



Standard Chartered Bank
(Hong Kong) Limited

Directors' Report and
Consolidated Financial
Statements

For the year ended 31 December 2006

Standard Chartered Bank (Hong Kong) Limited
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Report of the directors

The directors have pleasure in submitting their annual report together with the audited financial statements for the year ended 31 December 2006.

Principal place of business

Standard Chartered Bank (Hong Kong) Limited (the "Bank") is a bank incorporated and domiciled in Hong Kong and has its registered office at 32/F, 4 – 4A Des Voeux Road Central, Hong Kong.

Principal activities

The Bank is a licensed bank registered under the Hong Kong Banking Ordinance. The Bank's principal activities are the provision of banking and related financial services. The principal activities and other particulars of the Bank's subsidiaries are set out in note 17 to the financial statements.

Financial statements

The profit of the Bank and its subsidiaries for the year ended 31 December 2006 and the state of the Bank and its subsidiaries' affairs as at that date are set out in the financial statements on pages 5 to 74.

The directors do not recommend any payment of dividend (2005: HK\$ Nil) in respect of the year.

Other movements in reserves are set out in note 30 to the financial statements.

Charitable donations

Charitable donations made by the Bank and its subsidiaries during the year amounted to HK\$15 million (2005: HK\$11 million).

Fixed assets

Details of the movements in the fixed assets are set out in note 19 to the financial statements.

Share capital

Details of the movements in the share capital of the Bank during the year are set out in note 29 to the financial statements.

Directors

The directors during the year and up to the date of this report are:

Executive directors

Peter David Sullivan

Julian Fong Loong Choon

Non-executive directors

Chow Chung Kong*, Chairman
Kaikhushru Shiavax Nargolwala
Michael Bernard DeNoma
Raymond Kwok Ping Luen*
Edgar Cheng Wai Kin*
Ma Xuezheng*
Norman Lyle*

** Independent non-executive directors*

There being no provision in the Bank's articles of association for the retirement of directors by rotation, all the present directors continue in office for the ensuing year.

Directors' service contracts

The independent non-executive directors were appointed by the board of directors for a term of 3 years. Their remuneration is determined by the shareholders at the general meeting.

Directors' interests in Share Option Schemes

Certain directors of the Bank have been granted options under various share option schemes of Standard Chartered PLC, the ultimate holding company of the Bank. During the year, Peter David Sullivan, Julian Fong Loong Choon, Kaikhushru Shiavax Nargolwala and Michael Bernard DeNoma were granted options under these schemes.

Directors' rights to acquire shares

At no time during the year was the Bank, any of its holding companies, subsidiaries, or fellow subsidiaries, a party to any other 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.

Directors' interests in contracts

No contract of significance to which the Bank, its holding companies, subsidiaries or fellow subsidiaries was a party and in which a director of the Bank had a material interest, subsisted at the end of the year or at any time during the year.


Compliance with Supervisory Policy Manual on Financial Disclosure by Locally Incorporated Authorised Institutions

The financial statements for the year ended 31 December 2006 have complied fully with the guideline on "Financial Disclosure by Locally Incorporated Authorised Institutions" under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority ("HKMA").

Auditors

The financial statements have been audited by KPMG who will retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as auditors of the Bank is to be proposed at the forthcoming annual general meeting.

On behalf of the Board

A handwritten signature in black ink, appearing to read 'C K Chow', written in a cursive style.

Sir C K Chow
Chairman

Hong Kong, 27 February 2007

Auditors' report to the shareholders of Standard Chartered Bank (Hong Kong) Limited

(Incorporated in Hong Kong SAR with limited liability)

We have audited the consolidated financial statements of Standard Chartered Bank (Hong Kong) Limited (the "Bank") set out on pages 5 to 74, which comprise the consolidated and the Bank balance sheets as at 31 December 2006, and the consolidated income statement, the consolidated statement of recognised income and expenses and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors of the Bank are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you, as a body, in accordance with section 141 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.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Bank and of the consolidated state of affairs of the Bank and its subsidiaries as at 31 December 2006 and of the consolidated profit and cash flows of the Bank and its subsidiaries for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants

8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

27 February 2007

Consolidated income statement

For the year ended 31 December 2006

(Expressed in millions of Hong Kong dollars)

	Note	2006 HK\$'M	2005 HK\$'M
Interest income	3(a)	18,796	12,299
Interest expense	3(b)	(9,997)	(5,014)
Net interest income		<u>8,799</u>	<u>7,285</u>
Fee and commission income		3,957	3,353
Fee and commission expense		(801)	(631)
Net fee and commission income		3,156	2,722
Net trading gains	3(c)	760	747
Net (losses)/income from financial instruments designated at fair value through profit or loss	3(d)	(219)	24
Net gains from disposal of available-for-sale securities	5	22	81
Other operating income	3(e)	89	83
		<u>3,808</u>	<u>3,657</u>
Total operating income		12,607	10,942
Staff costs		(2,656)	(2,251)
Premises and equipment expense		(758)	(803)
Others		(1,969)	(1,584)
Operating expenses	3(f)	(5,383)	(4,638)
Operating profit before impairment		7,224	6,304
Impairment losses and impairment allowances on loans and advances	4(a)	49	(827)
Impairment losses on available-for-sale securities	4(b)	–	(5)
Operating profit after impairment		7,273	5,472
Share of result of an associate		(34)	–
Profit before taxation		7,239	5,472
Taxation	6(a)	(1,213)	(931)
Profit after taxation		6,026	4,541
Profit attributable to minority interests		–	(5)
Profit attributable to shareholders	30	<u>6,026</u>	<u>4,536</u>

The notes on pages 11 to 74 form part of these financial statements.

Consolidated balance sheet as at 31 December 2006*(Expressed in millions of Hong Kong dollars)*

	Note	2006 HK\$'M	2005 HK\$'M
Assets			
Cash and balances with banks and other financial institutions	9	7,809	5,764
Placements with banks and other financial institutions	10	49,122	39,625
Hong Kong SAR Government certificates of indebtedness	11	20,261	19,321
Trading assets	12	24,239	19,773
Advances to customers	13(a)	169,569	168,876
Amounts due from immediate holding company	16	38,099	32,310
Amounts due from fellow subsidiaries	16	11,941	4,948
Available-for-sale securities	15	57,140	39,866
Interest in an associate	18	959	959
Fixed assets	19	3,250	2,807
Intangible assets	20	763	845
Deferred tax assets	24	56	121
Other assets		7,834	1,945
		<u>391,042</u>	<u>337,160</u>
Liabilities			
Hong Kong SAR currency notes in circulation	11	20,261	19,321
Deposits and balances of banks and other financial institutions	21	7,514	8,723
Deposits from customers	22	288,513	247,663
Trading liabilities	25	15,854	14,587
Financial liabilities designated at fair value through profit or loss	23	9,514	5,153
Certificates of deposit issued		2,707	5,178
Amounts due to immediate holding company	16	2,608	5,067
Amounts due to fellow subsidiaries	16	580	69
Current taxation		553	430
Deferred tax liabilities	24	23	25
Other liabilities	26	9,258	3,706
Subordinated liabilities	28	3,756	3,781
		<u>361,141</u>	<u>313,703</u>
Equity			
Share capital	29	3,901	3,901
Reserves	30	25,949	19,505
Shareholders' equity		29,850	23,406
Minority interests	30(d)	51	51
		<u>29,901</u>	<u>23,457</u>
		<u>391,042</u>	<u>337,160</u>

Approved and authorised for issue by the Board of Directors on 27 February 2007.

Sir C K Chow
Chairman

Julian Fong Loong Choon
Director

Peter David Sullivan
Director

Lai Wing Nga
Company Secretary

The notes on pages 11 to 74 form part of these financial statements.

Balance sheet as at 31 December 2006*(Expressed in millions of Hong Kong dollars)*

	Note	2006 HK\$'M	2005 HK\$'M
Assets			
Cash and balances with banks and other financial institutions	9	7,809	5,764
Placements with banks and other financial institutions	10	49,118	39,623
Hong Kong SAR Government certificates of indebtedness	11	20,261	19,321
Trading assets	12	24,238	19,764
Advances to customers	13(a)	169,001	168,262
Amounts due from immediate holding company	16	38,098	32,310
Amounts due from fellow subsidiaries	16	11,937	4,948
Amounts due from subsidiaries of the Bank	16	782	507
Available-for-sale securities	15	56,971	39,696
Investments in subsidiaries of the Bank	17	249	302
Interest in an associate	18	959	959
Fixed assets	19	3,250	2,806
Intangible assets	20	763	845
Deferred tax assets	24	56	121
Other assets		7,753	1,930
		<u>391,245</u>	<u>337,158</u>
Liabilities			
Hong Kong SAR currency notes in circulation	11	20,261	19,321
Deposits and balances of banks and other financial institutions	21	7,514	8,723
Deposits from customers	22	288,513	247,663
Trading liabilities	25	15,853	14,587
Financial liabilities designated at fair value through profit or loss	23	9,514	5,153
Certificates of deposit issued		2,707	5,178
Amounts due to immediate holding company	16	2,608	5,060
Amounts due to fellow subsidiaries	16	563	69
Amounts due to subsidiaries of the Bank	16	301	121
Current taxation		551	426
Other liabilities	26	9,238	3,663
Subordinated liabilities	28	3,756	3,781
		<u>361,379</u>	<u>313,745</u>
Equity			
Share capital	29	3,901	3,901
Reserves	30	25,965	19,512
Shareholders' equity		<u>29,866</u>	<u>23,413</u>
		<u>391,245</u>	<u>337,158</u>

Approved and authorised for issue by the Board of Directors on 27 February 2007.

Sir C K Chow
Chairman

Julian Fong Loong Choon
Director

Peter David Sullivan
Director

Lai Wing Nga
Company Secretary

The notes on pages 11 to 74 form part of these financial statements.

Consolidated statement of recognised income and expenses
For the year ended 31 December 2006

(Expressed in millions of Hong Kong dollars)

	2006 HK\$'M	2005 HK\$'M
Effective portion of changes in fair value of cash flow hedges	48	(41)
Exchange difference on translation of investment in an associate	34	–
Net changes in fair value of available-for-sale securities	236	(113)
Transfer to income statement on disposal of available-for-sale securities	(22)	6
Defined benefit plan actuarial gains	195	62
Capitalisation of share premium	–	(23)
Income tax on income and expense recognised directly in equity	(73)	20
	<hr/>	<hr/>
Income and expenses recognised directly in equity	418	(89)
Profits for the year	6,026	4,536
	<hr/>	<hr/>
Total recognised income and expenses for the year	6,444	4,447
	<hr/> <hr/>	<hr/> <hr/>
Attributable to:		
Shareholders of the Bank	6,444	4,442
Minority interests	–	5
	<hr/>	<hr/>
	6,444	4,447
	<hr/> <hr/>	<hr/> <hr/>

The notes on pages 11 to 74 form part of these financial statements.

Consolidated cash flow statement

For the year ended 31 December 2006

(Expressed in millions of Hong Kong dollars)

	<i>Note</i>	<i>2006</i> <i>HK\$'M</i>	<i>2005</i> <i>HK\$'M</i>
Operating activities			
Profit before taxation		7,239	5,472
Adjustments for:			
Impairment losses on loans and advances and available-for-sale securities		(49)	832
Advances written off net of recoveries		(1,047)	(676)
Unwinding of discount on loan impairment losses		(18)	(22)
Gains on disposal of fixed assets		(9)	–
Depreciation		179	219
Amortisation of intangible assets		104	221
Share of results of an associate		34	–
Interest expense on subordinated liabilities		168	163
Amortisation and exchange movement of subordinated liabilities		10	(7)
		<u>6,611</u>	<u>6,202</u>
(Increase)/decrease in operating assets:			
Placements with banks and other financial institutions with original maturity beyond three months		(8,477)	1,987
Trading assets		(4,466)	(3,164)
Available-for-sale securities		(17,060)	(39,846)
Gross advances to customers		421	2,870
Amounts due from immediate holding company and fellow subsidiaries		(8,750)	14,298
Non-trading securities		–	34,315
Other assets		(5,869)	(279)
Increase/(decrease) in operating liabilities:			
Deposits and balances from banks and other financial institutions		(1,435)	(2,053)
Deposits from customers		40,850	12,397
Certificates of deposit issued		(2,471)	(5,347)
Financial liabilities designated at fair value through profit or loss		4,361	589
Debt securities issued		–	(36)
Amounts due to immediate holding company and fellow subsidiaries		627	(7,430)
Trading liabilities		1,267	(895)
Other liabilities		5,786	(281)
		<u>11,395</u>	<u>13,327</u>
Cash generated from operations		11,395	13,327
Tax paid			
Hong Kong profits tax paid		(1,100)	(666)
		<u>10,295</u>	<u>12,661</u>
Net cash generated from operating activities		10,295	12,661

	Note	2006 HK\$'M	2005 HK\$'M
Investing activities			
Purchase of a subsidiary, net of cash and cash equivalents acquired		–	(287)
Payment for purchase of an associate		–	(959)
Payment for purchase of fixed assets		(634)	(1,485)
Payment for purchase of intangible assets		(22)	(76)
Proceeds from disposal of intangible assets		–	34
Proceeds from disposal of fixed assets		21	–
Net cash used in investing activities		<u>(635)</u>	<u>(2,773)</u>
Financing activities			
Redemption/repurchase of subordinated liabilities		(45)	(4,500)
Interest paid on subordinated liabilities		(169)	(260)
Net cash used in financing activities		<u>(214)</u>	<u>(4,760)</u>
Net increase in cash and cash equivalents		9,446	5,128
Cash and cash equivalents at 1 January	31	<u>52,514</u>	<u>47,386</u>
Cash and cash equivalents at 31 December	31	<u><u>61,960</u></u>	<u><u>52,514</u></u>
Cash flows from operating activities include:			
Interest received		18,513	11,998
Interest paid		(9,618)	(4,621)
Dividends received		22	19

The notes on pages 11 to 74 form part of these financial statements.

Notes to the financial statements

(Expressed in millions of Hong Kong dollars)

1 Principal activities

The principal activities of Standard Chartered Bank (Hong Kong) Limited (the “Bank”) and its subsidiaries are the provision of banking and related financial services.

2 Significant accounting policies

(a) Statement of compliance

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (“HKFRSs”), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKAS”), and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance.

(b) Basis of preparation of the financial statements

(i) Basis of Preparation

These financial statements are prepared in accordance with HKFRSs. In accordance with the HKAS 27 “Consolidated and Separate Financial Statements”, the financial statements have been prepared on a consolidated basis.

(ii) Consolidated Financial Statements

During the year, the Bank had subordinated debt in issue. This was issued under a note issuance programme which is listed on both the Stock Exchange of Hong Kong and the London Stock Exchange. Consequently, the Bank is required to produce consolidated financial statements in accordance with HKAS 27 “Consolidated and Separate Financial Statements”.

(iii) New and revised HKFRSs

The HKICPA has issued certain new and revised HKFRSs that are first effective for the current accounting period of the Bank and its subsidiaries. There was no material impact on the financial statements. The accounting policies are set out below.

(c) Subsidiaries

Subsidiaries are all entities over which the Bank has the power to directly or indirectly govern the financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which the Bank effectively obtains control. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Bank. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, together with costs directly attributable to the acquisition. Identifiable net assets and contingent liabilities acquired are fair valued at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Bank’s share of the identifiable net assets and contingent liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets and contingent liabilities of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between the Bank and its subsidiaries are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred.

In the Bank's balance sheet, investments in subsidiaries are stated at cost less any impairment and dividends from pre-acquisition profits received, if any.

(d) Associates

Associates are all entities in respect of which the Bank has significant influence, but not control, over the financial and operating policies and procedures. Investments in associates are accounted for using the equity method of accounting in the consolidated financial statements and are initially recognised at cost.

The Bank's share of its associate's post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment in the consolidated balance sheet. When the Bank's share of losses in an associate is equal to or exceeds its interest in the associate, including any other unsecured receivables, the Bank does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

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

In the Bank's balance sheet, the investment in an associate is stated at cost less any impairment and dividends from pre-acquisition profits received, if any.

(e) Intangible assets

(i) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Bank's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition.

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses, if any. Goodwill is allocated to cash-generating units for the purpose of impairment testing.

(ii) Computer software

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Costs associated with the development of software are capitalised where it is probable that it will generate future economic benefits in excess of its cost. Computer software costs are amortised on the basis of the expected useful lives (two to five years). Costs associated with maintaining computer software programs are recognised as an expense as incurred.

(f) Investment properties

Investment properties are land and buildings which are owned either to earn rental income or for long term investments or for both. Investment properties are stated in the balance sheet at depreciated cost less impairment. Investment properties are depreciated over their estimated useful lives on a straight-line basis.

(g) Other property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and impairment, if any. Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation on other fixed assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

- Buildings and leasehold land and leasehold improvements, the shorter of their estimated useful lives, being 50 years from the date of completion, and the unexpired terms of the lease.
- Equipment and motor vehicles, 3 to 15 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Gains and losses on disposals are included in the income statement.

(h) Leases

Where the Bank is the lessee

The leases entered into by the Bank are primarily operating leases. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the leases.

Where the Bank is the lessor

When assets are held subject to a finance lease, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return ignoring tax and cash flows.

(i) Financial assets and liabilities (excluding derivatives)

Financial assets are classified in the following categories: financial assets at fair value through profit or loss, loans and receivables, and available-for-sale securities. Financial liabilities are classified as either at fair value through profit or loss, or at amortised cost. Management determines the classification of its financial assets and liabilities on initial recognition.

(i) Financial assets and liabilities at fair value through profit or loss

This category has two sub-categories: financial assets and liabilities held for trading, and those designated at fair value through profit or loss at inception. A financial asset or liability is classified as trading if acquired principally for the purpose of selling in the short term.

Financial assets and liabilities may be designated at fair value through profit or loss when:

- the designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities on a different basis, or
- a group of financial assets and/or liabilities is managed and its performance evaluated on a fair value basis, or
- assets or liabilities include embedded derivatives and such derivatives are not recognised separately.

(ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

(iii) Available-for-sale securities

Available-for-sale assets are those non-derivative financial assets intended to be held for an indefinite period of time, which may be sold in response to liquidity requirements or changes in interest rates, exchange rates or equity prices.

Initial recognition

Purchases and sales of financial assets and liabilities at fair value through profit or loss, and available-for-sale are initially recognised on trade-date (the date on which the Bank commits to purchase or sell the asset). Loans are recognised when cash is advanced to the borrowers. Financial assets and financial liabilities are initially recognised at fair value plus directly attributable transaction costs for those financial assets and liabilities not carried at fair value through profit and loss.

Subsequent measurement

Available-for-sale financial assets and financial assets and liabilities at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are carried at amortised cost using the effective interest method.

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active, and for unlisted securities, the Bank establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models, and other valuation techniques commonly used by market participants.

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognised when they are extinguished.

Income recognition

For available-for-sale assets, financial assets and liabilities held at amortised cost and trading assets and liabilities excluding derivatives, interest income and interest expense is recognised in the income statement using the effective interest method.

Gains and losses arising from changes in the fair value of financial assets and liabilities at fair value through profit or loss, as well as any interest receivable or payable, is included in the income statement in the period in which they arise.

Gains and losses arising from changes in the fair value of available-for-sale financial assets other than foreign exchange gains and losses from monetary items are recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity is recognised in profit or loss.

Dividends on available-for-sale equity instruments are recognized in the income statement when the Bank's right to receive payment is established.

(j) Derivative financial instruments and hedge accounting

Derivative contracts are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when their fair values are positive and as liabilities when their fair values are negative.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Bank designates certain derivatives as either: (1) hedges of the fair value of recognised assets or liabilities, or commitments (fair value hedge); or, (2) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (cash flow hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The Bank documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Bank also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

(i) Fair value hedge

Changes in the fair value of derivatives that are designated and qualified as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to profit or loss over the period to maturity.

(ii) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualified as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity 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 existing in equity at that time remains in equity and is recognised when 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 reported in equity is immediately transferred to the income statement.

Derivatives that do not qualify for hedge accounting

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement.

(k) Impairment of assets*Impairment of financial assets**Assets carried at amortised cost*

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Bank may measure impairment on the basis of an instrument's fair value using observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Bank and historical loss experience for assets with credit risk characteristics similar to those in the Bank. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

To the extent a loan is irrecoverable, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to the income statement. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Available-for-sale assets

A significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss (measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss) is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

(l) Offsetting financial instruments

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

(m) Fiduciary activities

The Bank commonly acts as trustee and in other fiduciary capacities that result in the holding or placing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions. The assets and income arising thereon are excluded from these financial statements, as they are not assets of the Bank.

(n) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash and balances with banks and other financial institutions, placements with banks and other financial institutions, and treasury bills.

(o) Revenue recognition

(i) Interest income and expense

Interest income and expense on available-for-sale assets, financial assets or liabilities held at amortised cost and trading assets and liabilities excluding derivatives is recognised in the income statement using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The

calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(ii) Fees and commissions

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank has retained no part of the loan package for itself or has retained a part at the same effective interest rate as for the other participants. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportioned basis.

(p) Income tax

Income tax payable on profits for the period is recognised as an expense in the period in which profits arise. The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates, and laws that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Current and deferred tax relating to items which are charged or credited directly to equity, is credited or charged directly to equity and is subsequently recognised in the income statement together with the current or deferred gain or loss.

(q) Provisions

Provisions for restructuring costs and legal claims are recognised when: the Bank has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated.

(r) Employee benefits

(i) Short term employee benefits

Salaries, annual bonuses, and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees.

(ii) Pension obligations

The Bank has defined contribution plans and defined benefit plans.

For defined contribution plans, the Bank pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis, and such amounts are charged to operating expenses. The Bank has no further payment obligations once the contributions have been paid.

For defined benefit plans, the liability recognised in the balance sheet is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using an interest rate equal to the yield on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have a term to maturity approximating to the term of the related pension liability.

Actuarial gains and losses that arise are recognised in shareholders' equity and presented in the statement of recognised income and expense in the period they arise. Past service costs are recognised immediately to the extent that benefits are vested and are otherwise recognised over the average period until benefits are vested on a straight-line basis. Current service costs and any past service costs, together with the unwinding of the discount on plan liabilities, offset by the expected return on plan assets, are charged to operating expenses.

(iii) Share-based compensation

The Standard Chartered PLC Group operates equity-settled share-based compensation plans in which the Bank's employees participate. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. For equity-settled awards, the total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and growth targets). The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments is estimated using an appropriate valuation technique, such as a binomial option pricing model.

(s) Translation of foreign currencies

Foreign currency transactions are translated into Hong Kong dollars using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the income statement.

Non-monetary assets and liabilities are translated at historical exchange rates if held at historical cost or year-end exchange rates if held at fair value, and the resulting foreign exchange gains and losses are recognised in either the income statement or shareholders' equity.

The results and financial position of all foreign operations that have a functional currency different from the presentation currency are accounted for as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the balance sheet date.
- income and expenses for each income statement are translated at average exchange rates or at rates on the date of the transaction where exchange rates fluctuate significantly; and
- all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. Such exchange differences arising are separately identified within equity. When a foreign operation is sold they are recognised in the income statement as part of the gain or loss on disposal.

(t) Related parties

For the purposes of these financial statements, parties are considered to be related to the Bank and its subsidiaries if the Bank and its subsidiaries have 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 Bank and its subsidiaries and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Bank where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Bank or of any entity that is a related party of the Bank.

3 Operating profit

The operating profit for the year is stated after taking into account of the following:

	2006 HK\$'M	2005 HK\$'M
(a) Interest income		
Interest income on listed securities	143	320
Interest income on unlisted securities	2,267	1,177
Other interest income	16,386	10,802
	<u>18,796</u>	<u>12,299</u>

Other interest income includes the amount of interest income on unwinding of discount on loan impairment losses of HK\$18 million (note 14) (2005: HK\$22 million) for the year ended 31 December 2006.

	2006 HK\$'M	2005 HK\$'M
(b) Interest expense		
Interest expense on customer deposits, deposits of banks, certificates of deposit issued and debt securities issued	9,829	4,851
Interest expense on subordinated liabilities	168	163
	<u>9,997</u>	<u>5,014</u>
(c) Net trading gains		
Gains less losses from dealing in foreign currencies	834	673
Gains less losses from trading securities	13	114
Losses from other dealing activities	(87)	(40)
	<u>760</u>	<u>747</u>
(d) Net (losses)/income from financial instruments designated at fair value through profit or loss		
Net realised and unrealised (losses)/gains	(219)	24

	2006 HK\$'M	2005 HK\$'M
(e) Other operating income		
Dividend income from listed available-for-sale securities	3	3
Dividend income from unlisted available-for-sale securities	19	16
Gains on disposal of fixed assets	9	–
Others	58	64
	<u>89</u>	<u>83</u>
(f) Operating expenses		
Staff costs		
– contributions to defined contribution plan	62	47
– current service costs in respect of defined benefits plan (note 27(d))	55	52
– equity-settled share-based payment expenses	80	75
– salaries and other staff costs	2,459	2,077
Depreciation (note 19(a))	179	219
Premises and equipment expense, excluding depreciation		
– rental of premises	352	346
– others	227	238
Amortisation		
– other intangible assets (note 20)	104	221
Other computer costs	318	509
Auditors' remuneration	8	7
Others	1,539	847
	<u>5,383</u>	<u>4,638</u>

4 Impairment losses and impairment allowances

	2006 HK\$'M	2005 HK\$'M
(a) Impairment losses on loans and advances		
Individual impairment provisions		
– additions (note 14)	866	1,229
– releases (note 14)	(488)	(124)
– recoveries (note 14)	(364)	(427)
	<u>14</u>	<u>678</u>
Portfolio impairment provisions		
– additions (note 14)	62	244
– releases (note 14)	(125)	(95)
	<u>(63)</u>	<u>149</u>
	<u>(49)</u>	<u>827</u>
(b) Impairment losses on available-for-sale securities		
– additions	–	5
	<u>–</u>	<u>5</u>

5 Net gains from disposal of available-for-sale securities

	2006 HK\$'M	2005 HK\$'M
Profit arising in current year	–	87
Net revaluation gains/(losses) transferred from reserves (note 30(a))	22	(6)
	<u>22</u>	<u>(6)</u>
	<u><u>22</u></u>	<u><u>81</u></u>

6 Taxation in the consolidated income statement**(a) Taxation in the consolidated income statement represents:**

	2006 HK\$'M	2005 HK\$'M
<i>Current tax – Hong Kong Profits Tax</i>		
Provision for the year	1,258	976
Over-provision in respect of prior years	(35)	–
	<u>1,223</u>	<u>976</u>
<i>Deferred tax</i>		
Reversal of temporary differences (note 24)	(10)	(45)
	<u>1,213</u>	<u>931</u>

The provision for Hong Kong Profits Tax for 2006 is calculated at 17.5% (2005: 17.5%) of the estimated assessable profits for the year.

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

	2006 HK\$'M	2005 HK\$'M
Profit before taxation	<u>7,239</u>	<u>5,472</u>
Notional tax on profit before taxation, calculated at		
Hong Kong profits tax rate of 17.5%	1,267	958
Tax effect of non-deductible expenses	37	36
Tax effect of non-taxable revenue	(64)	(57)
Over-provision in prior years	(35)	–
Others	8	(6)
	<u>1,213</u>	<u>931</u>
Actual tax expense	<u><u>1,213</u></u>	<u><u>931</u></u>

7 Directors' remuneration

Directors' remuneration disclosed pursuant to section 161 of the Hong Kong Companies Ordinance is as follows:

	<i>Bank</i>	
	2006 HK\$'M	2005 HK\$'M
Fees	2	2
Salaries and other emoluments	19	25
	<u>21</u>	<u>27</u>

8 Segmental reporting

	<i>Consumer banking</i>		<i>Wholesale banking</i>		<i>Other banking</i>		<i>Consolidated Total</i>	
	2006 HK\$'M	2005 HK\$'M	2006 HK\$'M	2005 HK\$'M	2006 HK\$'M	2005 HK\$'M	2006 HK\$'M	2005 HK\$'M
Total operating income	7,268	6,892	4,574	3,777	765	273	12,607	10,942
Total operating expenses	(3,215)	(2,887)	(2,221)	(1,691)	53	(60)	(5,383)	(4,638)
Operating profit	4,053	4,005	2,353	2,086	818	213	7,224	6,304
Impairment losses	(316)	(184)	365	(648)	–	–	49	(832)
Share of result of an associate	–	–	–	–	(34)	–	(34)	–
	<u>3,737</u>	<u>3,821</u>	<u>2,718</u>	<u>1,438</u>	<u>784</u>	<u>213</u>	<u>7,239</u>	<u>5,472</u>
Segment assets	<u>129,997</u>	<u>111,263</u>	<u>252,848</u>	<u>219,828</u>	<u>8,197</u>	<u>6,069</u>	<u>391,042</u>	<u>337,160</u>
Segment liabilities	<u>178,716</u>	<u>155,116</u>	<u>175,186</u>	<u>151,707</u>	<u>7,239</u>	<u>6,880</u>	<u>361,141</u>	<u>313,703</u>
Depreciation and amortisation for the year	(128)	(199)	(62)	(150)	(93)	(91)	(283)	(440)
Capital expenditure incurred during the year	(57)	(55)	(23)	(110)	(576)	(1,396)	(656)	(1,561)

The Bank and its subsidiaries comprise two main business segments: Consumer Banking which provides financial services to customers including lending and deposit taking activities, credit card facilities and investment services; and Wholesale Banking which provides financial services to corporations and institutions, including lending and deposit taking activities, structured finance products, syndicated loans, cash management, investment advice, distributing fixed income and equity investments, interbank and capital market activities and foreign exchange transactions. The Bank and its subsidiaries comprise only one geographical segment as over 90% of the business is based in Hong Kong.

9 Cash and balances with banks and other financial institutions

	<i>Consolidated and Bank</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Cash in hand	1,376	1,237
Balance with central bank	5,222	1,800
Balances with banks and other financial institutions	1,211	2,727
	<u>7,809</u>	<u>5,764</u>

10 Placements with banks and other financial institutions

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross placements with banks and other financial institutions				
– maturing within one month	35,823	31,775	35,819	31,775
– maturing between one month and one year	13,299	7,850	13,299	7,848
	<u>49,122</u>	<u>39,625</u>	<u>49,118</u>	<u>39,623</u>

11 Hong Kong SAR Government certificates of indebtedness and currency notes in circulation

The Hong Kong Special Administrative Region currency notes in circulation are secured by the deposit of funds in respect of which the Government of the Hong Kong Special Administrative Region certificates of indebtedness are held.

12 Trading assets

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Trading securities	20,238	16,064	20,238	16,064
Positive fair values of derivatives and others	4,001	3,709	4,000	3,700
	<u>24,239</u>	<u>19,773</u>	<u>24,238</u>	<u>19,764</u>
Trading securities:				
Treasury bills (including Exchange Fund Bills)	8,898	8,640	8,898	8,640
Certificates of deposit held	2,919	3,238	2,919	3,238
Debt securities	8,421	4,186	8,421	4,186
	<u>20,238</u>	<u>16,064</u>	<u>20,238</u>	<u>16,064</u>
Issued by:				
Central governments and central banks	11,654	10,507	11,654	10,507
Public sector entities	290	111	290	111
Banks and other financial institutions	7,751	4,994	7,751	4,994
Corporate entities	543	452	543	452
	<u>20,238</u>	<u>16,064</u>	<u>20,238</u>	<u>16,064</u>
By place of listing:				
Listed in Hong Kong	2,756	1,867	2,756	1,867
Listed outside Hong Kong	9	55	9	55
	<u>2,765</u>	<u>1,922</u>	<u>2,765</u>	<u>1,922</u>
Unlisted	17,473	14,142	17,473	14,142
	<u>20,238</u>	<u>16,064</u>	<u>20,238</u>	<u>16,064</u>

Positive fair value of derivatives included HK\$3,498 million (2005: HK\$2,754 million) relating to derivatives that are issued by the immediate holding company.

13 Advances to customers**(a) Advances to customers**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross advances to customers	168,470	165,730	167,902	165,114
Trade bills	2,674	5,835	2,674	5,835
	<u>171,144</u>	<u>171,565</u>	<u>170,576</u>	<u>170,949</u>
Less : Impairment losses				
– individually assessed (note 14)	(1,224)	(2,275)	(1,224)	(2,274)
– collectively assessed (note 14)	(351)	(414)	(351)	(413)
	<u>169,569</u>	<u>168,876</u>	<u>169,001</u>	<u>168,262</u>

(b) Advances to customers analysed by industry sector

The analysis of gross advances to customers by industry sector is based on the categories used by the Hong Kong Monetary Authority.

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2006</i> <i>HK\$'M</i>	<i>2005</i> <i>HK\$'M</i>	<i>2006</i> <i>HK\$'M</i>	<i>2005</i> <i>HK\$'M</i>
Gross advances for use in Hong Kong				
<i>Industrial, commercial and financial</i>				
– Property development	3,715	3,140	3,715	3,140
– Property investment	16,685	17,171	16,685	17,171
– Financial concerns	10,691	8,010	10,691	8,010
– Stockbrokers	804	542	804	542
– Wholesale and retail trade	5,655	5,135	5,655	5,135
– Manufacturing	7,168	6,803	7,168	6,803
– Transport and transport equipment	3,853	2,956	3,285	2,340
– Others	6,829	4,726	6,829	4,726
<i>Individuals</i>				
– Advances for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	1,852	2,178	1,852	2,178
– Advances for the purchase of other residential properties	79,313	85,607	79,313	85,607
– Credit card advances	9,575	9,892	9,575	9,892
– Others	6,614	4,725	6,614	4,725
Total gross advances for use in Hong Kong	152,754	150,885	152,186	150,269
Trade finance	13,949	12,435	13,949	12,435
Gross advances for use outside Hong Kong	1,767	2,410	1,767	2,410
Gross advances to customers (note 13(a))	168,470	165,730	167,902	165,114

(c) Impaired advances to customers

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2006</i> <i>HK\$'M</i>	<i>2005</i> <i>HK\$'M</i>	<i>2006</i> <i>HK\$'M</i>	<i>2005</i> <i>HK\$'M</i>
Gross impaired advances to customers	1,892	2,919	1,892	2,918
Impairment losses – individually assessed	(1,224)	(2,275)	(1,224)	(2,274)
	668	644	668	644
As a % of total advances to customers				
– gross impaired advances to customers (including trade bills)	1.11%	1.70%	1.11%	1.71%

Impaired advances are individually assessed loans with objective evidence of impairment on an individual basis.

Individually assessed impairment losses were made after taking into account the value of collateral in respect of such advances.

There were no impaired advances to banks and other financial institutions as at 31 December 2006 and 31 December 2005.

(d) Net investment in finance leases

Advances to customers include the net investment in equipment leased to customers under finance leases. The total minimum lease payments receivable under finance leases and their present values at the year end, are as follows:

	Consolidated					
	2006			2005		
	<i>Present value of the minimum lease payments receivable</i>	<i>Interest income relating to future periods</i>	<i>Total minimum lease payments</i>	<i>Present value of the minimum lease payments receivable</i>	<i>Interest income relating to future periods</i>	<i>Total minimum lease payments</i>
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Within 1 year	375	52	427	423	59	482
After 1 year but within 5 years	481	59	540	586	75	661
After 5 years	85	26	111	136	45	181
	941	137	1,078	1,145	179	1,324
Impairment losses:						
– individually assessed	–			(1)		
Net investment in finance leases	941			1,144		
	Bank					
	2006			2005		
	<i>Present value of the minimum lease payments receivable</i>	<i>Interest income relating to future periods</i>	<i>Total minimum lease payments</i>	<i>Present value of the minimum lease payments receivable</i>	<i>Interest income relating to future periods</i>	<i>Total minimum lease payments</i>
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Within 1 year	120	20	140	152	28	180
After 1 year but within 5 years	167	33	200	241	50	291
After 5 years	85	26	111	136	45	181
	372	79	451	529	123	652
Impairment losses:						
– individually assessed	–			(1)		
Net investment in finance leases	372			528		

14 Movement in impairment losses on advances to customers**Consolidated**

	<i>Individually assessed HK\$'M</i>	<i>2006 Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2006	2,275	414	2,689
Amounts written off	(1,411)	–	(1,411)
Recoveries of advances written off in previous years (note 4(a))	364	–	364
New impairment losses charged to the income statement (note 4(a))	866	62	928
Impairment losses released to the income statement (note 4(a))	(852)	(125)	(977)
Unwind of discount on loan impairment losses (note 3(a))	(18)	–	(18)
	<u>1,224</u>	<u>351</u>	<u>1,575</u>

Bank

	<i>Individually assessed HK\$'M</i>	<i>2006 Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2006	2,274	413	2,687
Amounts written off	(1,408)	–	(1,408)
Recoveries of advances written off in previous years	364	–	364
New impairment losses charged to the income statement	863	62	925
Impairment losses released to the income statement	(851)	(124)	(975)
Unwind of discount on loan impairment losses	(18)	–	(18)
	<u>1,224</u>	<u>351</u>	<u>1,575</u>

Consolidated

	<i>Individually assessed HK\$'M</i>	<i>2005 Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2005	2,295	265	2,560
Amounts written off	(1,103)	–	(1,103)
Recoveries of advances written off in previous years (note 4(a))	427	–	427
New impairment losses charged to the income statement (note 4(a))	1,229	244	1,473
Impairment losses released to the income statement (note 4(a))	(551)	(95)	(646)
Unwind of discount on loan impairment losses (note 3(a))	(22)	–	(22)
	<u>2,275</u>	<u>414</u>	<u>2,689</u>

Bank

	<i>Individually assessed HK\$'M</i>	<i>2005 Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2005	2,295	265	2,560
Amounts written off	(1,102)	–	(1,102)
Recoveries of advances written off in previous years	427	–	427
New impairment losses charged to the income statement	1,225	243	1,468
Impairment losses released to the income statement	(549)	(95)	(644)
Unwind of discount on loan impairment losses	(22)	–	(22)
	<u>2,274</u>	<u>413</u>	<u>2,687</u>
At 31 December 2005 (note 13(a))	<u>2,274</u>	<u>413</u>	<u>2,687</u>

15 Available-for-sale securities

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2006 HK\$'M</i>	<i>2005 HK\$'M</i>	<i>2006 HK\$'M</i>	<i>2005 HK\$'M</i>
Treasury bills (including Exchange Fund Bills)	15,218	8,836	15,218	8,836
Certificates of deposit held	307	479	307	479
Debt securities	41,160	30,252	41,160	30,252
Equity shares	460	304	291	134
	<u>57,145</u>	<u>39,871</u>	<u>56,976</u>	<u>39,701</u>
Less: Impairment losses	(5)	(5)	(5)	(5)
	<u>57,140</u>	<u>39,866</u>	<u>56,971</u>	<u>39,696</u>
Issued by:				
Central governments and central banks	16,487	12,728	16,487	12,728
Public sector entities	5,524	2,258	5,524	2,258
Banks and other financial institutions	34,059	23,608	33,890	23,438
Corporate entities	1,075	1,277	1,075	1,277
	<u>57,145</u>	<u>39,871</u>	<u>56,976</u>	<u>39,701</u>
By place of listing:				
Listed in Hong Kong	265	511	265	511
Listed outside Hong Kong	1,716	1,224	1,547	1,224
	<u>1,981</u>	<u>1,735</u>	<u>1,812</u>	<u>1,735</u>
Unlisted	55,164	38,136	55,164	37,966
	<u>57,145</u>	<u>39,871</u>	<u>56,976</u>	<u>39,701</u>

Available-for-sale securities included HK\$2,334 million (2005: HK\$2,273 million) of securities that are issued by the immediate holding company and HK\$ 2,084 million (2005: HK\$Nil) of securities that are issued by a fellow subsidiary.

16 Amounts due from/to immediate holding company, fellow subsidiaries and subsidiaries of the Bank**(a) The amounts due from immediate holding company, fellow subsidiaries and subsidiaries of the Bank represent:**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Balances with banks	2,049	1,046	2,049	1,046
Placements with banks	46,978	35,433	46,972	35,433
Advances	240	33	1,022	520
Other assets	773	746	774	766
	<u>50,040</u>	<u>37,258</u>	<u>50,817</u>	<u>37,765</u>
Immediate holding company	38,099	32,310	38,098	32,310
Fellow subsidiaries	11,941	4,948	11,937	4,948
Subsidiaries of the Bank	–	–	782	507
	<u>50,040</u>	<u>37,258</u>	<u>50,817</u>	<u>37,765</u>

The amounts due from immediate holding company, fellow subsidiaries and subsidiaries of the Bank are unsecured. HK\$47,218 million (2005: HK\$35,466 million) in the consolidated balance sheet and HK\$47,994 million (2005: HK\$35,953 million) in the Bank's balance sheet has fixed maturity and bears interest on normal commercial terms. The remaining balances are interest-free and repayable on demand.

(b) The amounts due to immediate holding company, fellow subsidiaries and subsidiaries of the Bank represent:

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Balances from banks	1,071	3,111	1,071	3,111
Deposits from banks	1,283	1,708	1,283	1,708
Deposits from customers	507	47	808	168
Other liabilities	327	270	310	263
	<u>3,188</u>	<u>5,136</u>	<u>3,472</u>	<u>5,250</u>
Immediate holding company	2,608	5,067	2,608	5,060
Fellow subsidiaries	580	69	563	69
Subsidiaries of the Bank	–	–	301	121
	<u>3,188</u>	<u>5,136</u>	<u>3,472</u>	<u>5,250</u>

The amounts due to immediate holding company, fellow subsidiaries and subsidiaries of the Bank are unsecured. HK\$1,790 million (2005: HK\$1,755 million) in the consolidated balance sheet and HK\$2,091 million (2005: HK\$1,876 million) in the Bank's balance sheet has fixed maturity and bears interest on normal commercial terms. The remaining balances are interest-free and repayable on demand.

(c) Transactions with group companies:

During the year, the Bank and its subsidiaries entered into transactions with related parties in the ordinary course of its banking business including lending, acceptance and placement of inter-bank deposits, correspondent banking transactions, banking operation/outsourcing activities and off-balance sheet transactions.

(i) Consolidated

The amounts of material transactions during the year and outstanding balances at the end of the year are set out below:

	<i>Immediate holding company</i>		<i>Fellow subsidiaries</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Income	1,258	970	471	169
Expenses	916	158	422	254
	<i>Immediate holding company</i>		<i>Fellow subsidiaries</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Amounts due from group companies:				
At 1 January	32,310	64,521	4,948	28
At 31 December	38,099	32,310	11,941	4,948
Average balance during the year	37,192	41,818	9,109	1,125
Amounts due to group companies:				
At 1 January	5,067	8,978	69	261
At 31 December	2,608	5,067	580	69
Average balance during the year	5,373	6,845	208	108

(ii) *The Bank*

The amounts of material transactions during the year and outstanding balances at the end of the year are set out below:

	<i>Immediate holding company</i>		<i>Fellow subsidiaries</i>		<i>Subsidiaries of the Bank</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Income	<u>1,258</u>	<u>970</u>	<u>471</u>	<u>169</u>	<u>37</u>	<u>6</u>
Expenses	<u>916</u>	<u>158</u>	<u>422</u>	<u>254</u>	<u>1</u>	<u>4</u>
	<i>Immediate holding company</i>		<i>Fellow subsidiaries</i>		<i>Subsidiaries of the Bank</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Amounts due from group companies:						
At 1 January	<u>32,310</u>	<u>64,458</u>	<u>4,948</u>	<u>28</u>	<u>507</u>	<u>577</u>
At 31 December	<u>38,098</u>	<u>32,310</u>	<u>11,937</u>	<u>4,948</u>	<u>782</u>	<u>507</u>
Average balance during the year	<u>37,191</u>	<u>41,800</u>	<u>9,108</u>	<u>1,035</u>	<u>555</u>	<u>510</u>
Amounts due to group companies:						
At 1 January	<u>5,060</u>	<u>8,951</u>	<u>69</u>	<u>261</u>	<u>121</u>	<u>22</u>
At 31 December	<u>2,608</u>	<u>5,060</u>	<u>563</u>	<u>69</u>	<u>301</u>	<u>121</u>
Average balance during the year	<u>5,373</u>	<u>6,838</u>	<u>205</u>	<u>101</u>	<u>125</u>	<u>72</u>

17 Investments in subsidiaries of the Bank

	<i>Bank</i>	
	<i>2006</i> <i>HK\$'M</i>	<i>2005</i> <i>HK\$'M</i>
Unlisted shares, at cost less impairment losses, if any	<u>249</u>	<u>302</u>

The following list contains only the particulars of subsidiaries which principally affected the results, assets or liabilities of the Bank and its subsidiaries. The class of shares held is ordinary unless otherwise stated.

<i>Name of company</i>	<i>Place of incorporation</i>	<i>Particulars of issued and paid up capital and securities</i>	<i>Proportion of ownership interest held by the bank</i>	<i>Principal activity</i>
C.E.C. Finance Limited	Hong Kong	12,800,000 shares of HK\$1 each	51%	Provision of instalment finance and hire purchase facilities
Standard Chartered Investment Services Limited	Hong Kong	1,500,000 shares of HK\$10 each	100%	Investment advisory services
Standard Chartered Corporate Advisory (Beijing) Company Limited**	The People's Republic of China	US\$1,680,000	100%	Consultancy services
S C Learning Limited	Hong Kong	2 shares of HK\$1 each	100%	Provision of learning solutions
SCL Consulting (Shanghai) Company Limited	The People's Republic of China	US\$140,000	100%*	Consultancy services
Standard Chartered APR Limited	United Kingdom	21,971,715 shares of US\$1 each	100%	Investment holdings
Horsford Nominees Limited	Hong Kong	10 shares of HK\$10 each	100%	Provision of nominee services

* indirectly held

** formerly known as "Standard Chartered Asset Consulting Services Company Limited"

18 Interest in an associate**Consolidated**

	2006 HK\$'M	2005 HK\$'M
Share of net assets	959	959

Bank

	2006 HK\$'M	2005 HK\$'M
Unlisted shares, at cost less impairment losses, if any	959	959

The following list contains only the particulars of the associate which principally affected the results or assets of the Bank and its subsidiaries:

<i>Name of associate</i>	<i>Place of establishment and operation</i>	<i>Particulars of issued and paid up capital</i>	<i>Proportion of ownership interest</i>	<i>Principal activity</i>
China Bohai Bank Company Limited ("Bohai")	The People's Republic of China	5,000,000,000 ordinary shares of RMB1 each	19.99%	Provision of banking and related financial services

Summary of financial information of an associate

	<i>Assets HK\$'M</i>	<i>Liabilities HK\$'M</i>	<i>Equity HK\$'M</i>	<i>Revenue HK\$'M</i>	<i>Loss HK\$'M</i>
2006					
100 per cent	15,293	10,494	4,799	277	172
Bank's effective interest	3,057	2,098	959	55	34
	<i>Assets HK\$'M</i>	<i>Liabilities HK\$'M</i>	<i>Equity HK\$'M</i>	<i>Revenue HK\$'M</i>	<i>Profit HK\$'M</i>
2005					
100 per cent	4,797	–	4,797	–	–
Bank's effective interest	959	–	959	–	–

19 Fixed assets**(a) Consolidated**

	2006				
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost:					
At 1 January 2006	2,406	519	2,925	385	3,310
Additions	53	80	133	501	634
Disposals	(28)	(130)	(158)	–	(158)
At 31 December 2006	2,431	469	2,900	886	3,786
Accumulated depreciation:					
At 1 January 2006	184	311	495	8	503
Charge for the year (note 3(f))	79	87	166	13	179
Written back on disposals	(16)	(130)	(146)	–	(146)
At 31 December 2006	247	268	515	21	536
Net book value:					
At 31 December 2006	2,184	201	2,385	865	3,250
	2005				
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost:					
At 1 January 2005	1,473	541	2,014	–	2,014
Additions	974	126	1,100	385	1,485
Disposals	(41)	(148)	(189)	–	(189)
At 31 December 2005	2,406	519	2,925	385	3,310
Accumulated depreciation:					
At 1 January 2005	146	327	473	–	473
Charge for the year (note 3(f))	79	132	211	8	219
Written back on disposals	(41)	(148)	(189)	–	(189)
At 31 December 2005	184	311	495	8	503
Net book value:					
At 31 December 2005	2,222	208	2,430	377	2,807

(b) Bank

	2006				
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost:					
At 1 January 2006	2,406	512	2,918	385	3,303
Additions	53	80	133	501	634
Disposals	(28)	(123)	(151)	–	(151)
	<u>2,431</u>	<u>469</u>	<u>2,900</u>	<u>886</u>	<u>3,786</u>
At 31 December 2006	2,431	469	2,900	886	3,786
Accumulated depreciation:					
At 1 January 2006	184	305	489	8	497
Charge for the year	79	86	165	13	178
Written back on disposals	(16)	(123)	(139)	–	(139)
	<u>247</u>	<u>268</u>	<u>515</u>	<u>21</u>	<u>536</u>
At 31 December 2006	247	268	515	21	536
Net book value:					
At 31 December 2006	<u>2,184</u>	<u>201</u>	<u>2,385</u>	<u>865</u>	<u>3,250</u>
			2005		
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost:					
At 1 January 2005	1,473	532	2,005	–	2,005
Additions	974	126	1,100	385	1,485
Disposals	(41)	(146)	(187)	–	(187)
	<u>2,406</u>	<u>512</u>	<u>2,918</u>	<u>385</u>	<u>3,303</u>
At 31 December 2005	2,406	512	2,918	385	3,303
Accumulated depreciation:					
At 1 January 2005	146	324	470	–	470
Charge for the year	79	127	206	8	214
Written back on disposals	(41)	(146)	(187)	–	(187)
	<u>184</u>	<u>305</u>	<u>489</u>	<u>8</u>	<u>497</u>
At 31 December 2005	184	305	489	8	497
Net book value:					
At 31 December 2005	<u>2,222</u>	<u>207</u>	<u>2,429</u>	<u>377</u>	<u>2,806</u>

Buildings and leasehold land held for own use:

	<i>Consolidated and Bank</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Leasehold in Hong Kong, at cost		
– medium-term leases	2,089	2,191
– short leases	95	31
	<u>2,184</u>	<u>2,222</u>

Investment properties:

	<i>Consolidated and Bank</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Leasehold in Hong Kong, at cost		
– medium-term leases	367	377
Leasehold outside Hong Kong, at cost		
– medium-term leases	498	–
	<u>865</u>	<u>377</u>

The investment properties are stated at depreciated cost less impairment. The fair value of the investment properties located in Hong Kong and outside Hong Kong as at 31 December 2006 was HK\$377 million (2005: HK\$377 million) and HK\$708 million (2005: HK\$ Nil) respectively. The fair value was based on an open market value basis calculated by reference to net rental income allowing for reversionary income potential. The valuations of investment properties located in Hong Kong were carried out by an independent firm which has among its staff Fellows of the Hong Kong Institute of Surveyors with recent experience in the location and category of property being valued. The valuation of investment properties located outside Hong Kong was carried out by an officer who is an associate member of Royal Institute of Chartered Surveyors and a qualified surveyor of a fellow subsidiary of the Bank with recent experience in the location and category of property being valued.

20 Intangible assets

	<i>Consolidated and Bank 2006</i>		
	<i>Capitalised software and other intangible assets HK\$'M</i>	<i>Goodwill HK\$'M</i>	<i>Total HK\$'M</i>
Cost:			
At 1 January 2006	713	611	1,324
Additions	22	–	22
Disposals	(405)	–	(405)
	<u> </u>	<u> </u>	<u> </u>
At 31 December 2006	330	611	941
	-----	-----	-----
Accumulated amortisation:			
At 1 January 2006	479	–	479
Charge for the year (note 3(f))	104	–	104
Written back on disposal	(405)	–	(405)
	<u> </u>	<u> </u>	<u> </u>
At 31 December 2006	178	–	178
	=====	=====	=====
Carrying amount:			
At 31 December 2006	<u> </u>	<u> </u>	<u> </u>
	=====	=====	=====

	<i>Consolidated and Bank 2005</i>		
	<i>Capitalised software and other intangible assets HK\$'M</i>	<i>Goodwill HK\$'M</i>	<i>Total HK\$'M</i>
Cost:			
At 1 January 2005	1,007	611	1,618
Additions	76	–	76
Disposals	(370)	–	(370)
	<u>713</u>	<u>611</u>	<u>1,324</u>
At 31 December 2005	713	611	1,324
Accumulated amortisation:			
At 1 January 2005	594	–	594
Charge for the year (note 3(f))	221	–	221
Written back on disposal	(336)	–	(336)
	<u>479</u>	<u>–</u>	<u>479</u>
At 31 December 2005	479	–	479
Carrying amount:			
At 31 December 2005	<u>234</u>	<u>611</u>	<u>845</u>

Impairment tests for cash-generating units containing goodwill

Goodwill is allocated to the Bank and its subsidiaries' cash-generating units ("CGU") as follows:

	<i>2006 HK\$'M</i>	<i>2005 HK\$'M</i>
Credit cards and personal loans	<u>611</u>	<u>611</u>

The recoverable amount of the CGU is determined based on value in use calculations. The key assumptions and approach to determining value in use calculations, as set out below, are solely estimates for the purpose of assessing impairment on acquired goodwill. These calculations use cash flow projections based on budgets and forecasts approved by management covering one year and extrapolated for a further 19 years using steady growth rates.

In assessing impairment of goodwill, the Bank assumed that growth would increase at a steady rate in line with long-term forecast GDP growth. A discount rate of 14.5 per cent was used.

21 Deposits and balances of banks and other financial institutions

	<i>Consolidated and Bank</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Deposits and balances of central bank	1,804	3,845
Deposits and balances of other banks	5,710	4,878
	<u>7,514</u>	<u>8,723</u>

22 Deposits from customers

	<i>Consolidated and Bank</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Demand deposits and current accounts	23,763	21,505
Savings deposits	126,820	96,649
Time, call and notice deposits	137,930	129,509
	<u>288,513</u>	<u>247,663</u>

23 Financial liabilities designated at fair value through profit or loss

	<i>Consolidated and Bank</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Structured customer deposits	8,137	4,254
Debt securities issued	1,377	899
	<u>9,514</u>	<u>5,153</u>

The Bank designates certain financial liabilities at fair value through profit or loss where either the liabilities:

- have fixed rates of interest and interest rate swaps or other interest related derivatives have been transacted with the intention of significantly reducing interest rate risk; or
- are exposed to foreign currency risk and derivatives have been transacted with the intention of significantly reducing exposure to market changes; or
- have been acquired to fund trading asset portfolios or assets, or where the assets and liabilities are managed, and performance evaluated, on a fair value basis for a documented risk management or investment strategy.

At 31 December 2006, the difference between the carrying amount and the contractual amount payable at maturity for the Bank and its subsidiaries amounted to HK\$60 million (2005: HK\$45 million). This change is attributable to changes in market rates.

24 Taxation in the balance sheet**Deferred tax assets and liabilities:**

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

Consolidated

	<i>Depreciation allowances in excess of related depreciation HK\$'M</i>	<i>Impairment losses on financial assets HK\$'M</i>	<i>Others HK\$'M</i>	<i>Total HK\$'M</i>
	2006			
Deferred tax arising from:				
At 1 January 2006	13	(71)	(38)	(96)
(Credited)/charged to income statement (note 6(a))	(11)	10	(9)	(10)
Charged to reserves (note 30(a))	—	—	73	73
At 31 December 2006	<u>2</u>	<u>(61)</u>	<u>26</u>	<u>(33)</u>
	2005			
At 1 January 2005	49	(46)	(34)	(31)
(Credited)/charged to income statement (note 6(a))	(36)	(25)	16	(45)
Credited to reserves (note 30(a))	—	—	(20)	(20)
At 31 December 2005	<u>13</u>	<u>(71)</u>	<u>(38)</u>	<u>(96)</u>

Bank

	<i>Depreciation allowances in excess of related depreciation HK\$'M</i>	<i>Impairment losses on financial assets HK\$'M</i>	<i>Others HK\$'M</i>	<i>Total HK\$'M</i>															
2006																			
Deferred tax arising from:																			
At 1 January 2006	(12)	(71)	(38)	(121)															
(Credited)/charged to income statement	(9)	10	(9)	(8)															
Charged to reserves (note 30(b))	—	—	73	73															
	<u> </u>	<u> </u>	<u> </u>	<u> </u>															
At 31 December 2006	<u>(21)</u>	<u>(61)</u>	<u>26</u>	<u>(56)</u>															
2005																			
At 1 January 2005	21	(46)	(28)	(53)															
(Credited)/charged to income statement	(33)	(25)	10	(48)															
Credited to reserves (note 30(b))	—	—	(20)	(20)															
	<u> </u>	<u> </u>	<u> </u>	<u> </u>															
At 31 December 2005	<u>(12)</u>	<u>(71)</u>	<u>(38)</u>	<u>(121)</u>															
<table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th></th> <th colspan="2" style="text-align: center;"><i>Consolidated</i></th> <th colspan="2" style="text-align: center;"><i>Bank</i></th> </tr> <tr> <th></th> <th style="text-align: center;"><i>2006</i></th> <th style="text-align: center;"><i>2005</i></th> <th style="text-align: center;"><i>2006</i></th> <th style="text-align: center;"><i>2005</i></th> </tr> <tr> <th></th> <th style="text-align: center;"><i>HK\$'M</i></th> <th style="text-align: center;"><i>HK\$'M</i></th> <th style="text-align: center;"><i>HK\$'M</i></th> <th style="text-align: center;"><i>HK\$'M</i></th> </tr> </thead> </table>						<i>Consolidated</i>		<i>Bank</i>			<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>		<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
	<i>Consolidated</i>		<i>Bank</i>																
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>															
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>															
Analysed by:																			
Net deferred tax asset recognised on the balance sheet	(56)	(121)	(56)	(121)															
Net deferred tax liability recognised on the balance sheet	23	25	—	—															
	<u> </u>	<u> </u>	<u> </u>	<u> </u>															
	<u>(33)</u>	<u>(96)</u>	<u>(56)</u>	<u>(121)</u>															

25 Trading liabilities

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Short positions in securities	11,886	10,491	11,886	10,491
Negative fair values of derivatives and others	3,968	4,096	3,967	4,096
	<u>15,854</u>	<u>14,587</u>	<u>15,853</u>	<u>14,587</u>

Negative fair values of derivatives included HK\$3,850 million (2005: HK\$3,082 million) relating to derivatives that are issued by the immediate holding company.

26 Other liabilities

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Accrued charges	1,963	1,638	1,949	1,624
Negative fair values of hedging derivatives	126	165	126	165
Others	7,169	1,903	7,163	1,874
	<u>9,258</u>	<u>3,706</u>	<u>9,238</u>	<u>3,663</u>

27 Employee retirement benefits

The Bank makes contributions to a defined benefit retirement scheme (the "Scheme") which covers 38% (2005: 46%) of the Bank's employees. The Scheme is administered by a trustee, with the assets held separately from those of the Bank.

(a) The amounts recognised in the Bank and its subsidiaries' balance sheet are as follows:

	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Fair value of plan assets	1,719	1,415
Present value of wholly or partly funded obligations	<u>(1,458)</u>	<u>(1,377)</u>
Net asset recognised in the balance sheet (included in "other assets")	<u>261</u>	<u>38</u>

(b) Movements in the present value of the obligation:

	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
At the beginning of the year	1,377	1,296
Current service cost	90	94
Interest cost	56	50
Benefits paid	(74)	(67)
Actuarial losses on obligation	9	4
	<u>1,458</u>	<u>1,377</u>

(c) Movements in the fair value of assets:

	2006 HK\$'M	2005 HK\$'M
At the beginning of the year	1,415	1,237
Contributions	83	87
Expected return on assets	91	92
Benefits paid	(74)	(67)
Actuarial gains on plan assets	204	66
	<u>1,719</u>	<u>1,415</u>

(d) Movements in the net asset/(liabilities) recognised in the consolidated balance sheet are as follows:

	2006 HK\$'M	2005 HK\$'M
At the beginning of the year	38	(59)
Contributions	83	87
Expense recognised in the income statement (note 3(f))	(55)	(52)
Actuarial gains to pension reserve (note 30(a))	195	62
	<u>261</u>	<u>38</u>

As at 31 December 2006, the Scheme did not invest in the Bank's own financial instruments and properties (2005: HK\$Nil). The Bank expects to contribute approximately HK\$83 million to the Scheme in 2007 (2006: HK\$70 million).

(e) The expense recognised in the consolidated income statement for the year is as follows:

	2006 HK\$'M	2005 HK\$'M
Current service cost	90	94
Interest cost	56	50
Actuarial expected return on plan assets	(91)	(92)
	<u>55</u>	<u>52</u>

The actual return on plan assets (taking into account all changes in the fair value of the plan assets excluding contributions paid and received) was a net income of HK\$295 million (2005: HK\$158 million).

(f) The principal actuarial assumptions used in the valuation are as follows:

	2006	2005
Discount rate	4.00%	4.25%
Expected rate of return on plan assets	6.50%	6.50%
Future salary increases	4.50%	4.50%

The expected return is based on market expectation, at the beginning of the year, for the return net of administration costs, over the entire life of the related obligations.

(g) The major categories of assets as a percentage of total assets are as follows:

	2006	2005
Equities	53%	53%
Bonds	43%	43%
Cash	4%	4%
	<u>100%</u>	<u>100%</u>

28 Subordinated liabilities

	<i>Consolidated and Bank</i>	
	2006	2005
	<i>HK\$'M</i>	<i>HK\$'M</i>
HK\$625 million (2005: HK\$670 million) Floating Rate Step-Up Notes 2014	624	669
HK\$500 million 3.5% Fixed/Floating Rate Step-Up Notes 2014	489	477
US\$350 million 4.375% Fixed/Floating Rate Step-Up Notes 2014	2,643	2,635
	<u>3,756</u>	<u>3,781</u>

All subordinated liabilities are unsecured and subordinated to the claims of other creditors.

29 Share capital

	2006		2005	
	<i>No. of shares in million</i>	<i>HK\$'M</i>	<i>No. of shares in million</i>	<i>HK\$'M</i>
Authorised, issued and fully paid:				
'A' ordinary shares of HK\$0.05 each	780	39	780	39
'B' ordinary shares of HK\$0.05 each	1,231	62	1,231	62
	<u>2,011</u>	<u>101</u>	<u>2,011</u>	<u>101</u>
Preference shares of HK\$1.00 each	3,800	3,800	3,800	3,800
	<u>5,811</u>	<u>3,901</u>	<u>5,811</u>	<u>3,901</u>

(i) The preference shares bear a non-cumulative preferential dividend at a rate of 8.25% per annum on their nominal amount and rank in priority to the 'A' ordinary shares and the 'B' ordinary shares with respect to the payment of dividends and any return of capital. The 'B' ordinary shares rank in priority to the 'A' ordinary shares with respect to any return of capital.

(ii) During the year, the Bank made no repurchase of its own shares.

30 Reserves**(a) Consolidated**

	Share premium HK\$'M	Property revaluation reserve HK\$'M	Hedging reserve HK\$'M	Available-for-sale investment reserve HK\$'M	Pension reserve HK\$'M	Exchange reserve HK\$'M	Retained profits HK\$'M	Total HK\$'M
At 1 January 2006	12,477	3	(44)	(86)	(31)	–	7,186	19,505
Available-for-sale securities:								
– changes in fair value	–	–	–	236	–	–	–	236
– transfer to income statement on disposal (note 5)	–	–	–	(22)	–	–	–	(22)
– deferred tax charged (note 24)	–	–	–	(31)	–	–	–	(31)
Cash flow hedge:								
– effective portion of changes in fair value	–	–	48	–	–	–	–	48
– deferred tax charged (note 24)	–	–	(8)	–	–	–	–	(8)
Exchange difference on translation of investment in associated company	–	–	–	–	–	34	–	34
Actuarial gains on defined benefits plan (note 27(d))	–	–	–	–	195	–	–	195
Tax on actuarial gains on defined benefits plan (note 24)	–	–	–	–	(34)	–	–	(34)
Profit for the year	–	–	–	–	–	–	6,026	6,026
At 31 December 2006	12,477	3	(4)	97	130	34	13,212	25,949

	Share premium HK\$'M	Property revaluation reserve HK\$'M	Hedging reserve HK\$'M	Available- for-sale investment reserve HK\$'M	Pension reserve HK\$'M	Retained profits HK\$'M	Total HK\$'M
At 1 January 2005	12,500	3	(10)	8	(93)	2,650	15,058
Available-for-sale securities:							
– changes in fair value	–	–	–	(113)	–	–	(113)
– transfer to income statement on disposal (note 5)	–	–	–	6	–	–	6
– deferred tax released (note 24)	–	–	–	13	–	–	13
Cash flow hedge:							
– effective portion of changes in fair value	–	–	(41)	–	–	–	(41)
– deferred tax released (note 24)	–	–	7	–	–	–	7
Actuarial gains on defined benefits plan (note 27(d))	–	–	–	–	62	–	62
Capitalisation of share premium	(23)	–	–	–	–	–	(23)
Profit for the year	–	–	–	–	–	4,536	4,536
At 31 December 2005	12,477	3	(44)	(86)	(31)	7,186	19,505

(b) Bank

	Share premium HK\$'M	Property revaluation reserve HK\$'M	Hedging reserve HK\$'M	Available- for-sale investment reserve HK\$'M	Pension reserve HK\$'M	Retained profits HK\$'M	Total HK\$'M
At 1 January 2006	12,477	3	(44)	(86)	(31)	7,193	19,512
Available-for-sale securities:							
– changes in fair value	–	–	–	237	–	–	237
– transfer to income statement on disposal	–	–	–	(22)	–	–	(22)
– deferred tax charged (note 24)	–	–	–	(31)	–	–	(31)
Cash flow hedge:							
– effective portion of changes in fair value	–	–	48	–	–	–	48
– deferred tax charged (note 24)	–	–	(8)	–	–	–	(8)
Actuarial gains on defined benefits plan	–	–	–	–	195	–	195
Tax on actuarial gains on defined benefits plan (note 24)	–	–	–	–	(34)	–	(34)
Profit for the year	–	–	–	–	–	6,068	6,068
At 31 December 2006	<u>12,477</u>	<u>3</u>	<u>(4)</u>	<u>98</u>	<u>130</u>	<u>13,261</u>	<u>25,965</u>

	Share premium HK\$'M	Property revaluation reserve HK\$'M	Hedging reserve HK\$'M	Available- for-sale investment reserve HK\$'M	Pension reserve HK\$'M	Retained profits HK\$'M	Total HK\$'M
At 1 January 2005	12,500	3	(10)	8	(93)	2,701	15,109
Available-for-sale securities:							
– changes in fair value	–	–	–	(113)	–	–	(113)
– transfer to income statement on disposal	–	–	–	6	–	–	6
– deferred tax released (note 24)	–	–	–	13	–	–	13
Cash flow hedge:							
– effective portion of changes in fair value	–	–	(41)	–	–	–	(41)
– deferred tax released (note 24)	–	–	7	–	–	–	7
Actuarial gains on defined benefits plan	–	–	–	–	62	–	62
Capitalisation of share premium	(23)	–	–	–	–	–	(23)
Profit for the year	–	–	–	–	–	4,492	4,492
At 31 December 2005	<u>12,477</u>	<u>3</u>	<u>(44)</u>	<u>(86)</u>	<u>(31)</u>	<u>7,193</u>	<u>19,512</u>

The consolidated profit attributable to equity shareholders of the Bank includes a profit of HK\$6,068 million (2005: HK\$4,492 million) which has been dealt with in the financial statements of the Bank.

(c) Nature and purpose of reserves

(i) Share premium

The application of the share premium account is governed by Section 48B of the Hong Kong Companies Ordinance.

(ii) Property revaluation reserve

The revaluation reserves have been set up and are dealt with in accordance with the accounting policies adopted for buildings and are distributable.

(iii) Available-for-sale investment reserve

The available-for-sale investment reserve comprises the cumulative net change in the fair value of available-for-sale securities held at the balance sheet date and is dealt with in accordance with the accounting policies in note 2(i).

(iv) Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of hedging instruments used in cash flow hedges pending subsequent recognition of the hedged cash flow in accordance with the accounting policy adopted for cash flow hedges in note 2(j).

(v) Pension reserve

The pension reserve comprises the cumulative net effect of the actuarial gains and losses for the defined benefits plan.

(vi) Exchange reserve

The exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations. The reserve is dealt with in accordance with the accounting policies set out in note 2(s).

The HKMA requires the Bank to maintain a minimum level of impairment allowances which is in excess of the impairment allowances required under Hong Kong Financial Reporting Standards. Of the retained earnings as at 31 December 2006, an amount of HK\$552 million (2005: HK\$355 million) has been reserved for this purpose.

(d) Minority interests

	<i>Consolidated</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
At 1 January	51	46
Profit for the year	—	5
At 31 December	<u>51</u>	<u>51</u>

31 Cash and cash equivalents

	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
(a) Components of cash and cash equivalents in the cash flow statement		
Cash and balances with banks and other financial institutions	7,333	5,514
Placements with banks and other financial institutions with original maturity within three months	31,753	30,733
Amounts due from immediate holding company and fellow subsidiaries with original maturity within three months	<u>22,874</u>	<u>16,267</u>
	<u>61,960</u>	<u>52,514</u>

	2006 HK\$'M	2005 HK\$'M
(b) Reconciliation with the consolidated balance sheet		
Cash and balances with banks and other financial institutions	7,809	5,764
Placements with banks and other financial institutions	49,122	39,625
Trading securities	20,238	16,064
Available-for-sale securities	57,140	39,866
Amounts due from immediate holding company and fellow subsidiaries	50,040	37,258
Overdraft included in "deposits and balances of banks and other financial institutions"	(476)	(250)
Overdraft included in "amounts due to immediate holding company"	(282)	(2,857)
	<u>183,591</u>	<u>135,470</u>
Less: amounts with an original maturity of beyond three months	(121,631)	(82,956)
	<u>61,960</u>	<u>52,514</u>
Cash and cash equivalents in the consolidated cash flow statement	<u>61,960</u>	<u>52,514</u>

(c) Investment in a subsidiary

	2006 HK\$'M	2005 HK\$'M
Net assets acquired:		
– Cash and balances from banks and other financial institutions	–	3
– Advances to customers	–	1,369
– Available-for-sale securities	–	132
– Other assets	–	20
– Deposits and balances from banks and other financial institutions	–	(230)
– Amounts due to fellow subsidiaries	–	(962)
– Deposits from customers	–	(13)
– Current taxation	–	(6)
– Other liabilities	–	(23)
	<u>–</u>	<u>290</u>
Total	<u>–</u>	<u>290</u>
Satisfied by:		
– Cash consideration	–	290
	<u>–</u>	<u>290</u>
Analysis of net cash outflow in respect of the purchase of a subsidiary:		
– Cash consideration paid	–	(290)
– Cash and balances with banks and other financial institutions acquired	–	3
	<u>–</u>	<u>(287)</u>
	<u>–</u>	<u>(287)</u>

32 Derivatives**(a) Notional amounts of derivatives**

Derivatives are contracts whose value depends on the value of one or more underlying financial instruments, interest or exchange rates or indices.

The following is a summary of the notional amounts of each significant type of derivative entered into by the Bank and its subsidiaries:

Consolidated

	2006			2005		
	Trading	Hedging	Total	Trading	Hedging	Total
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Exchange rate contracts						
Forwards	444,703	–	444,703	405,327	–	405,327
Cross currency swaps	523	–	523	1,718	–	1,718
Options purchased	7,082	–	7,082	4,561	–	4,561
Options written	7,082	–	7,082	4,561	–	4,561
Interest rate contracts						
Forwards	2,075	–	2,075	178	–	178
Swaps	25,753	14,722	40,475	6,007	12,071	18,078
Options purchased	3,029	–	3,029	4,312	–	4,312
Options written	3,029	–	3,029	4,312	–	4,312
Other derivatives	135	–	135	54	–	54
	<u>493,411</u>	<u>14,722</u>	<u>508,133</u>	<u>431,030</u>	<u>12,071</u>	<u>443,101</u>

Bank

	2006			2005		
	Trading	Hedging	Total	Trading	Hedging	Total
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Exchange rate contracts						
Forwards	444,703	–	444,703	405,327	–	405,327
Cross currency swaps	523	–	523	1,718	–	1,718
Options purchased	7,082	–	7,082	4,561	–	4,561
Options written	7,082	–	7,082	4,561	–	4,561
Interest rate contracts						
Forwards	2,075	–	2,075	178	–	178
Swaps	25,302	14,722	40,024	5,421	12,071	17,492
Options purchased	3,029	–	3,029	4,312	–	4,312
Options written	3,029	–	3,029	4,312	–	4,312
Other derivatives	135	–	135	54	–	54
	<u>492,960</u>	<u>14,722</u>	<u>507,682</u>	<u>430,444</u>	<u>12,071</u>	<u>442,515</u>

The notional amounts of these instruments indicate the volume of transactions outstanding and do not represent amounts at risk.

(b) Fair values and credit risk weighted amounts of derivatives

	Consolidated					
	2006			2005		
	Fair value assets HK\$'M	Fair value liabilities HK\$'M	Credit risk weighted amount HK\$'M	Fair value assets HK\$'M	Fair value liabilities HK\$'M	Credit risk weighted amount HK\$'M
Currency derivatives	3,680	3,649	1,667	2,894	3,037	1,312
Interest rate derivatives	355	444	203	125	342	104
Other derivatives	1	1	5	–	–	1
	<u>4,036</u>	<u>4,094</u>	<u>1,875</u>	<u>3,019</u>	<u>3,379</u>	<u>1,417</u>

	Bank					
	2006			2005		
	Fair value assets HK\$'M	Fair value liabilities HK\$'M	Credit risk weighted amount HK\$'M	Fair value assets HK\$'M	Fair value liabilities HK\$'M	Credit risk weighted amount HK\$'M
Currency derivatives	3,680	3,649	1,667	2,894	3,037	1,312
Interest rate derivatives	354	443	203	116	342	102
Other derivatives	1	1	5	–	–	1
	<u>4,035</u>	<u>4,093</u>	<u>1,875</u>	<u>3,010</u>	<u>3,379</u>	<u>1,415</u>

Credit risk weighted amount refers to the amount as computed in accordance with the Third Schedule to the Hong Kong Banking Ordinance on capital adequacy and depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 50% for exchange rate, interest rate and other derivatives contracts.

The above analysis did not take into account any bilateral netting arrangements entered into during the year and accordingly these amounts are shown on a gross basis.

(c) Fair value of derivative financial instruments designated as hedging instruments

The following is a summary of the fair values of derivatives held-for-hedging purposes by product type entered into by the Bank and its subsidiaries as at 31 December 2006:

	Consolidated and Bank	
	Assets	Liabilities
	(Included in other assets) HK\$'M	(Included in other liabilities) HK\$'M
Interest rate contracts	<u>35</u>	<u>126</u>

The following is a summary of the fair values of derivatives held-for-hedging purposes by product type entered into by the Bank and its subsidiaries as at 31 December 2005:

	Consolidated and Bank	
	Assets	Liabilities
	(Included in other assets) HK\$'M	(Included in other liabilities) HK\$'M
Interest rate contracts	<u>15</u>	<u>165</u>

Fair value hedges

The fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of certain fixed rate liabilities due to movements in market interest rates. At 31 December 2006, the net fair value of interest rate swaps held as fair value hedges was HK\$85 million (2005: HK\$95 million) which was all related to liabilities.

Cash flow hedges

The cash flow hedges principally consist of interest rate swaps that are used to hedge against the variability in cash flows of certain floating rate assets or liabilities. At 31 December 2006, the net fair value held as cash flow hedges was HK\$6 million (2005: HK\$55 million) comprising assets of HK\$35 million (2005: HK\$15 million) and liabilities of HK\$41 million (2005: HK\$70 million).

33 Contingent liabilities and commitments**(a) The following is a summary of the contractual amounts of each significant contingent liability and commitment:**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Direct credit substitutes	28,153	6,574	28,153	6,574
Transaction-related contingencies	8,104	8,463	8,104	8,463
Trade-related contingencies	15,324	16,503	15,324	16,503
Other commitments:				
– with an original maturity of under one year or which are unconditionally cancellable	123,743	127,105	123,732	127,092
– with an original maturity of one year and over	10,330	8,361	10,330	8,361
Others	691	1,802	691	1,802
	<u>186,345</u>	<u>168,808</u>	<u>186,334</u>	<u>168,795</u>
Credit risk weighted amount	<u>25,688</u>	<u>15,804</u>	<u>25,688</u>	<u>15,804</u>

Contingent liabilities and commitments are credit-related instruments, which include letters of credit, guarantees and commitments to extend credit. The risk involved is similar to the credit risk involved in extending loan facilities to customers. These transactions are, therefore, subject to the same credit application, portfolio maintenance and collateral requirements as for customers applying for loans. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. As the facilities may expire without being drawn upon, the contracted amounts do not represent expected future cash flows.

(b) Capital commitments

Capital commitments outstanding at 31 December not provided for in the financial statements were as follows:

	<i>Consolidated and Bank</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Contracted for	3	23
Authorised but not contracted	21	–
	<u>24</u>	<u>23</u>

(c) Lease commitments

The Bank and its subsidiaries lease a number of properties under operating leases. The leases typically run for an initial period of two to ten years, with an option to renew the lease when all terms are renegotiated. At 31 December, total future minimum lease payments under non-cancellable operating leases are payable as follows:

	<i>Consolidated and Bank</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Within 1 year	371	288
After 1 year but within 5 years	631	424
After 5 years	85	95
	<u>1,087</u>	<u>807</u>

(d) Contingencies

The Bank and its subsidiaries are named in and are defending a number of legal actions arising from its banking activities. Management of the Bank believes that the resolution of these actions and proceedings will not be material to the financial position of the Bank and its subsidiaries.

34 Financial risk management**(a) Credit risk management**

Credit risk arises from the possibility that the counterparty in a transaction may default. It arises from lending, trade finance, treasury and other activities. The Bank has dedicated standards, policies and procedures to monitor and control credit risk.

The Bank has put in place a credit control structure and effective credit risk management tools to ensure proper management of the quality of its credit portfolio. The Bank's credit policies and procedures define credit extension criteria, credit approval authorities delegated from the Board, credit monitoring processes, the loan grading system and provisioning policy. It also takes into account the requirements of the Hong Kong Banking Ordinance and the guidelines issued by the HKMA with respect to large exposures and provisioning requirements. The Bank's policy is not to have significant concentrations of exposure to individual counterparties or individual overseas countries.

(b) Market risk management*Market risk*

The Bank recognises market risk as the exposure created by potential changes in market prices and rates. The Bank is exposed to market risk arising principally from customer driven transactions.

The Bank transacts in the money market, foreign exchange markets and capital markets giving rise to market risk exposures. Positions are taken as a result of the execution of customers' orders, market making and proprietary trading activities.

Other financial instruments transacted include debt and other securities and certain off-balance sheet ("derivative") financial instruments. Derivative instruments are contracts whose characteristics and value are derived from underlying financial instruments, interest and exchange rates or indices. They include futures, forwards, swaps, and options transactions in the foreign exchange and interest rate markets. The Bank enters derivative positions to meet customer demand or for hedging purposes. Derivative contracts entered into by the Bank are primarily over-the-counter derivatives.

The Bank has established market risk management policies and framework, including limits setting, monitoring and reporting and control procedures, which are reviewed regularly by the Risk Committee. Market risk limits are proposed by the business within the terms of agreed policy. Market Risk department approves the limits within delegated authorities and monitors exposures against these limits.

(i) Currency risk

The Bank's foreign exchange positions arise from foreign exchange trading and commercial banking operations. Foreign exchange trading exposures are principally derived from customer driven transactions.

Foreign exchange exposures arising from trading, non-trading and structural positions, with an individual currency constituting 10% or more of the total net position in all foreign currencies, are shown as follows:

	<i>Consolidated and Bank</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
US dollar exposure		
Spot assets	122,020	95,852
Spot liabilities	(92,110)	(79,944)
Forward purchases	257,586	196,056
Forward sales	<u>(287,725)</u>	<u>(210,890)</u>
Net (short)/long non-structural position	<u>(229)</u>	<u>1,074</u>

	<i>Consolidated and Bank</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Euro exposure		
Spot assets	5,404	6,813
Spot liabilities	(6,571)	(6,461)
Forward purchases	35,923	35,103
Forward sales	(35,060)	(35,578)
	<u> </u>	<u> </u>
Net short non-structural position	<u>(304)</u>	<u>(123)</u>

	<i>Consolidated and Bank</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Swiss francs exposure		
Spot assets	110	38
Spot liabilities	(394)	(286)
Forward purchases	3,518	869
Forward sales	(3,309)	(598)
	<u> </u>	<u> </u>
Net (short)/long non-structural position	<u>(75)</u>	<u>23</u>

	<i>Consolidated and Bank</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
JPY exposure		
Spot assets	3,105	2,236
Spot liabilities	(2,830)	(2,732)
Forward purchases	29,794	13,254
Forward sales	(30,126)	(12,544)
	<u> </u>	<u> </u>
Net (short)/long non-structural position	<u>(57)</u>	<u>214</u>

The Bank and its subsidiaries had the following structural foreign currency exposures which exceed 10% of the net structural foreign currency exposure in all currencies.

	<i>Consolidated and Bank</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Chinese Renminbi	995	–
United Arab Emirates Dirham	498	–
Vietnamese Dong	238	170
	<u> </u>	<u> </u>
	<u>1,731</u>	<u>170</u>

(ii) Interest rate risk

The Bank's interest rate exposures comprise trading exposures and non-trading structural interest rate exposures. Structural interest rate risk generally arises from the differing re-pricing characteristics of commercial banking assets and liabilities.

The following tables indicate the effective interest rates for the relevant periods and the expected next repricing dates (or maturity dates whichever are earlier) for the assets and liabilities at the balance sheet date.

Consolidated

	Effective interest rate	2006					Non-interest bearing
		Total	Less than three months	Between three months and one year	Between one and five years	More than five years	
In millions of HK\$ equivalent							
Assets							
Cash and balances with banks and other financial institutions		7,809	–	–	–	–	7,809
Placements with banks and other financial institutions	4.63%	49,122	44,705	4,413	–	–	4
Hong Kong SAR Government certificates of indebtedness		20,261	–	–	–	–	20,261
Trading assets	4.14%	24,239	7,602	7,841	3,990	805	4,001
Advances to customers	6.26%	169,569	158,952	7,317	1,982	1,318	–
Amounts due from group companies	4.66%	50,040	36,443	9,583	1,192	–	2,822
Available-for-sale securities	4.28%	57,140	25,818	22,170	6,535	2,162	455
Others		12,862	–	–	–	–	12,862
Total assets		<u>391,042</u>	<u>273,520</u>	<u>51,324</u>	<u>13,699</u>	<u>4,285</u>	<u>48,214</u>
Liabilities							
Hong Kong SAR currency notes in circulation		20,261	–	–	–	–	20,261
Deposits and balances of banks and other financial institutions	3.78%	7,514	1,714	123	–	–	5,677
Deposits from customers	3.43%	288,513	259,084	8,157	1,128	249	19,895
Trading liabilities	3.98%	15,854	5,428	4,476	1,318	664	3,968
Financial liabilities designated at fair value through profit or loss	3.41%	9,514	3,699	4,809	864	142	–
Certificates of deposit issued	3.23%	2,707	120	1,202	1,355	30	–
Amounts due to group companies	2.67%	3,188	1,449	18	306	17	1,398
Subordinated liabilities	5.18%	3,756	624	–	3,132	–	–
Others		9,834	–	–	–	–	9,834
Total liabilities		<u>361,141</u>	<u>272,118</u>	<u>18,785</u>	<u>8,103</u>	<u>1,102</u>	<u>61,033</u>
Interest rate sensitivity gap			<u>1,402</u>	<u>32,539</u>	<u>5,596</u>	<u>3,183</u>	<u>(12,819)</u>

Consolidated

	Effective interest rate	2005					Non-interest bearing
		Total	Less than three months	Between three months and one year	Between one and five years	More than five years	
In millions of HK\$ equivalent							
Assets							
Cash and balances with banks and other financial institutions		5,764	–	–	–	–	5,764
Placements with banks and other financial institutions	3.27%	39,625	38,545	1,078	–	–	2
Hong Kong SAR Government certificates of indebtedness		19,321	–	–	–	–	19,321
Trading assets	3.07%	19,773	8,693	4,254	2,824	293	3,709
Advances to customers	4.84%	168,876	159,199	6,426	1,932	1,319	–
Amounts due from group companies	2.88%	37,258	28,707	6,607	152	–	1,792
Available-for-sale securities	3.49%	39,866	15,220	20,818	3,053	322	453
Others		6,677	–	–	–	–	6,677
Total assets		<u>337,160</u>	<u>250,364</u>	<u>39,183</u>	<u>7,961</u>	<u>1,934</u>	<u>37,718</u>
Liabilities							
Hong Kong SAR currency notes in circulation		19,321	–	–	–	–	19,321
Deposits and balances of banks and other financial institutions	2.54%	8,723	1,178	–	–	–	7,545
Deposits from customers	1.89%	247,663	226,319	4,280	1,480	54	15,530
Trading liabilities	2.68%	14,587	6,618	2,828	893	152	4,096
Financial liabilities designated at fair value through profit or loss	2.84%	5,153	5,153	–	–	–	–
Certificates of deposit issued	2.18%	5,178	3,482	583	1,083	30	–
Amounts due to group companies	1.80%	5,136	970	590	195	–	3,381
Subordinated liabilities	3.56%	3,781	669	–	3,112	–	–
Others		4,161	–	–	–	–	4,161
Total liabilities		<u>313,703</u>	<u>244,389</u>	<u>8,281</u>	<u>6,763</u>	<u>236</u>	<u>54,034</u>
Interest rate sensitivity gap			<u>5,975</u>	<u>30,902</u>	<u>1,198</u>	<u>1,698</u>	<u>(16,316)</u>

Bank

	Effective interest rate	2006					Non-interest bearing
		Total	Less than three months	Between three months and one year	Between one and five years	More than five years	
In millions of HK\$ equivalent							
Assets							
Cash and balances with banks and other financial institutions		7,809	–	–	–	–	7,809
Placements with banks and other financial institutions	4.63%	49,118	44,705	4,413	–	–	–
Hong Kong SAR Government certificates of indebtedness		20,261	–	–	–	–	20,261
Trading assets	4.14%	24,238	7,602	7,841	3,990	805	4,000
Advances to customers	6.26%	169,001	158,885	7,137	1,661	1,318	–
Amounts due from group companies	4.66%	50,817	37,219	9,583	1,192	–	2,823
Available-for-sale securities	4.28%	56,971	25,818	22,170	6,535	2,162	286
Others		13,030	–	–	–	–	13,030
Total assets		<u>391,245</u>	<u>274,229</u>	<u>51,144</u>	<u>13,378</u>	<u>4,285</u>	<u>48,209</u>
Liabilities							
Hong Kong SAR currency notes in circulation		20,261	–	–	–	–	20,261
Deposits and balances of banks and other financial institutions	3.78%	7,514	1,714	123	–	–	5,677
Deposits from customers	3.43%	288,513	259,084	8,157	1,128	249	19,895
Trading liabilities	3.98%	15,853	5,428	4,476	1,318	664	3,967
Financial liabilities designated at fair value through profit or loss	3.41%	9,514	3,699	4,809	864	142	–
Certificates of deposit issued	3.23%	2,707	120	1,202	1,355	30	–
Amounts due to group companies	2.67%	3,472	1,784	16	276	15	1,381
Subordinated liabilities	5.18%	3,756	624	–	3,132	–	–
Others		9,789	–	–	–	–	9,789
Total liabilities		<u>361,379</u>	<u>272,453</u>	<u>18,783</u>	<u>8,073</u>	<u>1,100</u>	<u>60,970</u>
Interest rate sensitivity gap			<u>1,776</u>	<u>32,361</u>	<u>5,305</u>	<u>3,185</u>	<u>(12,761)</u>

Bank

	Effective interest rate	2005					Non-interest bearing
		Total	Less than three months	Between three months and one year	Between one and five years	More than five years	
In millions of HK\$ equivalent							
Assets							
Cash and balances with banks and other financial institutions		5,764	–	–	–	–	5,764
Placements with banks and other financial institutions	3.27%	39,623	38,545	1,078	–	–	–
Hong Kong SAR Government certificates of indebtedness		19,321	–	–	–	–	19,321
Trading assets	3.07%	19,764	8,693	4,254	2,824	293	3,700
Advances to customers	4.84%	168,262	159,129	6,235	1,579	1,319	–
Amounts due from group companies	2.88%	37,765	29,194	6,607	152	–	1,812
Available-for-sale securities	3.49%	39,696	15,220	20,818	3,053	322	283
Others		6,963	–	–	–	–	6,963
Total assets		<u>337,158</u>	<u>250,781</u>	<u>38,992</u>	<u>7,608</u>	<u>1,934</u>	<u>37,843</u>
Liabilities							
Hong Kong SAR currency notes in circulation		19,321	–	–	–	–	19,321
Deposits and balances of banks and other financial institutions	2.54%	8,723	1,178	–	–	–	7,545
Deposits from customers	1.89%	247,663	226,319	4,280	1,480	54	15,530
Trading liabilities	2.68%	14,587	6,618	2,828	893	152	4,096
Financial liabilities designated at fair value through profit or loss	2.84%	5,153	5,153	–	–	–	–
Certificates of deposit issued	2.18%	5,178	3,482	583	1,083	30	–
Amounts due to group companies	1.80%	5,250	1,091	590	195	–	3,374
Subordinated liabilities	3.56%	3,781	669	–	3,112	–	–
Others		4,089	–	–	–	–	4,089
Total liabilities		<u>313,745</u>	<u>244,510</u>	<u>8,281</u>	<u>6,763</u>	<u>236</u>	<u>53,955</u>
Interest rate sensitivity gap			<u>6,271</u>	<u>30,711</u>	<u>845</u>	<u>1,698</u>	<u>(16,112)</u>

(c) Liquidity risk management

The Bank defines liquidity risk as the risk that it either does not have sufficient financial resources available to meet all its obligations and commitments as they fall due, or can only secure them at excessive cost.

The Bank has established standards, principles, policies and techniques for managing liquidity risk. Liquidity risk management is governed by the Asset and Liability Committee (“ALCO”). The tools used for the management of liquidity risk, range from key balance sheet ratios and medium-term funding requirements to ensure balance sheets are not developing structural imbalances, to short term cash flow limits and controls on borrowing in the wholesale markets. They are supplemented by the establishment of a liquidity crisis contingency plan and regular stress test on liquidity positions.

Global Markets is responsible for the day-to-day management of all the liquidity risk in the Bank, executing liquidity directives and operating within the liquidity policy and approved limits. Liquidity limits are regularly monitored by a Market Risk function that is independent from the business. Liquidity profiles are reviewed by ALCO on a regular basis.

Customer deposits form a significant part of the Bank's overall funding. Its composition has remained relatively diversified and stable. Professional markets are accessed for the purposes of providing additional funding, maintaining a presence in local money markets and optimising asset and liability maturities.

(i) Analysis of assets and liabilities by remaining maturity

The following maturity profile is based on the remaining period at the balance sheet date to the contractual maturity date. The disclosure does not imply that the assets will be held to maturity or that the liabilities will be withdrawn on maturity.

Consolidated

	2006						Total HK\$'M
	Repayable on demand HK\$'M	Less than 3 months HK\$'M	From 3 months to 1 year HK\$'M	From 1 year to 5 years HK\$'M	After 5 years HK\$'M	Undated or overdue more than 1 month HK\$'M	
Assets							
Cash and balances with banks and other financial institutions	7,809	–	–	–	–	–	7,809
Placements with banks and other financial institutions	1,000	43,709	4,413	–	–	–	49,122
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	20,261	20,261
Trading assets	–	6,971	8,417	4,045	805	4,001	24,239
Advances to customers	3,447	55,305	14,760	33,188	59,882	1,888	168,470
Trade bills	1,139	1,093	442	–	–	–	2,674
Available-for-sale securities	–	20,996	22,780	10,720	2,189	455	57,140
Amounts due from group companies	2,822	36,443	9,583	1,192	–	–	50,040
Others	–	–	–	–	–	11,287	11,287
Total Assets	16,217	164,517	60,395	49,145	62,876	37,892	391,042
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	20,261	20,261
Deposits and balances of banks and other financial institutions	6,153	1,238	123	–	–	–	7,514
Deposits from customers	150,690	129,488	8,069	68	198	–	288,513
Trading liabilities	–	5,428	4,476	1,318	664	3,968	15,854
Financial liabilities designated at fair value through profit or loss	–	1,278	5,749	2,226	261	–	9,514
Certificates of deposit issued	–	106	1,193	1,378	30	–	2,707
Amounts due to group companies	1,398	1,378	22	370	20	–	3,188
Subordinated liabilities	–	–	–	–	3,756	–	3,756
Others	–	–	–	–	–	9,834	9,834
Total Liabilities	158,241	138,916	19,632	5,360	4,929	34,063	361,141

Consolidated

	2005						Total HK\$'M
	Repayable on demand HK\$'M	Less than 3 months HK\$'M	From 3 months to 1 year HK\$'M	From 1 year to 5 years HK\$'M	After 5 years HK\$'M	Undated or overdue more than 1 month HK\$'M	
Assets							
Cash and balances with banks and other financial institutions	5,764	–	–	–	–	–	5,764
Placements with banks and other financial institutions	9	37,173	2,443	–	–	–	39,625
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	19,321	19,321
Trading assets	–	7,491	4,987	3,293	293	3,709	19,773
Advances to customers	5,334	37,866	20,484	34,639	62,862	4,545	165,730
Trade bills	2,859	2,549	427	–	–	–	5,835
Available-for-sale securities	–	13,599	21,366	2,751	1,852	298	39,866
Amounts due from group companies	1,792	28,590	6,723	153	–	–	37,258
Others	–	–	–	–	–	3,988	3,988
Total Assets	15,758	127,268	56,430	40,836	65,007	31,861	337,160
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	19,321	19,321
Deposits and balances of banks and other financial institutions	5,058	3,592	73	–	–	–	8,723
Deposits from customers	114,790	127,290	5,286	297	–	–	247,663
Trading liabilities	–	6,618	2,828	893	152	4,096	14,587
Financial liabilities designated at fair value through profit or loss	2,174	175	1,371	1,379	54	–	5,153
Certificates of deposit issued	–	240	1,121	3,725	92	–	5,178
Amounts due to group companies	3,381	710	850	195	–	–	5,136
Subordinated liabilities	–	–	–	–	3,781	–	3,781
Others	–	–	–	–	–	4,161	4,161
Total Liabilities	125,403	138,625	11,529	6,489	4,079	27,578	313,703

Bank

	2006						Total HK\$'M
	Repayable on demand HK\$'M	Less than 3 months HK\$'M	From 3 months to 1 year HK\$'M	From 1 year to 5 years HK\$'M	After 5 years HK\$'M	Undated or overdue more than 1 month HK\$'M	
Assets							
Cash and balances with banks and other financial institutions	7,809	–	–	–	–	–	7,809
Placements with banks and other financial institutions	996	43,709	4,413	–	–	–	49,118
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	20,261	20,261
Trading assets	–	6,971	8,417	4,045	805	4,000	24,238
Advances to customers	3,447	55,237	14,580	32,868	59,882	1,888	167,902
Trade bills	1,139	1,093	442	–	–	–	2,674
Available-for-sale securities	–	20,996	22,780	10,720	2,189	286	56,971
Amounts due from group companies	2,823	37,219	9,583	1,192	–	–	50,817
Others	–	–	–	–	–	11,455	11,455
Total Assets	16,214	165,225	60,215	48,825	62,876	37,890	391,245
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	20,261	20,261
Deposits and balances of banks and other financial institutions	6,153	1,238	123	–	–	–	7,514
Deposits from customers	150,690	129,488	8,069	68	198	–	288,513
Trading liabilities	–	5,428	4,476	1,318	664	3,967	15,853
Financial liabilities designated at fair value through profit or loss	–	1,278	5,749	2,226	261	–	9,514
Certificates of deposit issued	–	106	1,193	1,378	30	–	2,707
Amounts due to group companies	1,381	1,762	17	296	16	–	3,472
Subordinated liabilities	–	–	–	–	3,756	–	3,756
Others	–	–	–	–	–	9,789	9,789
Total Liabilities	158,224	139,300	19,627	5,286	4,925	34,017	361,379

Bank

	2005						Total HK\$'M
	Repayable on demand HK\$'M	Less than 3 months HK\$'M	From 3 months to 1 year HK\$'M	From 1 year to 5 years HK\$'M	After 5 years HK\$'M	Undated or overdue more than 1 month HK\$'M	
Assets							
Cash and balances with banks and other financial institutions	5,764	–	–	–	–	–	5,764
Placements with banks and other financial institutions	7	37,173	2,443	–	–	–	39,623
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	19,321	19,321
Trading assets	–	7,491	4,987	3,293	293	3,700	19,764
Advances to customers	5,334	37,794	20,292	34,287	62,862	4,545	165,114
Trade bills	2,859	2,549	427	–	–	–	5,835
Available-for-sale securities	–	13,599	21,366	2,751	1,852	128	39,696
Amounts due from group companies	1,812	29,078	6,723	152	–	–	37,765
Others	–	–	–	–	–	4,276	4,276
Total Assets	15,776	127,684	56,238	40,483	65,007	31,970	337,158
Liabilities							
Hong Kong SAR currency notes in circulation	–	–	–	–	–	19,321	19,321
Deposits and balances of banks and other financial institutions	5,058	3,592	73	–	–	–	8,723
Deposits from customers	114,790	127,290	5,286	297	–	–	247,663
Trading liabilities	–	6,618	2,828	893	152	4,096	14,587
Financial liabilities designated at fair value through profit or loss	2,174	175	1,371	1,379	54	–	5,153
Certificates of deposit issued	–	240	1,121	3,725	92	–	5,178
Amounts due to group companies	3,374	831	850	195	–	–	5,250
Subordinated liabilities	–	–	–	–	3,781	–	3,781
Others	–	–	–	–	–	4,089	4,089
Total Liabilities	125,396	138,746	11,529	6,489	4,079	27,506	313,745

35 Fair value information**(a) Estimation of fair values**

Fair value estimates are generally subjective in nature, and are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. Where available, the most suitable measure for fair value is the quoted market price. In the absence of organised secondary markets for most financial instruments, and in particular for loans and deposits, direct market prices are not available. The fair value of such instruments was therefore calculated on the basis of valuation techniques using current market parameters. In particular, the fair value is a theoretical value applicable at a given reporting date, and hence can only be used as an indicator of the value realisable in a future sale.

These techniques involve uncertainties and are significantly affected by the assumptions used and judgements made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experiences and other factors. Changes in assumptions could significantly affect these estimates and the resulting fair values. Derived fair value estimates cannot necessarily be substantiated by comparison to independent markets and, in many cases, could not be realised in an immediate sale of the instruments.

(b) Fair value

All financial instruments are stated at fair value or carried at amounts not materially different from their fair values as at 31 December 2006 and 2005 unless otherwise stated.

(i) Financial assets

The Bank's financial assets mainly include cash, amounts due from banks and other financial institutions, loans and advances to customers, and investments.

Amounts due from banks and other financial institutions, loans and advances to customers

Amounts due from banks and other financial institutions, loans and advances to customers are mainly priced at market interest rate or to be matured within one year. Accordingly, the carrying values approximate the fair values.

Investments

Available-for-sale securities and trading securities are stated at fair value in the financial statements.

(ii) Financial liabilities

The Bank's financial liabilities mainly include amounts due to banks and other financial institutions, deposits from customers and certificates of deposit issued.

36 Assets pledged as security for liabilities

The Bank maintains pledged cash and securities accounts with financial institutions to secure any borrowings or other obligations resulting from the Bank's use of clearing systems. As at 31 December 2006, the Bank did not have borrowings due to the financial institutions and the pledged cash and securities amounted to HK\$8 million (2005: HK\$0.1 million) and HK\$37,109 million (2005 HK\$25,353 million) respectively.

37 Material related party transactions

In addition to the transactions and balances disclosed elsewhere in these financial statements, the Bank and its subsidiaries entered into the following material related party transactions. The transactions of the Bank are materially the same as for those appearing in the consolidated financial statements in 2006 and 2005.

(a) Key management personnel remuneration

Remuneration for key management personnel, including amounts paid to the Bank's directors as disclosed in note 7 is as follows:

	<i>Consolidated</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Short-term employee benefits	87	84
Post-employment benefits	6	8
Equity compensation benefits	4	5
	<u>97</u>	<u>97</u>

Total remuneration is included in staff costs (see note 3(f)).

(b) Credit facilities and loans to key management personnel

During the year, the Bank provided credit facilities to key management personnel of the Bank and its holding companies and their close family members and companies controlled or significantly influenced by them. The credit facilities 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.

	<i>Consolidated</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Loan balances:		
At 1 January	<u>1,585</u>	<u>1,210</u>
At 31 December	<u>1,391</u>	<u>1,585</u>
Average balance during the year	<u>1,079</u>	<u>1,175</u>
Income earned	<u>50</u>	<u>28</u>

(c) Share based payments

The Standard Chartered PLC Group (the "Group") operates a number of share based payment schemes for its directors and employees in which the Bank's employees participate.

1997/2006 Restricted Share Scheme

The Group operates a discretionary Restricted Share Scheme for high performing and high potential staff at any level of the organisation whom the Group wish to motivate and retain. Except upon appointment when an executive director may be granted an award of restricted shares, the Restricted Share Scheme is not applicable to executive directors, as it has no performance conditions attached to it. Fifty per cent of the award vests two years after the date of grant and the balance after three years. The value of shares awarded in any year to any individual may not exceed two times their base salary.

2000 Executive Share Option Scheme

The 2000 scheme is designed to be internationally competitive and focus executive directors and their senior management teams on delivering long-term performance. An EPS performance criterion needs to be met before options can be exercised.

Executive share options to purchase ordinary shares in the Ultimate Holding Company are exercisable after the third, but before the tenth, anniversary of the date of grant. The exercise price per share is the share price at the date of grant and options can normally only be exercised if a performance condition is satisfied.

2001 Performance Share Plan

The Performance Share Plan is designed to be an intrinsic part of total remuneration for the Group's executive directors and for a small number of the group's most senior executives. It is an internationally competitive long-term incentive plan that focuses executives on meeting and exceeding the long-term performance targets of the Group. Awards of nil price options to acquire shares are granted to the individual and will normally be exercised between three and ten years after the date of grant if the individual is still employed by the Group. There is provision for earlier exercise in certain limited circumstances.

All Employee Sharesave Schemes

Under the Sharesave schemes, employees have the choice of opening a three-year or five-year savings contract. Within a period of six months after the third or fifth anniversary, employees may purchase ordinary shares in the Ultimate Holding Company. The price at which they may purchase shares is at a discount of up to 20 per cent on the share price at the date of invitation. There are no performance conditions attached to options granted under the all employee sharesave schemes.

2000 Executive Share Option Scheme

No option under 2000 Executive Share Option Scheme was granted in 2006 and 2005.

A reconciliation of option movements over the year to 31 December 2006 is shown below:

	2006		2005	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	3,901,637	£8.03	5,071,041	£8.00
Granted	–	–	–	–
Lapsed	(22,997)	£9.36	(163,270)	£7.77
Exercised	(959,031)	£7.41	(1,006,134)	£8.71
Outstanding at 31 December	2,919,609	£8.22	3,901,637	£8.03
Exercisable at 31 December	2,246,119	£7.88	1,813,664	£8.36

Range of exercise price	2006			2005		
	Weighted average exercise price	No. of shares	Weighted average contractual life	Weighted average exercise price	No. of shares	Weighted average contractual life
£6.905/£10.395	£8.22	2,919,609	5 years	–	–	–
£6.905/£10.395	–	–	–	£8.03	3,901,637	6.5 years

2001 Performance Share Plan

Valuation

For awards, the fair value is based on the market value less an adjustment to take into account the expected dividends over the vesting period.

Grant Date	2006			2005
	12 September	11 May	14 March	9 March
Share price at grant date	£13.17	£14.60	£14.35	£9.71
Shares granted	9,453	3,766	163,214	101,591
Vesting period (years)	3	3	3	3
Expected dividends (yield) (%)	3 - 3.2	3 - 3.2	3 - 3.2	3.5
Fair value (EPS) (£)	6.00	6.67	6.56	4.35
Fair value (TSR) (£)	2.60	2.89	2.84	1.89

The expected dividend yield is based on the historical dividend yield over the last three years or the three years prior to grant.

A reconciliation of option movements over the year to 31 December 2006 is shown below:

	2006		2005	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	342,968	–	295,034	–
Granted	176,433	–	101,591	–
Lapsed	(63,220)	–	(49,605)	–
Exercised	(73,563)	–	(4,052)	–
Outstanding at 31 December	382,618	–	342,968	–
Exercisable at 31 December	71,866	–	64,508	–

Range of exercise price	2006			2005		
	Weighted average exercise price	No. of shares	Weighted average contractual life	Weighted average exercise price	No. of shares	Weighted average contractual life
n/a	–	382,618	8.1 years	–	342,968	7.8 years

1997/2006 Restricted Share Scheme

Valuation

For awards, the fair value is based on the market value less an adjustment to take into account the expected dividends over the vesting period.

<i>Grant Date</i>	<i>2006</i>		<i>2005</i>		
	<i>12 September</i>	<i>14 March</i>	<i>20 September</i>	<i>14 June</i>	<i>9 March</i>
Share price at grant date	£13.17	£14.35	£11.89	£10.395	£9.71
Shares granted	34,316	227,807	43,327	4,039	366,248
Vesting period (years)	2/3	2/3	2/3	2/3	2/3
Expected dividends (yield) (%)	3.2	3	3.5	3.5	3.5
Fair value (£)	12.00	13.12	10.72	9.55	8.92

The expected dividend yield is based on the historical dividend yield over the last three years or the three years prior to grant.

A reconciliation of option movements over the year to 31 December 2006 is shown below:

	<i>2006</i>		<i>2005</i>	
	<i>No. of shares</i>	<i>Weighted average exercise price</i>	<i>No. of shares</i>	<i>Weighted average exercise price</i>
Outstanding at 1 January	1,012,199	–	882,479	–
Granted	262,123	–	413,614	–
Lapsed	(41,276)	–	(57,333)	–
Exercised	(240,744)	–	(226,561)	–
Outstanding at 31 December	992,302	–	1,012,199	–
Exercisable at 31 December	293,214	–	292,738	–

<i>Range of exercise price</i>	<i>2006</i>			<i>2005</i>		
	<i>Weighted average exercise price</i>	<i>No. of shares</i>	<i>Weighted average contractual life</i>	<i>Weighted average exercise price</i>	<i>No. of shares</i>	<i>Weighted average contractual life</i>
n/a	–	992,302	4.8 years	–	1,012,199	5.0 years

2004 Sharesave

Valuation

Options are valued using a Binomial option-pricing model. The fair value per option granted and the assumptions used in the calculation are as follows:

<i>Grant Date</i>	<u>2006</u>	<u>2005</u>
	<i>12 September</i>	<i>20 September</i>
Share price at grant date	£13.03	£11.89
Exercise price	£10.64	£9.87
Shares granted	800,945	688,678
Vesting period (years)	3/5	3/5
Expected volatility (%)	20 - 29	21 - 31
Expected option life (years)	3.33/5.33	3.33/5.33
Risk free rate (%)	4.8 - 5.1	4.2
Expected dividends (yield) (%)	3 - 3.6	3.5 - 3.7
Fair value (£)	3.39 - 4.30	2.85 - 3.92

The expected volatility is based on historical volatility over the last three to five years or three to five years prior to grant. The expected life is the average expected period to exercise. The risk free rate of return is the yield on zero-coupon UK government bonds of a term consistent with the assumed option life. The expected dividend yield is based on historical dividend yield over the last three years or three years prior to grant. Where two amounts are shown for volatility, risk free rates, expected dividends yield and fair values, this represents the range based on three to five year vesting periods.

A reconciliation of option movements over the year to 31 December 2006 is shown below:

	<u>2006</u>		<u>2005</u>	
	<i>No. of shares</i>	<i>Weighted average exercise price</i>	<i>No. of shares</i>	<i>Weighted average exercise price</i>
Outstanding at 1 January	1,196,185	£8.82	592,874	£7.43
Granted	800,945	£10.64	688,678	£9.87
Lapsed	(128,906)	£8.06	(84,641)	£7.67
Exercised	(4,515)	£7.93	(726)	£7.43
Outstanding at 31 December	1,863,709	£9.60	1,196,185	£8.82
Exercisable at 31 December	-	-	-	-

<i>Range of exercise price</i>	<u>2006</u>			<u>2005</u>		
	<i>Weighted average exercise price</i>	<i>No. of shares</i>	<i>Weighted average contractual life</i>	<i>Weighted average exercise price</i>	<i>No. of shares</i>	<i>Weighted average contractual life</i>
£7.43/£10.64	£9.60	1,863,709	2.8 years	-	-	-
£7.43/£9.87	-	-	-	£8.82	1,196,185	3.2 years

(d) Loans to officers

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

	2006 HK\$'M	2005 HK\$'M
Aggregate amount of relevant loans by the Bank outstanding at 31 December	<u>21</u>	<u>11</u>
Maximum aggregate amount of relevant loans by the Bank outstanding during the year	<u>25</u>	<u>14</u>

38 Ultimate holding company

The Bank's ultimate holding company is Standard Chartered PLC, a company registered in England and Wales. Standard Chartered PLC has dual primary listings on the London Stock Exchange and the Stock Exchange of Hong Kong.

39 Changes in accounting policies**(a) Financial instruments (Amendments to HKAS 39, Financial instruments: Recognition and measurement: Financial guarantee contracts)**

In prior years, financial guarantees issued by the Bank and its subsidiaries were disclosed as contingent liabilities in accordance with HKAS 37, *Provisions, contingent liabilities and contingent assets*. No provisions were made in respect of these guarantees unless it was more likely than not that the guarantee would be called upon.

With effect from 1 January 2006, in order to comply with the amendments to HKAS 39 in respect of financial guarantee contracts, the Bank and its subsidiaries have changed their accounting policy for financial guarantees issued. Under the new policy, financial guarantees issued are accounted for as financial liabilities under HKAS 39 and measured initially at fair value, where the fair value can be reliably measured. Subsequently, they are measured at the higher of the amount initially recognised, less accumulated amortisation, and the amount of the provision, if any, that should be recognised in accordance with HKAS 37.

The Bank and its subsidiaries assessed each financial guarantee contract and considered that there was no material impact on the financial statements. Accordingly, comparatives have not been restated.

(b) Fair value option (Amendments to HKAS 39, Financial instruments: Recognition and measurement: Fair value option)

With effect from 1 January 2006, in order to comply with the amendments to HKAS 39 in respect of fair value option, the Bank and its subsidiaries changed their accounting policy for financial instruments designated at fair value through profit or loss. The Bank and its subsidiaries assessed each financial instrument designated at fair value through profit or loss and determined that the adoption of the amendments to HKAS 39 in respect of fair value option has no impact on the financial statements. Accordingly, comparatives have not been restated.

40 Significant accounting estimates and judgements

In determining the carrying amounts of some assets and liabilities, the Bank and its subsidiaries make assumptions of the effects of uncertain future events on those assets and liabilities at the balance sheet date. The Bank and its subsidiaries' estimations and assumptions are based on historical experience and expectation of future events and are reviewed periodically. This disclosure excludes uncertainty over future events and judgments in respect of measuring financial instruments.

Pensions

Actuarial assumptions are made in valuing future pension obligations as set out in note 27. There is uncertainty that these assumptions will continue in the future. They are updated periodically.

Taxes

Determining income tax provisions involves judgement on the future tax treatment of certain transactions.

Impairment of financial assets

Policies on impairment of financial assets are set out in note 2(k).

41 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2006

Up to the date of issue of the financial statements, the HKICPA has issued a number of amendments, new standards and interpretations and the Hong Kong Monetary Authority has recommended additional disclosures, which are not yet effective for the accounting year ended 31 December 2006 and which have not been adopted in these financial statements.

In addition, the following developments may result in new or amended disclosures in the financial statements:

	<i>Effective for accounting periods beginning on or after</i>
HKFRS 7, <i>Financial instruments: disclosures</i>	1 January 2007
HK(IFRIC) Interpretation 10, Interim financial reporting and impairment	1 November 2006
Amendment to HKAS 1, <i>Presentation of financial statements: capital disclosures</i>	1 January 2007
Banking (Disclosure) Rules	1 January 2007

The Bank and its subsidiaries are in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application.

Unaudited supplementary financial information**(a) Capital adequacy ratios**

	2006 %	2005 %
Capital adequacy ratio as at 31 December	<u>14.9%</u>	<u>15.1%</u>
Adjusted capital adequacy ratio as at 31 December	<u>14.7%</u>	<u>14.8%</u>

The capital adequacy ratio is computed on the consolidated basis of the Bank and certain of its financial subsidiaries as specified by the HKMA for its regulatory purposes, and is in accordance with the Third Schedule to the Hong Kong Banking Ordinance. The adjusted capital adequacy ratio incorporating market risk is computed on an unconsolidated basis as agreed with the HKMA, and is in accordance with the guideline on "Maintenance of Adequate Capital Against Market Risks" under the Supervisory Policy Manual issued by the HKMA.

	<i>Consolidated</i>	
	2006 HK\$'M	2005 HK\$'M
Components of capital base after deductions		
Core capital:		
Paid up ordinary share capital	101	101
Irredeemable non-cumulative preference shares	3,800	3,800
Share premium	12,477	12,477
Reserves (including retained profits)	12,828	6,794
Minority interest	51	51
Deduct: Goodwill	<u>(611)</u>	<u>(611)</u>
	<u>28,646</u>	<u>22,612</u>
Eligible supplementary capital:		
Properties revaluation reserves (at 70%)	2	2
Available-for-sale investment reserve (at 70%)	68	(86)
Collective impairment allowances for impaired assets and regulatory reserve	903	769
Subordinated liabilities	<u>3,756</u>	<u>3,781</u>
	<u>4,729</u>	<u>4,466</u>
Total capital base before deductions	33,375	27,078
Deductions from total capital base	<u>(1,522)</u>	<u>(1,400)</u>
Total capital base after deductions	<u>31,853</u>	<u>25,678</u>

(b) Liquidity ratios

	<i>Bank</i>	
	2006	2005
	%	%
Average liquidity ratio for the year	<u>44.0%</u>	<u>35.2%</u>

The average liquidity ratio is computed as the simple average of each calendar month's average ratio and in accordance with the Fourth Schedule to the Hong Kong Banking Ordinance.

(c) Overdue and rescheduled assets*(i) Overdue advances to customers*

	<i>Consolidated</i>			
	2006		2005	
	<i>HK\$'M</i>	<i>% of advances</i>	<i>HK\$'M</i>	<i>% of advances</i>
Gross advances to customers which have been overdue with respect to either principal or interest for periods of:				
– 6 months or less but over 3 months	141	0.1%	193	0.1%
– 1 year or less but over 6 months	156	0.1%	417	0.3%
– over 1 year	<u>974</u>	<u>0.6%</u>	<u>1,679</u>	<u>1.0%</u>
	<u>1,271</u>	<u>0.8%</u>	<u>2,289</u>	<u>1.4%</u>
Breakdown by countries				
– Hong Kong	1,128		2,012	
– People's Republic of China (excluding Hong Kong)	128		266	
– Others	<u>15</u>		<u>11</u>	
	<u>1,271</u>		<u>2,289</u>	

(ii) Advances to customers – by geographical area

Advances to customers by geographical area are classified according to the location of the counterparties after taking into account the transfer of risk. In general, risk transfer applies when an advance is guaranteed by a party in an area which is different from that of the counterparty. At 31 December 2006 and 31 December 2005, over 90 per cent of the Bank and its subsidiaries' advances to customers were classified under the area of Hong Kong.

(iii) Rescheduled advances to customers

	2006		Consolidated 2005	
	HK\$'M	% of advances	HK\$'M	% of advances
Rescheduled advances	443	0.3%	591	0.4%

Rescheduled advances are those advances, which have been restructured or renegotiated because of deteriorations in the financial position of the borrowers, or the inability of the borrowers to meet the original repayment schedule and for which the revised repayment terms are non-commercial to the Bank. Rescheduled advances to customers are stated net of any advances that have subsequently become overdue for over 3 months and reported as overdue advances in note(c)(i) above.

There were no overdue advances and rescheduled advances to banks and other financial institutions as at 31 December 2006.

(d) Cross border claims

Cross border claims are on-balance sheet exposures of counterparties based on the location of those counterparties after taking into account the transfer of risk. For a claim guaranteed by a party situated in a country different from the counterparty, risk will be transferred to the country of the guarantor. For a claim on the branch of a bank or other financial institution, the risk will be transferred to the country where its head office is situated. Claims on individual countries or area, after risk transfer, amounting to 10% or more of the aggregate cross border claims are shown as follows:

	Consolidated 2006			
	<i>Banks and other financial institutions</i> HK\$'M	<i>Public sector entities</i> HK\$'M	<i>Other</i> HK\$'M	<i>Total</i> HK\$'M
Asia Pacific excluding Hong Kong	31,547	–	8,790	40,337
Western Europe				
– United Kingdom	43,750	–	2,528	46,278
– Others	48,750	464	4,333	53,547
	92,500	464	6,861	99,825

	<i>Consolidated</i>			<i>Total</i>
	<i>2005</i>			
	<i>Banks and other financial institutions</i>	<i>Public sector entities</i>	<i>Other</i>	
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Asia Pacific excluding Hong Kong	16,741	–	4,522	21,263
Western Europe				
– United Kingdom	42,712	–	715	43,427
– Others	34,371	1,195	507	36,073
	77,083	1,195	1,222	79,500

Geographical segments are identified based on the location of the principal operations of the subsidiaries or, in case of the Bank itself, on the location of branches responsible for reporting the results or booking the assets. For the years ended 31 December 2006 and 31 December 2005, all the Bank's operations and branches were located in Hong Kong. More than 90% of the Bank and its subsidiaries' assets were located in Hong Kong.

(e) Repossessed assets

	<i>Consolidated</i>	
	<i>2006</i>	<i>2005</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Repossessed assets	61	39

(f) Corporate governance

The Bank is committed to high standards of corporate governance, and has fully complied throughout the year with the guideline on "Corporate Governance of Locally Incorporated Authorised Institutions" under the Supervisory Policy Manual issued by the HKMA.

Board committees

The Board has established various committees while reserving key strategic matters for its own approval. The major committees are detailed below:

(i) Audit Committee

The Audit Committee meets regularly with the internal audit and the external auditors to review and discuss the Bank's internal financial control, internal control, compliance and risk management systems. The Committee also discusses matters raised by the internal and external auditors and ensures that audit recommendations are implemented appropriately. The Committee comprises of at least 3 non-executive directors, the majority of whom are independent.

(ii) Executive Committee ("EXCO")

The EXCO operates under the direct authority of the Board and meets regularly in relation to the day to day management, operation and control of the business. It also sub-delegates to various committees certain aspects of the conduct of the business as detailed below. The EXCO comprises the Chief Executive Officer, the Chief Financial Officer and the Heads of various business functions.

(iii) *Risk Committee*

The Risk Committee is responsible for assisting the Board to supervise and direct the management of credit, market, country, operational, compliance and reputational risk within the Bank. It also ensures that processes and procedures in place for monitoring and control of risk meet the standards set down in internal procedures and external regulatory requirements.

The Committee meets regularly and comprises of the Chief Risk Officer, the Chief Financial Officer, Heads of Credit and representatives from other relevant units. It has appointed various sub-committees to supervise and review specific areas of risk, including the Portfolio Management Committee, the Early Alert Committee, the Group Special Asset Management Committee, the Excess Approval Committee and the Country Operational Risk Group.

(iv) *Asset and Liability Committee (“ALCO”)*

The ALCO is appointed by the EXCO. It is chaired by the Chief Executive Officer, and with authority derived from the Board, is responsible for both statutory and prudential liquidity. It is also responsible to ensure that the balance sheet management is in compliance with regulatory requirements relating to management of liquidity, capital adequacy and structural market risks. These are managed through the provision of liquidity policies and guidelines agreed in ALCO. The members of the ALCO include the Chief Executive Officer, the Chief Financial Officer, key business and risk management heads.

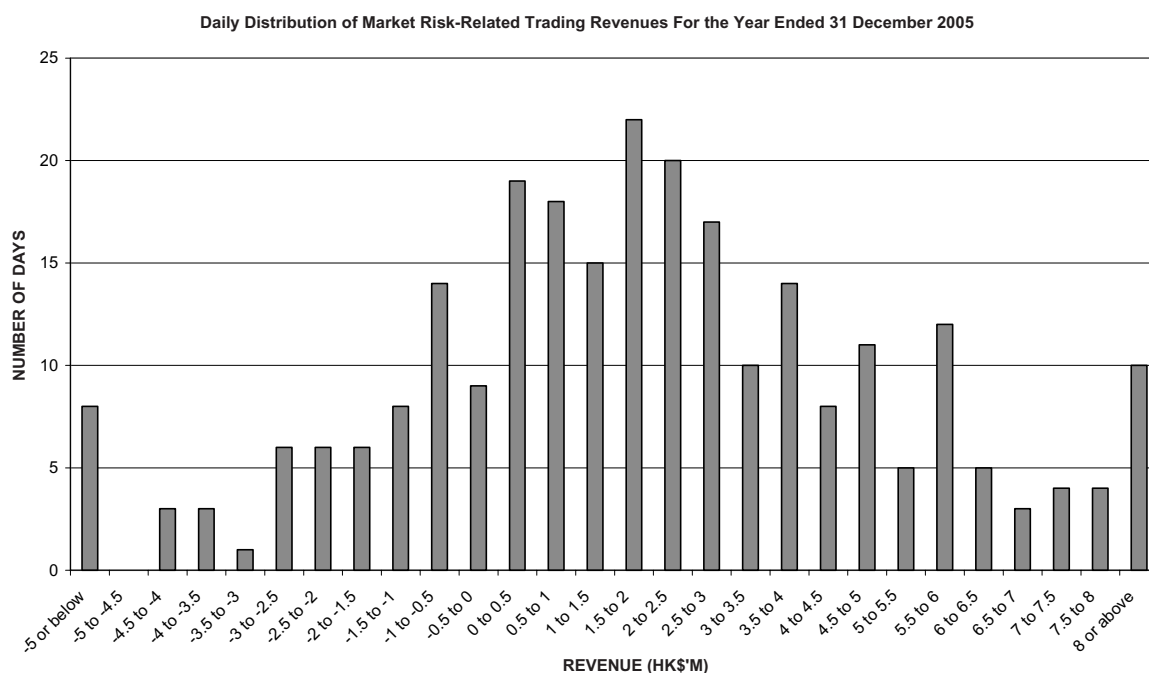
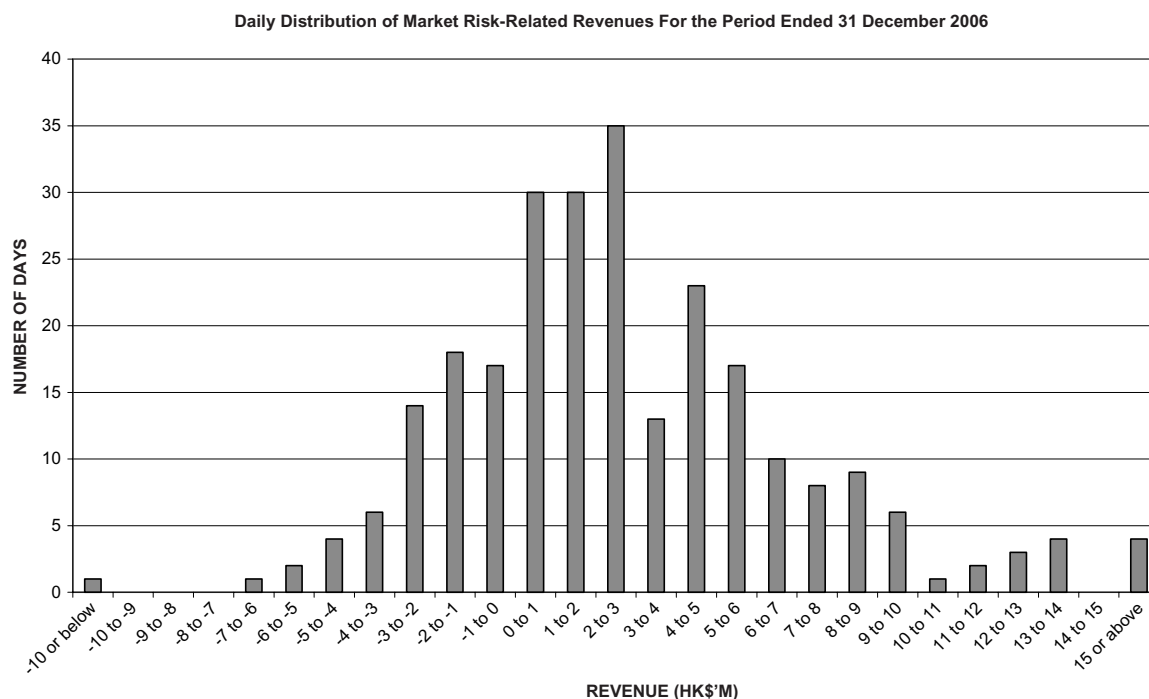
(v) *Country Operational Risk Group (“CORG”)*

CORG is appointed by the Risk Committee to review the country Operational Risk Profile with the objective to provide a forum for the management oversight of country and business level Operational Risk (“OR”) trends and issues arising from control lapses/failures, regulatory breaches, policy non-compliance, as well as exceptions and weaknesses identified through the self-assessment processes, risk toolkits, compliance and business reviews, internal and external audits and external developments/changes. Its main responsibilities include reviewing of the Country OR Profile. This entails deliberating the root causes of risk issues, appropriateness of risk rating, as well as the adequacy and effectiveness of remedial actions. The CORG comprises the Chief Executive Officer, Manager, Operational Risk and representatives from other relevant units.

(g) Market risk management exposures

Historical simulation is used to measure Value at Risk (“VaR”) on trading exposure by applying actual historical market rate movements based on one-day holding period and a 97.5% confidence level. Additional limits are placed on specific instruments and currency concentrations where appropriate. Sensitivity measures are used in addition to VaR as part of the overall risk management tools. Market risk exposures are measured and monitored against approved limits or triggers to ensure the Bank’s market risk exposures are within acceptable levels. Regular stress test on market risk exposures are also performed. The Risk Committee reviews stress test results on a regular basis.

For the year ended 31 December 2006, the average daily revenue of the Bank earned from market risk-related activities was HK\$2.6 million (2005: HK\$2.0 million). The standard deviation of these daily revenues was HK\$4.2 million (2005: HK\$3.5 million). An analysis on the daily distribution of market risk-related revenues is provided below.



(h) Foreign exchange exposure

The average daily foreign exchange related revenue for the year ended 31 December 2006 was HK\$2.4 million (2005: HK\$1.3 million).

Foreign Exchange related VaR as at 31 December 2006 was HK\$0.3 million (2005: HK\$1.0 million). The average VaR for the year ended 31 December 2006 was HK\$1.5 million (2005: HK\$1.5 million).

(i) Interest rate risk exposure

The average daily revenue earned from interest rate activities for the year ended 31 December 2006 was HK\$0.2 million (2005: HK\$0.6 million).

Interest rate related VaR as at 31 December 2006 was HK\$4.7 million (2005: HK\$6.3 million). The average VaR for the year end 31 December 2006 was HK\$10 million (2005: HK\$5.5 million).