent that further cumulative impairment losses have been incurred. Subsequent recovery in the fair value of the available-for-sale equity security is recognised in the other comprehensive income and the past impairment loss recognised in the income statement is not reversed.

3. Significant accounting policies continued

(l) Subsidiaries and associates

The Group classifies investments in entities which it controls as subsidiaries. The Group classifies investments in entities over which it has significant influence, and that are neither subsidiaries nor joint arrangement, as associates.

The Group's investments in subsidiaries and associates are stated at cost less any impairment losses. Investment in associates is recognised using the equity method. Under this method, such investments are initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in the Group's share of net assets less any impairment losses. An impairment loss recognised in prior periods shall be reversed through the income statement if, and only if, there has been a change in the estimates used to determine the recoverable amount of the investment since the last impairment loss was recognised.

(m) Investment properties

Investment properties are land and/or buildings which are owned or held under a leasehold interest to earn rental income and/or for capital appreciation. Investment properties are stated at fair value with changes in fair value being recognised in the income statement. Fair values are determined by independent professional valuers, primarily on the basis of capitalisation of net incomes with due allowance for outgoings and reversionary income potential. Property interests which are held under operating leases to earn rentals, or for capital appreciation, or both, are classified and accounted for as investment property on a property-by-property basis.

(n) Premises, plant and equipment

(i) Land and buildings

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

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

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

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

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

– freehold land is not depreciated;

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

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

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

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

(ii) Other plant and equipment

Furniture, plant and equipment, are stated at cost less depreciation calculated on the straight-line basis to write off the assets over their estimated useful lives, which are generally between 3 and 20 years. On disposal, the profit and loss is calculated as the difference between the net sales proceeds and the net carrying amount.

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

3. Significant accounting policies continued

(n) Premises, plant and equipment continued

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

The Government of Hong Kong owns all the land in Hong Kong and permits its use under leasehold arrangements. Similar arrangements exist in mainland China. At inception of the lease,

– where the cost of land is known or can be reliably determined and the term of the lease is less than 50 years, the Group records its interest in leasehold land and land use rights separately as operating leases;

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

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

(o) Goodwill and intangible assets

(i) Goodwill

Goodwill arises on business combinations, including the acquisition of subsidiaries or associates when the cost of acquisition exceeds the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities acquired and is reported in the consolidated balance sheet. If the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of an acquired business is greater than the cost of acquisition, the excess is recognised immediately in the income statement. Goodwill on acquisitions of associates is included in "Interest in associates" and is not tested separately for impairment.

Goodwill is allocated to cash-generating units ("CGUs") for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. Impairment testing is performed at least annually, and whenever there is an indication that the CGU may be impaired, by comparing the recoverable amount of a CGU with the carrying value of its net assets, including attributable goodwill. The recoverable amount of an asset is the higher of, its fair value less cost to sell, and its value in use. Value in use is the present value of the expected future cash flows from a CGU. If the recoverable amount of the CGU is less than the carrying value, an impairment loss is charged to the income statement. Any write-off in excess of the carrying value of goodwill is limited to the fair value of the individual assets and liabilities of the CGU. Goodwill is stated at cost less any accumulated impairment losses, if any.

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

(ii) Intangible assets

Intangible assets include PVIF, acquired software licences and capitalised development costs of computer software programmes.

– The PVIF is stated at a valuation determined at the reporting date by using the methodology as described in note 3(t).

– Computer software acquired is stated at cost less amortisation and impairment allowances. Amortisation of computer software is charged to the income statement over its estimated useful life. Costs incurred in the development phase of a project to produce application software for internal use are capitalised and amortised over the software's estimated useful life, usually five years.

Intangible assets that have an indefinite estimated useful life or are not yet ready for use are tested for impairment annually. Intangible assets that have a finite estimated useful life, except for the PVIF, are stated at cost less amortisation and accumulated impairment losses and are amortised over their estimated useful lives. Estimated useful life is the lower of legal duration and expected economic life. Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

(p) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Income tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in other comprehensive income or directly in equity, respectively.

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

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purpose and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits. Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available, against which deductible temporary differences can be utilised at each reporting date.

3. Significant accounting policies continued

(p) Income tax continued

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

(q) Employee benefits

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

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

Payments to defined contribution plans and state-managed retirement benefit plans, where the Group's obligations under the plans are equivalent to a defined contribution plan, are charged as an expense as they incur.

The costs recognised for funding defined benefit plans are determined using the projected unit credit method, with annual actuarial valuations performed on each plan. The net charge to the income statement mainly comprises the service cost and the net interest on the net defined benefit liability and is presented in operating expenses. Service cost comprises current service cost, past service cost, and gain or loss on settlement.

The net defined benefit asset or liability recognised in the balance sheet represents the difference between the fair value of plan assets and the present value of the defined benefit obligations adjusted for unrecognised past service costs. In the case of a defined benefit asset, it is limited to unrecognised past service costs plus the present value of available refunds and reductions in future contributions to the plan.

(r) Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation arising from past events and a reliable estimate can be made as to the amount of the obligation. Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or nonoccurrence, of one or more uncertain future events not wholly within the control of the Group; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

(s) Financial guarantees

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

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

(t) Insurance contracts

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

A contract issued by the Group that transfers financial risk, without significant insurance risk, is classified as an investment contract, and is accounted for as a financial instrument. The financial assets held by the Group for the purpose of meeting liabilities under insurance and investment contracts are classified and accounted for based on their classifications as set out in notes 3(g) to 3(i).

Insurance contracts are accounted for as follows:

Net earned insurance premiums

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

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

3. Significant accounting policies continued

(t) Insurance contracts continued

Claims and reinsurance recoveries

Gross insurance claims for life insurance contracts reflect the total cost of all claims arising during the reporting period, including policyholder cash dividend payment upon policy anniversary and payments of maturities, surrenders and death claims. Reinsurance recoveries are accounted for in the same period as the related claims.

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

A value is placed on insurance contracts that are classified as long-term insurance business or long-term investment contracts with discretionary participating features ("DPF") and in force at the reporting date. This asset represents the present value of the shareholders' interest in the profits expected to emerge from those insurance contracts written at the reporting date.

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

Liabilities under insurance contracts

Liabilities under non-linked life insurance contracts are calculated by each life insurance operation based on local actuarial principles. Some insurance contracts may contain discretionary participation features whereby the policyholder is entitled to additional payments whose amount and/or timing is at the discretion of the issuer. The discretionary element of these contracts is included in "Liabilities under insurance contracts".

Liabilities under unit-linked life insurance contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

A liability adequacy test is carried out on insurance liabilities to ensure that the carrying amount of the liabilities is sufficient in the light of current estimates of future cash flows. When performing the liability adequacy test, all expected cash flows are discounted and compared with the carrying value of the liability. When a shortfall is identified it is charged immediately to the income statement.

(u) Investment contracts

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

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

(v) Subordinated liabilities

Financial liabilities are recognised when the Group enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.

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

Financial instruments issued are classified as equity when there is no contractual obligation to transfer cash or other financial assets or issue a variable number of own equity instruments.

(w) Translation of foreign currencies

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

3. Significant accounting policies continued

(w) Translation of foreign currencies continued

The results of branches, subsidiaries and associates not reporting in Hong Kong dollars are translated into Hong Kong dollars at the average rates of exchange for the reporting period. Exchange differences arising from the re-translation of opening foreign currency net investments and the related cost of hedging, if any, and exchange differences arising from re-translation of the result for the reporting period from the average rate to the exchange rate ruling at the period-end, are recognised in other comprehensive income and accumulated separately in equity in the foreign exchange reserve.

Exchange differences on a monetary item that is part of a net investment in a foreign operation are recognised in the income statement of separate subsidiary's financial statements. In the consolidated financial statements, these exchange differences are recognised in other comprehensive income and accumulated separately in equity in the foreign exchange reserve. On disposal of a foreign operation, exchange differences relating thereto previously recognised in reserves are recognised in the income statement.

(x) Operating segments

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

HKFRS 8 *"Operating Segments"* 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 decision about operating matters.

(y) Related parties

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

4. Interest income/interest expense

(a) Interest income

	2017	2016
Interest income arising from:		
– financial assets that are not at fair value through profit and loss	**28,745**	26,193
– trading assets	**465**	284
– financial assets designated at fair value	**11**	16
	29,221	26,493
of which:		
– interest income from impaired financial assets	**49**	60

(b) Interest expense

	2017	2016
Interest expense arising from:		
– financial liabilities that are not at fair value through profit and loss	**2,821**	3,069
– trading liabilities	**1,779**	1,129
– financial liabilities designated at fair value	**44**	41
	4,644	4,239
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	**118**	112

5. Net fee income

	2017	2016
– securities broking and related services	1,673	1,175
– retail investment funds	1,894	1,573
– insurance	586	674
– account services	511	464
– remittances	540	481
– cards	2,742	2,503
– credit facilities	463	394
– trade services	421	416
– other	379	362
Fee income	9,209	8,042
Fee expense	(2,454)	(2,103)
	6,755	5,939
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	2,046	2,057
– fee income	4,155	3,813
– fee expense	(2,109)	(1,756)
Net fee income on trust and other fiduciary activities where the Group holds or invests on behalf of its customers	968	826
– fee income	1,154	998
– fee expense	(186)	(172)

6. Net trading income

	2017	2016
Dealing profits	2,384	1,664
– foreign exchange	2,084	1,564
– interest rate derivatives	40	(38)
– debt securities	82	5
– equities and other trading	178	133
Net gain from hedging activities	–	21
– fair value hedges		
– net loss on hedged items attributable to the hedged risk	(230)	(398)
– net gain on hedging instruments	229	402
– cash flow hedges		
– net hedging gain	1	17
	2,384	1,685

7. Net income from financial instruments designated at fair value

	2017	2016
Net income on assets designated at fair value which back insurance and investment contracts	**1,768**	89
Net change in fair value of other financial instruments designated at fair value	**5**	(16)
	1,773	73
of which dividend income from:		
– listed investments	**220**	172
– unlisted investments	**1**	–
	221	172

8. Gains less losses from financial investments

	2017	2016
Net gains from disposal of available-for-sale equity securities	**–**	7
Net gains from disposal of available-for-sale debt securities	**48**	98
	48	105

There were no impairment losses or net gains/(losses) from disposal of held-to-maturity debt securities and financial liabilities measured at amortised cost for 2017 and 2016.

9. Dividend income

	2017	2016
Dividend income:		
– listed investments	**120**	124
– unlisted investments	**68**	66
	188	190

10. Net insurance premium income

	Non-linked insurance	Linked insurance	Total
2017			
Gross insurance premium income	**13,946**	**4**	**13,950**
Reinsurers' share of gross insurance premium income	**(1,133)**	**–**	**(1,133)**
Net insurance premium income	**12,813**	**4**	**12,817**
2016			
Gross insurance premium income	13,126	4	13,130
Reinsurers' share of gross insurance premium income	(2,071)	–	(2,071)
Net insurance premium income	11,055	4	11,059

11. Other operating income

	2017	2016
Rental income from investment properties	**363**	362
Movement in present value of in-force long-term insurance business (note 37(a))	**910**	2,233
Net losses from disposal of fixed assets	**(10)**	(13)
Others	**271**	246
	1,534	2,828

12. Net insurance claims and benefits paid and movement in liabilities to policyholders

	Non-linked insurance	Linked insurance	Total
2017			
Claims, benefits and surrenders paid	**9,298**	**11**	**9,309**
Movement in provisions	**6,476**	**11**	**6,487**
Gross claims and benefits paid and movement in liabilities to policyholders	**15,774**	**22**	**15,796**
Reinsurers' share of claims, benefits and surrenders paid	**(572)**	**–**	**(572)**
Reinsurers' share of movement in provisions	**(505)**	**–**	**(505)**
Reinsurers' share of claims and benefits paid and movement in liabilities to policyholders	**(1,077)**	**–**	**(1,077)**
Net insurance claims and benefits paid and movement in liabilities to policyholders	**14,697**	**22**	**14,719**
2016			
Claims, benefits and surrenders paid	8,393	7	8,400
Movement in provisions	6,889	(1)	6,888
Gross claims and benefits paid and movement in liabilities to policyholders	15,282	6	15,288
Reinsurers' share of claims, benefits and surrenders paid	(129)	–	(129)
Reinsurers' share of movement in provisions	(1,625)	–	(1,625)
Reinsurers' share of claims and benefits paid and movement in liabilities to policyholders	(1,754)	–	(1,754)
Net insurance claims and benefits paid and movement in liabilities to policyholders	13,528	6	13,534

13. Loan impairment charges and other credit risk provisions

	2017	2016
Net charge for impairment of loans and advances to customers (note 30(b)):		
Individually assessed impairment charges:		
– new charges	**542**	662
– releases	**(56)**	(43)
– recoveries	**(43)**	(80)
	443	539
Collectively assessed impairment charges	**599**	774
Loan impairment charges and other credit risk provisions	**1,042**	1,313

There was no impairment charge (2016: Nil) provided for available-for-sale debt securities, held-to-maturity debt securities and placings with and advances to banks by the Group in 2017.

14. Operating expenses

	2017	2016
Employee compensation and benefits:		
– salaries and other costs*	**4,720**	4,394
– retirement benefit costs		
– defined benefit scheme (note 52(a))	**194**	219
– defined contribution scheme (note 52(b))	**208**	194
	5,122	4,807
General and administrative expenses:		
– rental expenses	**614**	664
– other premises and equipment	**1,345**	1,235
– marketing and advertising expenses	**426**	499
– other operating expenses	**1,925**	1,828
	4,310	4,226
Depreciation of premises, plant and equipment (note 36(a))	**1,229**	1,114
Amortisation of intangible assets (note 37(c))	**107**	105
	10,768	10,252
* of which:		
share-based payments: (note 53(d))	**33**	29
Cost efficiency ratio	**30.5%**	33.5%

Included in operating expenses are minimum lease payments under operating lease of HK$629m (2016: HK$676m).

15. The emoluments of the five highest paid individuals
(a) The aggregate emoluments

	2017	2016
Salaries, allowances and benefits in kind	22	28
Payments in respect of termination of services/other payments	11	–
Retirement scheme contributions	1	2
Variable bonuses		
– Cash bonus	9	12
– Share-based payment	9	11
	52	53

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

	2017 Number of Individuals	2016 Number of Individuals
HK$		
5,500,001 – 6,000,000	–	1
6,000,001 – 6,500,000	–	1
6,500,001 – 7,000,000	2	–
8,000,001 – 8,500,000	–	1
11,000,001 – 11,500,000	1	–
11,500,001 – 12,000,000	–	1
12,000,001 – 12,500,000	1	–
14,500,001 – 15,000,000	1	–
20,500,001 – 21,000,000	–	1
	5	5

The emoluments of the five highest paid individuals set out above include the emoluments of three (2016: three) Executive Directors which are included in note 16. There is no Non-executive Director included in the table above (2016: Nil).

16. Directors' remunerations

The emoluments of the Directors of the Bank disclosed pursuant to section 383 of the Hong Kong Companies Ordinance (Cap.622) and the Companies (Disclosure of Information about Benefits of Directors) Regulation were set out below:

	Emoluments[11]							Payments in respect of termination of services/ other payments[8]		
				Variable bonus[5]						
				Cash		Shares				
	Fees '000	Salaries, allowances and benefits in kind[6] '000	Contribution to retirement benefit schemes[4] '000	Deferred '000	Non-deferred '000	Deferred '000	Non-deferred '000	'000	Total 2017 '000	Total 2016 '000
Executive Directors										
Ms Louisa Cheang, Chief Executive[1] (Appointed on 1 Jul 2017)	–	5,816	335	1,765	1,160	2,016	1,160	–	12,252	–
Ms Rose Lee, Chief Executive[1] (Resigned on 1 Jul 2017)	–	5,773	182	1,721	1,135	1,883	1,135	3,065[9]	14,894	20,719
Ms Margaret W H Kwan[1] (Appointed on 13 May 2017)	–	2,053	265	606	900	663	900	–	5,387	–
Mr Andrew H C Fung[1] (Resigned on 4 Jul 2017)	–	2,254	141	416	615	475	615	–	4,516	8,152
Mr Patrick Chan[1] (Resigned on 1 May 2017)	–	2,970	120	–	–	–	–	8,368[10]	11,458	10,635
Mr Nixon Chan[7] (Redesignated as NED on 1 Jul 2016)	–	–	–	–	–	–	–	–	–	3,889
Non-Executive Directors										
Dr Raymond K F Ch'ien[3]	800	–	–	–	–	–	–	–	800	740
Dr John C C Chan[3]	650	–	–	–	–	–	–	–	650	600
Mr Nixon Chan[7]	500	–	–	–	–	–	–	–	500	225
Ms L Y Chiang[3]	560	–	–	–	–	–	–	–	560	510
Mr Kenneth S Y Ng	500	–	–	–	–	–	–	–	500	450
Dr Fred Zuliu Hu[3]	660	–	–	–	–	–	–	–	660	610
Dr Henry K S Cheng[3]	500	–	–	–	–	–	–	–	500	450
Ms Irene Y L Lee[3]	920	–	–	–	–	–	–	–	920	870
Ms Sarah C Legg[2]	500	–	–	–	–	–	–	–	500	450
Dr Eric K C Li[3]	920	–	–	–	–	–	–	–	920	870
Dr Vincent H S Lo	500	–	–	–	–	–	–	–	500	450
Mr Richard Y S Tang[3]	868	–	–	–	–	–	–	–	868	820
Mr Peter T S Wong[2]	560	–	–	–	–	–	–	–	560	510
Mr Michael W K Wu[3]	720	–	–	–	–	–	–	–	720	670
Past Directors	–	–	2,214	–	–	–	–	–	2,214	2,287
	9,158	18,866	3,257	4,508	3,810	5,037	3,810	11,433	59,879	53,907
2016	8,225	22,409	3,249	5,037	4,975	5,037	4,975	–		

Notes:

(1) In line with the HSBC Group's remuneration policy, no Director's fees were paid to those Directors who were full time employees of the Bank or its subsidiaries.

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

(3) Independent Non-Executive Director.

(4) The aggregate amount of pensions received by the past Directors of the Bank under the relevant pension schemes amounted to HK$2.214m in 2017. The Bank made contributions during 2017 into the retirement benefit schemes of which the Bank's Directors are among their members.

(5) The amount of variable bonus comprises the cash and the estimated purchase cost of the award of HSBC Holdings Restricted Share. The bonus comprises the deferred and non-deferred variable pay, details of which are also set out in the section of "remuneration of director, senior management and key personnel" under "Corporate Governance Report". The details are also set out in note 54.

(6) Benefits in kind mainly include housing allowances and estimated money value of other non-cash benefits: share options, accommodation, car, insurance premium.

(7) Total emoluments for 2016 amounted to HK$4.114m.

(8) Settled by cash.

(9) Contractual payments of HK$3.065m representing payment in lieu of notice.

(10) Contractual payments of HK$4.168m (including HK$3.875m representing payment in lieu of notice) and other non-contractual payments of HK$4.2m.

(11) Remunerations/emoluments for Executive Directors are for services in connection with management of the affairs of the Hang Seng Bank and its subsidiary undertakings.

17. Auditors' remuneration

	2017	2016
Statutory audit services	21	13
Non-statutory audit services and others	9	9
	30	22

18. Net surplus/(deficit) on property revaluation

	2017	2016
Surplus/(deficit) of revaluation on investment properties	141	(37)

19. Tax expense

(a) Taxation in the consolidated income statement represents:

	2017	2016
Current tax – provision for Hong Kong profits tax		
Tax for the year	3,208	2,653
Adjustment in respect of prior years	70	(25)
	3,278	2,628
Current tax – taxation outside Hong Kong		
Tax for the year	49	52
Adjustment in respect of prior years	(3)	(1)
	46	51
Deferred tax (note 45(b))		
Origination and reversal of temporary differences	347	207
Total tax expense	3,671	2,886

The current tax provision is based on the estimated assessable profit for 2017, 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 (2016: 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.

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

	2017	2016
Profit before tax	23,674	19,090
Notional tax on profit before tax, calculated at Hong Kong tax rate of 16.5% (2016: 16.5%)	3,906	3,150
Tax effect of:		
– different tax rates in other countries/areas	12	15
– non-taxable income and non-deductible expenses	(423)	(268)
– share of results of associates	2	(15)
– others	174	4
Actual charge for taxation	3,671	2,886

20. Earnings per share – basic and diluted

The calculation of basic and diluted earnings per share is based on earnings of HK$19,693m in 2017 (2016: HK$15,866m) which is after the deduction of the coupon paid on AT1 capital instrument and on the weighted average number of ordinary shares in issue of 1,911,842,736 shares (unchanged from 2016).

21. Dividends per share

(a) Dividends attributable to the year:

	2017		2016	
	per share HK$	HK$m	per share HK$	HK$m
First interim	**1.20**	**2,294**	1.10	2,103
Second interim	**1.20**	**2,294**	1.10	2,103
Third interim	**1.20**	**2,294**	1.10	2,103
Fourth interim	**3.10**	**5,927**	2.80	5,353
	6.70	**12,809**	6.10	11,662

The fourth interim dividend are proposed after the balance sheet date, and have not been recognised as a liability at the balance sheet date.

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

	2017	2016
Fourth interim dividend and special interim dividend in respect of the previous year, approved and paid during the year, of HK$2.80 per share (2016: HK$5.40 per share)	**5,353**	10,324

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

	2017	2016
Coupon paid on AT1 capital instrument	**389**	346

22. 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 small and medium-sized enterprises ("SME") customers – including corporate lending, trade and receivable finance, payments and cash management, treasury and foreign exchange, general insurance, key-person insurance, investment services and corporate wealth management;

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

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

22. Segmental analysis continued

(a) Segmental result

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

	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Other	Total
2017					
Net interest income	13,667	7,030	3,953	(73)	24,577
Net fee income	4,444	1,820	290	201	6,755
Net trading income	412	507	1,457	8	2,384
Net income from financial instruments designated at fair value	1,763	5	5	–	1,773
Gains less losses from financial investments	30	–	18	–	48
Dividend income	24	–	–	164	188
Net insurance premium income	12,172	645	–	–	12,817
Other operating income	1,044	210	7	273	1,534
Total operating income	33,556	10,217	5,730	573	50,076
Net insurance claims and benefits paid and movement in liabilities to policyholders	(14,211)	(508)	–	–	(14,719)
Net operating income before loan impairment charges and other credit risk provisions	19,345	9,709	5,730	573	35,357
Loan impairment charges and other credit risk provisions	(490)	(544)	(8)	–	(1,042)
Net operating income	18,855	9,165	5,722	573	34,315
Operating expenses*	(6,384)	(2,816)	(967)	(601)	(10,768)
Operating profit	12,471	6,349	4,755	(28)	23,547
Net surplus on property revaluation	–	–	–	141	141
Share of losses from associates	(12)	–	–	(2)	(14)
Profit before tax	12,459	6,349	4,755	111	23,674
Share of profit before tax	52.6%	26.8%	20.1%	0.5%	100.0%
Operating profit excluding loan impairment charges and other credit risk provisions	12,961	6,893	4,763	(28)	24,589
* *Depreciation/amortisation included in operating expenses*	(25)	(4)	(2)	(1,305)	(1,336)
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
Non-current assets acquired during the year	148	11	1	561	721

22. Segmental analysis continued
(a) Segmental result continued

	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Other	Total
2016 (restated)					
Net interest income	12,195	6,132	3,993	(66)	22,254
Net fee income	3,798	1,662	292	187	5,939
Net trading income/(loss)	(46)	251	1,394	86	1,685
Net income/(loss) from financial instruments designated at fair value	94	(6)	(4)	(11)	73
Gains less losses from financial investments	65	–	33	7	105
Dividend income	1	–	–	189	190
Net insurance premium income	10,458	601	–	–	11,059
Other operating income	2,348	185	7	288	2,828
Total operating income	28,913	8,825	5,715	680	44,133
Net insurance claims and benefits paid and movement in liabilities to policyholders	(13,049)	(485)	–	–	(13,534)
Net operating income before loan impairment charges and other credit risk provisions	15,864	8,340	5,715	680	30,599
Loan impairment releases/(charges) and other credit risk provisions	(733)	(590)	10	–	(1,313)
Net operating income	15,131	7,750	5,725	680	29,286
Operating expenses*	(6,400)	(2,499)	(919)	(434)	(10,252)
Operating profit	8,731	5,251	4,806	246	19,034
Net deficit on property revaluation	–	–	–	(37)	(37)
Share of profits from associates	93	–	–	–	93
Profit before tax	8,824	5,251	4,806	209	19,090
Share of profit before tax	46.2%	27.5%	25.2%	1.1%	100.0%
Operating profit excluding loan impairment charges and other credit risk provisions	9,464	5,841	4,796	246	20,347
* *Depreciation/amortisation included in operating expenses*	(28)	(5)	(2)	(1,184)	(1,219)
At 31 December 2016					
Total assets	411,949	305,914	586,740	72,639	1,377,242
Total liabilities	798,473	254,521	161,387	22,175	1,236,556
Interest in associates	2,273	–	–	1	2,274
Non-current assets acquired during the year	189	11	1	698	899

22. Segmental analysis continued

(b) Geographic information

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

	Hong Kong	Mainland China	Others	Inter-segment elimination	Total
Year ended 31 December 2017					
Total operating income	**47,940**	**1,917**	**286**	**(67)**	**50,076**
Profit before tax	**23,242**	**241**	**191**	**–**	**23,674**
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**
Contingent liabilities and commitments	**388,347**	**59,573**	**5,549**	**–**	**453,469**
Year ended 31 December 2016					
Total operating income	41,849	2,097	266	(79)	44,133
Profit before tax	18,640	277	173	–	19,090
At 31 December 2016					
Total assets	1,292,392	102,552	20,063	(37,765)	1,377,242
Total liabilities	1,154,324	91,171	19,301	(28,240)	1,236,556
Equity	138,068	11,381	762	(9,525)	140,686
Share capital	9,658	9,669	–	(9,669)	9,658
Interest in associates	2,273	1	–	–	2,274
Non-current assets*	50,170	987	18	–	51,175
Contingent liabilities and commitments	351,252	43,156	5,752	–	400,160

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

23. Analysis of assets and liabilities by remaining maturity

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

	Within one month	Over one month but within three months	Over three months but within one year	Over one year but within five years	Over five years	Trading	No contractual maturity	Total
2017								
Assets								
Cash and sight balances at central banks	21,718	–	–	–	–	–	–	21,718
Placings with and advances to banks	61,977	37,346	1,404	1,331	1,055	–	–	103,113
Trading assets	–	–	–	–	–	53,704	–	53,704
Financial assets designated at fair value	400	–	4	8	380	–	8,521	9,313
Derivative financial instruments	24	173	181	448	1	10,009	–	10,836
Loans and advances to customers	93,111	50,647	137,915	305,287	219,613	–	–	806,573
Financial investments	68,248	81,072	63,361	106,404	59,965	–	6,211	385,261
	245,478	169,238	202,865	413,478	281,014	63,713	14,732	1,390,518
Interest in associates								2,170
Investment properties								10,166
Premises, plant and equipment								28,499
Intangible assets								15,354
Other assets								31,711
								1,478,418
Liabilities								
Current, savings and other deposit accounts	969,741	64,244	39,425	1,427	–	–	–	1,074,837
Repurchase agreements – non trading	2,389	–	–	–	–	–	–	2,389
Deposits from banks	3,676	–	–	–	–	–	–	3,676
Trading liabilities	–	–	–	–	–	88,270	–	88,270
Financial liabilities designated at fair value	3	–	–	493	551	–	–	1,047
Derivative financial instruments	10	35	362	752	5	10,005	–	11,169
Certificates of deposit and other debt securities in issue	600	–	–	–	–	–	–	600
	976,419	64,279	39,787	2,672	556	98,275	–	1,181,988
Other liabilities								22,222
Liabilities under insurance contracts								115,545
Current tax liabilities								568
Deferred tax liabilities								6,016
								1,326,339

23. Analysis of assets and liabilities by remaining maturity continued

	Within one month	Over one month but within three months	Over three months but within one year	Over one year but within five years	Over five years	Trading	No contractual maturity	Total
2016								
Assets								
Cash and sight balances at central banks	23,299	–	–	–	–	–	–	23,299
Placings with and advances to banks	43,855	55,459	1,855	1,277	1,014	–	–	103,460
Trading assets	–	–	–	–	–	44,427	–	44,427
Financial assets designated at fair value	–	–	–	15	354	–	8,154	8,523
Derivative financial instruments	1	60	645	1,130	12	14,847	–	16,695
Loans and advances to customers	76,525	51,881	125,415	244,106	201,065	–	–	698,992
Financial investments	37,522	102,800	87,371	113,347	52,796	–	4,301	398,137
	181,202	210,200	215,286	359,875	255,241	59,274	12,455	1,293,533
Interest in associates								2,274
Investment properties								9,960
Premises, plant and equipment								26,772
Intangible assets								14,443
Other assets								30,260
								1,377,242
Liabilities								
Current, savings and other deposit accounts	872,985	77,259	37,648	1,647	–	–	–	989,539
Repurchase agreements – non trading	1,805	–	–	–	–	–	–	1,805
Deposits from banks	12,958	1,117	–	–	–	–	–	14,075
Trading liabilities	–	–	–	–	–	68,124	–	68,124
Financial liabilities designated at fair value	3	–	3,002	482	504	–	–	3,991
Derivative financial instruments	–	13	142	426	2	12,720	–	13,303
Certificates of deposit and other debt securities in issue	–	–	5,116	–	–	–	–	5,116
Subordinated liabilities	–	–	–	–	2,327	–	–	2,327
	887,751	78,389	45,908	2,555	2,833	80,844	–	1,098,280
Other liabilities								24,765
Liabilities under insurance contracts								108,326
Current tax liabilities								25
Deferred tax liabilities								5,160
								1,236,556

24. Accounting classifications

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

	Trading	Designated at fair value	Available-for-sale/ hedging	Held-to-maturity	Loans and receivables	Other amortised cost	Total
2017							
Cash and sight balances at central banks	–	–	–	–	14,309	7,409	21,718
Placings with and advances to banks	–	–	–	–	103,113	–	103,113
Derivative financial instruments	10,009	–	827	–	–	–	10,836
Loans and advances to customers	–	–	–	–	806,573	–	806,573
Investment securities	51,599	9,313	290,204	95,057	–	–	446,173
Acceptances and endorsements	–	–	–	–	5,108	–	5,108
Other financial assets	2,105	–	–	–	13,805	–	15,910
Total financial assets	63,713	9,313	291,031	95,057	942,908	7,409	1,409,431
Non-financial assets							68,987
Total assets							1,478,418
Current, savings and other deposit accounts	36,507	–	–	–	–	1,074,837	1,111,344
Repurchase agreements – non-trading	–	–	–	–	–	2,389	2,389
Deposits from banks	–	–	–	–	–	3,676	3,676
Derivative financial instruments	10,005	4	1,160	–	–	–	11,169
Certificates of deposit and other debt securities in issue	2,929	493	–	–	–	600	4,022
Other financial liabilities	48,834	–	–	–	–	15,632	64,466
Subordinated liabilities	–	–	–	–	–	–	–
Liabilities to customers under investment contracts	–	554	–	–	–	–	554
Acceptances and endorsements	–	–	–	–	–	5,108	5,108
Total financial liabilities	98,275	1,051	1,160	–	–	1,102,242	1,202,728
Non-financial liabilities							123,611
Total liabilities							1,326,339

24. Accounting classifications continued

	Trading	Designated at fair value	Available-for-sale/ hedging	Held-to-maturity	Loans and receivables	Other amortised cost	Total
2016							
Cash and sight balances at central banks	–	–	–	–	15,681	7,618	23,299
Placings with and advances to banks	–	–	–	–	103,460	–	103,460
Derivative financial instruments	14,847	1	1,847	–	–	–	16,695
Loans and advances to customers	–	–	–	–	698,992	–	698,992
Investment securities	38,629	8,523	311,237	86,900	–	–	445,289
Acceptances and endorsements	–	–	–	–	5,292	–	5,292
Other financial assets	5,798	–	–	–	12,573	–	18,371
Total financial assets	59,274	8,524	313,084	86,900	835,998	7,618	1,311,398
Non-financial assets							65,844
Total assets							1,377,242
Current, savings and other deposit accounts	26,090	–	–	–	–	989,539	1,015,629
Repurchase agreements – non-trading	–	–	–	–	–	1,805	1,805
Deposits from banks	–	–	–	–	–	14,075	14,075
Derivative financial instruments	12,720	8	575	–	–	–	13,303
Certificates of deposit and other debt securities in issue	5,026	3,484	–	–	–	5,116	13,626
Other financial liabilities	37,008	–	–	–	–	17,520	54,528
Subordinated liabilities	–	–	–	–	–	2,327	2,327
Liabilities to customers under investment contracts	–	507	–	–	–	–	507
Acceptances and endorsements	–	–	–	–	–	5,292	5,292
Total financial liabilities	80,844	3,999	575	–	–	1,035,674	1,121,092
Non-financial liabilities							115,464
Total liabilities							1,236,556

25. Cash and sight balances at central banks

	2017	2016
Cash in hand	**7,409**	7,618
Sight balances at central banks	**14,309**	15,681
	21,718	23,299

26. Placings with and advances to banks

	2017	2016
Balances with banks	**5,182**	7,456
Placings with and advances to banks maturing within one month	**56,795**	36,399
Placings with and advances to banks maturing after one month but less than one year	**38,750**	57,314
Placings with and advances to banks maturing after one year	**2,386**	2,291
	103,113	103,460
of which:		
Placings with and advances to central banks	**11,248**	10,785

There were no overdue advances, impaired advances and rescheduled advances to banks at 31 December 2017 (2016: Nil).

27. Trading assets

	2017	2016
Treasury bills	**33,066**	27,733
Other debt securities	**18,509**	10,880
Debt securities	**51,575**	38,613
Investment funds	**24**	16
Total trading securities	**51,599**	38,629
Other*	**2,105**	5,798
Total trading assets	**53,704**	44,427

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

28. Financial assets designated at fair value

	2017	2016
Treasury bills	**400**	–
Other debt securities	**392**	369
Debt securities	**792**	369
Equity shares	**5,486**	4,648
Investment funds	**3,035**	3,506
	9,313	8,523

29. Derivative financial instruments

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

All activities relating to derivatives are subject to the same credit approval and monitoring standards used to control credit risk for other transactions. Market risk from derivative positions is controlled individually and in combination with on-balance sheet market risk positions within the Group's market risk limits regime as described in the Management Discussion and Analysis.

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

	2017			2016		
	Contract amounts	**Derivative assets**	**Derivative liabilities**	Contract amounts	Derivative assets	Derivative liabilities
Derivatives held for trading						
Exchange rate contracts	**808,696**	**7,893**	**8,284**	857,540	13,102	10,983
Interest rate contracts	**379,937**	**1,327**	**1,386**	247,284	1,387	1,479
Equity and other contracts	**42,591**	**789**	**335**	29,480	358	258
Total derivatives held for trading	**1,231,224**	**10,009**	**10,005**	1,134,304	14,847	12,720
Derivatives managed in conjunction with financial assets designated at fair value						
Interest rate contracts	**500**	**–**	**4**	3,500	1	8
Cash flow hedge derivatives						
Exchange rate contracts	**22,531**	**375**	**926**	27,151	1,511	181
Interest rate contracts	**18,026**	**55**	**30**	13,341	–	51
	40,557	**430**	**956**	40,492	1,511	232
Fair value hedge derivatives						
Interest rate contracts	**48,539**	**397**	**204**	46,296	336	343
Total derivatives	**1,320,820**	**10,836**	**11,169**	1,224,592	16,695	13,303

Trading derivatives

Most of the Group's trading derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities in derivatives include market-making and risk management.

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

Hedging instruments

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

(a) Fair value hedge

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

29. Derivative financial instruments continued

Hedging instruments continued

(b) Cash flow hedge

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

Gains and losses are initially recognised in equity, in the cash flow hedging reserve, and are transferred to the income statement when the forecast cash flows affect the income statement. During the year ended 31 December 2017, the amount of cash flow hedging reserve transferred to the income statement consist of HK$310m (2016: HK$175m) in net interest income and HK$2,259m in net trading loss (2016: HK$749m net trading income).

There was HK$1m (2016: HK$18m) gain of ineffectiveness recognised in the Group's income statement arising from cash flow hedge during 2017. During 2017, there were no termination made for forecast transactions for which hedge accounting had previously been used but which were no longer expected to occur. (2016: loss of HK$1m).

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

	Three months or less	Over three months but within one year	Over one year but within five years	Over five years
At 31 December 2017				
Cash inflows from assets	**26,248**	**28,462**	**16,457**	**321**
Cash outflows from liabilities	**–**	**–**	**–**	**–**
Net cash inflows	**26,248**	**28,462**	**16,457**	**321**
At 31 December 2016				
Cash inflows from assets	21,071	36,633	17,991	–
Cash outflows from liabilities	–	–	–	–
Net cash inflows	21,071	36,633	17,991	–

30. Loans and advances to customers

(a) Loans and advances to customers

	2017	2016
Gross loans and advances to customers	**808,170**	700,851
Less:		
Loan impairment allowances		
– individually assessed	**(602)**	(923)
– collectively assessed	**(995)**	(936)
	806,573	698,992

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

	2017 **%**	2016 %
Loan impairment allowances:		
– individually assessed	**0.08**	0.13
– collectively assessed	**0.12**	0.13
Total loan impairment allowances	**0.20**	0.26

30. Loans and advances to customers continued

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

	Individually assessed	Collectively assessed	Total
2017			
At 1 January	**923**	**936**	**1,859**
Amounts written off	**(790)**	**(646)**	**(1,436)**
Recoveries of loans and advances written off in previous years	**43**	**87**	**130**
New impairment allowances charged to income statement (note 13)	**542**	**686**	**1,228**
Impairment allowances released to income statement (note 13)	**(99)**	**(87)**	**(186)**
Unwinding of discount of loan impairment allowances recognised as "interest income"	**(45)**	**(4)**	**(49)**
Exchange difference	**28**	**23**	**51**
At 31 December	**602**	**995**	**1,597**
2016			
At 1 January	807	808	1,615
Amounts written off	(430)	(698)	(1,128)
Recoveries of loans and advances written off in previous years	80	74	154
New impairment allowances charged to income statement (note 13)	662	848	1,510
Impairment allowances released to income statement (note 13)	(123)	(74)	(197)
Unwinding of discount of loan impairment allowances recognised as "interest income"	(55)	(5)	(60)
Exchange difference	(18)	(17)	(35)
At 31 December	923	936	1,859

(c) Impaired loans and advances to customers and allowances

	2017	2016
Gross impaired loans and advances	**1,970**	3,235
Individually assessed allowances	**(602)**	(923)
Net impaired loans and advances	**1,368**	2,312
Individually assessed allowances as a percentage of gross impaired loans and advances	**30.6%**	28.5%
Gross impaired loans and advances as a percentage of gross loans and advances to customers	**0.24%**	0.46%

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

	2017	2016
Gross individually assessed impaired loans and advances	**1,718**	2,968
Individually assessed allowances	**(602)**	(923)
	1,116	2,045
Gross individually assessed impaired loans and advances as a percentage of gross loans and advances to customers	**0.21%**	0.42%
Amount of collateral which has been taken into account in respect of individually assessed impaired loans and advances to customers	**958**	1,701

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

30. Loans and advances to customers continued

(d) Overdue loans and advances to customers

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

		%
2017		
Gross loans and advances which have been overdue with respect to either principal or interest for periods of:		
– more than three months but not more than six months	**162**	**0.02**
– more than six months but not more than one year	**253**	**0.03**
– more than one year	**1,226**	**0.15**
	1,641	**0.20**
of which:		
– individually impaired allowances	**(589)**	
– covered portion of overdue loans and advances	**880**	
– uncovered portion of overdue loans and advances	**761**	
– current market value of collateral held against the covered portion of overdue loans and advances	**1,488**	
2016		
Gross loans and advances which have been overdue with respect to either principal or interest for periods of:		
– more than three months but not more than six months	438	0.06
– more than six months but not more than one year	580	0.08
– more than one year	1,336	0.19
	2,354	0.33
of which:		
– individually impaired allowances	(726)	
– covered portion of overdue loans and advances	1,419	
– uncovered portion of overdue loans and advances	935	
– current market value of collateral held against the covered portion of overdue loans and advances	2,653	

Collateral held with respect to overdue loans and advances is mainly residential properties and commercial properties. The current market value of residential properties and commercial properties were HK$1,221m and HK$200m respectively (2016: HK$1,349m and HK$390m respectively).

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

30. Loans and advances to customers continued

(e) Rescheduled loans and advances to customers

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

		%
2017	**118**	**0.01**
2016	458	0.07

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

Rescheduled loans and advances to customers are stated net of any advances which have subsequently become overdue for more than three months and which are included in "Overdue loans and advances to customers" (note 30(d)).

(f) 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 is as follows:

	2017		2016	
		% 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	**62,715**	**46.5**	51,935	44.4
– property investment	**136,214**	**81.4**	119,553	86.4
– financial concerns	**8,757**	**59.8**	5,049	55.0
– stockbrokers	**150**	**13.3**	141	92.9
– wholesale and retail trade	**27,523**	**44.4**	26,880	48.5
– manufacturing	**23,548**	**40.2**	23,079	41.6
– transport and transport equipment	**14,153**	**55.0**	9,302	67.7
– recreational activities	**191**	**29.7**	48	77.8
– information technology	**7,027**	**1.1**	6,624	13.3
– other	**65,039**	**66.5**	46,523	66.0
	345,317	**63.2**	289,134	65.7
Individuals				
– loans and advances for the purchase of flats under the Government Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	**22,046**	**100.0**	17,808	100.0
– loans and advances for the purchase of other residential properties	**174,068**	**100.0**	161,165	100.0
– credit card loans and advances	**29,229**	**–**	27,019	–
– other	**24,888**	**48.3**	20,385	43.0
	250,231	**83.2**	226,377	82.9
Total gross loans and advances for use in Hong Kong	**595,548**	**71.6**	515,511	73.2
Trade finance	**47,125**	**21.1**	43,235	22.7
Gross loans and advances for use outside Hong Kong	**165,497**	**35.3**	142,105	33.0
Gross loans and advances to customers	**808,170**	**61.2**	700,851	62.0

30. Loans and advances to customers continued

(g) Net investments in finance leases

Loans and advances to customers include net investments in equipment leased to customers under finance leases and hire purchase contracts having the characteristics of finance leases. The contracts usually run for an initial period of 5 to 25 years, with an option for acquiring by the lessee the leased asset at nominal value at the end of the lease period. The total minimum lease payments receivable and their present value at the year-end are as follows:

	2017	2016
Finance leases	**–**	–
Hire purchase contracts	**6,794**	6,041
	6,794	6,041

	Present value of minimum lease payments receivable	**Interest income relating to future periods**	**Total minimum lease payments receivable**
2017			
Amounts receivable:			
– within one year	**304**	**130**	**434**
– after one year but within five years	**1,624**	**455**	**2,079**
– after five years	**4,866**	**896**	**5,762**
	6,794	**1,481**	**8,275**
Loans impairment allowances	**–**		
Net investments in finance leases and hire purchase contracts	**6,794**		
2016			
Amounts receivable:			
– within one year	302	118	420
– after one year but within five years	1,202	415	1,617
– after five years	4,537	811	5,348
	6,041	1,344	7,385
Loans impairment allowances	–		
Net investments in finance leases and hire purchase contracts	6,041		

31. Financial investments

	2017	2016
Available-for-sale at fair value:		
– treasury bills	**153,592**	180,951
– debt securities	**130,401**	125,985
– equity securities (including investment funds)	**6,211**	4,301
	290,204	311,237
Held-to-maturity at amortised cost:		
– treasury bills	**700**	–
– debt securities	**94,357**	86,900
	95,057	86,900
	385,261	398,137

There was no overdue debt securities at 31 December 2017 (2016: Nil). The Group did not hold any asset-backed securities, mortgage-backed securities and collateralised debt obligations.

There was no financial investments determined to be impaired at 31 December 2017 (2016: Nil).

32. Assets transferred, assets charged as security for liabilities, and collateral accepted as security for assets

(a) Financial assets pledged to secure liabilities

	2017	2016
Trading assets and financial investments	**55,860**	42,588

The table above shows assets where a charge has been granted to secure liabilities on a legal and contractual basis.

These transactions are conducted under terms that are usual and customary to collateralised transactions including, where relevant, standard securities lending and repurchase agreements.

(b) Transferred financial assets not qualifying for full derecognition and their associated financial liabilities

	2017		2016	
	Carrying amount of transferred assets	**Carrying amount of associated liabilities**	Carrying amount of transferred assets	Carrying amount of associated liabilities
Repurchase agreement	**2,619**	**2,389**	1,852	1,805
Securities lending agreements	**1,481**	**–**	2,574	–
	4,100	**2,389**	4,426	1,805

The financial assets shown above include amounts transferred to third parties that do not qualify for derecognition are mainly debt securities held by counterparties as collateral under repurchase agreements. As the substance of these transactions is secured borrowings, the collateral assets continue to be recognised in full and the related liabilities, reflecting the Group's obligation to repurchase the transferred assets for a fixed price at a future date, are also recognised on the balance sheet. As a result of these transactions, the Group is unable to use, sell or pledge the transferred assets for the duration of the transactions. The Group remains exposed to interest rate risk, credit risk and market risk on these pledged instruments. The counterparty's recourse is not limited to the transferred assets.

(c) Collateral accepted as security for assets

There were no collateral permitted to sell or repledge in the absence of default and collateral actually sold or repledged in 2017 and 2016.

33. Subsidiaries

The following is a list of the principal subsidiaries at 31 December 2017:

Name of company	Place of incorporation	Principal activities	Issued equity capital
Hang Seng Bank (China) Limited	People's Republic of China	Banking	RMB8,317,500,000
Hang Seng Finance Limited	Hong Kong SAR	Lending	HK$1,000,000,000
Hang Seng Credit Limited	Hong Kong SAR	Lending	HK$200,000,000
Hang Seng Bank (Trustee) Limited	Hong Kong SAR	Trustee service	HK$3,000,000
Hang Seng (Nominee) Limited	Hong Kong SAR	Nominee service	HK$100,000
Hang Seng Life Limited	Hong Kong SAR	Retirement benefits and life assurance	HK$970,000,000
Hang Seng Insurance Company Limited	Hong Kong SAR	Retirement benefits and life assurance	HK$6,426,184,570
Hang Seng Investment Management Limited	Hong Kong SAR	Fund management	HK$10,000,000
Haseba Investment Company Limited	Hong Kong SAR	Investment holding	HK$6,000
Hang Seng Securities Limited	Hong Kong SAR	Stockbroking	HK$26,000,000
Yan Nin Development Company Limited	Hong Kong SAR	Investment holding	HK$100,000
Hang Seng Indexes Company Limited	Hong Kong SAR	Compilation and dissemination of the Hang Seng share index	HK$10,000
Hang Seng Real Estate Management Limited	Hong Kong SAR	Property management	HK$10,000
High Time Investments Limited	Hong Kong SAR	Investment holding	HK$2,250,010,000

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

In 2016, the Bank and Shenzhen Qianhai Financial Holdings Company Limited ("QFH") established a joint venture, Hang Seng Qianhai Fund Management Company Limited ("Hang Seng Qianhai Fund Management"). Hang Seng Qianhai Fund Management is the first foreign-majority-owned joint venture fund management company established on the Mainland under Supplement X to the Mainland and Hong Kong Closer Economic Partnership Arrangement ("CEPA"). The Bank has a 70% stake in the joint venture and QFH holds 30%. The principal activities of the subsidiary include fund raising, fund sales and asset management. The place of incorporation of Hang Seng Qianhai Fund Management is People's Republic of China with an issued equity capital of RMB200,000,000.

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

34. Interest in associates

	2017	2016
Share of net assets	**2,170**	2,274

The associates are:

Name of company	Place of incorporation and operation	Principal activity	Group's interest in equity capital	Issued equity capital
Unlisted				
Barrowgate Limited	Hong Kong SAR	Property investment	24.64%	HK$10,000
GZHS Research Co., Ltd.	People's Republic of China	Conduct market/ securities analysis and publish research reports	33.00%	RMB44,680,000

The interests in Barrowgate Limited and GZHS Research Co., Ltd. ("GZHS") are owned by the subsidiaries of the Bank.

The above two associates are accounted for using the equity method in the consolidated financial statements as at 31 December 2017 and 2016.

For the year ended 31 December 2017, the financial results of GZHS was included in the financial statements based on financial statements drawn up to 30 September 2017, but taking into account any changes in the subsequent period from 1 October 2017 to 31 December 2017 that would materially affect the results. The Group has taken advantage of the provision contained in HKAS 28 (2011) *"Investments in Associates and Joint Ventures"* whereby it is permitted to include the attributable share of associates' results based on accounts drawn up to a non-coterminous period end where the difference must be no greater than three months.

	Assets	Liabilities	Equity	Revenue	Expenses	Revenue less expenses
2017						
100 per cent	**10,154**	**1,348**	**8,806**	**198**	**252**	**(54)**
The Group's effective interest	**2,505**	**335**	**2,170**	**51**	**65**	**(14)**
2016						
100 per cent	10,521	1,295	9,226	608	232	376
The Group's effective interest	2,596	322	2,274	154	61	93

At 31 December 2017, the investment in GZHS was tested for impairment by estimating the recoverable amount of the investment based on "value in use". Nil impairment loss was recognised since the recoverable amount exceeded the carrying amount (2016: Nil).

35. Investment properties

The Group's investment properties were revalued by Cushman & Wakefield Limited, an independent professional valuer, at 30 November 2017, and were updated for any material changes in the valuation as at 31 December 2017. The valuations were carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of valuations of investment properties were market value which is consistent with the definition of fair value under HKFRS 13 *"Fair Value Measurement"* and take into account the highest and best use of the property from the perspective of market participants.

(a) Movement of investment properties

	2017	2016
At 1 January	**9,960**	10,075
Surplus on revaluation credited to income statement	**206**	5
Transfer to premises (note 36(a))	**–**	(120)
At 31 December	**10,166**	9,960
Representing:		
– measure at valuation	**10,166**	9,960

(b) Terms of lease

	2017	2016
Leaseholds		
Held in Hong Kong:		
– long leases (over 50 years unexpired)	**1,840**	1,797
– medium leases (10 to 50 years unexpired)	**8,326**	8,163
	10,166	9,960

(c) The Group leases out investment properties under operating leases. The leases typically run for an initial period of 2 to 3 years, and may contain an option to renew the lease after that date at which time all terms are renegotiated. None of the leases includes contingent rentals.

	2017	2016
Direct operating expenses arising from investment properties	**35**	29
Direct operating expenses arising from investment properties that generated rental income	**31**	25

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

	2017	2016
Less than one year	**256**	267
Over one year but within five years	**132**	165
Over five years	**–**	–
	388	432

36. Premises, plant and equipment

The Group's premises were revalued by Cushman & Wakefield Limited, an independent professional valuer, at 30 November 2017, and were updated for any material changes in the valuation as at 31 December 2017. The valuations were carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of valuations of premises were market value which is consistent with the definition of fair value under HKFRS 13 *"Fair Value Measurement"* and take into account the highest and best use of the property from the perspective of market participants.

(a) Movement of premises, plant and equipment

	Premises	Plant and equipment	Total
2017			
Cost or valuation:			
At 1 January	25,409	4,934	30,343
Additions	244	375	619
Disposals	–	(104)	(104)
Elimination of accumulated depreciation on revalued premises	(837)	–	(837)
Surplus on revaluation:			
– credited to premises revaluation reserve	2,285	–	2,285
Exchange adjustments and other	56	36	92
At 31 December	27,157	5,241	32,398
Accumulated depreciation:			
At 1 January	–	(3,571)	(3,571)
Exchange adjustments	–	–	–
Charge for the year (note 14)	(837)	(392)	(1,229)
Written off on disposal	–	94	94
Elimination of accumulated depreciation on revalued premises	837	(30)	807
At 31 December	–	(3,899)	(3,899)
Net book value at 31 December	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

36. Premises, plant and equipment continued

(a) Movement of premises, plant and equipment continued

	Premises	Plant and equipment	Total
2016			
Cost or valuation:			
At 1 January	25,108	4,505	29,613
Additions	147	655	802
Disposals	–	(192)	(192)
Elimination of accumulated depreciation on revalued premises	(764)	–	(764)
Surplus on revaluation:			
– credited to premises revaluation reserve	853	–	853
Transfer from investment properties (note 35(a))	120	–	120
Exchange adjustments and other	(55)	(34)	(89)
At 31 December	25,409	4,934	30,343
Accumulated depreciation:			
At 1 January	–	(3,427)	(3,427)
Exchange adjustments	–	27	27
Charge for the year (note 14)	(764)	(350)	(1,114)
Written off on disposal	–	179	179
Elimination of accumulated depreciation on revalued premises	764	–	764
At 31 December	–	(3,571)	(3,571)
Net book value at 31 December	25,409	1,363	26,772
Representing:			
– measure at cost	–	1,363	1,363
– measure at valuation	25,409	–	25,409
	25,409	1,363	26,772

(b) Terms of lease

The net book value of premises comprises:

	2017	2016
Leaseholds		
Held in Hong Kong:		
– long leases (over 50 years unexpired)	**2,514**	2,441
– medium leases (10 to 50 years unexpired)	**23,648**	22,144
Held outside Hong Kong:		
– long leases (over 50 years unexpired)	**–**	–
– medium leases (10 to 50 years unexpired)	**995**	824
	27,157	25,409

36. Premises, plant and equipment continued

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

	2017	2016
Cost less accumulated depreciation at 31 December	6,481	6,401

(d) Fair value measurement of properties

(i) Fair value hierarchy

The level into which a fair value measurement is classified for properties is determined with reference to the observability and significance of the inputs used in the valuation technique as follows:

Level 1: Fair value measured using unadjusted quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2: Fair value measured using observable inputs and not using significant unobservable inputs. Unobservable inputs are inputs for which market data are not available.

Level 3: Fair value measured using significant unobservable inputs.

The resultant values of both investment properties and properties held for own use for the Group were Level 3 in the fair value hierarchy as defined in HKFRS 13 *"Fair value measurement"*. During the year ended 31 December 2017, there were no transfers into or out of Level 3. (2016: Nil)

The fair value of investment properties is determined using Investment Approach on the basis of capitalisation of net incomes with due allowance for outgoings and reversionary income potential.

The fair values of the majorities of properties owned and occupied by the Group in Hong Kong and the PRC are determined using Direct Comparison Approach assuming sale with immediate vacant possession and by making reference to comparable sales evidence.

For properties with development potentials, their values are on redevelopment basis and reported upon the assessment on the basis that each of these properties will be developed to its full potential and completed to a good standard. The fair values are determined using Direct Comparison Approach by making reference to comparable sales transactions as available in the relevant market and have also taken into account the development costs that will be expended to complete the development.

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

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

	Investment properties	Properties held for own use
At 1 January 2017	9,960	25,409
Additions	–	244
Depreciation for the year	–	(837)
Surplus on revaluation:		
– credited to premises revaluation reserve	–	2,285
– credited to income statement	206	–
Transfer	–	–
Exchange adjustments and other	–	56
At 31 December 2017	10,166	27,157
Unrealised gains or losses recognised in profit or loss relating to those assets held at the end of the reporting period		
– other operating income	65	–
– net surplus on property revaluation	141	–
– depreciation of premises, plant and equipment	–	(837)

36. Premises, plant and equipment continued
(d) Fair value measurement of properties continued
(i) Fair value hierarchy continued
Reconciliation of fair value measurements in Level 3 of the fair value hierarchy continued

	Investment properties	Properties held for own use
At 1 January 2016	10,075	25,108
Additions	–	147
Depreciation for the year	–	(764)
Surplus on revaluation:		
– credited to premises revaluation reserve	–	853
– credited to income statement	5	–
Transfer	(120)	120
Exchange adjustments and other	–	(55)
At 31 December 2016	9,960	25,409
Unrealised gains or losses recognised in profit or loss relating to those assets held at the end of the reporting period		
– other operating income	42	–
– net deficit on property revaluation	(37)	–
– depreciation of premises, plant and equipment	–	(764)

(ii) Information about significant unobservable inputs in Level 3 valuations

	Valuation technique(s)	Unobservable input(s)	Range 2017	Range 2016
Investment properties	Investment approach	Market yields (reversionary yield)	**2.5% to 5.0%**	2.7% to 5.0%
		Market rental	**HK$16.1 to HK$799 per square foot**	HK$18.4 to HK$780 per square foot
Premises held for own use	Direct comparison approach	Premium (discount) on characteristic of the properties	**–20% to 20%**	–20% to 20%

The fair value measurement for investment properties is positively correlated to the market rental but inversely correlated to the market yields. The valuations for premises held for own use take into account the characteristic of the properties which included the location, size, shape, view, floor level, year of completion and other factors collectively. Higher premium for properties with better characteristic will result in a higher fair value measurement.

37. Intangible assets

	2017	2016
Present value of in-force long-term insurance business	**14,574**	13,664
Internally developed software	**375**	394
Acquired software	**76**	56
Goodwill	**329**	329
	15,354	14,443

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

	2017	2016
At 1 January	**13,664**	11,431
Addition from current year new business (note 11)	**2,192**	1,906
Movement from in-force business (note 11)	**(1,282)**	327
At 31 December	**14,574**	13,664

The key assumptions used in the computation of "PVIF" are as follows:

	2017	2016
Risk discount rate	**5.4%**	5.4%
Expenses inflation	**3.0%**	3.0%
Average lapse rate:		
– 1st year	**3.0%**	3.2%
– 2nd year onwards	**5.1%**	2.1%

The sensitivity of PVIF valuation to changes in individual assumptions at the balance sheet dates is shown in the Management Discussion and Analysis.

(b) Goodwill

	2017	2016
At 1 January and at 31 December	**329**	329

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

During 2017, there was no impairment of goodwill (2016: Nil). Impairment testing in respect of goodwill is performed annually by comparing the recoverable amount of cash generating unit based on appraisal value with the carrying amount of its net assets, including attributable goodwill.

The appraisal value comprises HSIC's net assets (other than value of business acquired and goodwill), the PVIF and the expected value of future business as at 31 December 2017. The PVIF is determined by discounting future earnings expected from the current business, taking into account factors such as future mortality, lapse rates, levels of expenses and risk discount rate. The above details are shown in note 37(a) and the Management Discussion and Analysis.

37. Intangible assets continued

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

	2017	2016
Cost:		
At 1 January	**1,489**	1,418
Additions	**102**	97
Disposals	**(4)**	(17)
Exchange and others	**13**	(9)
At 31 December	**1,600**	1,489
Accumulated amortisation:		
At 1 January	**(1,039)**	(957)
Charge for the year (note 14)	**(107)**	(105)
Written off on disposal	**4**	17
Exchange and others	**(7)**	6
At 31 December	**(1,149)**	(1,039)
Net book value at 31 December	**451**	450

During 2017, no impairment (2016: Nil) was made on internally developed application software and acquired software.

38. Other assets

	2017	2016
Items in the course of collection from other banks	**6,464**	6,354
Bullion	**4,127**	4,440
Prepayments and accrued income	**3,773**	3,378
Acceptances and endorsements	**5,108**	5,292
Reinsurers' share of liabilities under insurance contracts (note 44)	**8,232**	7,395
Other accounts	**4,007**	3,401
	31,711	30,260

Other accounts include "Assets held for sale" of HK$42m (2016: HK$24m). It also includes "Retirement benefit assets" of HK$54m (2016: HK$45m).

There was no accumulated loss recognised directly in equity relating to assets held for sale for 2017 and 2016.

There was no significant impaired, overdue or rescheduled other assets at the year-end of 2017 and 2016.

39. Current, savings and other deposit accounts

	2017	2016
Current, savings and other deposit accounts:		
– as stated in consolidated balance sheet	**1,074,837**	989,539
– structured deposits reported as trading liabilities (note 40)	**36,507**	26,090
	1,111,344	1,015,629
By type:		
– demand and current accounts	**117,525**	99,051
– savings accounts	**757,828**	686,371
– time and other deposits	**235,991**	230,207
	1,111,344	1,015,629

40. Trading liabilities

	2017	2016
Other structured debt securities in issue (note 42)	**2,929**	5,026
Structured deposits (note 39)	**36,507**	26,090
Short positions in securities and others	**48,834**	37,008
	88,270	68,124

41. Financial liabilities designated at fair value

	2017	2016
Certificates of deposit in issue (note 42)	**493**	3,484
Liabilities to customers under investment contracts	**554**	507
	1,047	3,991

At 31 December 2017, the accumulated gain in fair value attributable to changes in credit risk for certificates of deposit in issue was HK$5m (2016: HK$7m).

42. Certificates of deposit and other debt securities in issue

	2017	2016
Certificates of deposit and other debt securities in issue:		
– as stated in consolidated balance sheet	**600**	5,116
– certificates of deposit in issue designated at fair value (note 41)	**493**	3,484
– other structured debt securities in issue reported as trading liabilities (note 40)	**2,929**	5,026
	4,022	13,626
By type:		
– certificates of deposit in issue	**1,093**	7,484
– other debt securities in issue	**2,929**	6,142
	4,022	13,626

43. Other liabilities

	2017	2016
Items in the course of transmission to other banks	**8,987**	11,276
Accruals	**3,511**	3,201
Acceptances and endorsements	**5,108**	5,292
Retirement benefit liabilities	**89**	626
Other	**4,527**	4,370
	22,222	24,765

44. Liabilities under insurance contracts

	Gross	Reinsurers' share[1]	Net
2017			
Non-linked insurance contracts			
At 1 January	**108,256**	**(7,395)**	**100,861**
Benefits paid	**(9,298)**	**572**	**(8,726)**
Increase in liabilities to policyholders	**15,774**	**(1,077)**	**14,697**
Exchange and other movements	**732**	**(332)**	**400**
At 31 December	**115,464**	**(8,232)**	**107,232**
Linked insurance contracts			
At 1 January	**70**	**–**	**70**
Benefits paid	**(11)**	**–**	**(11)**
Increase in liabilities to policyholders	**22**	**–**	**22**
Exchange and other movements	**–**	**–**	**–**
At 31 December	**81**	**–**	**81**
	115,545	**(8,232)**	**107,313**
2016			
Non-linked insurance contracts			
At 1 January	101,746	(5,782)	95,964
Benefits paid	(8,393)	129	(8,264)
Increase in liabilities to policyholders	15,282	(1,754)	13,528
Exchange and other movements	(379)	12	(367)
At 31 December	108,256	(7,395)	100,861
Linked insurance contracts			
At 1 January	71	–	71
Benefits paid	(7)	–	(7)
Increase in liabilities to policyholders	6	–	6
Exchange and other movements	–	–	–
At 31 December	70	–	70
	108,326	(7,395)	100,931

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

45. Current tax and deferred tax

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

	2017	2016
Included in "Other assets":		
Current taxation recoverable	**3**	197
Deferred tax assets	**211**	158
	214	355
Current tax liabilities:		
Provision for Hong Kong profits tax	**546**	5
Provision for taxation outside Hong Kong	**22**	20
	568	25
Deferred tax liabilities	**6,016**	5,160
	6,584	5,185

(b) Deferred tax assets and liabilities recognised

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

	Depreciation allowances in excess of related depreciation	Revaluation of properties	Loan impairment allowances	Fair value adjustments for available-for-sale financial assets	Cash flow hedge	Other	Total
2017							
At 1 January	**231**	**3,455**	**(243)**	**(28)**	**(25)**	**1,612**	**5,002**
Exchange adjustment	**(5)**	**2**	**(9)**	**(2)**	**–**	**(3)**	**(17)**
Charged/(credited) to income statement (note 19(a))	**(19)**	**(95)**	**144**	**–**	**–**	**317**	**347**
Charged/(credited) to reserves	**–**	**381**	**–**	**(7)**	**6**	**93**	**473**
At 31 December	**207**	**3,743**	**(108)**	**(37)**	**(19)**	**2,019**	**5,805**
2016							
At 1 January	188	3,410	(193)	31	(1)	1,267	4,702
Exchange adjustment	–	(4)	12	(2)	–	3	9
Charged/(credited) to income statement (note 19(a))	43	(95)	(62)	–	–	321	207
Charged/(credited) to reserves	–	144	–	(57)	(24)	21	84
At 31 December	231	3,455	(243)	(28)	(25)	1,612	5,002

(c) Deferred tax assets not recognised

The amounts of unused tax losses and other temporary difference for which no deferred tax asset is recognised in the balance sheet are HK$595m and HK$201m (2016: HK$264m and HK$257m) respectively. Of these amounts, HK$252m and HK$201m (2016: HK$238m and HK$257m) have no expiry date and the remaining will expire within 10 years.

(d) Deferred tax liabilities not recognised

There were no deferred tax liabilities not recognised as at 31 December 2017 (31 December 2016: Nil).

46. Subordinated liabilities

Nominal value	Description	2017	2016
Amount owed to HSBC Group undertakings			
US$300 million	Floating rate subordinated loan due July 2022[1]	–	2,327
Representing:			
– measured at amortised cost		–	2,327

1 The Bank exercised its option in 2017 to redeem the subordinated loan at par of US$300m.

The Group has not had any defaults of principal, interest or other breaches with respect to its debt securities during the years of 2017 and 2016.

47. Share capital

	2017		2016	
	No. of shares	HK$	No. of shares	HK$
Ordinary shares, issued and fully paid				
At 1 January and 31 December	**1,911,842,736**	**9,658**	1,911,842,736	9,658

48. Other equity instruments

Nominal value	Description	2017	2016
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.

49. Contingent liabilities and commitments

(a) Off-balance sheet contingent liabilities and commitments

	2017	2016
Contingent liabilities and financial guarantee contracts		
Guarantee and irrevocable letters of credit pledged as collateral security	**15,267**	17,925
Other contingent liabilities	**61**	91
	15,328	18,016
Commitments		
Documentary credits and short-term trade-related transactions	**3,188**	2,110
Forward asset purchases and forward forward deposits placed	**983**	788
Undrawn formal standby facilities, credit lines and other commitments to lend	**433,970**	379,246
	438,141	382,144

The above table discloses the nominal principal amounts of commitments (excluding capital commitments), guarantees and other contingent liabilities, which 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. As a significant portion of guarantees and commitments is 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.

50. Other commitments

(a) Capital commitments

At 31 December 2017, capital commitments, mainly related to the commitment for renovation of branches and offices, were HK$540m (2016: HK$555m).

(b) Lease commitments

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

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

	2017	2016
Within one year	**566**	598
Between one and five years	**721**	1,010
Over five years	**1**	35
	1,288	1,643

51. Offsetting of financial assets and financial liabilities

	Amounts subject to enforceable netting arrangements								
	Effects of offsetting in the balance sheet			Amounts not set off in the balance sheet					
	Gross amounts	Amounts offset	Amounts reported in the balance sheet	Financial instruments	Non-cash collateral	Cash collateral	Net amount	Amounts not subject to enforceable netting agreements[1]	Balance sheet total
Financial assets									
Derivatives	**9,716**	**–**	**9,716**	**(8,044)**	**–**	**(796)**	**876**	**1,120**	**10,836**
Reverse repos, stock borrowing and similar agreements classified as:	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
– trading assets	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
– non-trading assets	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Loans and advances to customers at amortised cost	**2,305**	**(1,226)**	**1,079**	**–**	**–**	**–**	**1,079**	**–**	**1,079**
At 31 December 2017	**12,021**	**(1,226)**	**10,795**	**(8,044)**	**–**	**(796)**	**1,955**	**1,120**	**11,915[2]**
Derivatives	15,687	–	15,687	(11,202)	–	(2,262)	2,223	1,008	16,695
Reverse repos, stock borrowing and similar agreements classified as:	–	–	–	–	–	–	–	–	–
– trading assets	–	–	–	–	–	–	–	–	–
– non-trading assets	–	–	–	–	–	–	–	–	–
Loans and advances to customers at amortised cost	836	(770)	66	–	–	–	66	–	66
At 31 December 2016	16,523	(770)	15,753	(11,202)	–	(2,262)	2,289	1,008	16,761
Financial liabilities									
Derivatives	**9,918**	**–**	**9,918**	**(8,044)**	**–**	**(1,362)**	**512**	**1,251**	**11,169**
Repos, stock lending and similar agreements classified as:	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**2,389**	**2,389**
– trading liabilities	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
– non-trading liabilities	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**2,389**	**2,389**
Customer accounts at amortised cost	**1,231**	**(1,226)**	**5**	**–**	**–**	**–**	**5**	**–**	**5**
At 31 December 2017	**11,149**	**(1,226)**	**9,923**	**(8,044)**	**–**	**(1,362)**	**517**	**3,640**	**13,563[3]**
Derivatives	12,321	–	12,321	(11,202)	–	(734)	385	982	13,303
Repos, stock lending and similar agreements classified as:	–	–	–	–	–	–	–	1,805	1,805
– trading liabilities	–	–	–	–	–	–	–	–	–
– non-trading liabilities	–	–	–	–	–	–	–	1,805	1,805
Customer accounts at amortised cost	904	(770)	134	–	–	–	134	–	134
At 31 December 2016	13,225	(770)	12,455	(11,202)	–	(734)	519	2,787	15,242

1 These exposures continue to be secured by financial collateral, but the Bank may not have sought or been able to obtain a legal opinion evidencing enforceability of the offsetting right.

2 Amounts presented in the balance sheet included balances due from HSBC entities of HK$2,405m (2016: HK$2,574m).

3 Amounts presented in the balance sheet included balances due to HSBC entities of HK$2,092m (2016: HK$3,167m).

51. Offsetting of financial assets and financial liabilities continued

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

The "Amounts not set off in the balance sheet" for derivatives and reverse repurchase/repurchase, stock borrowing/lending and similar arrangements include transactions where:

- the counterparty has an offsetting exposure with the group and a master netting or similar arrangement is in place with a right of set off only in the event of default, insolvency or bankruptcy, or the offset criteria are otherwise not satisfied; and
- cash and non-cash collaterals are received and pledged in respect of the transactions described above.

52. Employee retirement benefits

(a) Defined benefit schemes

The Group operates three defined benefit schemes, the Hang Seng Bank Limited Defined Benefit Scheme ("HSBDBS"), which is the principal scheme which covers about 23 per cent of the Group's employees, and two other schemes, the Hang Seng Bank Limited Pension Scheme ("HSBPS") and the Hang Seng Bank Limited Non-contributory Terminal Benefits Scheme ("HSBNTBS"). HSBDBS was closed to new entrants with effect from 1 April 1999, and HSBPS and HSBNTBS were closed to new entrants with effect from 31 December 1986. Since the defined benefit section of the HSBDBS is a final salary lump sum scheme, its exposure to longevity risk and interest rate risk is limited.

These schemes are registered under Occupational Retirement Schemes Ordinance (Cap. 426 of the law of Hong Kong) ("the Ordinance"). These schemes are administered by trustees, with their assets held separately from those of the Group. The trustees are required by the Trust Deed to act in the best interest of the scheme participants and are responsible for setting investment policies of the schemes.

HSBDBS is predominantly a funded scheme with assets which is held under insurance policy separate from the Group. HSBDBS is reviewed at least on a triennial basis in accordance with local regulations. The actuarial assumptions used to calculate the defined benefit obligations of HSBDBS vary according to the economic conditions.

HSBDBS mainly invests in bonds and equities and each investment manager has been assigned an investment mandate with the targeted asset allocation. The ranges of target asset allocations for the portfolio are as follows: Bonds (0 – 72%) and Equity (0 – 28%).

(i) Cumulative actuarial gains/(losses) recognised in other comprehensive income in respect of defined benefit schemes

	2017	2016
At 1 January	**(1,312)**	(1,439)
Actuarial gains recognised in other comprehensive income	**564**	127
At 31 December	**(748)**	(1,312)

52. Employee retirement benefits continued

(a) Defined benefit schemes continued

(ii) Movements in the scheme assets and present value of the defined benefit obligations

Net asset/(liability) under defined benefit schemes

	Fair value of scheme assets	Present value of defined benefit obligations	Net defined benefit (liability)/asset
At 1 January 2017	**4,618**	**(5,199)**	**(581)**
Current service cost (note 14)	**–**	**(182)**	**(182)**
Interest income/(cost) on the defined benefit scheme asset/(liability) (note 14)	**83**	**(93)**	**(10)**
Remeasurement effects recognised in other comprehensive income	**624**	**(60)**	**564**
– Actuarial gains from changes in demographic assumptions	**–**	**43**	**43**
– Actuarial losses from changes in financial assumptions	**–**	**(93)**	**(93)**
– Actuarial gains/(losses) from experience	**624**	**(10)**	**614**
Contributions by the Group	**175**	**–**	**175**
Benefits paid	**(479)**	**479**	**–**
Administrative costs and taxes paid by scheme (note 14)	**(2)**	**–**	**(2)**
At 31 December 2017	**5,019**	**(5,055)**	**(36)**
Retirement benefit liabilities recognised in balance sheet (included in "Other liabilities")	**4,814**	**(4,903)**	**(89)**
Retirement benefit assets recognised in balance sheet (included in "Other accounts" of "Other assets")	**205**	**(152)**	**53**
Present value of defined benefit obligation relating to:			
– Actives		**(4,906)**	
– Pensioners		**(149)**	

The Group expects to make HK$175m of contributions to defined benefit schemes during 2018.

	Fair value of scheme assets	Present value of defined benefit obligations	Net defined benefit (liability)/asset
At 1 January 2016	4,594	(5,565)	(971)
Current service cost (note 14)	–	(202)	(202)
Interest income/(cost) on the defined benefit scheme asset/(liability) (note 14)	77	(92)	(15)
Remeasurement effects recognised in other comprehensive income	(104)	231	127
– Actuarial gains from changes in demographic assumptions	–	–	–
– Actuarial gains from changes in financial assumptions	–	496	496
– Actuarial losses from experience	(104)	(265)	(369)
Contributions by the Group	482	–	482
Benefits paid	(429)	429	–
Administrative costs and taxes paid by scheme (note 14)	(2)	–	(2)
At 31 December 2016	4,618	(5,199)	(581)
Retirement benefit liabilities recognised in balance sheet (included in "Other liabilities")	4,414	(5,040)	(626)
Retirement benefit assets recognised in balance sheet (included in "Other accounts" of "Other assets")	204	(159)	45
Present value of defined benefit obligation relating to:			
– Actives		(5,043)	
– Pensioners		(156)	

52. Employee retirement benefits continued

(a) Defined benefit schemes continued

(iii) Benefits expected to be paid

Benefits expected to be paid from the HSBDBS, HSBPS and HSBNTBS to retirees over each of the next five years, and in aggregate for the five years thereafter, are as follows:

	2018	2019	2020	2021	2022	2023-2027
HSBDBS	379	471	499	566	574	1,867
HSBPS/HSBNTBS	13	12	12	11	10	43

The duration of the principal scheme HSBDBS is 6.4 years (2016: 7.3 years) under the disclosure assumptions adopted.

(iv) Fair value of scheme assets by asset classes

	Value	Quoted market price in active market	Of which placed with the Group
2017			
Fair value of scheme assets			
– Equities	**1,401**	**1,401**	**–**
– Bonds	**3,480**	**3,480**	**–**
– Other*	**138**	**138**	**53**
	5,019	**5,019**	**53**
2016			
Fair value of scheme assets			
– Equities	2,387	2,387	–
– Bonds	1,732	1,732	–
– Other*	499	499	409
	4,618	4,618	409

* Other mainly consists of cash and deposits.

(v) The Principal Scheme's actuarial financial assumptions

These schemes are funded defined benefit schemes and are administered by trustees with assets held separately from those of the Group. The latest annual actuarial valuations at 31 December 2017 were performed by Joseph Yip, Fellow of the Society of Actuaries of the United States, of Mercer (Hong Kong) Limited, using the Attained Age Method.

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

On an on-going basis, the value of the principal scheme assets of HSBDBS represented 112 per cent (2016: 101 per cent) of the benefits accrued to scheme members, after allowing for expected future increases in salaries, and the resulting surplus amounted to HK$501m (surplus in 2016: HK$44m). On a wind-up basis, the actuarial value of the HSBDBS assets represented 113 per cent (2016: 102 per cent) of the members' vested benefits, based on salaries at that date, and the resulting surplus amounted to HK$546m (surplus in 2016: HK$75m).

The determinations for actuarial funding valuation purposes are based on different methods and assumptions from those used for financial reporting purposes, and as a result should neither be compared nor related to other determinations included in these financial statements.

52. Employee retirement benefits continued

(a) Defined benefit schemes continued

(v) The Principal Scheme's actuarial financial assumptions continued

The present value of the principal scheme's obligation was a final lump sum salary of HK$4,903m (2016: HK$5,040m). The principal actuarial assumptions used to calculate the Group's obligations for the HSBDBS for each year, and used as the basis for measuring the expenses in relation to the scheme, were as follows:

Principal actuarial assumptions for the principal scheme

	HSBDBS %
2017	
Discount rate	**1.70**
Expected rate of salary increases	**3.00**
of which:	
– 2018	**3.00**
– thereafter	**3.00**
2016	
Discount rate	1.85
Expected rate of salary increases	2.80
of which:	
– 2017	2.80
– thereafter	2.80

The Group determines the discount rates to be applied to its obligations in consultation with the schemes' actuaries, on the basis of current average yields of high quality (AA rated or equivalent) debt instruments, with maturities consistent with those of the defined benefit obligations. Where there is not a deep market in corporate bonds, government bond yields have been used, and this is the case for HSBDBS. The yield curve has been extrapolated where the term of the liabilities is longer than the duration of available bonds and the discount rate used then takes into account the term of the liabilities and the shape of the yield curve.

(vi) Actuarial assumption sensitivities

The discount rate and rate of pay increase are sensitive to changes in market conditions arising during the reporting year. The following table shows the effect of changes in these on the HSBDBS:

The effect of changes in key assumptions:

	HSBDBS	
	2017	2016
Discount rate		
– change in retirement benefit obligation at year end from a 25bps increase	**(76)**	(89)
– change in retirement benefit obligation at year end from a 25bps decrease	**78**	92
– change in 2018/2017 retirement benefit cost from a 25bps increase	**(4)**	(4)
– change in 2018/2017 retirement benefit cost from a 25bps decrease	**4**	3
Rate of pay increase		
– change in retirement benefit obligation at year end from a 25bps increase	**86**	101
– change in retirement benefit obligation at year end from a 25bps decrease	**(84)**	(98)
– change in 2018/2017 retirement benefit cost from a 25bps increase	**5**	6
– change in 2018/2017 retirement benefit cost from a 25bps decrease	**(5)**	(6)

52. Employee retirement benefits continued

(b) Defined contribution schemes

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

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

	2017	2016
Amounts charged to the income statement (note 14)	**208**	194

Under the schemes, the Group's contributions are reduced by contributions forfeited by those employees who leave the schemes prior to the contributions vesting fully. The forfeited contributions utilised during the year or available at the year-end to reduce future contributions is HK$0.5m (2016: HK$0.5m).

53. Share-based payments

The Group participated in various share compensation plans as listed in the following tables that are operated by the HSBC Group for acquiring of HSBC Holdings plc shares. These are to be settled by the delivery of shares of HSBC Holdings plc.

Share awards and option plans

Award	**Policy**
Restricted Share Awards	– Vesting of awards generally subject to continued employment with the Group – Vesting often staggered over a period ranging from three to five years – Certain shares subject to a retention requirement post-vesting – Awards are generally subject to the rules of Share Plan and any performance conditions – Awards granted from 2010 onwards are subject to clawback provision prior to vesting
International Employee Share Purchase Plan	– The plan was introduced in 2013. – Eligible employees make contributions up to the local equivalent of GBP250 per month which are applied in the purchase of shares on a quarterly basis. For every three shares purchased, the employee is granted a matching award by the HSBC Group of one share – The matching award vests subject to continued employment with the Group and retention of the purchased shares in the plan until the third anniversary of the start of the relevant plan year
Savings-related Share Option Plan	– Eligible employees save up to the local equivalent of GBP250 per month, with the option to use the savings to acquire shares. The last grant of options under this plan was in 2012 – Exercisable within six months following either the third or fifth anniversaries of the commencement of three-year or five-year contracts, respectively – The option price is set at a 20% discount to the market value preceding the date of invitation

53. Share-based payments continued

(a) Savings-related share option plan

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

Option scheme with exercise price set in Hong Kong dollars

	2017		2016	
	Weighted average exercise price HK$	**Number ('000)**	Weighted average exercise price HK$	Number ('000)
Outstanding at 1 January	**55.47**	**79**	56.60	194
Exercised in the year	**55.47**	**(62)**	55.47	(10)
Less: Cancellation/Lapsed in the year	**55.47**	**(7)**	56.60	(105)
Outstanding at 31 December	**55.47**	**10**	55.47	79
Exercisable at 31 December	**–**	**–**	–	–

The weighted average share price at the date of exercise for share options exercised during the year was HK$75.77 (2016: HK$54.43).

The options outstanding at the year end of 2017 had an exercise price of HK$55.47 (2016: HK$55.47), and a weighted average remaining contractual life of 0.08 years (2016: 1.08 years).

No share option was granted during 2017 and 2016.

(b) HSBC share awards

	2017	2016
	Number ('000)	Number ('000)
Outstanding at 1 January	**1,131**	886
Additions during the year	**537**	808
Less: Released/lapsed in the year	**(650)**	(563)
Outstanding at 31 December	**1,018**	1,131

The closing price of the HSBC Holdings plc share at 31 December 2017 was £7.67 (2016: £6.57).

The weighted average remaining vesting period as at 31 December 2017 was 0.60 years (2016: 0.64 years).

(c) Calculation of fair value

The fair values of share options at the date of grant of the options are calculated using a Black-Scholes model. The fair value of a share award is based on the share price at the date of the grant.

(d) Income statement charge

	2017	2016
Restricted share awards	**21**	17
Savings-related share awards and option plans	**12**	12
Income statement charge (note 14)	**33**	29
Equity-settled share-based payments	**26**	29
Cash-settled share-based payments	**7**	–
	33	29

The above charge was computed from the fair values of the share-based payment transaction when contracted, that arose under employee share awards made in accordance with HSBC's reward structures.

54. Material related-party transactions

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

In 2017, the Group entered into transactions with its immediate holding company, its subsidiaries and fellow subsidiary companies in the ordinary course of its interbank activities mainly including lending activities, acceptance and placement of interbank deposits, correspondent banking transactions, off-balance sheet transactions and the provision of other banking and financial services. The activities were on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

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

There was an arrangement whereby a fellow subsidiary provided certain management services to Hang Seng Insurance Company Limited. The fees on these transactions are determined on an arm's length basis.

During 2017, the Bank has paid coupon on AT1 capital instrument of HK$389m to its immediate holding company (2016: HK$346m).

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

	Immediate holding company and its subsidiaries		Fellow subsidiaries		Associates#	
	2017	2016	**2017**	2016	**2017**	2016
Interest income	**92**	73	**2**	8	**29**	12
Interest expense	**(209)**	(232)	**–**	–	**(6)**	(1)
Other operating income	**95**	73	**(9)**	(6)	**–**	–
Operating expenses*	**(538)**	(674)	**(1,010)**	(871)	**(31)**	(30)
Amounts due from:						
Placings with and advances to banks	**8,795**	17,608	**807**	1,017	**3,765**	3,470
Financial assets designated at fair value	**–**	–	**–**	–	**–**	–
Derivative financial instruments	**2,324**	2,420	**81**	154	**–**	–
Loans and advances to customers	**–**	–	**–**	–	**233**	233
Financial investments	**–**	–	**–**	–	**–**	–
Other assets	**449**	297	**9**	9	**8**	6
	11,568	20,325	**897**	1,180	**4,006**	3,709
Amounts due to:						
Current, savings and other deposit accounts	**1,631**	1,432	**–**	–	**685**	669
Deposits from banks	**1,073**	7,785	**25**	–	**128**	76
Repurchase agreements – non-trading	**–**	766	**–**	–	**–**	–
Derivative financial instruments	**1,851**	2,338	**241**	829	**–**	–
Certificates of deposit and other debt securities in issue	**–**	4,000	**–**	–	**–**	–
Subordinated liabilities	**–**	2,327	**–**	–	**–**	–
Other liabilities	**596**	499	**203**	176	**–**	–
	5,151	19,147	**469**	1,005	**813**	745
Derivative contracts:						
Contract amount	**340,544**	207,553	**24,013**	35,124	**–**	–

* 2017 operating expenses included payment of HK$61m (2016: HK$64m) of software costs which were capitalised as intangible assets in the balance sheet of the Group.
# Representing associates in HSBC Group.

54. Material related-party transactions continued

(b) Key management personnel remuneration

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group and Bank. It includes members of the Board of Directors and Executive Committee of the Bank. During the year, the members of the Bank's Executive Committee remained unchanged at 14. The amount of remuneration paid to key management personnel was pro-rata from the date of being appointed as Directors of the Bank or members of Executive Committee, if any. The aggregate amount of remuneration of the key management personnel during the year are as follows:

	2017	2016
Salaries, allowances and benefits in kind	**59**	60
Payments in respect of termination of services/other payments	**11**	–
Retirement scheme contributions	**4**	4
Variable bonuses		
– Cash bonus	**22**	23
– Share-based payment	**16**	14
	112	101

(c) Material transactions with key management personnel

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

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

	2017	2016
For the year		
Interest income	**396**	413
Interest expense	**41**	46
Fees and commission income	**56**	39
Maximum aggregate amount of loans and advances	**29,760**	17,048
At the year-end		
Loans and advances	**23,854**	13,971
Deposits	**11,575**	9,459
Guarantees issued	**57**	69
Undrawn commitments	**2,531**	2,350

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

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

54. Material related-party transactions continued

(d) Loans to Directors

Particulars of loans to directors disclosed pursuant to section 17 of the Companies (Disclosure of Information about Benefits of Directors) Regulations for the year ended 31 December 2017 are shown as below.

	2017	2016
Aggregate amount of relevant transactions outstanding at 31 December		
– Loans and advances	22,118	12,966
– Guarantees issued	53	69
Maximum aggregate amount of relevant transactions during the year		
– Loans and advances	27,744	15,534
– Guarantees issued	429	76

The above relevant transactions in 2017 were all transacted by the Bank.

(e) Directors' material interests in transactions, arrangements or contracts

No transaction, arrangement or contract (that is significant in relation to the Bank's business), to which the Bank or any of its holding companies or any of its subsidiaries or fellow subsidiaries was a party and in which a Director of the Bank had, directly or indirectly, a material interest, subsisted as at the end of the year or at any time during the year.

(f) Associates

Information relating to associates and transactions with associates can be found in notes 34 and 54(a).

The Group maintains a shareholders' loan to an associate. The shareholders' loan is unsecured, interest free and with no fixed term of repayment. The balance at 31 December 2017 was HK$233m (2016: HK$233m).

(g) Ultimate holding company

The Group participates in various share option and share plans operated by HSBC Holdings plc whereby share options or shares of HSBC Holdings plc are granted to employees of the Group. As disclosed in note 53, the Group recognises an expense in respect of these share options and share awards. The cost borne by the ultimate holding company in respect of these share options and share awards is treated as a capital contribution and is recorded under "Other reserves". The balance of this reserve as at 31 December 2017 amounted to HK$638m comprising HK$668m relating to share option schemes and negative reserve amounted to HK$30m relating to share award schemes (2016: HK$657m comprising HK$668m relating to share option schemes and negative reserve amounted to HK$11m relating to share award schemes).

(h) Employee retirement benefits

At 31 December 2017, defined benefit scheme assets amounted to HK$4,988m (2016: HK$3,374m) was under management by the Bank's subsidiary company and the related fee paid was HK$11m (2016: HK$7m).

55. Fair value of financial instruments

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

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

	Valuation techniques					
	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3	Third party total	Amounts with HSBC entities*	Total
Recurring fair value measurements						
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**
2016						
Assets						
Trading assets	37,407	7,020	–	44,427	–	44,427
Financial assets designated at fair value	5,655	2,141	727	8,523	–	8,523
Derivative financial instruments	453	13,636	32	14,121	2,574	16,695
Available-for-sale financial investments	212,522	97,493	1,222	311,237	–	311,237
Liabilities						
Trading liabilities	36,856	31,189	79	68,124	–	68,124
Financial liabilities designated at fair value	–	3,991	–	3,991	–	3,991
Derivative financial instruments	48	10,042	46	10,136	3,167	13,303

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

	Assets				Liabilities		
	Available-for-sale	Held for trading	Designated at fair value through profit or loss	Derivatives	Held for trading	Designated at fair value through profit or loss	Derivatives
At 31 December 2017							
Transfer from Level 1 to Level 2	**1,463**	**9,437**	**–**	**–**	**–**	**–**	**–**
Transfer from Level 2 to Level 1	**–**	**–**	**–**	**–**	**–**	**–**	**–**
At 31 December 2016							
Transfer from Level 1 to Level 2	–	–	–	–	–	–	–
Transfer from Level 2 to Level 1	–	–	–	–	–	–	–

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

55. Fair value of financial instruments continued

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

Control framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk-taker.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the Group will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable.

For fair values determined using a valuation model, the control framework may include, as applicable, development or validation by independent support functions of (i) the logic within valuation models; (ii) the inputs to those models; (iii) any adjustments required outside the valuation models; and (iv) where possible, model outputs. Valuation models are subject to a process of due diligence and calibration before becoming operational and are calibrated against external market data on an ongoing basis.

To this end, ultimate responsibility for the determination of fair values lies with Finance. Finance establishes the accounting policies and procedures governing valuation, and is responsible for ensuring compliance with all relevant accounting standards.

Determination of fair value

Fair values are determined according to the following hierarchy:

(i) Level 1: Quoted market price

Financial instruments with quoted prices for identical instruments in active markets that the Group can assess at the measurement date.

(ii) Level 2: Valuation technique using observable inputs

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

(iii) Level 3: Valuation technique with significant unobservable inputs

Financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. In inactive markets, obtaining assurance that the transaction price provides evidence of fair value or determining the adjustments to transaction prices that are necessary to measure the fair value of the instrument requires additional work during the valuation process.

Financial liabilities measured at fair value

Structured notes issued and certain other hybrid instrument liabilities are included within trading liabilities and are measured at fair value. The credit spread applied to these instruments is derived from the spreads at which the Group issues structured notes.

Fair value adjustments

Fair value adjustments are adopted when the Group considers that there are additional factors that would be considered by a market participant that are not incorporated within the valuation model. Movements in the level of fair value adjustments do not necessarily result in the recognition of profits or losses within the income statement. For example, as models are enhanced, fair value adjustments may no longer be required.

55. Fair value of financial instruments continued

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

Fair value adjustments continued

Risk-related adjustments

– Bid-offer

HKFRS 13 requires use of the price within the bid-offer spread that is most representative of fair value. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the extent to which bid-offer cost would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the position.

– Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, an adjustment may be necessary to reflect the likelihood that market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the Group's valuation model.

– Credit valuation adjustment ("CVA") and debit valuation adjustment ("DVA")

The CVA is an adjustment to the valuation of over-the-counter ("OTC") derivative contracts to reflect within fair value the possibility that the counterparty may default and that the Group may not receive the full market value of the transactions.

The DVA is an adjustment to the valuation of OTC derivative contracts to reflect the possibility that the Group may default, and that the Group may not pay the full market value of the transactions.

The Group calculates a separate CVA and DVA for each legal entity, and for each counterparty to which the entity has exposure. With the exception of central clearing parties, all third-party counterparties are included in the CVA and DVA calculations, and these adjustments are not netted across Group entities.

The Group calculates the CVA by applying the probability of default ("PD") of the counterparty, conditional on the non-default of the Group, to the Group's expected positive exposure to the counterparty and multiplying the result by the loss expected in the event of default. Conversely, the Group calculates the DVA by applying the PD of the Group, conditional on the non-default of the counterparty, to the expected positive exposure of the counterparty to the Group and multiplying the result by the loss expected in the event of default. Both calculations are performed over the life of the potential exposure.

For most products the Group uses a simulation methodology, which incorporates a range of potential exposures over the life of the portfolio, to calculate the expected positive exposure to a counterparty. The simulation methodology includes credit mitigants, such as counterparty netting agreements and collateral agreements with the counterparty.

The methodologies do not, in general, account for "wrong-way risk" which arises when the underlying value of the derivative prior to any CVA is positively correlated to the PD of the counterparty. When there is significant wrong-way risk, a trade-specific approach is applied to reflect this risk in the valuation.

– Funding fair value adjustment

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

Model-related adjustments

– Model limitation

Models used for portfolio valuation purposes may be based upon a simplifying set of assumptions that do not capture all material market characteristics. In these circumstances, model limitation adjustments are adopted.

– Inception profit (Day 1 P&L reserves)

Inception profit adjustments are adopted where the fair value estimated by a valuation model is based on one or more significant unobservable inputs.

55. Fair value of financial instruments continued

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

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

	Assets				Liabilities		
	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
2017							
Private equity	**1,455**	**–**	**1,832**	**–**	**–**	**–**	**–**
Structured notes	**–**	**–**	**–**	**–**	**392**	**–**	**–**
Derivatives	**–**	**–**	**–**	**8**	**–**	**–**	**3**
	1,455	**–**	**1,832**	**8**	**392**	**–**	**3**
2016							
Private equity	1,222	–	727	–	–	–	–
Structured notes	–	–	–	–	79	–	–
Derivatives	–	–	–	32	–	–	46
	1,222	–	727	32	79	–	46

Movement in Level 3 financial instruments

	Assets				Liabilities		
	Available-for-sale	Held for trading	Designated at fair value through profit or loss	Derivatives	Held for trading	Designated at fair value through profit or loss	Derivatives
At 1 January 2017	**1,222**	**–**	**727**	**32**	**79**	**–**	**46**
Total gains or losses recognised in profit or loss							
– trading income	**–**	**–**	**–**	**(12)**	**(165)**	**–**	**(28)**
– net income from financial instruments designated at fair value	**–**	**–**	**325**	**–**	**–**	**–**	**–**
– gains less losses from financial investments	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Total gains or losses recognised in other comprehensive income							
– fair value gains	**233**	**–**	**–**	**–**	**–**	**–**	**–**
– exchange differences	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Purchases	**–**	**–**	**997**	**–**	**–**	**–**	**–**
Issues/deposit taking	**–**	**–**	**–**	**–**	**762**	**–**	**–**
Sales	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Settlements	**–**	**–**	**(217)**	**–**	**(66)**	**–**	**–**
Transfers out	**–**	**–**	**–**	**(12)**	**(218)**	**–**	**(16)**
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	**–**	**–**	**–**	**8**	**6**	**–**	**(2)**
– net income from financial instruments designated at fair value	**–**	**–**	**325**	**–**	**–**	**–**	**–**

55. Fair value of financial instruments continued

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

Movement in Level 3 financial instruments continued

	Assets				Liabilities		
	Available-for-sale	Held for trading	Designated at fair value through profit or loss	Derivatives	Held for trading	Designated at fair value through profit or loss	Derivatives
At 1 January 2016	1,161	–	547	13	27	–	3
Total gains or losses recognised in profit or loss							
– trading income	–	–	–	20	(3)	–	43
– net income from financial instruments designated at fair value	–	–	34	–	–	–	–
– gains less losses from financial investments	–	–	–	–	–	–	–
Total gains or losses recognised in other comprehensive income							
– fair value gains	61	–	–	–	–	–	–
– exchange differences	–	–	–	–	–	–	–
Purchases	–	–	458	–	–	–	–
Issues/deposit taking	–	–	–	–	225	–	–
Sales	–	–	–	–	–	–	–
Settlements	–	–	(312)	–	(169)	–	–
Transfers out	–	–	–	(1)	(1)	–	–
Transfers in	–	–	–	–	–	–	–
At 31 December 2016	1,222	–	727	32	79	–	46
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	–	–	–	32	3	–	(46)
– net income from financial instruments designated at fair value	–	–	34	–	–	–	–

In 2017, the transfer out of Level 3 derivative assets and liabilities was predominantly resulted from increase in observability in equity volatilities. In respect of the held for trading liabilities, the transfer out of level 3 reflected the change in observability of correlations between equity and equity index used for pricing the instrument.

55. 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

As discussed above, 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.

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
2017				
Private equity	**92**	**(92)**	**63**	**(63)**
Structured notes	**–**	**–**	**–**	**–**
Derivatives	**–**	**–**	**–**	**–**
	92	**(92)**	**63**	**(63)**
2016				
Private equity	36	(36)	49	(49)
Structured notes	–	–	–	–
Derivatives	–	–	–	–
	36	(36)	49	(49)

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 (2016: 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.

55. 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

	Fair value at 31 December 2017	Valuation technique(s)	Unobservable input(s)	Range
Assets				
Private equity	**3,287**	Net asset value	N/A	N/A
		Market-comparable approach	Earnings Multiple	24 – 35
			P/B ratios	0.69 – 1.68
			Liquidity Discount	10% – 30%
Derivatives	**8**	Option model	Equity Volatility	20.80% – 83.54%
			FX Volatility	5.51% – 20.31%
Liabilities				
Structured notes	**392**	Option model	FX Volatility	5.49% – 10.77%
			Equity and Equity Index Correlation	0.14 – 0.52
Derivatives	**3**	Option model	Equity Volatility	13.00% – 83.54%
			FX Volatility	7.68% – 20.31%

	Fair value at 31 December 2016	Valuation technique(s)	Unobservable input(s)	Range
Assets				
Private equity	1,949	Net asset value	N/A	N/A
		Market-comparable approach	Earnings Multiple	22 – 28
			P/B ratios	0.69 – 2.55
			Liquidity Discount	10% – 30%
Derivatives	32	Option model	Equity Volatility	24.35% – 34.83%
			FX Volatility	10.19% – 16.09%
Liabilities				
Structured notes	79	Option model	FX Volatility	10.24% – 14.76%
			Equity and Equity Index Correlation	0.178 – 0.178
Derivatives	46	Option model	Equity Volatility	24.35% – 34.83%
			FX Volatility	8.56% – 16.09%

Key unobservable inputs to Level 3 financial instruments
The key unobservable inputs to Level 3 financial instruments include volatility and correlation for structured notes and deposits valued using option models, bid quotes for corporate bonds valued using approaches that take into account of market comparables, and multiple items for private equity and strategic investments. In the absence of an active market, the fair value of private equity and strategic investments is estimated on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors, as well as by reference to market valuations for similar entities quoted in an active market, or the price at which similar companies have changed ownership. The change in fair values due to changes in reasonably possible alternative assumptions for these unobservable inputs is not significant.

55. 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 balance sheet:

	Carrying amount	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3	Fair value
2017					
Financial assets					
Placings with and advances to banks	**103,113**	**–**	**103,146**	**–**	**103,146**
Loans and advances to customers	**806,573**	**–**	**2,317**	**805,903**	**808,220**
Held-to-maturity debt securities	**95,057**	**1,143**	**96,471**	**–**	**97,614**
Financial liabilities					
Current, savings and other deposit accounts	**1,074,837**	**–**	**1,074,903**	**–**	**1,074,903**
Repurchase agreements – non-trading	**2,389**	**–**	**2,389**	**–**	**2,389**
Deposits from banks	**3,676**	**–**	**3,676**	**–**	**3,676**
Certificates of deposit and other debt securities in issue	**600**	**–**	**600**	**–**	**600**
Subordinated liabilities	**–**	**–**	**–**	**–**	**–**
2016					
Financial assets					
Placings with and advances to banks	103,460	–	103,441	–	103,441
Loans and advances to customers	698,992	–	975	696,428	697,403
Held-to-maturity debt securities	86,900	494	86,881	–	87,375
Financial liabilities					
Current, savings and other deposit accounts	989,539	–	989,629	–	989,629
Repurchase agreements – non-trading	1,805	–	1,805	–	1,805
Deposits from banks	14,075	–	14,075	–	14,075
Certificates of deposit and other debt securities in issue	5,116	–	5,130	–	5,130
Subordinated liabilities	2,327	–	2,828	–	2,828

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.

The calculation of fair values of financial instruments that are not carried at fair value is described below.

The calculation of fair value incorporates the Group's estimate of the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It does not reflect the economic benefits and costs that the Group expects to flow from the instruments' cash flows over their expected future lives.

55. Fair value of financial instruments continued

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

(i) Repurchase and reverse repurchase agreements – non-trading

Fair values are estimated by using discounted cash flows, applying current rates. Fair values approximate carrying amounts as their balances are generally short dated.

(ii) Loans and advances to banks and customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using valuation models that incorporate a range of input assumptions. Loans are grouped, as far as possible, into homogeneous groups and stratified by loans with similar characteristics to improve the accuracy of estimated valuation outputs. The stratification of a loan book considers all material factors. The fair value of a loan reflects loan impairments at the balance sheet date. For impaired loans, fair value is estimated by discounting the future cash flows over the time period they are expected to be recovered.

(iii) Deposits by banks and customer accounts

Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is assumed to be the amount payable on demand at the balance sheet date.

(iv) Debt securities in issue and subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments.

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. In many cases, it would not be possible to realise immediately the estimated fair values given the size of the portfolios measured. Accordingly, these fair values do not represent the value of these financial instruments to the Group as a going concern.

56. Comparative figures

In 2017, we enhanced the presentation of the consolidated statement of cash flows. For details, please refer to the footnote under the consolidated statement of cash flows. Other than the above, certain comparative figures in the consolidated financial statements have also been reclassified to conform with current year's presentation.

57. 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.

58. Bank balance sheet and statement of changes in equity

Bank balance sheet at 31 December 2017

	2017	2016
ASSETS		
Cash and sight balances at central banks	**19,242**	21,080
Placings with and advances to banks	**75,690**	78,717
Trading assets	**53,046**	44,024
Derivative financial instruments	**10,001**	15,864
Loans and advances to customers	**737,368**	637,822
Amounts due from subsidiaries	**26,543**	17,363
Financial investments	**264,248**	288,994
Investments in subsidiaries	**19,925**	19,925
Investment properties	**4,212**	4,120
Premises, plant and equipment	**23,172**	21,639
Intangible assets	**362**	376
Other assets	**16,669**	17,020
Total assets	**1,250,478**	1,166,944
LIABILITIES AND EQUITY		
Liabilities		
Current, savings and other deposit accounts	**1,028,189**	944,263
Deposits from banks	**3,316**	10,757
Trading liabilities	**53,209**	44,150
Financial liabilities designated at fair value	**493**	3,484
Derivative financial instruments	**10,857**	12,746
Certificates of deposit and other debt securities in issue	**–**	4,000
Amounts due to subsidiaries	**9,273**	6,687
Other liabilities	**18,140**	20,797
Current tax liabilities	**549**	20
Deferred tax liabilities	**2,893**	2,523
Subordinated liabilities	**–**	2,327
Total liabilities	**1,126,919**	1,051,754
Equity		
Share capital	**9,658**	9,658
Retained profits	**89,757**	83,434
Other equity instruments	**6,981**	6,981
Other reserves	**17,163**	15,117
Shareholders' equity	**123,559**	115,190
Total equity and liabilities	**1,250,478**	1,166,944

Louisa Cheang *Vice-Chairman and Chief Executive*
John C C Chan *Director*
Richard Y S Tang *Director*

Andrew W L Leung *Chief Financial Officer*

58. Bank balance sheet and statement of changes in equity continued

Bank statement of changes in equity for the year ended 31 December 2017

	Share capital	Other equity instruments	Retained profits[1]	Other reserves: Premises revaluation reserve[2]	Other reserves: Available-for-sale investment reserve[3]	Other reserves: Cash flow hedge reserve[4]	Other reserves: Foreign exchange reserve[5]	Other reserves: Others[6]	Total equity
At 1 January 2017	**9,658**	**6,981**	**83,434**	**13,318**	**1,246**	**(128)**	**24**	**657**	**115,190**
Profit for the year	**–**	**–**	**17,992**	**–**	**–**	**–**	**–**	**–**	**17,992**
Other comprehensive income (net of tax)	**–**	**–**	**471**	**1,734**	**734**	**29**	**(4)**	**(4)**	**2,960**
Available-for-sale investments	**–**	**–**	**–**	**–**	**734**	**–**	**–**	**–**	**734**
Cash flow hedges	**–**	**–**	**–**	**–**	**–**	**29**	**–**	**–**	**29**
Change in fair value of financial liabilities designated at fair value arising from changes in own credit risk	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(4)**	**(4)**
Property revaluation	**–**	**–**	**–**	**1,734**	**–**	**–**	**–**	**–**	**1,734**
Actuarial losses on defined benefit plans	**–**	**–**	**471**	**–**	**–**	**–**	**–**	**–**	**471**
Exchange differences and others	**–**	**–**	**–**	**–**	**–**	**–**	**(4)**	**–**	**(4)**
Total comprehensive income for the year	**–**	**–**	**18,463**	**1,734**	**734**	**29**	**(4)**	**(4)**	**20,952**
Dividends paid	**–**	**–**	**(12,235)**	**–**	**–**	**–**	**–**	**–**	**(12,235)**
Coupon paid to holder of AT1 capital instrument	**–**	**–**	**(389)**	**–**	**–**	**–**	**–**	**–**	**(389)**
Movement in respect of share-based payment arrangements	**–**	**–**	**(4)**	**–**	**–**	**–**	**–**	**(19)**	**(23)**
Other movements	**–**	**–**	**64**	**–**	**–**	**–**	**–**	**–**	**64**
Transfers	**–**	**–**	**424**	**(433)**	**–**	**–**	**–**	**9**	**–**
At 31 December 2017	**9,658**	**6,981**	**89,757**	**14,619**	**1,980**	**(99)**	**20**	**643**	**123,559**
At 1 January 2016	9,658	6,981	81,503	13,092	1,465	(9)	24	672	113,386
Profit for the year	–	–	18,395	–	–	–	–	–	18,395
Other comprehensive income (net of tax)	–	–	105	627	(219)	(119)	–	–	394
Available-for-sale investments	–	–	–	–	(219)	–	–	–	(219)
Cash flow hedges	–	–	–	–	–	(119)	–	–	(119)
Property revaluation	–	–	–	627	–	–	–	–	627
Actuarial gains on defined benefit plans	–	–	106	–	–	–	–	–	106
Exchange differences and others	–	–	(1)	–	–	–	–	–	(1)
Total comprehensive income for the year	–	–	18,500	627	(219)	(119)	–	–	18,789
Dividends paid	–	–	(16,633)	–	–	–	–	–	(16,633)
Coupon paid to holder of AT1 capital instrument	–	–	(346)	–	–	–	–	–	(346)
Movement in respect of share-based payment arrangements	–	–	9	–	–	–	–	(15)	(6)
Transfers	–	–	401	(401)	–	–	–	–	–
At 31 December 2016	9,658	6,981	83,434	13,318	1,246	(128)	24	657	115,190

1 Retained profits are the cumulative net earnings of the Bank that have not been paid out as dividends, but retained to be reinvested in the business. To satisfy the provisions of the Hong Kong Banking Ordinance and local regulatory requirements for prudential supervision purposes, the Group has earmarked a "regulatory reserve" from retained profits. Movements in the reserve are made directly through retained earnings. As at 31 December 2017, the effect of this requirement is to restrict the amount of reserves which can be distributed by the Bank to shareholders by HK$5,755m (2016: HK$5,613m).

2 The premises revaluation reserve represents the difference between the fair value of the premises and its original depreciated cost. There is no premises revaluation reserve related to premises classified as assets held for sale, included in "Other assets" in the balance sheet at 31 December 2017 (31 December 2016: Nil).

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

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

5 The foreign exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations.

6 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.

58. Bank balance sheet and statement of changes in equity continued

Bank statement of changes in equity for the year ended 31 December 2017 continued

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

At 31 December 2017, the aggregate amount of reserves available for distribution to equity shareholders of the Bank as calculated under the provision of Part 6 of the Hong Kong Companies Ordinance (Cap. 622) amounted to HK$78,463m (2016: HK$72,270m). After considering regulatory capital requirement and business development needs, an amount of HK$5,927m (2016: HK$5,353m) has been declared as the proposed fourth interim dividend in respect of the financial year ended 31 December 2017. The difference between the aggregate distributable reserves of HK$78,463m and the Bank's retained profit of HK$89,757m as reported above mainly represents the exclusion of unrealised revaluation gain on investment properties and the regulatory reserve of the Bank.

59. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 20 February 2018.

Independent Auditor’s Report

To the Members of Hang Seng Bank Limited

(incorporated in Hong Kong with limited liability)

Opinion

What we have audited

The consolidated financial statements of Hang Seng Bank Limited (the “Bank”) and its subsidiaries (together, the “Group”) set out on pages 138 to 216, which comprise the:

- consolidated balance sheet as at 31 December 2017;
- consolidated income statement for the year then ended;
- consolidated statement of comprehensive income for the year then ended;
- consolidated statement of changes in equity for the year then ended;
- consolidated statement of cash flows for the year then ended; and
- notes to the consolidated financial statements, which include a summary of significant accounting policies.

Our opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2017, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards (“HKFRSs”) issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”) and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing (“HKSAs”) issued by the HKICPA. Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Consolidated Financial Statements section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Group in accordance with the HKICPA’s Code of Ethics for Professional Accountants (“the Code”), and we have fulfilled our other ethical responsibilities in accordance with the Code.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matters identified in our audit are summarised as follows:

- Impairment of loans and advances to customers
- HKAS 8 disclosures on impact of adopting HKFRS 9 on expected credit losses
- Information Technology access management
- The present value of in-force long-term insurance business and liabilities under non-linked life insurance contracts

Key Audit Matters continued

Impairment of loans and advances to customers

Nature of the Key Audit Matter

The Group recorded loan impairment charges of HK$1,042 million for 2017, of which HK$443 million was individually assessed and HK$599 million was collectively assessed. The corresponding loan impairment allowances recorded as at 31 December 2017 amounted to HK$1,597 million, with HK$602 million being individual impairment allowances and the remaining HK$995 million being collective impairment allowances.

Impairment allowances of loans and advances to customers are calculated on an individual basis for significant impaired loans and on a collective basis for portfolios of loans with similar characteristics. These represent management's best estimate of the losses incurred within the loan portfolios as at the balance sheet date.

In deriving individual impairment allowances, determination of impairment event and estimation of expected future cash flows on the impaired loans require management's judgement. The audit focus was primarily on wholesale impairment due to the materiality of the loan balances and associated impairment allowances.

For collective impairment allowances, they are calculated using models which approximate the impact of current economic and credit conditions on the loan portfolios of the Group. The inputs to these models are derived based on historical loss experience with management judgement applied to determine the assumptions used to calculate impairment allowances.

Our audit focused on loan impairment due to the materiality of the impairment allowances to the consolidated financial statements and the fact that the calculations are inherently subject to significant management judgement.

Matters discussed with the Audit Committee

At our meetings with the Audit Committee, we presented the details of our testing procedures over management's controls of impaired loan identification and our assessment of the calculations over individual and collective impairment allowances. This included our evaluation of the appropriateness of key judgements and assumptions made in calculating the impairment allowances. We also discussed with the Audit Committee significant impaired accounts and changes to risk factors that were relevant to the impairment allowance calculations.

How our audit addressed the Key Audit Matter

We evaluated and tested the controls that management have established to support their calculations of impairment allowances:

- For individual impairment allowances, this included controls over the identification of impaired loans (including compilation and review of the credit watch list and periodic credit file review), approval of external collateral valuation vendors and recording and approval of significant individual impairment allowances; and

- For collective impairment allowances, this included controls over appropriateness of models used for calculation of impairment allowances, the completeness and accuracy of the data input to those models and management's review of key assumptions within those models.

We also performed other audit procedures which included:

Individual impairment allowances –

- We evaluated the impairment calculations prepared by management based on the Group's methodologies and policies for a sample of loans across the portfolio; and

- For the selected sample of impaired loans, we evaluated management's judgement over the occurrence of the impairment event against the evidence available and re-performed discounted cash flow calculations. We challenged management on the key assumptions and estimations of expected future cash flows as to whether they were supportable by comparing with our industry knowledge, market practice and the Group's actual loss experience.

Collective impairment allowances –

- We independently evaluated the appropriateness of the modelling methodology by making reference to our industry knowledge and market practice; and

- We tested the model calculations through re-performance. We also challenged management on the appropriateness of key judgements, assumptions and inputs applied with respect to loan portfolio segmentation and impairment calculations, including economic factors, the period of historical loss rates used and loss emergence periods.

Relevant references in the Annual Report 2017

- Management Discussion and Analysis – Risk Management(a) Credit Risk, pages 53, 55-56
- Note 2(i): Critical accounting estimates and judgements in applying accounting policies, Loan impairment charges, page 146
- Note 13: Loan impairment charges and other credit risk provisions, page 161
- Note 30: Loans and advances to customers, pages 175-176

Key Audit Matters continued

HKAS 8 disclosures on impact of adopting HKFRS 9 on expected credit losses

Nature of the Key Audit Matter

The accounting standard HKAS 8 requires disclosure of the reasonably estimable information relevant to assessing the possible impact that application of new accounting standards will have on the entity's financial statements.

HKFRS 9 is a new and complex accounting standard effective from 1 January 2018 which requires considerable judgements and interpretations in its implementation. These judgements and interpretations are essential in the development of the new models which have been built and implemented to measure expected credit losses ("ECL") on loans measured at amortised cost which is considered to have material impact to the Group's consolidated financial statements.

There is also a large increase in the data inputs required by these new models. The data is from a number of systems that have not been used previously for the preparation of the accounting records. This increases the risk of completeness and accuracy of the data that has been used to develop assumptions and to calculate the ECL. In some cases, the lack of available data and quality of data has led to reasonable alternatives being sought to allow calculations to be performed.

Matters discussed with the Audit Committee

Status updates were regularly provided during the year due to the complexity and scale of the HKFRS 9 implementation program. The Audit Committee reviewed the Global Public Policy Committee paper issued in July 2017 which promotes the high-quality audit of the accounting for ECL.

Our assessment on the more judgmental interpretations made by management was shared with the Audit Committee. These included the determination of what constitutes a significant increase in credit risk for retail portfolios, the life of retail and wholesale revolving products and the judgements made in applying forward economic guidance to the impairment calculation. We highlighted the post model adjustments that had been recorded to address challenges in data availability and quality or areas of model weakness.

Our perspectives on the control environment in relation to the disclosure of the ECL impact of adopting HKFRS 9 were also shared with the Audit Committee.

How our audit addressed the Key Audit Matter

We evaluated and tested the controls that had been established to support the balances reported within the HKAS 8 disclosures which included:

- Controls over the selection and approval of the accounting policy, and also those controls over ECL model governance and development; and
- Review controls over the output of ECL model and assessment of the reasonableness of the disclosed ECL impact of adopting HKFRS 9.

Also, we performed other audit procedures which included:

- We assessed the compliance of the technical methodology papers prepared by management with the HKFRS 9 requirements for ECL;
- With the assistance of our modelling specialists, we assessed the modelling methodology for material portfolios, independently validated key assumptions and performed model effectiveness tests; and
- We also performed testing of key reconciliations of system interfaces to assess the accuracy and completeness of data transfer.

Relevant references in the Annual Report 2017

– Note 1, Basis of preparation (d), Future Accounting Developments, pages 144-145

Key Audit Matters continued

Information Technology ("IT") access management

Nature of the Key Audit Matter

All banks are highly dependent on technology due to the significant number of transactions that are processed daily. The audit approach relies extensively on automated controls and therefore on the effectiveness of controls over IT systems.

As reported in prior year, we identified and reported that the entity's controls over access rights to applications, operating systems and data used in the financial reporting process required improvements. Access management controls are critical to ensure that changes to applications and underlying data are made in an appropriate manner. Appropriate access controls contribute to mitigating the risk of potential fraud or errors as a result of changes to applications and data.

Several remediation activities were implemented to reduce the risk over access management in the financial reporting process. These included implementation of group wide preventative and detective controls across critical applications and infrastructure. However, due to the pervasive nature of access management issues, we continued to assess the risk of a material misstatement arising from access to technology as significant for the audit.

Matters discussed with the Audit Committee

The status on remediation of access controls was discussed at several Audit Committee meetings during the year. We also discussed our audit approach, the extent of testing and the results of audit work with the Audit Committee.

Controls were enhanced during 2017 to respond to our audit findings and to reduce the risks over privileged access to IT infrastructure such as databases and operating systems. However, given the scale and complexity of the remediation, there were still actions to be taken during the year to ensure that controls are fully embedded and operate effectively.

By the end of the financial year, the Group had put in place controls to address the critical operating system and database related matters previously reported. The remediation relating to the management of business application access continues to progress.

How our audit addressed the Key Audit Matter

We tested access rights to applications, operating systems and databases relied upon for financial reporting. Specifically, we tested that:

- New access requests for joiners were properly reviewed and authorised;
- User access rights were removed on a timely basis when an individual left or moved role;
- Access rights to applications, operating systems and databases were periodically monitored for appropriateness; and
- Highly privileged access was restricted to appropriate personnel.

Other areas that were independently assessed included password policies, security configurations, controls over changes to applications and databases; and that business users, developers and production support personnel did not have access to change applications, the operating system or databases in the production environment.

As a consequence of deficiencies identified in the controls, we performed a range of other procedures which included:

- Where inappropriate access was identified, we understood the nature of the access and obtained additional evidence on the appropriateness of the activities performed;
- We performed additional substantive testing on specific year-end reconciliations (i.e. custodian, bank account and suspense account reconciliations) and confirmations with external counterparties;
- We performed testing on other compensating controls such as business performance reviews;
- We also tested controls that prevent inappropriate combinations of access; and
- We obtained a list of users' access permissions and manually compared it to other access lists where segregation of duties was deemed to be of higher risk, for example users having access to both create and approve journals in the general ledger systems.

A significant amount of the Group's technology processes and controls were undertaken in shared service centres located outside of Hong Kong. Our audit testing of access rights controls was also performed in the shared service centre locations.

Relevant references in the Annual Report 2017

– Management Discussion and Analysis – Risk Management (e), Operational risk, pages 78-79

Key Audit Matters continued

The present value of in-force long-term insurance business ("PVIF") and liabilities under non-linked life insurance contracts

Nature of the Key Audit Matter

The Group has recorded an asset for PVIF of HK$14,574 million and liabilities under non-linked life insurance contracts of HK$115,464 million as at 31 December 2017.

The determination of these balances requires the use of appropriate actuarial methodologies and also highly judgemental assumptions. Such assumptions include the long term economic returns of insurance contracts issued, assumptions over policyholder behaviour such as longevity, mortality and persistency, and management assumptions over future costs of obtaining and maintaining the Group's insurance business.

Small movement in these assumptions can have a material impact on the PVIF asset and the liabilities under non-linked life insurance contracts.

Matters discussed with the Audit Committee

We discussed with the Audit Committee the results of our testing procedures over key assumptions used in the valuation of the PVIF asset and the liabilities under non-linked life insurance contracts including testing of changes made during the reporting period to the models and to the basis of determination of key assumptions.

How our audit addressed the Key Audit Matter

We understood and tested the controls that management had established over the valuation of PVIF asset and liabilities under non-linked life insurance contracts which included:

- Controls over policy data reconciliations from the policyholder administration system to the actuarial valuation system;
- Controls over assumption setting and the review and determination of valuation methodology;
- System access and user acceptance testing controls over the actuarial models used; and
- Controls over the production and approval of the actuarial results.

Also, we performed our other audit procedures which included:

- With the assistance of our actuarial experts, we independently assessed the appropriateness of the models, methodologies and assumptions used (including assumptions over the long term economic returns of insurance contracts issued, assumptions over policyholder behaviour such as longevity, mortality and persistency, and assumptions relating to future costs of obtaining and maintaining the insurance business); and
- We evaluated and challenged management's key judgements and assumptions. Our challenge and evaluation included whether these judgements were supported by relevant experience, market information and formed a reasonable basis for setting the assumptions.

Relevant references in the Annual Report 2017

- Management Discussion and Analysis – Risk management (d), Insurance risk, page 71
- Note 2(v): Critical accounting estimates and judgements in applying accounting policies, Insurance contracts, page 147
- Note 37: Intangible assets, page 188
- Note 44: Liabilities under insurance contracts, page 191

Other Information

The directors of the Bank are responsible for the other information. The other information comprises all of the information included in the Annual Report other than the consolidated financial statements and our auditor’s report thereon, which we obtained prior to the date of this auditor’s report, and the Banking Disclosure Statement for the year ended 31 December 2017, which is expected to be made available to us after the date of this auditor’s report.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor’s report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

When we read the Banking Disclosure Statement for the year ended 31 December 2017, if we conclude that there is a material misstatement therein, we are required to communicate the matter to the Audit Committee and take appropriate action considering our legal rights and obligations.

Responsibilities of Directors and the Audit Committee for the Consolidated Financial Statements

The directors of the Bank are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with HKFRSs issued by the HKICPA and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors are responsible for assessing the Group’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

The Audit Committee is responsible for overseeing the Group’s financial reporting process.

Auditor’s Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. We report our opinion solely to you, as a body, in accordance with Section 405 of the Hong Kong Companies Ordinance and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements continued

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Audit Committee, we determine those matters that were of most significance in the audit of the consolidated financial statements for the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Mr. Tam Man Kit, James.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 20 February 2018

Analysis of Shareholders

As at 31 December 2017	Shareholders		Number of Shares	
	Number	Percentage of total	Number in millions	Percentage of total
Number of shares held				
1 – 500	6,476	35.19	1.5	0.08
501 – 2,000	5,633	30.60	6.9	0.36
2,001 – 5,000	2,962	16.09	10.1	0.53
5,001 – 20,000	2,522	13.70	25.9	1.35
20,001 – 50,000	532	2.89	16.6	0.87
50,001 – 100,000	151	0.82	10.7	0.56
100,001 – 200,000	70	0.38	10.2	0.53
Over 200,000	60	0.33	1,829.9	95.72
	18,406	100.00	1,911.8	100.00
Geographical Distribution				
Hong Kong	18,129	98.49	1,909.0	99.86
Malaysia	52	0.28	0.4	0.02
Singapore	44	0.24	1.8	0.09
Canada	40	0.22	0.1	0.00
Macau	31	0.17	0.2	0.01
United States of America	28	0.15	0.2	0.01
United Kingdom	27	0.15	0.0	0.00
Australia	27	0.15	0.0	0.00
Others	28	0.15	0.1	0.01
	18,406	100.00	1,911.8	100.00

Subsidiaries*

Fulcher Enterprises Company Limited

Hang Seng Bank (China) Limited

Hang Seng Bank (Trustee) Limited

Hang Seng Bullion Company Limited

Hang Seng Credit Limited

Hang Seng Data Services Limited

Hang Seng Finance Limited

Hang Seng Financial Information Limited

Hang Seng Futures Limited

Hang Seng Indexes Company Limited

Hang Seng Insurance Company Limited

Hang Seng Investment Management Limited

Hang Seng Investment Services Limited

Hang Seng Life Limited

Hang Seng (Nominee) Limited

Hang Seng Qianhai Fund Management Company Limited

Hang Seng Real Estate Management Limited

Hang Seng Security Management Limited

Hang Seng Securities Limited

Haseba Investment Company Limited

High Time Investments Limited

HSI International Limited

Imenson Limited

Yan Nin Development Company Limited

* As defined in Section 15 of the Hong Kong Companies Ordinance (Cap 622).

Directors of Subsidiaries

The names of Directors who have served on the Boards of the Bank's subsidiaries during the period from 1 January 2017 to the date of Report of Directors of this Annual Report (unless otherwise stated) are set out below:

CHAN Kwok Wai Patrick*

CHAN Shuk Pui Ivy

CHAN Yiu Cheong*

Sridhar CHANDRASEKHARAN

CHEANG Wai Wan Louisa

CHEN Kwan Yiu Edward

CHENG Cheng Shing Agnes

CHEUNG Ho Fai Derek

CHEUNG Yiu Kwong

CHUNG Wai Yee Betty*

ERH Chung Kei Johnson*

FU Yin Ho

FUNG Hau Chung Andrew*

JIA Tingyu

KONG Kwong Ming

KWAN Wing Han Margaret

KWAN Wing Shing Vincent

LAM Wai Chung Gordon

LAM Yin Shing Donald

LAM CHEUNG Alexa

LEE Pui Shan

LEE Sai Kit

LEE Wai Mun Rose*

LEONG Ka Chai

LEUNG Cheuk Yee Eunice

LEUNG Kit Yee*

LEUNG Kin Ping

LEUNG Wing Lok

LI Chi Chung

LI Chi Kwong Jason

LI Qiang

LIANG Chun Fei Belle

LIM Sau Fung

LIN Yik Kwong

LIU Hung Ho

LIU Yu

LUK Sai Lung

LUK Ting Lung Alan

MAU Suet Fan

MENG Xiao

MUK Chung Wing

NGAN Man Kit

PANG Yiu Hung*

POON Chun Ming David

POON Sun Cheong

PUN Tze Wah

SHEN Sibao

SIN Pui Pik*

TAM Chi Kok Gabriel

TAM Lai King Peggy

TANG Chee Ping Wilson

TONG Hing Yuen Michael

TSUI Chun Man Thomas

WANG Yee Ning Elaine

WONG Chun Fai

WONG Wai Hung

YIP Kay Chun Katie

YOU Anshan

YUEN Kin Chung

* He/She has resigned/ceased as a Director of the relevant subsidiary(ies) of the Bank.

Corporate Information and Calendar

Corporate Information

Board of Directors

Chairman
Raymond K F Ch'ien GBS, CBE, JP

Vice-Chairman
Louisa Cheang

Directors
John C C Chan GBS, JP
Nixon L S Chan
Henry K S Cheng GBM
L Y Chiang JP
Fred Zuliu Hu
Margaret W H Kwan
Irene Y L Lee
Sarah C Legg
Eric K C Li GBS, OBE, JP
Vincent H S Lo GBM, JP
Kenneth S Y Ng
Richard Y S Tang SBS, JP
Peter T S Wong JP
Michael W K Wu

Secretary
C C Li

Registered Office

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

Stock Code

The Stock Exchange of Hong Kong Limited: 11

Registrar

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

Depositary*

BNY Mellon Shareowner Services
PO Box 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.

Annual Report 2017

This Annual Report 2017 in both English and Chinese is now available in printed form and on the Bank's website (www.hangseng.com) and the website of Hong Kong Exchanges and Clearing Limited ("HKEx") (www.hkexnews.hk).

Shareholders who:

A) browse this Annual Report 2017 on the Bank's website and wish to receive a printed copy; or

B) receive this Annual Report 2017 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 Annual Report 2017 on the Bank's website, have difficulty in reading or gaining access to this Annual Report 2017 via the Bank's website for any reason, the Bank will promptly send this Annual Report 2017 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.

Calendar

2017 Full Year Results

Announcement date	20 February 2018

2017 Fourth Interim Dividend*

Announcement date	20 February 2018
Book close and record date	7 March 2018
Payment date	23 March 2018

2017 Annual Report

to be posted to shareholders in late March 2018

Annual General Meeting

to be held on 10 May 2018

* The Register of Shareholders of the Bank will be closed on Wednesday, 7 March 2018, during which no transfer of shares can be registered. To qualify for the fourth 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 Tuesday, 6 March 2018. The fourth interim dividend will be payable on Friday, 23 March 2018 to shareholders on the Register of Shareholders of the Bank on Wednesday, 7 March 2018. Shares of the Bank will be traded ex-dividend as from Monday, 5 March 2018.

Published by
Hang Seng Bank Limited

Concept, design and art direction by
Lilian Tang Design

Photography by
Josiah Leung Photography

Printed in Hong Kong by
Magnum (Offset) Printing Co. Ltd

恒生銀行
HANG SENG BANK

83 Des Voeux Road Central, Hong Kong
www.hangseng.com

Member HSBC *Group*