

星展銀行（香港）有限公司
DBS BANK (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability)

Annual Report 2018

DBS Bank (Hong Kong) Limited and its Subsidiaries

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DBS Bank (Hong Kong) Limited and its Subsidiaries

REPORT OF THE DIRECTORS

The directors of DBS Bank (Hong Kong) Limited (the “Bank”) submit their report together with the audited financial statements of the Bank and its subsidiaries (together the “Group”) for the year ended 31 December 2018.

Principal activities

The principal activity of the Bank is the provision of banking and related financial services. The principal activities of the subsidiaries are shown in Note 21 of the financial statements.

Results and appropriations

The results of the Group for the year ended 31 December 2018 are set out in the consolidated income statement on page 6.

During the year, interim dividends totalling HK\$4,000 million were paid to the holder of ordinary shares and preferential dividend of HK\$55 million (2017: HK\$23 million) was paid to holder of Class A preference shares.

The directors do not recommend the payment of a final dividend for the year ended 31 December 2018 (2017: final dividend of HK\$1,500 million).

Share capital

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

No debentures were issued by the Bank during the year.

Donations

Donations made by the Group during the year amounted to HK\$399,283 (2017: HK\$261,144).

Directors

The directors, including Executive Director (“ED”), non-executive directors (“NED”) and independent non-executive directors (“INED”) of the Bank during the year and up to the date of this report are:

Seah Lim Huat, Peter (NED) – Chairman

Piyush Gupta (NED) – Vice Chairman

J. E. Sebastian Paredes Muirragui (ED) – Chief Executive

Dominic Chiu Fai Ho (INED)

Kwok Kwok Chuen (INED)

Yip Dicky Peter (INED)

Nancy Sau Ling Tse (INED)

Ng Chee Siong, Robert (INED)

(resigned on 29 June 2018)

Liu Chee Ming (INED)

(appointed on 29 June 2018)

In accordance with the articles of association of the Bank, Mr. Seah Lim Huat, Peter, Mr. Piyush Gupta, Mr. J. E. Sebastian Paredes Muirragui, Mr. Dominic Chiu Fai Ho, Mr. Kwok Kwok Chuen, Mr. Yip Dicky Peter and Mr. Liu Chee Ming will retire from office at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-election.

Directors (continued)

During the year and up to the date of this report, Mr. J. E. Sebastian Paredes Muirragui is also a director of the Bank's subsidiaries. Other directors of the Bank's subsidiaries during the year and up to the date of this report include Mr. Nimish Anil Bhanulal Panchmatia, Mr. Gaston Vagos, Mr. Januar Tjandra, Mr. Peter Henry Triggs, Mr. Cheung Kin Sang, Ms. Soh Fern Boey, Mr. V Arivazhagan and Mr. Ajay Surendra Mathur. Mr. Gaston Vagos, Mr. Peter Henry Triggs and Mr. V Arivazhagan ceased to be directors of the Bank's subsidiary on 15 January 2019.

Directors' material interests in significant transactions, arrangements and contracts

In 2015, the Bank granted a four-year tenor banking facility ("Facility") of HK\$1,300 million to Great Maker Limited, in which Sino Land Company Limited ("Sino Land") has 30% indirect shareholding interest, in the ordinary course of business and on normal commercial terms. Sino Land granted in favour of the Bank a 30% pro-rated and several corporate guarantees for the Facility. Mr. Ng Chee Siong, Robert is interested in the Facility as he is the chairman and a substantial shareholder of Sino Land. Mr. Ng resigned as an INED of the Bank with effect from 29 June 2018.

No other transactions, arrangements and contracts of significance in relation to the Bank's business, to which the Bank or any of its subsidiaries or its holding companies or any subsidiary of its holding companies was a party and in which a director of the Bank or the director's connected party had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Directors' interest in shares

As at the end of the year or at any time during the year, the DBSH Share Plan (the "Share Plan") was the only arrangement that enabled a director of the Bank to acquire benefits by means of the acquisition of shares of DBS Group Holdings Ltd. ("DBSH"), or to be awarded shares of DBSH (or their equivalent cash value).

The Share Plan is granted to DBSH Group executives as determined by the Compensation and Management Development Committee ("CMDC") of DBSH appointed to administer the Share Plan from time to time. Participants are awarded shares of DBSH, their equivalent cash value or a combination of both.

Awards consist of the main award and the retention award (being 20% of the main award). The vesting of the main award is staggered between two to four years after grant, i.e. 33% of the shares comprised in the main award will vest 2 years after grant; another 33% will vest in the third year; and the remainder 34% plus the retention award will vest four years after grant. The fair value of the shares awarded is computed based on the market price of the ordinary shares at the time of the award.

During the year, the following directors were eligible to receive awards under the Share Plan as set out below:

- 1) A total of 18,443 share awards were granted to Mr. Seah Lim Huat, Peter and 18,443 share awards were vested in him;
- 2) A total of 230,381 share awards were granted to Mr. Piyush Gupta and 366,676 share awards were vested in him;
- 3) A total of 70,834 share awards were granted to Mr. J. E. Sebastian Paredes Muirragui and 101,044 share awards were vested in him.

Apart from the above, at no time during the year was the Bank or any of its subsidiaries or its holding companies or any subsidiaries of its holding companies a party to any arrangement to enable the directors of the Bank to acquire benefits by means of the acquisition of shares in or debentures of the Bank or any other body corporates.

Permitted indemnity provisions

The articles of association of the Bank provide that every director of the Bank shall be entitled to be indemnified out of the assets of the Bank against all liabilities incurred by him/her as a director for the benefit of the Bank or in defending any proceedings in which judgement is given in his/her favour, or in which he/she is acquitted or in connection with relief granted to him/her by the court.

All directors of the Bank and its associated companies are covered by the Directors and Officers Liability Insurance Policy taken out by DBSH.

Management contracts

In December 2017, the Bank renewed a five-year outsourcing agreement, with respect to the provision of information technology and related support for the Group's operation in Hong Kong. There are various termination clauses contained within the agreement which indicated that under certain circumstances the service company could require the Group to pay termination cost on early termination of the contract. The exact amount of termination cost cannot be reliably determined as it is dependent upon business volumes over the period of the contract and on the timing of the termination itself.

Apart from the foregoing, no contract concerning the management and administration of the whole or any substantial part of the business of the Bank was entered into or existed during the year.

Auditor

The financial statements have been audited by PricewaterhouseCoopers who will retire at the forthcoming Annual General Meeting and eligible to offer themselves for re-appointment.

On behalf of the Board

Seah Lim Huat, Peter
Chairman

Hong Kong, 1 February 2019

DBS Bank (Hong Kong) Limited and its Subsidiaries

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF DBS BANK (HONG KONG) LIMITED

(incorporated in Hong Kong with limited liability)

Opinion

What we have audited

The consolidated financial statements of DBS Bank (Hong Kong) Limited (the "Bank") and its subsidiaries (together the "Group") set out on pages 6 to 61, which comprise:

- the consolidated statement of financial position as at 31 December 2018;
- the consolidated income statement for the year then ended;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated cash flow statement for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Our opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2018, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSA") issued by the HKICPA. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report.

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

Independence

We are independent of the Group in accordance with the HKICPA's Code of Ethics for Professional Accountants ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code.

Other Information

The directors of the Bank are responsible for the other information. The other information comprises the information included in the report of the directors and corporate governance report, but does not include the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Directors and Those Charged with Governance for the Consolidated Financial Statements

The directors of the Bank are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with HKFRSs issued by the HKICPA and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. We report our opinion solely to you, as a body, in accordance with Section 405 of the Hong Kong Companies Ordinance and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with HKSAAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 1 February 2019

DBS Bank (Hong Kong) Limited and its Subsidiaries

CONSOLIDATED INCOME STATEMENT

In HK\$ millions	Note	Year ended 31 December	
		2018	2017*
Interest income		11,118	7,631
Interest expense		(3,261)	(1,700)
Net interest income	4	7,857	5,931
Net fee and commission income	5	2,950	2,587
Net trading income	6	528	723
Net income from investment securities	7	22	31
Other income	8	567	81
Total income		11,924	9,353
Total expenses	9	(5,315)	(4,696)
Profit before allowances for credit and other losses		6,609	4,657
Allowances for credit and other losses	10	(567)	34
Profit before income tax		6,042	4,691
Income tax expense	12	(914)	(801)
Profit attributable to shareholders		5,128	3,890

* In accordance with the principles of merger accounting, 2017 figures have been restated due to the acquisition of DBS Vickers (Hong Kong) Limited's retail brokerage business. Please refer to note 2(a) for details.

The notes on pages 11 to 61 form part of these financial statements.

DBS Bank (Hong Kong) Limited and its Subsidiaries

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

In HK\$ millions	Year ended 31 December	
	2018	2017*
Profit attributable to shareholders	5,128	3,890
Other comprehensive income:		
Items that may be reclassified subsequently to income statement:		
Debt instruments classified at fair value through other comprehensive income / Available-for-sale financial investments and others		
– Net valuation taken to equity	(11)	82
– Transferred to income statement	1	(9)
– Deferred income tax credited/(debited) to equity	2	(12)
Cash flow hedge		
– Net valuation taken to equity	88	–
– Transferred to income statement	(59)	–
– Deferred income tax debited to equity	(5)	–
Items that will not be reclassified to income statement:		
Equity instruments classified at fair value through other comprehensive income		
– Net valuation taken to equity	9	–
Other comprehensive income attributable to shareholders, net of tax	25	61
Total comprehensive income attributable to shareholders	5,153	3,951

Arising from the adoption of HKFRS 9 on 1 January 2018, realised gains or losses on equity instruments classified as "Fair Value through Other Comprehensive Income" are not reclassified to the income statement. Previously, HKAS 39 required realised gains or losses on available-for-sale equity instruments to be classified in the income statement.

Items recorded in "Other comprehensive income" above will be reclassified subsequently to the income statement when specific conditions are met, e.g. when debt securities classified as "Fair Value through Other Comprehensive Income" are disposed.

* In accordance with the principles of merger accounting, 2017 figures have been restated due to the acquisition of DBS Vickers (Hong Kong) Limited's retail brokerage business. Please refer to note 2(a) for details.

The notes on pages 11 to 61 form part of these financial statements.

DBS Bank (Hong Kong) Limited and its Subsidiaries

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

In HK\$ millions	Note	As at 31 December 2018	2017*
Assets			
Cash and balances with central banks	15	3,028	2,911
Government securities and treasury bills	16	38,289	20,111
Due from banks	17	222,057	200,726
Derivatives	32	471	1,188
Bank and corporate securities	18	9,418	11,095
Loans and advances to customers	19	162,171	154,175
Other assets	20	7,893	5,471
Properties and other fixed assets	23(a)	2,166	1,979
Goodwill	22	168	168
Total assets		445,661	397,824
Liabilities			
Due to banks		9,880	7,666
Deposits and balances from customers	24	363,658	327,483
Derivatives	32	840	883
Certificates of deposit issued	25	5,558	4,189
Other liabilities	26	23,544	14,489
Subordinated liability	28	4,229	4,220
Total liabilities		407,709	358,930
Equity			
Share capital	29(a)	8,995	8,995
Reserves	29(b)	28,957	29,899
Total equity		37,952	38,894
Total liabilities and equity		445,661	397,824

* In accordance with the principles of merger accounting, 2017 figures have been restated due to the acquisition of DBS Vickers (Hong Kong) Limited's retail brokerage business. Please refer to note 2(a) for details.

The notes on pages 11 to 61 form part of these financial statements.

Seah Lim Huat, Peter
Chairman

J.E. Sebastian Paredes Muirragui
Director

DBS Bank (Hong Kong) Limited and its Subsidiaries

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

In HK\$ millions	Share capital	Other reserves	Retained earnings	Total equity
Balance as at 1 January 2017	8,995	2,273	23,867	35,135
Impact of merger of a commonly controlled business (Note 2(a))	–	–	235	235
Impact of change in measurement model of investment properties (Note 2(j))	–	–	(4)	(4)
Restated balance as at 1 January 2017	8,995	2,273	24,098	35,366
Total comprehensive income	–	61	3,890	3,951
Dividend paid	–	–	(423)	(423)
Restated balance as at 31 December 2017	8,995	2,334	27,565	38,894
Balance as at 1 January 2018	8,995	2,334	27,565	38,894
Impact of adopting HKFRS 9 on 1 January 2018 (Note 2(b))	–	96	(414)	(318)
Restated balance as at 1 January 2018	8,995	2,430	27,151	38,576
Acquisition of a commonly controlled business (Note 2(a))	–	–	(222)	(222)
Total comprehensive income	–	25	5,128	5,153
Dividend paid	–	–	(5,555)	(5,555)
Balance as at 31 December 2018	8,995	2,455	26,502	37,952

Retained earnings as at 1 January 2018 has been restated to reflect the impact of merging a commonly controlled business in accordance with Accounting Guideline No. 5 – “Merger Accounting for Common Control Combinations” issued by the HKICPA, and change in measurement model of investment properties from fair value to cost model. These have resulted in an increase of \$231 million and a decrease of HK\$7 million respectively in the balance previously reported in the financial statements for the year ended 31 December 2017. Please refer to note 29 for details.

In 2017, final dividend of HK\$1,500 million for ordinary shares was proposed after the end of the reporting period. No dividend was recommended after the end of the reporting period. Please refer to Note 13(a) for details.

The notes on pages 11 to 61 form part of these financial statements.

DBS Bank (Hong Kong) Limited and its Subsidiaries

CONSOLIDATED CASH FLOW STATEMENT

In HK\$ millions	Note	Year ended 31 December 2018	2017*
Cash flows from operating activities			
Profit before income tax		6,042	4,691
Adjustments for non-cash items:			
Net gain on disposal of asset held for sale and fixed assets		(488)	–
Allowances for credit and other losses		567	(34)
Write-off of properties and other fixed assets		–	6
Depreciation and amortisation		272	286
Advances and other assets written off net of recoveries		(443)	(476)
Interest expense for subordinated liability		162	155
Profit before changes in operating assets and liabilities		6,112	4,628
Increase / (decrease) in:			
Due to banks		2,214	(6,944)
Deposits and balances from customers		36,175	53,332
Other liabilities and derivatives		9,092	(3,800)
Certificates of deposit issued		1,369	1,424
(Increase) / decrease in:			
Due from banks		(37,738)	(24,035)
Government securities and treasury bills		(14,347)	3,069
Loans and advances to customers		(8,590)	(7,334)
Bank and corporate securities		1,771	1,905
Other assets and derivatives		(1,629)	2,709
Net cash (used in) / generated from operating activities before income tax		(5,571)	24,954
Hong Kong profits tax paid		(1,097)	(191)
Overseas tax paid		(6)	(4)
Net cash (used in) / generated from operating activities		(6,674)	24,759
Cash flows from investing activities			
Purchase of fixed assets		(459)	(207)
Proceeds from disposal of asset held for sale and fixed assets		598	–
Acquisition of a commonly controlled business		(222)	–
Net cash used in investing activities		(83)	(207)
Cash flows from financing activities			
Dividend paid		(5,555)	(423)
Interest paid for subordinated liability		(159)	(160)
Issuance of subordinated liability	31(a)	–	4,216
Redemption of subordinated liability	31(a)	–	(4,216)
Net cash used in financing activities		(5,714)	(583)
Exchange differences and other adjustments		9	32
Net change in cash and cash equivalents		(12,462)	24,001
Cash and cash equivalents as at 1 January		85,984	61,983
Cash and cash equivalents as at 31 December	31(b)	73,522	85,984

* In accordance with the principles of merger accounting, 2017 figures have been restated due to the acquisition of DBS Vickers (Hong Kong) Limited's retail brokerage business. Please refer to note 2(a) for details.

The notes on pages 11 to 61 form part of these financial statements.

DBS Bank (Hong Kong) Limited and its Subsidiaries

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2018

1 GENERAL INFORMATION

The principal activities of DBS Bank (Hong Kong) Limited (the "Bank") and its subsidiaries (together the "Group") are the provision of banking and related financial services. The Bank is a limited company incorporated and domiciled in Hong Kong. The address of its registered office is 11th Floor, The Center, 99 Queen's Road Central, Hong Kong.

The immediate holding company is DHB Limited, which is incorporated in Hong Kong. The ultimate holding company is DBS Group Holdings Ltd ("DBSH") which is listed, incorporated and domiciled in the Republic of Singapore. The address of its registered office is 12 Marina Boulevard, Marina Bay Financial Centre Tower 3, Singapore 018982.

The consolidated financial statements were approved for issue by the Board of Directors on 1 February 2019.

For regulatory reporting purposes, the Bank computes key regulatory ratios on a combined basis including the Bank and its overseas branch that is different from the basis of consolidation for accounting purposes. The basis is set out in the Regulatory Disclosure Statements. The disclosures of regulatory capital, liquidity and other disclosures are available in the section of Regulatory Disclosures on our website www.dbs.com/hongkong/investor/financial-results.page.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the principal accounting policies applied by the Group and, except where noted, are consistent with those applied in the previous financial year.

(a) Basis of preparation

The consolidated financial statements are prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and the requirements of the Hong Kong Companies Ordinance Cap 622.

The consolidated financial statements are presented in Hong Kong dollars and rounded to the nearest million, unless otherwise stated. Comparative figures in the consolidated financial statements have been reclassified to conform with current year's presentation.

The preparation of financial statements requires management to exercise judgement, use estimates and make assumptions that affect the application of policies and reported amounts in the financial statements. Although these estimates are based on management's best knowledge of current events and actions, actual results may differ from these estimates. Critical accounting estimates and assumptions used that are significant to the financial

statements, and areas involving a higher degree of judgement and complexity, are disclosed in Note 3.

Application of merger accounting

On 20 July 2018, the Bank signed a Business Transfer Agreement with DBS Vickers (Hong Kong) Limited ("DBSVHK") to purchase certain rights in connection with the securities broking business for retail customers (the "Acquired Business") and the transaction ("Business Transfer") was completed on 13 October 2018 (the "Effective Date").

As part of the Business Transfer, the assets (comprising mainly loans and advances to customers) of HK\$222 million and liabilities (comprising mainly deposits and balances with customers) of HK\$1,364 million were transferred to the Bank at their carrying amounts in form of cash on the Effective Date.

As the Bank and DBSVHK were under common control of DBSH before and after the Business Transfer, the Group applied Accounting Guideline No.5 – "Merger Accounting for Common Control Combinations" issued by the HKICPA ("AG5") in accounting for the acquisition of the Acquired Business in the Group's consolidated financial statements.

In accordance with the principles of merger accounting, the Group's consolidated financial statements and the Bank's own financial statements have been presented as if the acquisition by the Bank had occurred from the date when the Acquired Business first came under the common control.

The assets and liabilities of the Acquired Business have been included at their carrying amounts of DBSH. In accordance with merger accounting principles, no adjustments to fair value are made and no goodwill is recognised.

The net assets of the Acquired Business have been recognised using the carrying amounts in the consolidated financial statements of the Group and the financial statements of the Bank. Comparative amounts have been restated so that they are presented as if the Business Transfer had been combined from 1 January 2017.

The effects of the combination of Acquired Business on the financial position of the Group as at 31 December 2018 and 2017 and the results of the Group for the year ended 31 December 2018 and 2017 are summarised as below:

Consolidated Statement of Financial Position

In HK\$ millions	The Group	Acquired Business	Intercompany elimination	Consolidated
As at 31 December 2017				
Total assets	396,812	2,437	(1,425)	397,824
Total liabilities	358,149	2,206	(1,425)	358,930
Total equity	38,663	231	–	38,894

The Business Transfer was completed on 13 October 2018 and the positions of the Acquired Business have already been merged to the Group as at 31 December 2018. Thus, no effect of the combination on the financial position of the Group as at 31 December 2018 was presented.

Consolidated Income Statement

In HK\$ millions	The Group	Acquired Business*	Consolidated
For the year ended 31 December 2018			
Total income	11,908	16	11,924
Total expenses	(6,771)	(25)	(6,796)
Profit attributable to shareholders	5,137	(9)	5,128

* For the period from 1 January 2018 to 12 October 2018

In HK\$ millions	The Group	Acquired Business	Consolidated
For the year ended 31 December 2017			
Total income	9,328	25	9,353
Total expenses	(5,434)	(29)	(5,463)
Profit attributable to shareholders	3,894	(4)	3,890

(b) Adoption of new and revised accounting standards

On 1 January 2018, the Group adopted the following new or revised HKFRSs that are issued by HKICPA and relevant for the Group.

- HKFRS 9: Financial Instruments
- HKFRS 15: Revenue from Contract with Customers

HKFRS 9: Financial Instruments

HKFRS 9, which replaces the HKAS 39, includes revised guidance on the classification and measurement of financial instruments; more timely recognition of expected credit losses ("ECL") of financial assets; and introduces revised requirements for general hedge accounting. Except for the provisions relating to the presentation of gains and losses on financial liabilities designated at fair value, which were earlier adopted by the Group from 1 January 2017, the requirements of HKFRS 9 were adopted from 1 January 2018.

Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of HKFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. The aggregate impact from the transition to HKFRS 9 was a net decrease of HK\$318 million in the Group shareholders' funds.

The main changes to the accounting policies from the implementation of HKFRS 9 are covered in Note 2(f), 2(h) and 2(o).

The tables in the following sections summarise the key differences between HKAS 39 and HKFRS 9 and the transition impact on adoption of HKFRS 9, including information on classification and measurement, and ECL.

Key differences between HKAS 39 and HKFRS 9

The key differences between HKAS 39 and HKFRS 9 are described below. Refer to the Group's 2017 financial statements for details on the accounting policies for HKAS 39.

Classification and Measurement of financial assets

	HKAS 39 (Prior to 1 Jan 2018)	HKFRS 9 (From 1 Jan 2018 onwards)
Classification criteria	<p>Financial assets are measured at amortised cost (loans and receivables, held to maturity), FVOCI (AFS) or FVPL.</p> <p>Classification is based on the investment intention of individual instruments and the nature of the instruments. Embedded derivatives are separated from their host instrument or measured in entirety at FVPL.</p>	<p>Debt instruments are measured at amortised cost, FVOCI or FVPL.</p> <p>Classification of debt instruments is based on the business model in which the debt instruments are held and the contractual terms of the assets ('solely payments of principal and interest' (SPPI) test). Embedded derivatives are not separated i.e. the asset is accounted for in its entirety.</p> <p>Equity instruments are measured at FVOCI or FVPL as elected by the Group.</p>
Presentation	<p>Upon derecognition of AFS securities (both debt and equity instruments), the cumulative gains or losses in other comprehensive income is recognised in the income statement.</p>	<p>Upon derecognition of FVOCI debt instruments cumulative gains or losses in other comprehensive income is recognised in the income statement.</p> <p>Upon derecognition of FVOCI equity instruments, cumulative gains or losses in other comprehensive income is not recognised in the income statement.</p>

Impairment

Prior to HKFRS 9, the Group adopted HKAS 39. The key similarities and differences between the two standards are summarised below:

	HKAS 39 (Prior to 1 Jan 2018)	HKFRS 9 (From 1 Jan 2018 onwards)
Instruments in scope	<p>Debt instruments that are measured at amortised cost and FVOCI (AFS) are subject to impairment. Off balance sheet credit exposures are also in scope for impairment.</p> <p>AFS equity instruments are subject to impairment.</p>	<p>The scope of financial instruments that are subject to impairment is generally similar between HKAS 39 and HKFRS 9.</p> <p>However, FVOCI equity instruments are not subject to impairment.</p>
Impaired/ Stage 3	<p>The criteria used to determine objective evidence of impairment is similar to HKFRS 9.</p> <p>Specific allowances for credit losses are recognised based on the circumstances existing at balance sheet date and is not adjusted for forward looking factors.</p>	<p>Stage 3 refers to financial assets and other credit exposures that have been impaired.</p> <p>Lifetime ECL is recognised on such exposures. Lifetime ECL incorporates forward looking factors.</p>
Stage 2	<p>There is no concept of Stage 1 or Stage 2 prior to HKFRS 9.</p> <p>General allowances are recorded in the income statement.</p>	<p>Stage 2 refers to financial assets and other off balance sheet credit exposures that have experienced a significant increase in credit risk since its inception.</p> <p>Lifetime ECL is recognised on such exposures.</p>
Stage 1		<p>Stage 1 refers to financial assets and other off balance sheet credit exposures which have not experienced a significant increase in credit risk since inception.</p> <p>Stage 1 exposures are measured at an amount equal to 12 months of ECL.</p>

Hedge accounting

The main concepts of hedge accounting remain unchanged between HKAS 39 and HKFRS 9. The main change which is relevant to the Group relates to currency basis spreads which is described in Note 2(o).

Transition impact of adopting HKFRS 9 on 1 Jan 2018

The table below reflects the impact of adopting HKFRS 9 on the Group's opening balance sheet as at 1 January 2018.

In HK\$ millions	31 Dec 2017 HKAS 39	Transitional impact of classification and measurement	Transitional impact of ECL	1 Jan 2018 HKFRS 9
Assets				
Cash and balances with central banks	2,911	–	–	2,911
Government securities and treasury bills	20,111	–	–	20,111
Due from banks	200,726	–	(2)	200,724
Derivatives	1,188	–	–	1,188
Bank and corporate securities	11,095	101	(1)	11,195
Loans and advances to customers	154,175	–	(375)	153,800
Other assets ¹	5,471	(5) ¹	81	5,547
Properties and other fixed assets	1,979	–	–	1,979
Goodwill	168	–	–	168
Total assets	397,824	96	(297)	397,623
Liabilities				
Due to banks	7,666	–	–	7,666
Deposits and balances from customers	327,483	–	–	327,483
Derivatives	883	–	–	883
Certificate of deposit used	4,189	–	–	4,189
Other liabilities ^{1,2}	14,489	–	117	14,606
Subordinated term debts	4,220	–	–	4,220
Total liabilities	358,930	–	117	359,047
Total equity	38,894	96	(414)	38,576

Notes:

1 Include current and deferred tax impact

2 The ECL on guarantees and other off-balance sheet exposures are recorded in "Other liabilities"

Additional information on impact from classification and measurement

The table below does not reflect reclassifications when the measurement basis between HKAS 39 and HKFRS 9 remains similar. This includes reclassifications from available for sale ("AFS") to fair value through other comprehensive income ("FVOCI") as they are measured at fair value with changes in fair value being generally recorded in other comprehensive income.

In HK\$ millions	Reclassification		31 Dec 2017	Remeasurement	1 Jan 2018
	From HKAS 39	To HKFRS 9			
Bank and corporate securities			7,479	101	7,580
Debt instruments that are part of a hold to collect business model ^(a)	AFS	Amortised Cost	6,300	31	6,331
Unquoted equities previously measured at cost remeasured to fair value	AFS (Cost)	FVOCI	29	70	99
Debt instruments that are not SPPI in nature	AFS	Fair value through profit or loss ("FVPL")	1,150	–	1,150

(a) As at 31 December 2018, the fair value of the reclassified assets that continue to be recognised on the Group's balance sheet is HK\$5,797 million. If these financial assets had not been reclassified, HK\$54 million of loss would have been recognised in other comprehensive income.

Additional information on impact of ECL

The following table is a comparison of impairment allowances determined in accordance with HKAS 39, to the corresponding ECL allowances determined in accordance with HKFRS 9 as at 1 January 2018.

In HK\$ millions	31 Dec 2017 HKAS 39		1 Jan 2018 HKFRS 9			Impact of ECL
	Collectively assessed	Individually assessed	Stage 1	Stage 2	Stage 3	
Assets						
Cash and balances with central banks	–	–	–	–	–	–
Government securities and treasury bills	–	–	–	–	–	–
Due from banks	–	–	2	–	–	(2)
Bank and corporate securities	–	–	1	–	–	(1)
Loans and advances to customers	837	829	409	637	995	(375)
Other assets	–	206	4	–	206	(4)
Liabilities						
Other liabilities ¹	–	–	97	18	–	(115)
Total	837	1,035	513	655	1,201	(497)
Tax impact	–	–	–	–	–	83
	837	1,035	513	655	1,201	(414)

¹ The ECL on guarantees and other off-balance sheet exposures are recorded in "Other liabilities"

HKFRS 15: Revenue from Contract with Customers

From 1 January 2018, HKFRS 15 replaced the existing revenue recognition guidance and established a comprehensive framework for determining whether, how much and when revenue is recognised. Revenue is recognised when a performance obligation is satisfied, which could either be at a point in time or when the obligation is satisfied over time. HKFRS 15 applies mainly to "fee and commission income".

The adoption of HKFRS 15 does not have a material impact on the Group's consolidated financial statements.

New HKFRS and Interpretations effective for future periods

The significant new HKFRS that is applicable to the Group for future reporting period, and which have not been early adopted is HKFRS 16 Leases (effective 1 January 2019).

HKFRS 16 Leases replaces the existing lease accounting guidance and requires almost all leases to be recognised on the balance sheet. It also changes the way in which lease expenses are presented in the income statement.

The Group would apply HKFRS 16 on 1 January 2019, using the modified retrospective approach. The cumulative effect of adopting HKFRS 16 would be recognised as an adjustment to the opening balance of retained earnings at 1 January 2019, with no restatement of comparative information.

On transition, the estimated impact on the Group's financial statements will be a gross-up of HK\$2.8 billion right-of-use assets and HK\$2.8 billion lease liabilities, together with a net increase in retained earnings of HK\$9 million.

General Accounting Policies

(c) Group accounting

Subsidiaries

Subsidiaries are entities (including structured entities) over which the Group has control. The Group controls an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are consolidated from the date control is transferred to the Group to the date control ceases.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Business combinations – common control combinations

Business combinations under common control are accounted for in accordance with the AG5. In applying merger accounting, the consolidated financial statements incorporate the items of the combining entities or businesses in which the common control combination occurs as if they had been combined from the date when the combining entities or businesses first came under the control of the controlling party.

The net assets of the combining entities or businesses are consolidated using the existing book values from the controlling party's perspective. No amount is recognised in respect of goodwill or excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost at the time of common control combination, to the extent of the continuation of the controlling party's interest.

The comparative amounts in the consolidated financial statements are presented as if the entities or businesses had been combined at the beginning of the previous reporting period or when they first came under common control, whichever is shorter.

Business combinations under acquisition method

The acquisition method is used to account for business combinations other than common control. Refer to Note 2(i) for the Group's accounting policy on goodwill.

Investment cost at Bank level

Investments in subsidiaries are stated at cost less accumulated impairment losses in the Bank's statement of financial position. On disposal of investments in subsidiaries and joint venture, the difference between the net proceeds and the carrying amounts of the investments is taken to the income statement.

(d) Foreign currency treatment

(i) Functional and presentation currency

Items in the financial statements are measured using the functional currency of each entity in the Group, being the currency of the primary economic environment in which the entity operates. The Group's financial statements are presented in Hong Kong dollars, which is the functional currency of the Bank.

(ii) Foreign currency transactions and balances

Transactions in foreign currencies are measured using exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the exchange rate as at the end of the reporting period. Foreign exchange differences arising from this translation are recognised in the income statement as trading income.

Non-monetary assets and liabilities measured at cost in a foreign currency are translated using the exchange rate at the date of the transaction.

Non-monetary assets and liabilities measured at fair values in foreign currencies are translated using the exchange rates at the date when the fair values are determined, which is generally the end of the reporting period.

Unrealised foreign exchange differences arising from non-monetary financial assets and liabilities classified as FVPL are recognised in the income statement as trading income. Non-monetary financial assets that are classified as FVOCI relates mainly to FVOCI equities. Refer to section 2(f) for the accounting treatment.

(iii) Subsidiaries and branches

The results and financial positions of subsidiaries and branches whose functional currency is not Hong Kong dollars ("foreign operations") are translated into Hong Kong dollars in the following manner:

- Assets and liabilities are translated at the exchange rates as at the end of the reporting period;
- Income and expenses in the income statement are translated at exchange rates prevailing at each month-end, approximating the exchange rates at the dates of the transactions; and
- All resulting exchange differences are recognised in other comprehensive income and accumulated under capital reserves in equity. When a foreign operation is disposed of, such currency translation differences are recognised in the income statement as part of the gain or loss on disposal.

Income Statement

(e) Income recognition

(i) Interest income and interest expense

Interest income and interest expense as presented in Note 4 arise from all interest-bearing financial assets and financial liabilities regardless of their classification and measurement, with the exception of the Group's structured investment deposits which are carried at FVPL. Interest expense on such structured investment deposits is presented together with other fair value changes in "net trading income".

Interest income and interest expense are recognised on a time-proportionate basis using the effective interest method as prescribed by HKFRS. The calculation includes significant fees and transaction costs that are integral to the effective interest rate, as well as premiums or discounts.

(ii) Fee and commission income

The Group earns fee and commission income from a diverse range of products and services provided to its customers.

Fee and commission income are recognised when the Group has satisfied its performance obligation in providing the promised products and services to the customer, and are recognised based on contractual rates agreed with customers, net of expected waivers based on historical experience, and net of expenses directly related to it. The Group generally satisfies its performance obligation and recognises the fee and commission income on the following basis:

- Transaction-based fee and commission income is recognised on the completion of the transaction. Such fees include underwriting fees, brokerage fees, bancassurance sales commission and variable service fees, and fees related to the completion of corporate finance transactions.
- For a service that is provided over a period of time, fee and commission income is recognised on equal proportion basis over the period during which the related service is provided or credit risk is undertaken. This basis of recognition most appropriately reflects the nature and pattern of provision of these services to the customers over time. Fees for these services can be billed to customers in advance or periodically over time. Such fees include the income from issuance of financial guarantees and bancassurance fixed service fees.

The Group does not provide any significant credit terms to customers for the above products and services.

Directly related expenses typically include brokerage fees paid, card-related expenses and sales commissions, but do not include expenses for services delivered over a period (such as service contracts) and other expenses that are not specifically related to fee and commission income transactions.

(iii) Dividend income

Dividend income is recognised when the right to receive payment is established. This is generally the ex-dividend date for listed equity securities, and usually the date when shareholders approve the dividend for unlisted equity securities. Dividend income arising from financial assets classified as FVPL is recognised in "Net trading income", while those arising from FVOCI or AFS financial assets is recognised in "Net income from investment securities".

(iv) Rental income

Rental income from operating leases on properties is recognised on a straight-line basis over the lease term.

(v) Allowances for credit losses

Please refer to Note 2(h) for the accounting policy on impairment of financial assets including loan loss provisions.

Statement of Financial Position

(f) Financial assets

Initial recognition

Purchases and sales of all financial assets, even if their classification and measurement are subsequently changed, are recognised on the date that the Group enters into the contractual arrangements with counterparties. When the Group acts as a trustee or in a fiduciary capacity for assets it does not directly control or benefit from, the assets and the corresponding income belonging to a customer are excluded from the financial statements.

Financial assets are initially recognised at fair value, which is generally the transaction price.

Classification and subsequent measurement

The Group applied the classification and measurement requirements under HKFRS 9 for the year ended 31 December 2018. The 2017 comparative period was not restated and requirements under HKAS 39 were applied. Please refer to Note 2(b) for further details on the key differences between HKAS 39 and HKFRS 9 and the transition impact of classification and measurement.

Policy applicable from 1 January 2018

HKFRS 9 replaces the classification and measurement model in HKAS 39 with a model that categorises debt-like financial assets based on the business model within which the assets are managed, and whether the assets constitute a "basic lending arrangement" where their contractual cash flows represent solely payments of principal and interest ("SPPI"). Interest is defined as consideration for the time value of money, credit risk, other basic lending risks and may include a profit margin.

The classification of the financial assets and the associated accounting treatment is as follows:

- Debt instruments are measured at amortised cost when they are in a "hold to collect" (HTC) business model and have contractual cash flows that are SPPI in nature. The objective of a HTC business model is to collect contractual principal and interest cash flows. Sales are incidental to the objective and expected to be either insignificant or infrequent.
- Debt instruments are measured at FVOCI when they are in a "hold to collect & sell" (HTC & S) business model and have cash flows that are SPPI in nature. Both the collection of

contractual cash flows and sales are integral to achieving the objective of the HTC & S business model.

Unrealised gains or losses on FVOCI debt instruments are recorded in other comprehensive income and accumulated in FVOCI reserves. When they are sold, the accumulated fair value adjustments in FVOCI are reclassified to the income statement as "Net income from investment securities".

- Debt instruments are measured at FVPL when:
 - (i) the assets are not SPPI in nature;
 - (ii) the assets are not part of a "HTC" or "HTC & S" business model; or
 - (iii) the assets are designated at FVPL to eliminate or significantly reduce the measurement or recognition inconsistencies that would otherwise arise from measuring assets or liabilities on different bases.

Realised and unrealised gains or losses on FVPL financial assets, except interest income, are taken to "Net trading income" in the income statement in the period they arise.

- Subsequent changes in fair value of non-trading equity can be taken through profit or loss or comprehensive income, as elected. The Group generally elects its non-trading equity instruments to be classified as FVOCI. Other than dividend income, gains and losses on FVOCI equity instruments are recorded in other comprehensive income and accumulated in FVOCI reserves, and not reclassified to profit or loss upon derecognition.
- Derivatives (including derivatives embedded in financial liabilities but separated for accounting purposes) are also classified as held for trading unless they are designated as hedging instruments. Derivatives are classified as assets when the fair value is positive and as liabilities when the fair value is negative. Changes in the fair value of derivatives other than those designated as hedging instruments in cash flow or net investment hedges are included in "Net trading income".

Policy applicable before 1 January 2018

The Group classifies and measures financial assets based on their nature and the purpose for which they are acquired. This generally corresponds to the business models in which they are applied and how management monitors performance, as follows:

- Non-derivative financial assets that are managed mainly for longer-term holding and collection of payments are classified as loans and receivables. These assets have fixed or determinable payments, are not quoted in an active market. Loans and receivables are carried at amortised cost and using the effective interest method.
- Non-derivative financial assets that are managed on a fair value basis, are classified as financial assets at fair value through profit or loss. Such assets include instruments held for the purpose of short term selling and market making ("Held for trading"), or designated under the fair value option if doing

so eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise, or if the financial asset contains an embedded derivative that would otherwise need to be separately recorded ("Designated at fair value through profit or loss").

Realised or unrealised gains or losses on such financial assets, except interest income, are taken to "Net trading income" in the income statement in the period they arise.

Derivatives (including derivatives embedded in other contracts but separated for accounting purposes) are also categorised as "Held for trading" unless they are designated as hedging instruments in accordance with Note 2(o). Derivatives are classified as assets when the fair value is positive and as liabilities when the fair value is negative. Changes in the fair value of derivatives are included in "Net trading income".

- The Group also holds other non-derivative financial assets for the purpose of investment or satisfying regulatory liquidity requirements. Such assets are held for an indefinite period and may be sold in response to needs for liquidity or changes in interest rates, credit spreads, exchange rates or equity prices. These assets are classified as available-for-sale and initially and subsequently measured at fair value.

Unrealised gains or losses arising from changes in fair value are recognised in other comprehensive income and accumulated in investments revaluation reserve. When sold or impaired, the accumulated fair value adjustments in the investments revaluation reserves are reclassified to the income statement. Unquoted equity investments classified as available-for-sale for which fair values cannot be reliably determined are carried at cost, less impairment (if any).

Where the classification and measurement of financial assets do not reflect the management of the financial assets (or financial liabilities), the Group may apply hedge accounting where permissible and relevant to better reflect the management of the financial assets. Please refer Note 2(o) for details on hedging and hedge accounting.

Please refer to Note 14 for further details on the types of financial assets classified and measured as above.

Reclassification of financial assets

Reclassification of financial assets are prohibited unless the Group changes its business model for managing financial assets. In practice, this is expected to be infrequent under HKFRS 9.

When the purpose for holding a financial asset changes, or when HKFRS otherwise requires it, non-derivative financial assets are reclassified accordingly. Financial assets may be classified out of the fair value through profit or loss or available-for-sale categories only in particular circumstances as prescribed by HKAS 39.

Determination of fair value

The fair value of financial assets is the price that would be received if the asset is sold in an orderly transaction between market participants at the measurement date. Fair value is generally estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments. Where applicable, a valuation reserve or pricing adjustment is applied to arrive at the fair value. The determination of fair value is considered a significant accounting policy for the Group and further details are disclosed in Note 30 on fair value measurements.

Offsetting

Financial assets and liabilities are presented net when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle them on a net basis, or realise the asset and settle the liability simultaneously.

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or when they have been transferred together with substantially all risks and rewards of ownership.

The Group enters into certain transactions where it transfers financial assets recognised on its statement of financial position but retains either all or a portion of the risks and rewards of the transferred financial assets. In such cases, the transferred financial assets are not derecognised from the statement of financial position. They also include certain transactions where control over the financial asset is retained, for example, by a simultaneous transaction (such as options) with the same counterparty to which the asset is transferred. In such cases, the Group continues to recognise the asset to the extent of its continuing involvement which is the extent to which it is exposed to changes in the value of the transferred asset. Please refer to Note 35 for disclosures on transfers of financial assets.

(g) 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, balances with banks, placements with and advances to banks and short-term bills and notes classified as held-for-trading and available-for-sale financial assets which are readily convertible into cash.

(h) Impairment

The Group applied the impairment requirements under HKFRS 9 for the year ended 31 December 2018. The 2017 comparative period was not restated and requirements under HKAS 39 were applied. Please refer to Note 2(b) for further details on the key differences between HKAS 39 and HKFRS 9 and the transition impact of impairment.

Policy applicable from 1 January 2018

Expected Credit Loss ("ECL")

All financial assets, except for financial assets classified or designated as FVPL and equity securities, are subject to impairment and recognition of ECL. Off-balance sheet items that are also subject to ECL include financial guarantees and undrawn loan commitments.

Under HKFRS 9, ECL will be assessed using an approach which classifies financial assets into three stages, each of which is associated with an ECL requirement that is reflective of the assessed credit risk profile. A financial asset is classified under:

- Stage 1, if it was not credit-impaired upon origination, and there has not been a significant increase in its credit risk. Stage 1 ECLs are measured as the credit loss that is expected to result from a default occurring within the next 12 months.
- Stage 2, if it was not credit-impaired upon origination but has since experienced a significant increase in credit risk. Stage 2 ECLs are measured as the lifetime expected credit loss from a default from the expected remaining life of the financial instrument.
- Stage 3, if it has been credit-impaired with objective evidence of default. Stage 3 ECLs are also measured as lifetime expected credit loss from the expected remaining life of the financial instrument.

The impairment requirements of HKFRS 9 require management judgements, estimates and assumptions, particularly in the areas discussed below.

Measurement of ECLs

ECLs are unbiased probability-weighted estimates of credit losses determined by evaluating a range of possible outcomes and taking into account past events, current conditions and assessments of future economic conditions. The measurement of ECL is based primarily on the product of the instrument's probability of default ("PD"), loss given default ("LGD") and exposure at default ("EAD") discounted using the Effective Interest Rate to the reporting date. The main difference between Stage 1 and Stage 2 ECL is the respective calculation horizon. Stage 1 estimates project PD, LGD and EAD over a maximum period of 12 months while Stage 2 estimates these parameters over the expected remaining life of the financial asset.

The Group leverages the models / parameters implemented under the Basel II Internal Ratings-Based ("IRB") framework where feasible and available, with calibration to meet the HKFRS 9 requirements. For portfolio without appropriate Basel model/

parameter, other relevant historical information, loss experience or proxies will be utilised if deemed feasible, with a view to maximise the use of available information that is reliable and supportable. LGD has been primarily determined on collective basis grouped by industry or products with shared risk characteristics.

A simplified approach using appropriate proxies has been applied to estimate the ECL for other assets such as trade receivables.

The Group's approach to retail and wholesale portfolios including key judgements is set out below.

Expected Life

When measuring the ECL for Stage 2 assets, cashflows over the expected remaining life of the financial asset are considered. For most financial instruments, this is the same as the remaining contractual life which represents the maximum contractual period over which the Group is exposed to the credit risk of the customers.

However, for certain retail revolving products like credit cards, the expected remaining life may exceed the contractual remaining maturity. For such products, a behavioural expected remaining life is estimated using the Group's internal historical data based on the period over which the Group is exposed to the credit risk of such customers.

Assessments of significant increase in credit risk

The analysis underpinning the assessment of whether a financial asset has experienced a significant increase in credit risk since origination is multi-factor in nature, with a range of qualitative and quantitative parameters taken into consideration.

For wholesale exposures, financial assets are deemed to have experienced a significant increase in credit risk when: (1) observed changes in the probability of default, as measured in the downgrade in internal credit risk rating for each obligor between initial recognition and reporting date, are more than pre-specified thresholds; and (2) exposures are placed on certain categories of internal credit "watchlists" for closer scrutiny of developing credit issues. For retail exposures, days past due is the main driver, supplemented with a probability of default-based criterion.

For retail exposures, days past due is the main driver, supplemented with a PD based criterion.

In any event, all retail and wholesale exposures that are more than 30 days past due are considered to have demonstrated a significant increase in credit risk and are classified as Stage 2.

A Stage 2 exposure can migrate back to Stage 1 if it is assessed that there is assurance of a sustainable improvement in its credit profile.

The Group has not used the low credit risk exemption for any financial instruments.

Definition of default for credit-impaired financial assets

Exposures are classified as Stage 3 if deemed to be credit-impaired or have suffered objective evidence of default as at the reporting date. The definition of default that will be applied upon adoption

of HKFRS 9 is consistent with that specified in the Basel regulatory capital rules.

The Group assesses whether there is evidence that a financial asset or a group of financial assets is impaired at each balance sheet date. The Group carries out regular and systematic reviews of all credit facilities extended to customers. The criteria that the Group uses to determine whether there is evidence of an impairment loss include:

- Significant financial difficulty of the issuer or obligor, including breach of covenants and/or financial conditions.
- A breach of contract, such as a default or delinquency in interest or principal payments.
- Granting of a concession to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, that the Group would not otherwise consider.
- High probability of bankruptcy or other financial reorganisation of the borrower.

In any event, all retail and wholesale exposures that are 90 days past due or more are classified under Stage 3.

A Stage 3 exposure can be upgraded to Stage 2 if there are reasonable grounds to conclude that the obligor is able to service future principal and interest payments on the credit facility in accordance with the restructured terms.

ECL Modelling- Point-in-Time and Forward-Looking Adjustments

Portfolio-specific adjustments are made to the Group's existing credit rating systems, models and processes to meet the requirements of HKFRS 9.

For the wholesale portfolios, credit risk cycle indices (CCIs) have been developed for significant industries and geographies using expected default frequencies. Expected default frequency is a market based default risk measure driven by equity prices, market volatility and leverage. CCIs are then used as inputs to convert the through-the-cycle PDs from Basel models / parameters into the point-in-time equivalents and also to incorporate forward-looking factors into the PDs. LGDs are based on historical data adjusted for latest and forecasted recovery experience. No adjustments are made to Basel EADs for stage 1 exposures. For retail portfolios, forecasted loss rates based on adjustments to historical loss experience, informed by management's forecast on relevant macroeconomic variables, such as property-price indices and unemployment rates, are used.

Expert credit judgement and post model adjustments

The measurement of ECLs requires application of expert credit judgement. Key areas of judgement include:

- The risk rating assignment and determining whether exposures should be placed on credit watchlists;
- Determination of the criteria for significant increase in credit risk;
- Establishment of groups of similar financial assets for measuring ECL;
- Forecast and the selection of macro-economic variables such as property-price indices, unemployment rates and gross

domestic product and determining its effect on the loss rates for the retail portfolio; and

- Adjustments made as part of the post-model adjustment framework (elaborated below)

The Group has in place a robust governance framework for making thematic overlays based on themes that are discussed at the Board Risk Management Committee level. The main thematic overlay relates to geo-political tensions between US and China.

As at 31 December 2018, this adjustment was approximately 9% of the Stage 1 and Stage 2 ECLs.

Policy applicable before 1 January 2018

The Group assesses at the end of each reporting period whether there is evidence that a financial asset or a group of financial assets is impaired.

Financial assets carried at amortised cost

The Group carries out regular and systematic reviews of all credit facilities extended to customers.

The criteria that the Group uses to determine whether there is evidence of an impairment loss under HKAS 39 is similar to HKFRS 9.

Impairment allowance is made when there is objective evidence of impairment as a result of the occurrence of loss events that will have an impact on the estimated future cash flows. The Group 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 Group 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.

Individual impairment allowances are assessed using the discounted cash flow method. Individual impairment allowances are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the original effective interest rate. If a financial asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

Collective impairment allowances are assessed on the basis of contractual cash flows and historical loss experience adjusted for current conditions.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the allowance is recognised in the income statement.

If, in a subsequent period, the amount of the impairment decreases and the decrease can be related objectively to an event occurring

after the impairment was recognised, the previously recognised impairment allowances are reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

When a loan is uncollectible, it is written off against the related allowances 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 reduce the amount of the allowances for loan impairment in the income statement.

Financial assets classified as available-for-sale

The Group assesses at the end of each reporting period whether there is evidence that an available-for-sale financial assets is impaired. In the case of an equity investment, a significant or prolonged decline in the fair value of security below its cost is a factor in determining whether the asset is impaired. When there is evidence of an impairment of an available-for-sale financial asset, 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 the income statement – is reclassified from the investments revaluation reserve within equity to the income statement. For equity investments, impairment losses are not reversed until they are disposed of. For impaired debt instruments that subsequently recover in value, the impairment losses are reversed through the income statement if there has been an identifiable event that led to the recovery.

(i) Goodwill

Goodwill arising from business combinations generally represents the excess of the acquisition cost over the fair value of the identifiable assets acquired and liabilities and contingent liabilities assumed on acquisition date. Goodwill is stated at cost less impairment losses and it is tested at least annually for impairment.

At the acquisition date, any goodwill acquired is allocated to each of the cash-generating units (CGU) or group of CGUs expected to benefit from the combination's synergies.

An impairment loss is recognised when the carrying amount of a CGU, or a group of CGUs, including the goodwill, exceeds the applicable recoverable amount. The recoverable amount of a CGU or CGU group is the higher of the CGU's or CGU group's fair value less cost to sell and its value-in-use. An impairment loss on goodwill is recognised in the income statement and cannot be reversed in subsequent periods.

(j) Properties and other fixed assets

Properties (including investment properties) and other fixed assets are stated at cost less accumulated depreciation and impairment losses. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets. Generally, the useful lives are as follows:

Freehold land	Not depreciated
Land	Over the remaining lease period
Buildings	Over the remaining lease period of the land on which it is situated or 50 years, whichever is shorter
Leasehold improvements	Over the lease term of the leased properties or 5 years, whichever is shorter
Furniture, fixtures and equipment	3 – 8 years

Subsequent expenditure relating to properties and other fixed assets that has already been recognised is added to the carrying amount of the asset only when it is probable that future economic benefit associated with the item can be measured reliably. Other subsequent expenditure is recognised as hire and maintenance expense in the income statement during the financial year in which it is incurred.

Property and other fixed assets are subject to an impairment review if there are events or changes in circumstances which indicate that the carrying amount may not be recoverable.

Upon disposal, the difference between the net disposal proceeds and its carrying amount is taken to the income statement.

Policy applicable before 1 July 2018

In prior years, investment properties were carried at fair value, representing estimated open market value determined by independent qualified valuers. The changes in fair value were recognised in the income statement.

In order to align with the accounting policies adopted by DBSH, which has adopted the cost model in measuring its investment properties when it prepares its consolidated financial statements, the Group has adopted a change in accounting policies to apply the cost model in measuring its investment properties from 1 July 2018. The change in measurement has resulted in a net reduction in the Group's shareholders' funds of HK\$7 million as at 1 January 2018 and a decrease in consolidated profits for the year ended 31 December 2017 by HK\$3 million, as a result of the reversal of fair value gains previously recorded.

Please refer to Note 23 for the details of properties and other fixed assets and their movements during the year.

(k) Financial liabilities

Initial recognition, classification and subsequent measurement

Financial liabilities are initially recognised at fair value. The Group generally classifies and measures its financial liabilities in accordance with the purpose for which the financial liabilities are incurred and managed. Accordingly:

- Financial liabilities are classified as financial liabilities at fair value through profit or loss if they are incurred for the purpose of repurchasing in the near term (held-for-trading), and this

may include debt securities issued and short positions in securities for the purpose of ongoing market-making, or trading. Financial liabilities at the fair value through profit or loss can also be designated by management on initial recognition (designated at fair value through profit or loss).

Realised or unrealised gains or losses on financial liabilities held for trading and financial liabilities designated at fair value through profit or loss, except interest expense, are taken to "Net trading income" in the income statement in the period they arise. Interest expense on structured investment deposits at fair value through profit or loss are also presented together with other fair value changes in "Net trading income".

With effect from 1 January 2017, the Group has early adopted the requirements under HKFRS 9 that allows for changes to the fair value of financial liabilities designated under the fair value option that are attributable to a reporting entity's own credit risk to be taken to revenue reserves through other comprehensive income. These amounts are not transferred to the income statement even when realised.

- Derivative liabilities are treated consistently with derivative assets. Please refer to Note 2(f) for the accounting policy on derivatives.
- Other financial liabilities are carried at amortised cost using the effective interest method. These comprise predominantly the Group's deposit portfolio under "Deposits and balances from customers" and "Due to banks" and those under "Other liabilities".

Please refer to Note 14 for further details on the types of financial liabilities classified and measured as above.

Determination of fair value

The fair value of financial liabilities is the price that would be paid to transfer the liability in an orderly transaction between market participants at the measurement date.

Please refer also to Note 30 for further fair value measurement disclosures.

Derecognition

A financial liability is derecognised from the statement of financial position when the obligation specified in the contract is discharged, cancelled or expired.

(l) Loan commitments, letters of credit and financial guarantees

Loan Commitments

Loan commitments are typically not financial instruments and are not recognised on statement of financial position but are disclosed as off-balance sheet in accordance with HKAS 37. They form part of the disclosures in Note 33. Upon a loan draw-down, the amount of the loan is accounted for at amortised cost as described in Note 2(f).

Letters of Credit

Letters of credit are recorded off-balance sheet as contingent liabilities upon issuance, and the corresponding payables to the beneficiaries and receivables from the applicants are recognised on-balance sheet upon acceptance of the underlying documents.

Financial Guarantees

A financial guarantee is initially recognised in the financial statements at fair value on the date the guarantee is given. Financial guarantees are subsequently measured at the higher of:

- The amount of the ECL (note 2 (h)); and
- The unamortised portion of the fees that were received on initial recognition. The fee is recognised over time as income in accordance with the principles in Note 2(e).

Off-balance sheet credit exposures are managed for credit risk in the same manner as financial assets.

(m) Provisions

Provisions are recognised when:

- the Group has a present legal or constructive obligation as a result of past events;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate of the amount of the obligation can be made.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

(n) Share capital

Ordinary shares, and preference shares which do not result in the Group having a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the Group, are classified as equity. Incremental external costs directly attributable to the issuance of these instruments are accounted for as a deduction from equity.

Interim dividends are recorded during the financial year in which they are declared payable. Final dividends are recorded during the financial year in which the dividends are approved by the shareholders at the Annual General Meeting.

Other Specific Topics

(o) Hedging and hedge accounting

The Group uses derivative instruments mainly as part of its risk management strategies for hedging interest rate risk arising from maturity mismatches or for hedging currency risk arising from currency mismatches and cash flows in foreign currencies. Non-derivative assets and liabilities can also be designated as hedging instruments to hedge foreign currency exposure to avoid an accounting mismatch.

Hedge accounting

HKFRS 9 introduces a principles-based approach for hedge accounting and requires a linkage between risk management objectives and hedge accounting. The application of hedge accounting under HKFRS 9 is described in the subsequent paragraphs.

At the inception of each hedging relationship, the Group documents the relationship between the hedging instrument and the hedged item; the risk management objective for undertaking the hedge transaction; and the methods used to assess the effectiveness of the hedge. At inception and on an on-going basis, the Group also documents and assesses the economic relationship between the hedging instrument and the hedged item. When required and for the purpose of maintaining a hedge ratio that complies with the hedge effectiveness requirements, the Group rebalances the hedge ratio by adjusting either the notional amount of hedging instrument or the notional amounts of hedged items.

Fair value hedge

The Group's fair value hedges consist principally of interest rate swaps used for managing the interest rate gaps that naturally arise from its purchases or issues of debt securities, and where a mismatch in the measurement between the hedging derivative and the hedged item exists.

For a qualifying fair value hedge, the changes in the fair value of the hedging derivative are recorded in the income statement, together with any changes in the fair value of the hedged item attributable to the hedged risk. Gain or loss arising from hedge ineffectiveness is recognised in the income statement under "Net trading income".

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the income statement over its remaining maturity, using the effective interest method.

Cash flow hedge

For transactions with highly probable cash flows, derivatives are used to hedge against cash flow variability due to exchange rate movements in certain situations. Cash flow hedge accounting is principally applied in such cases.

The effective portion of changes in the fair value of a derivative designated and qualifying as a cash flow hedge is recognised in other comprehensive income and accumulated under the cash flow hedge reserve in equity. This amount is reclassified to the income statements in the periods when the hedged forecast cash flows affect the income statement. The ineffective portion of the gain or loss is recognised immediately in the income statement under "Net trading income".

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 the cash flow hedge reserve remains until the forecast transaction is recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss in the cash flow hedge reserve is reclassified from equity to the income statement.

Economic hedges which do not qualify for hedge accounting

Some derivatives may be transacted as economic hedges as part of the Group's risk management but do not qualify for hedge accounting under HKFRS 9. This includes swaps and other derivatives (e.g. futures and options) that the Group transacts to manage interest rate, foreign exchange and other risks. Such derivatives are treated in the same way as derivative held for trading purposes, i.e. realised and unrealised gains and losses are recognised in "Net trading income". In some cases, the hedged exposures are designated at fair value through profit or loss, thereby achieving some measure of offset in the income statement.

Please refer to Note 32 for disclosures on hedging derivatives.

(p) Employee benefits

Employee benefits, which include base pay, cash bonuses, share-based compensation, contribution to defined contribution plans and other staff related allowances, are recognised in the income statement when incurred. For defined contribution plans, contributions are made to publicly or privately administered funds on a mandatory, contractual or voluntary basis. Once the contributions have been paid, the Group has no further payment obligations.

Employee entitlement to annual leave is recognised when they accrue to employees. A provision is made for the estimated liability for annual unutilised leave as a result of services rendered by employees up to the end of the reporting period.

(q) Share-based compensation

Employee benefits also include share-based compensation, namely, the DBSH Share Option Plan, the DBSH Share Plan and the DBSH Employee Share Plan run by DBSH, the ultimate holding company of the Bank. The details of the Plans are described in Note 40.

These share-based compensation expenses, which are measured at their fair values at grant date, are cash-settled with DBSH, amortised and recognised in the income statement over the relevant vesting periods. Non-market vesting conditions are taken into account in determining the number of shares to be granted or number of options that are expected to become exercisable on vesting dates. The impact of subsequent revision of original estimates, if any, is recognised in the income statement.

(r) Current and deferred taxes

Current income tax for current and prior periods is recognised as the amount expected to be paid or recovered from the tax authorities, using the tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period. The Group considers uncertain tax positions generally at the level of the total tax liability to each tax authority for each period. The liability is determined based on the total amount of current tax expected to be paid, taking into account all tax uncertainties, using either an expected value approach or a single best estimate of the most likely outcome.

Tax assets and liabilities of the same type (current or deferred) are offset when a legal right of offset exists and settlement in this manner is intended. This applies generally when they arise from the same tax reporting group and relate to the same tax authority.

Deferred income tax is provided on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted by the end of the reporting period.

The amount of deferred tax assets recognised takes into account the likelihood the amount that can be used to offset payables taxes for future profits.

Deferred tax related to fair value re-measurement of available-for-sale investments, which are recognised outside the income statement, is also recognised outside the income statement i.e. in other comprehensive income and accumulated in the FVOCI reserve.

(s) Leases**(i) Finance leases**

Leases where substantially all the risks and rewards of ownership are transferred to the Group are accounted for as finance leases. Finance leases are capitalised at the commencement of the leases at the lower of the fair values of the leased assets and the present values of the minimum lease payments. The Group's interests in leasehold land are accounted for as finance leases.

Where the Group is a lessor under finance leases and hire purchase transactions, the amounts due under the leases, net of unearned finance income, are recognised as receivables and included in "Loans and advances to customers". Finance income implicit in rentals receivable is credited to the income statement over the lease period so as to produce an approximately constant periodic rate of return on the net investments outstanding for each financial period.

(ii) Operating leases

Leases where substantially all the risks and rewards of ownership of assets remain with the lessor are accounted for as operating leases. Operating leases are charged to the income statement on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment that has to be made to the lessor is recognised as an expense in the period the termination takes place.

Where the Group is a lessor under operating leases, rentals receivable under operating leases is credited to the income statement on a straight-line basis over the lease term.

3 CRITICAL ACCOUNTING ESTIMATES

The Group's accounting policies and use of estimates are integral to the reported results. Certain accounting estimates require management's judgement in determining the appropriate methodology for valuation of assets and liabilities. Procedures are in place to ensure that methodologies are reviewed and revised as appropriate. The Group believes its estimates for determining the valuation of its assets and liabilities are appropriate.

The following is a brief description of the Group's critical accounting estimates that involve management's valuation judgement.

(a) Impairment of financial assets

It is the Group's policy to recognise, through charges against profit, allowances in respect of estimated and inherent credit losses in its portfolio as described in Note 2(h).

The Group applied the impairment requirements under HKFRS 9 for financial year ended 2018, resulting in changes in assumptions used in the computation of impairment allowances using the ECL model. The numbers in the comparative period have not been restated.

ECLs are probability-weighted amounts determined by evaluating a range of possible outcomes and taking into account past events, current conditions and assessments of future economic conditions, which will necessarily involve the use of judgement.

In estimating specific allowances under HKFRS 9, the Group assesses the gap between borrowers' obligations to the Group and their repayment ability. The assessment takes into account various factors, including the economic or business outlook, the future profitability of the borrowers and the liquidation value of collateral. Such assessment requires considerable judgement.

The general allowances under HKFRS 9 are determined after taking into account historical data and management's assessment of the current economic and credit environment, country and portfolio risks, as well as industry practices.

(b) Fair value of financial instruments

The majority of the Group's financial instruments reported at fair value are based on quoted and observable market prices or on internally developed models that are based on independently sourced market parameters.

The fair value of financial instruments without an observable market price in a liquid market may be determined using valuation models. The choice of model requires significant judgement for complex products.

Policies and procedures have been established to facilitate the exercise of judgement in determining the risk characteristics of various financial instruments, discount rates, estimates of future cash flows and other factors used in the valuation process.

Please refer to Note 30 for details on valuation process and the fair value hierarchy of the Group's financial instruments measured at fair value.

(c) Goodwill impairment

The Group performs an impairment review to ensure that the carrying amount of the CGU to which goodwill is allocated, does not exceed the recoverable amount of the CGU. Note 22 provides details of goodwill as of the reporting date.

The recoverable amount represents the present value of the estimated future cash flows expected to arise from continuing operations. Therefore, in arriving at the recoverable amount, management exercises judgement in estimating the future cash flows, growth rate and discount rate.

(d) Income taxes

Judgement is involved in determining the group-wide provision for income taxes. The Group recognises liabilities for expected tax issues based on reasonable estimates of whether additional taxes will be due. Note 27 provides details of the Group's deferred tax assets / liabilities.

4 NET INTEREST INCOME

In HK\$ millions	2018	2017
Interest income from investment securities	751	515
Other interest income	10,367	7,116
Total interest income	11,118	7,631
Interest expense on subordinated liability (Note 28)	(162)	(155)
Other interest expense	(3,099)	(1,545)
Total interest expense	(3,261)	(1,700)
Net interest income	7,857	5,931
Comprising:		
Interest income from financial assets at FVPL	196	97
Interest income from financial assets at FVOCI (2017: AFS)	311	370
Interest income from financial assets at amortised cost	10,611	7,164
Interest expense from financial liabilities at FVPL	(156)	(69)
Interest expense from financial liabilities not at FVPL	(3,105)	(1,631)
Total	7,857	5,931

5 NET FEE AND COMMISSION INCOME

In HK\$ millions	2018	2017
Fee and commission income	3,565	3,075
Less: Fee and commission expense	(615)	(488)
Net fee and commission income	2,950	2,587
Comprising:		
– Wealth management ^(a)	1,328	1,119
– Trade and transaction services ^(b)	853	567
– Loan related	225	324
– Cards	331	331
– Stockbroking	62	65
– Others	151	181
Total net fee and commission income	2,950	2,587

(a) Includes HK\$156 million (2017: HK\$120 million) wealth management income that would have been previously classified as other non-interest income. The amount represents fees earned from wealth management treasury products sold on open investment architecture platforms. The change in classification was applied prospectively from 1 April 2017.

(b) Includes trade & remittances, guarantees, deposit-related fees and investment banking.

Of which:

Fee and commission income arising from:

– Financial assets or financial liabilities not at fair value through profit or loss	1,224	1,227
– Trust or other fiduciary activities	35	35

Fee and commission expense arising from:

– Financial assets or financial liabilities not at fair value through profit or loss	490	363
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6 NET TRADING INCOME

In HK\$ millions	2018	2017
Net trading income ^(a)		
– Foreign exchange	560	729
– Interest rates, equities and others	22	59
	582	788
Net loss from financial instruments designated at fair value through profit or loss	(54)	(65)
	528	723

(a) Includes income from assets that are mandatorily classified at FVPL as they are not SPPI in nature

7 NET INCOME FROM INVESTMENT SECURITIES

In HK\$ millions	2018	2017
Debt securities at FVOCI (2017: AFS)	(1)	9
Equity securities at FVOCI (2017: AFS)	23	22
	22	31
Of which dividend income from:		
– Listed investments	–	–
– Unlisted investments	23	22
	23	22

8 OTHER INCOME

In HK\$ millions	2018	2017
Rental income	35	40
Net gain on disposal of asset held for sale and fixed assets	488	–
Others	44	41
	567	81

9 TOTAL EXPENSES

In HK\$ millions	2018	2017
Employee benefits		
– Salaries and other short term employee benefits	2,756	2,498
– Pensions	154	140
– Share-based compensation	51	53
Premises and equipment expenses excluding depreciation		
– Rental of premises	348	308
– Others	238	181
Depreciation (Note 23(a))	272	277
Auditor's remuneration	10	9
Computerisation expenses	494	513
Other operating expenses	992	717
	5,315	4,696

10 ALLOWANCES FOR CREDIT AND OTHER LOSSES

In HK\$ millions	2018	2017
Loans and advances to customers	597	(9)
Off-balance sheet credit exposures	(14)	–
Other assets	(16)	(25)
Total	567	(34)

The table below shows the movements in specific and general allowances during the year for the Group.

In HK\$ millions	Balance at 1 January	Charge/ (Write-back) to income statement	Recoveries	Write-off	Exchange and other movements	Balance at 31 December
2018						
Specific allowances^(a)						
Loans and advances to customers (Note 19)	995	452	67	(445)	38	1,107
Others	206	(16)	–	(65)	–	125
Total specific allowances	1,201	436	67	(510)	38	1,232
General allowances^(a)						
Loans and advances to customers (Note 19)	1,046	145	–	–	–	1,191
Others ^(b)	122	(14)	–	–	–	108
Total general allowances	1,168	131	–	–	–	1,299
Total allowances for credit and other losses	2,369	567	67	(510)	38	2,531
2017						
Individual impairment allowances						
Loans and advances to customers (Note 19)	1,214	(255)	31	(160)	(1)	829
Others	316	(25)	–	(85)	–	206
Total individual impairment allowances	1,530	(280)	31	(245)	(1)	1,035
Collective impairment allowances loans and advances to customers	803	246	53	(315)	50	837
Total allowances for credit and other losses	2,333	(34)	84	(560)	49	1,872

(a) The opening balance for the specific and general allowances measured comprised Stage 1 to Stage 3 ECL following the adoption of HKFRS 9, with no restatement to prior period presentation. Refer to Note 2(b) for information on the adoption of HKFRS 9.

(b) Include general allowances for other assets and off balance sheet exposures.

The following table explains the changes in ECL allowances under HKFRS 9 in 2018. Movement items include the following:

- Model changes, which generally comprise the impact of significant changes to the quantitative models used to estimate expected credit losses, and any staging impacts that may arise.
- Transfers between stages, which are presumed to occur before any corresponding remeasurements of the allowance.
- Originations and purchases, which reflect the allowance related to instruments that were newly recognized during the year.
- Derecognitions which reflect the allowance related to instruments derecognised (e.g. matured or sold) during the year.
- Remeasurements which comprise the impact of changes in model inputs or assumptions, partial repayments, additional drawdowns on existing facilities and changes in the measurement following a transfer between stages.

In HK\$ millions	General allowances (Non-impaired)		Specific allowances (Impaired)	Total
	Stage 1	Stage 2	Stage 3	
2018				
Balance at 1 January	513	655	1,201	2,369
Allowance for credit and other losses				
Transfer to (from)	125	(146)	21	–
– Stage 1	(15)	14	1	–
– Stage 2	144	(147)	3	–
– Stage 3	(4)	(13)	17	–
Net portfolio change	41	(59)	–	(18)
Remeasurements	(103)	354	415	666
Model refinements ^(a)	(114)	33	–	(81)
Net write-offs ^(b)	–	–	(443)	(443)
Exchange and other movements	–	–	38	38
Balance at 31 December	462	837	1,232	2,531
Charge/(release) in the income statement	(51)	182	436	567

(a) The retail methodology was refined during the year to replace Basel models with actual historical losses and forecasted losses based on adjustments to historical losses, adjusted by macroeconomic forecasts. No other significant model refinements were made.

(b) Write-offs are net of recoveries.

There were no significant modifications of financial assets during the period.

The following table provides additional information on the financial instruments that are subject to loss allowances as at 31 December 2018. FVPL assets and FVOCI equity instruments are not subject to loss allowances and therefore not reflected in the table.

In HK\$ millions	Gross carrying value				ECL allowances balances			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
2018								
Assets								
Cash and balances with central banks	3,028	–	–	3,028	–	–	–	–
Government securities and treasury bills ¹	27,220	–	–	27,220	–	–	–	–
Due from banks	222,059	–	–	222,059	2	–	–	2
Bank and corporate securities ¹	8,218	–	–	8,218	1	–	–	1
Loans and advances to customers	144,136	17,828	2,505	164,469	391	800	1,107	2,298
Other assets	1,993	–	136	2,129	4	–	125	129
Liabilities								
ECL allowances on guarantees and other off-balance sheet exposures	–	–	–	–	64	37	–	101
Total	406,654	17,828	2,641	427,123	462	837	1,232	2,531

Notes:

1 Includes loss allowances of HK\$1 million for debt securities that are classified at FVOCI

11 BENEFITS AND INTERESTS OF DIRECTORS

(a) Directors' emoluments

The aggregate amounts of emoluments paid or payable to directors of the Bank during the year are as follows:

In HK\$ millions	2018	2017
Fees ^(a)	5	3
Salaries, housing and other allowances and benefits ^(b)	25	23
Contributions paid under a retirement benefit scheme	1	1
	31	27

(a) The directors' fees, if any, are payable in 2019 to eligible persons who acted as directors of the Bank during the year ended 31 December 2018. Such fees are subject to the approval of the shareholders of the Bank.

(b) The amount included cash bonus accrued during the year, to be paid in the following year. Such cash bonus is subject to the approval of DBSH's Board of Directors. The amount also included the estimated money value of other perquisites.

During the year, no termination benefits were paid by the Bank to any of the Bank's directors.

During the year, the Bank did not incur any payment to third parties for making available directors' services.

(b) Directors' material interests in transactions, arrangements and contracts

In 2015, the Bank granted a four-year tenor banking facility ("Facility") of HK\$1,300 million to Great Maker Limited, in which Sino Land Company Limited ("Sino Land") has 30% indirect shareholding interest, in the ordinary course of business and on normal commercial terms. Sino Land granted in favour of the Bank a 30% pro-rated and several corporate guarantees for the Facility. Mr. Ng Chee Siong, Robert is interested in the Facility as he is the chairman and a substantial shareholder of Sino Land. Mr. Ng resigned as an independent non-executive director of the Bank with effect from 29 June 2018.

No other transaction, arrangement and contracts of significance in relation to the Bank's business, to which the Bank or any of its subsidiaries or its holding companies or any subsidiary of its holding companies was a party and in which a director of the Bank or the director's connected party had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

12 INCOME TAX EXPENSE

(a) Income tax expense in the consolidated income statement is comprised of:

In HK\$ millions	2018	2017
Hong Kong profits tax		
– Current year	949	790
– (Over)/under provision in prior years	(8)	5
Overseas tax		
– Current year	5	11
– Under provision in prior years	–	3
Current income tax	946	809
Deferred income tax (Note 27(b))	(32)	(8)
	914	801

Hong Kong profits tax has been provided at 16.5% (2017: 16.5%) on the estimated assessable profits for the year. Taxation for overseas subsidiaries and branch are charged at the appropriate current rates of taxation ruling in the countries in which they operate.

(b) The deferred income tax (credited) / charged to the consolidated income statement comprises the following temporary differences:

In HK\$ millions	2018	2017
Accelerated depreciation allowances	17	(5)
Impairment allowances	(23)	(4)
Share-based compensation	–	1
Accrued expenses	(26)	–
	(32)	(8)

(c) The tax on the Group's profit before income tax differs from the theoretical amount that would arise using the Hong Kong profits tax rate of 16.5% (2017: 16.5%) is as follows:

In HK\$ millions	2018	2017
Profit before income tax	6,042	4,691
Tax calculated at tax rate of 16.5% (2017: 16.5%)	997	775
Effect of different tax rates in other countries	(2)	(2)
Income not subject to tax	(138)	(5)
Expenses not deductible for tax purposes	65	20
(Over)/under provision in prior years	(8)	8
Others	–	5
Income tax expense	914	801

13 DIVIDEND

(a) Ordinary shares

	2018		2017	
	Per share HK\$	HK\$ millions	Per share HK\$	HK\$ millions
First interim dividend	0.286	2,000	–	–
Second interim dividend	0.286	2,000	–	–
Final dividend	–	–	0.214	1,500
	0.572	4,000	0.214	1,500

In 2017, the final dividend proposed after the end of the reporting period was not reflected as a dividend payable in the financial statements and was reflected as an appropriation of retained earnings of next financial year.

(b) Preference shares

Preferential dividend of HK\$55 million (2017: HK\$23 million) was paid to holder of Class A preference shares during the year.

14 CLASSIFICATION OF FINANCIAL INSTRUMENTS

In HK\$ millions	Mandatorily at FVPL ^(a)	FVPL designated	FVOCI-Debt	FVOCI-Equity	Amortised cost	Hedging derivatives	Total
2018							
Assets							
Cash and balances with central banks	–	–	–	–	3,028	–	3,028
Government securities and treasury bills	11,069	–	21,348	–	5,872	–	38,289
Due from banks	–	–	–	–	222,057	–	222,057
Derivatives	434	–	–	–	–	37	471
Bank and corporate securities	1,092	–	2,367	109	5,850	–	9,418
Loans and advances to customers	–	–	–	–	162,171	–	162,171
Other financial assets	–	–	–	–	7,740	–	7,740
Total financial assets	12,595	–	23,715	109	406,718	37	443,174
Non-financial assets ^(a)	–	–	–	–	–	–	2,487
Total assets							445,661
Liabilities							
Due to banks	–	–	–	–	9,880	–	9,880
Deposits and balances from customers	–	4,185	–	–	359,473	–	363,658
Derivatives	741	–	–	–	–	99	840
Certificates of deposit issued	–	–	–	–	5,558	–	5,558
Other financial liabilities	2,793	–	–	–	20,303	–	23,096
Subordinated liability	–	–	–	–	4,229	–	4,229
Total financial liabilities	3,534	4,185	–	–	399,443	99	407,261
Non-financial liabilities ^(b)	–	–	–	–	–	–	448
Total liabilities							407,709

(a) Includes goodwill, properties and other assets, current tax assets and deferred tax assets

(b) Includes current tax and deferred tax liabilities

(c) Assets and liabilities are mandatorily classified as FVPL when they are held for trading. In addition, debt-type financial assets that are not SPPI in nature are mandatorily classified as FVPL

In HK\$ millions	Held for trading	FVPL designated	Available-for-sale	Loans and receivables / amortised cost	Hedging derivatives	Total
2017						
Assets						
Cash and balances with central banks	–	–	–	2,911	–	2,911
Government securities and treasury bills	5,561	–	14,550	–	–	20,111
Due from banks	–	–	–	200,726	–	200,726
Derivatives	1,108	–	–	–	80	1,188
Bank and corporate securities	2	–	9,943	1,150	–	11,095
Loans and advances to customers	–	–	–	154,175	–	154,175
Other financial assets	–	–	–	5,319	–	5,319
Total financial assets	6,671	–	24,493	364,281	80	395,525
Non-financial assets ^(a)	–	–	–	–	–	2,299
Total assets						397,824
Liabilities						
Due to banks	–	–	–	7,666	–	7,666
Deposits and balances from customers	–	1,911	–	325,572	–	327,483
Derivatives	883	–	–	–	–	883
Certificates of deposit issued	–	–	–	4,189	–	4,189
Other financial liabilities	4,395	–	–	9,491	–	13,886
Subordinated liability	–	–	–	4,220	–	4,220
Total financial liabilities	5,278	1,911	–	351,138	–	358,327
Non-financial liabilities ^(b)	–	–	–	–	–	603
Total liabilities						358,930

(a) Includes goodwill, properties and other assets, asset held for sale, current tax assets and deferred tax assets

(b) Includes current tax liabilities

15 CASH AND BALANCES WITH CENTRAL BANKS

In HK\$ millions	2018	2017
Cash in hand	636	547
Balances with central banks	2,392	2,364
	3,028	2,911

16 GOVERNMENT SECURITIES AND TREASURY BILLS

In HK\$ millions	Mandatorily at FVPL	FVOCI	Amortised cost	Total
2018				
Treasury bills	10,394	13,362	–	23,756
Other debt securities	675	7,986	5,872	14,533
	11,069	21,348	5,872	38,289
Of which:				
– listed in Hong Kong, at fair value	673	600	–	1,273
– listed outside Hong Kong, at fair value	–	552	–	552
– listed outside Hong Kong, at cost	–	–	5,872	5,872
– unlisted, at fair value	10,396	20,196	–	30,592
	11,069	21,348	5,872	38,289
Analysed by issuer as follows:				
– Sovereigns	11,069	21,348	5,872	38,289
Analysed by rating agency designation as follows:				
– AAA	–	6,817	–	6,817
– AA- to AA+	11,067	13,961	–	25,028
– A- to A+	2	570	5,872	6,444
	11,069	21,348	5,872	38,289

In HK\$ millions	Held for trading	Available-for-sale	Loans and receivables	Total
2017				
Treasury bills	4,956	9,447	–	14,403
Other debt securities	605	5,103	–	5,708
	5,561	14,550	–	20,111
Of which:				
– listed in Hong Kong, at fair value	603	511	–	1,114
– listed outside Hong Kong, at fair value	–	603	–	603
– unlisted, at fair value	4,958	13,436	–	18,394
	5,561	14,550	–	20,111
Analysed by issuer as follows:				
– Sovereigns	5,561	14,550	–	20,111
Analysed by rating agency designation as follows:				
– AAA	–	4,591	–	4,591
– AA- to AA+	5,387	9,949	–	15,336
– A- to A+	174	10	–	184
	5,561	14,550	–	20,111

The ratings refer to Standard & Poor's ratings (or their equivalent) to the respective issues of the securities, while in the absence of such issue ratings, ratings designated for the issuers or location of incorporation of the issuers are reported.

As at 31 December 2018, the fair value of the above debt securities classified as amortised cost/loans and receivables is HK\$5,927 million (2017: nil).

As at 31 December 2018 and 2017, there were no impaired, overdue, or rescheduled fair value through other comprehensive income/available-for-sale financial assets.

17 DUE FROM BANKS

In HK\$ millions	2018	2017
Balances with banks	4,352	5,770
Placements with and advances to banks		
Remaining maturity		
– Within one month	64,307	79,881
– One year or less but over one month	40,502	45,508
– Over one year and others	112,898	69,567
	217,707	194,956
Gross amount due from banks	222,059	200,726
Allowance for credit and other losses	(2)	–
Net amount due from banks	222,057	200,726

As at 31 December 2018 and 2017, there were no impaired, overdue or rescheduled placements with and advances to banks.

18 BANK AND CORPORATE SECURITIES

In HK\$ millions	Mandatorily at FVPL	FVOCI	Amortised cost	Total
2018				
Debt securities	1,092	2,367	5,851	9,310
Equity securities	–	109	–	109
	1,092	2,476	5,851	9,419
Allowance for credit and other losses	–	–	(1)	(1)
	1,092	2,476	5,850	9,418
Of which:				
Debt securities				
– Listed in Hong Kong, at fair value	1	445	–	446
– Listed outside Hong Kong, at fair value	–	1,707	–	1,707
– Listed outside Hong Kong, at cost	–	–	1,849	1,849
– Unlisted, at fair value	1,091	215	–	1,306
– Unlisted, at cost	–	–	4,001	4,001
	1,092	2,367	5,850	9,309
Equity securities				
– Unlisted, at fair value	–	109	–	109
	1,092	2,476	5,850	9,418

In HK\$ millions	Mandatorily at FVPL	FVOCI	Amortised cost	Total
2018				
Analysed by issuer as follows:				
– Banks	1,090	2,339	5,850	9,279
– Corporates	2	109	–	111
– Others	–	28	–	28
	1,092	2,476	5,850	9,418
Debt securities analysed by rating agency designation as follows:				
– AAA	–	1,397	5,850	7,247
– A- to A+	1,090	942	–	2,032
– BBB- to BBB+	2	–	–	2
– Unrated	–	28	–	28
	1,092	2,367	5,850	9,309
2017				
Debt securities	2	9,914	1,150	11,066
Equity securities	–	29	–	29
	2	9,943	1,150	11,095
Of which:				
Debt securities				
– Listed in Hong Kong, at fair value	1	444	–	445
– Listed outside Hong Kong, at fair value	–	4,683	–	4,683
– Listed outside Hong Kong, at cost	–	–	–	–
– Unlisted, at fair value	1	4,787	–	4,788
– Unlisted, at cost	–	–	1,150	1,150
	2	9,914	1,150	11,066
Equity securities				
– Unlisted, at cost	–	29	–	29
	–	29	–	29
	2	9,943	1,150	11,095
Analysed by issuer as follows:				
– Banks	–	9,903	1,150	11,053
– Corporates	2	29	–	31
– Others	–	11	–	11
	2	9,943	1,150	11,095

Debt securities analysed by rating agency designation as follows:

In HK\$ millions	Held for trading	Available- for-sale	Loans and receivables	Total
– AAA	–	8,961	–	8,961
– A- to A+	–	942	1,150	2,092
– BBB- to BBB+	2	–	–	2
– Unrated	–	11	–	11
	2	9,914	1,150	11,066

The ratings refer to Standard & Poor's ratings (or their equivalent) to the respective issues of the securities, while in the absence of such issue ratings, ratings designated for the issuers are reported.

As at 31 December 2018, the fair value of the above debt securities classified as amortised cost/loans and receivables is HK\$5,797 million (2017: HK\$1,150 million).

As at 31 December 2018 and 2017, there were no impaired, overdue or rescheduled FVOCI/AFS and amortised cost/loans and receivables financial assets.

19 LOANS AND ADVANCES TO CUSTOMERS

In HK\$ millions	2018	2017
Gross loans and advances to customers	164,469	155,841
Allowance for credit and other losses		
– Specific allowances	(1,107)	–
– General allowances	(1,191)	–
– Individually assessed	–	(829)
– Collectively assessed	–	(837)
	162,171	154,175
Comprising:		
– Trade bills	10,482	6,874
– Loans	151,689	147,301
	162,171	154,175

Loans and advances to customers include finance leases and hire purchase contracts receivables and are analysed as follows:

In HK\$ millions	2018	2017
Gross investments in finance leases and hire purchase contracts receivables:		
– Not later than one year	433	517
– Later than one year and not later than five years	1,593	1,765
– Later than five years	6,806	7,106
	8,832	9,388
Unearned future finance income	(8)	(4)
Net investments in finance leases and hire purchase contracts receivables	8,824	9,384
The net investments in finance leases and hire purchase contracts receivables are analysed as follows:		
– Not later than one year	429	515
– Later than one year and not later than five years	1,588	1,763
– Later than five years	6,807	7,106
	8,824	9,384

The unguaranteed residual values included in the gross investments in finance leases and hire purchase contracts receivables as at 31 December 2018 and 2017 are not material.

The individual impairment allowances for finance leases and hire purchase contracts receivables amounted to HK\$1 million as at 31 December 2018 (2017: HK\$1 million).

20 OTHER ASSETS

In HK\$ millions	2018	2017
Accrued interest receivables	1,729	730
Acceptances	1,993	2,294
Deferred tax assets (Note 27(b))	153	45
Cash collateral placed	105	195
Asset held for sale ^(a)	–	107
Others	4,042	2,306
	8,022	5,677
Allowance for credit and other losses	(129)	(206)
	7,893	5,471

(a) No accumulated loss was recognised directly in equity relating to the asset held for sale. The asset was sold in 2018 with a disposal gain of HK\$484 million.

21 SUBSIDIARIES

The main operating subsidiary of the Group, which is wholly and directly owned by the Bank, is listed below:

Name of company	Place of incorporation	Place of operation	Particulars of issued share capital	Principal activities
Ting Hong Nominees Limited	Hong Kong	Hong Kong	10,000 shares	Provision of nominee, trustee and agency services

22 GOODWILL

As at 31 December 2018, the carrying value of the Group's goodwill arising from acquisition of subsidiaries is allocated to the Group's cash-generating units (CGUs) or groups of CGUs as follows:

In HK\$ millions	2018	2017
Goodwill	168	168

The carrying values of the CGUs are reviewed at least once a year to determine if the goodwill associated with them should be impaired. If a CGU's carrying value exceeds its recoverable value, a goodwill impairment charge is recognised in the income statement.

The recoverable value is determined based on a value-in-use calculation. The CGU's five-year projected cash flows, taking into account projected regulatory capital requirements, are discounted by its cost of capital to derive their present value. To derive the value beyond the fifth year, a long-term growth rate is imputed to the fifth-year cash flow and then discounted by the cost of capital to derive the terminal value. The long-term growth rate used does not exceed the historical long-term growth rate of the market the CGU operates in. The recoverable value is the sum of the present value of the five-year cash flows and the terminal value.

A growth rate of 4.5% (2017: 4.5%) and discount rate of 9.0% (2017: 9.0%) were assumed in the value-in-use calculation.

The process of evaluating goodwill impairment involves management judgement and prudent estimates of various factors including future cash flows as well as the cost of capital and long-term growth rates. The results can be highly sensitive to the assumptions used. Management believes that any reasonably possible change in the key assumptions would not cause the carrying amount of the operating unit to exceed its recoverable amount at 31 December 2018. However, if conditions in Hong Kong and the banking industry deteriorate and turn out to be significantly worse than anticipated in the Group's performance forecast, the goodwill may be impaired in future periods.

23 PROPERTIES AND OTHER FIXED ASSETS**(a) Properties and other fixed assets movements**

In HK\$ millions	Freehold land and building	Land and buildings	Furniture, fixtures and equipment	Subtotal	Investment properties	Total
Cost						
As at 1 January 2018	23	2,361	1,707	4,091	8	4,099
Impact of change of measurement model of investment properties ^(a)	–	–	–	–	(6)	(6)
As at 1 January 2018, as restated	23	2,361	1,707	4,091	2	4,093
Additions	–	17	442	459	–	459
Disposals	–	(1)	(15)	(16)	–	(16)
Transfers	–	(31)	–	(31)	31	–
As at 31 December 2018	23	2,346	2,134	4,503	33	4,536
Accumulated depreciation and impairment						
As at 1 January 2018, as previously reported	17	928	1,168	2,113	–	2,113
Impact of change of measurement model of investment properties ^(a)	–	–	–	–	1	1
As at 1 January 2018, as restated	17	928	1,168	2,113	1	2,114
Charge for the year (Note 9)	–	53	219	272	–	272
Disposals	–	(1)	(15)	(16)	–	(16)
Transfers	–	(19)	–	(19)	19	–
As at 31 December 2018	17	961	1,372	2,350	20	2,370
Net book value						
As at 31 December 2018	6	1,385	762	2,153	13	2,166

(a) The measurement model of investment properties has been changed from fair value to cost. Please refer to note 2(j) for details.

In HK\$ millions	Freehold land and building	Land and buildings	Furniture, fixtures and equipment	Subtotal	Investment properties	Total
Cost						
As at 1 January 2017	23	2,533	1,545	4,101	5	4,106
Impact of change in measurement model of investment properties ^(a)	–	–	–	–	(3)	(3)
As at 1 January 2017, as restated	23	2,533	1,545	4,101	2	4,103
Additions	–	10	197	207	–	207
Disposals	–	(7)	(35)	(42)	–	(42)
Transfer to asset held for sale	–	(175)	–	(175)	–	(175)
As at 31 December 2017	23	2,361	1,707	4,091	2	4,093
Accumulated depreciation and impairment						
As at 1 January 2017 as previously reported	17	947	976	1,940	–	1,940
Impact of change in measurement model of investment properties ^(a)	–	–	–	–	1	1
As at 1 January 2017, as restated	17	947	976	1,940	1	1,941
Charge for the year (Note 9)	–	56	221	277	–	277
Disposals	–	(7)	(29)	(36)	–	(36)
Transfer to asset held for sale	–	(68)	–	(68)	–	(68)
As at 31 December 2017	17	928	1,168	2,113	1	2,114
Net book value						
As at 31 December 2017	6	1,433	539	1,978	1	1,979

(a) The measurement model of investment properties has been changed from fair value to cost. Please refer to note 2(j) for details.

The total market value of all properties as at 31 December 2018 was \$9,000 million (2017: \$8,121 million), of which investment properties accounted for \$332 million (2017: \$8 million). The market values are determined using investment method, or using a combination of comparable sales and investment methods. The properties are classified under Level 3 of the fair value hierarchy and the significant unobservable input used for valuation is market yields. As at 31 December 2018, there were no transfers into or out of Level 3.

The Group leases out investment properties under operating leases that run for a period of three years.

The minimum lease receivables as at the balance sheet date are as follows:

In HK\$ millions	2018	2017
Minimum lease receivables		
Not later than 1 year	9	–
Later than 1 year but not later than 5 years	17	–
Total	26	–

During the year, the Group purchased furniture, fixtures and equipment of HK\$5 million from a fellow subsidiary (2017: nil).

The net book values of land and buildings and investment properties held by the Group are as follows:

In HK\$ millions	2018		2017	
	Land and buildings	Investment properties	Land and buildings	Investment properties
Freeholds				
Held outside Hong Kong	6	–	6	–
Leaseholds				
Held in Hong Kong				
– Leases of over 50 years	142	1	144	1
– Leases of between 10 to 50 years	1,241	12	1,287	–
Held outside Hong Kong				
– Leases of between 10 to 50 years	2	–	2	–
	1,385	13	1,433	1

24 DEPOSITS AND BALANCES FROM CUSTOMERS

In HK\$ millions	2018	2017
Deposits from customers, at amortised cost	359,473	325,572
Structured investment deposits classified as financial liabilities designated at FVPL ^(a)	4,185	1,911
	363,658	327,483

Analysed by:

– Demand deposits and current accounts	67,130	65,214
– Savings deposits	140,032	131,622
– Time, call and notice deposits	156,496	130,647
	363,658	327,483

(a) Changes in fair value arising from changes in credit risk are determined as the amount of change in their fair value that is not attributable to changes in market conditions that give rise to market risk. Changes in market conditions that give rise to market risk include changes in benchmark interest rate, foreign exchange rate or index of prices or rates. Changes in fair value arising from changes in credit risk are considered not significant. The carrying amount of the financial liabilities designated at fair value through profit or loss was HK\$21 million lower than the contractual amount at maturity as at 31 December 2018 (2017: HK\$7 million lower).

25 CERTIFICATES OF DEPOSIT ISSUED

In HK\$ millions	2018	2017
Certificates of deposit issued, measured at amortised cost	5,558	4,189

26 OTHER LIABILITIES

In HK\$ millions	2018	2017
Accrued interest payable	716	332
Acceptances	1,993	2,294
Current income tax liabilities (Note 27(a))	446	603
Deferred tax liabilities (Note 27(b))	2	–
Payable in respect of short sale of securities	2,793	4,395
Other liabilities and provisions ^{(a)(b)}	17,594	6,865
	23,544	14,489

(a) Included income received in advance of HK\$1,337 million (2017: HK\$1,461 million) arising from the 15-year distribution agreement with Manulife to be amortised on a straight-line basis. HK\$111 million (2017: HK\$111 million) of the income received in advance was recognised as fee income during the year.

(b) Included allowance for credit and other losses of HK\$101 million (2017: nil).

27 TAXATION**(a) Current income tax assets and liabilities**

In HK\$ millions	2018	2017
Current income tax liabilities (Note 26)		
Hong Kong profits tax payable	428	584
Overseas tax payable	18	19
	446	603

(b) Deferred income tax

In HK\$ millions	2018	2017
Included in "Other assets" (Note 20)		
– Deferred tax assets	153	45
Included in "Other liabilities" (Note 26)		
– Deferred tax liabilities	(2)	–
	151	45

The movements on the net deferred tax assets and liabilities are as follows:

In HK\$ millions	2018	2017
As at 1 January	45	49
Impact of adopting HKFRS 9 at 1 January 2018	77	–
As at 1 January, as restated	122	49
Deferred income tax charged to income statement (Note 12(a))	32	8
Deferred income tax debited to equity (Note 29(b))	(3)	(12)
As at 31 December	151	45

Deferred tax assets and liabilities are attributable to the following items:

In HK\$ millions	2018	2017
Deferred tax assets		
Impairment allowances	213	106
Share-based compensation	17	17
Accrued expenses	28	2
Revaluation of investment securities	13	16
	271	141
Deferred tax liabilities		
Impairment allowances	2	–
Accelerated depreciation allowances	113	96
Cash flow hedge investment	5	–
	120	96

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The deferred tax assets and liabilities are to be recovered and settled after one year and the following amounts, determined after appropriate offsetting, are shown in the statement of financial position:

In HK\$ millions	2018	2017
Deferred tax assets	271	141
Deferred tax liabilities	(118)	(96)
Deferred tax assets included in "Other assets"	153	45

28 SUBORDINATED LIABILITY

On 13 December 2017, the Bank repaid an existing subordinated loan of US\$540 million to its parent holding company, DBS Group Holdings Ltd. On the same date, the Bank issued a new subordinated loan ("New Loan") of the same amount to DBS Group Holdings Ltd. Interest on the New Loan is payable quarterly at USD 3-month LIBOR plus 1.62% per annum. The New Loan will mature on 13 December 2027, and is repayable on 13 December 2022 or any date thereafter. The terms require the New Loan to be written off if and when the Hong Kong Monetary Authority ("HKMA") notifies the Bank that a write-off, or a public sector injection of capital (or equivalent support), is necessary, without which the Bank would become non-viable. In addition, the lender of the New Loan is subject to the exercise of the Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority. The New Loan is qualified as Tier 2 capital of the Bank under the Banking (Capital) Rules made by the HKMA.

29 CAPITAL AND RESERVES**(a) Share capital**

	2018		2017	
	Number of shares	HK\$ millions	Number of shares	HK\$ millions
Ordinary shares				
At 1 January and 31 December	7,000 million	7,595	7,000 million	7,595
Preference shares⁽ⁱ⁾				
At 1 January and 31 December	140	1,400	140	1,400
Issued share capital at 31 December		8,995		8,995

(i) The Bank issued 140 non-cumulative Class A preference shares to its parent holding company, DBS Group Holdings Ltd, on 13 October 2016 for an aggregate issue price of HK\$1,400 million. Dividends are payable annually at the rate of 3.9% per annum at the discretion of the Bank. The preference shares are redeemable on 13 October 2021 or any date thereafter. The terms require the preference shares to be converted into ordinary shares if and when the HKMA notifies the Bank that a conversion of the instrument, or a public sector injection of capital (or equivalent support), is necessary, without which the Bank would become non-viable. In addition, the holder of the preference shares is subject to the exercise of the Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority. The preference shares qualify as Additional Tier 1 capital of the Bank under the Banking (Capital) Rules made by the HKMA.

(b) Reserves**Group**

In HK\$ millions	Capital reserves	FVOCI/AFS reserve	Cash flow hedge reserve	Property revaluation reserve	General reserve	Retained earnings	Total reserves
2018							
Balance as at 1 January 2018, as previously reported	12	(86)	–	9	2,399	27,341	29,675
Impact of merger of a commonly controlled business (Note 2(a))	–	–	–	–	–	231	231
Impact of change in measurement model of investment properties (Note 2(j))	–	–	–	–	–	(7)	(7)
	12	(86)	–	9	2,399	27,565	29,899
Impact of adopting HKFRS 9 on 1 January 2018 (Note 2(b))	–	96	–	–	–	(414)	(318)
Restated balance as at 1 January 2018	12	10	–	9	2,399	27,151	29,581
Net valuation taken to equity	–	(2)	88	–	–	–	86
Transferred to income statement	–	1	(59)	–	–	–	(58)
Deferred income tax debited to equity (Note 27(b))	–	2	(5)	–	–	–	(3)
Acquisition of a commonly controlled business	–	–	–	–	–	(222)	(222)
Profit attributable to shareholders	–	–	–	–	–	5,128	5,128
Dividend paid	–	–	–	–	–	(5,555)	(5,555)
Balance as at 31 December 2018	12	11	24	9	2,399	26,502	28,957
2017							
Balance as at 1 January 2017	12	(147)	–	9	2,399	23,867	26,140
Impact of merger of a commonly controlled business (Note 2(a))	–	–	–	–	–	235	235
Impact of change in measurement model of investment properties (Note 2(j))	–	–	–	–	–	(4)	(4)
Restated balance as at 1 January 2017	12	(147)	–	9	2,399	24,098	26,371
Net valuation taken to equity	–	82	–	–	–	–	82
Transferred to income statement	–	(9)	–	–	–	–	(9)
Deferred income tax debited to equity (Note 27(b))	–	(12)	–	–	–	–	(12)
Profit attributable to shareholders	–	–	–	–	–	3,890	3,890
Dividend paid	–	–	–	–	–	(423)	(423)
Balance as at 31 December 2017	12	(86)	–	9	2,399	27,565	29,899

Bank

In HK\$ millions	FVOCI/AFS reserve	Cash flow hedge reserve	Property revaluation reserve	General reserve	Retained earnings	Total reserves
2018						
Balance as at 1 January 2018, as previously reported	(86)	–	9	2,285	27,272	29,480
Impact of merger of a commonly controlled business (Note 2(a))	–	–	–	–	231	231
Impact of change in measurement model of investment properties (Note 2(j))	–	–	–	–	(7)	(7)
	(86)	–	9	2,285	27,496	29,704
Impact of adopting HKFRS 9 on 1 January 2018 (Note 2(b))	96	–	–	–	(414)	(318)
Restated balance as at 1 January 2018	10	–	9	2,285	27,082	29,386
Net valuation taken to equity	(2)	88	–	–	–	86
Transferred to income statement	1	(59)	–	–	–	(58)
Deferred income tax credited to equity (Note 27(b))	2	(5)	–	–	–	(3)
Consideration paid for acquiring a commonly controlled business	–	–	–	–	(222)	(222)
Profit attributable to shareholders	–	–	–	–	5,126	5,126
Dividend paid	–	–	–	–	(5,555)	(5,555)
Balance as at 31 December 2018	11	24	9	2,285	26,431	28,760
2017						
Balance as at 1 January 2017	(147)	–	9	2,285	23,788	25,935
Impact of merger of a commonly controlled business (Note 2(a))	–	–	–	–	235	235
Impact of change in measurement model of investment properties (Note 2(j))	–	–	–	–	(4)	(4)
Restated balance as at 1 January 2017	(147)	–	9	2,285	24,019	26,166
Net valuation taken to equity	82	–	–	–	–	82
Transferred to income statement	(9)	–	–	–	–	(9)
Deferred income tax debited to equity (Note 27(b))	(12)	–	–	–	–	(12)
Profit attributable to shareholders	–	–	–	–	3,900	3,900
Dividend paid	–	–	–	–	(423)	(423)
Balance as at 31 December 2017	(86)	–	9	2,285	27,496	29,704

The investment revaluation reserve represents the cumulative net change in the fair value of financial instruments classified at fair value through other comprehensive income.

Properties revaluation reserve represents the difference between the carrying amount and the fair value of the properties transferred as investment property at the date of changes.

The general reserve is comprised of transfers from the previous years' retained earnings.

As at 31 December 2018, HK\$534 million (2017: HK\$1,031 million) was earmarked as the regulatory reserve from the retained earnings. The regulatory reserve is maintained to satisfy the provisions of the Banking Ordinance for prudential supervision purposes. Movements in the reserve are made directly through retained earnings and in consultation with the HKMA.

30 FAIR VALUE OF FINANCIAL INSTRUMENTS

(a) Valuation process

The valuation processes within the Group are governed by the Valuation Policy and Supporting Standards. These policy and standards apply to financial assets and liabilities where mark-to-market or model valuation is required. The overall framework is endorsed by Group Market and Liquidity Risk Committee and Risk Executive Committee before approval by the Board Risk Management Committee.

The Valuation Policy and supporting Standards govern the revaluation of all financial assets and liabilities that are fair value measured, covering both market prices as well as model inputs. Financial assets and liabilities are marked directly using reliable and independent market prices or by using reliable and independent market parameters (as model inputs) in conjunction with a valuation model. Products with a liquid market or those traded via an exchange will fall under the former while most over-the-counter ("OTC") products will form the latter. Market parameters include interest rate yield curves, credit spreads, exchange prices, dividend yields, option volatilities and foreign exchange rates.

Valuation models go through an assurance process carried out by the Risk Management Group, independent of the model developers. This assurance process would review the underlying methodology including its logic and conceptual soundness together with the model inputs and outputs. Model assurances are conducted prior to implementation and subject to regular review or when there are significant changes arising from market or portfolio changes. Where necessary, the Group also imposes model reserves and other adjustments in determining fair value. Models are approved by the Group Market and Liquidity Risk Committee.

The majority of OTC derivatives are traded in active markets. Valuations are determined using generally accepted models (discounted cash flows, Black-Scholes model, interpolation techniques) based on quoted market prices for similar instruments or underlyings or market parameters.

A process of independent price verification ("IPV") is in place to establish the accuracy of the market parameters used when the marking is performed by the Front Office. The IPV process entails independent checks to compare traders' marks to independent sources such as broker/dealer sources or market consensus providers. The results of the IPV are reviewed by independent control functions on a monthly basis.

For illiquid financial instruments where mark-to-market is not possible, the Group will value these products using an approved valuation model. Prices and parameters used as inputs to the model or to any intermediate technique involving a transformation process must be derived using approved market reliable sources. Where possible, the inputs must be checked against multiple sources for reliability and accuracy. Reliance will be placed on the model assurance process established by Risk Management Group for assurance of valuation models as fit for purpose.

The Group uses various market accepted benchmark interest rates such as LIBOR and Swap Offer Rates to determine the fair value of the financial instruments.

Where unobservable inputs are used in these models resulting in Level 3 classification, valuation adjustments or reserves will be taken for the purpose of adjusting for uncertainty in valuations. Valuation adjustment or reserve methodologies are used to substantiate the unobservable inputs and attempt to quantify the level of uncertainty in valuations. Such methodologies are governed by the Valuation Policy and supporting Standards and require approval by the Group Market and Liquidity Risk Committee.

The main valuation adjustments and reserves are described below:

Model and Parameter Uncertainty Adjustments

Valuation uncertainties may occur during fair value measurement either due to uncertainties in the required input parameters or uncertainties in the modeling methods used in the valuation process. In such situations, adjustments may be necessary to take these factors into account.

For example, where market data such as prices or rates for an instrument are no longer observable after an extended period of time, these inputs used to value the financial instruments may no longer be relevant in the current market conditions. In such situations, adjustments may be necessary to address the pricing uncertainty arising from the use of stale market data inputs.

Credit Valuation Adjustments

Credit valuation adjustments are taken to reflect the impact on fair value of counterparty credit risk. Credit valuation adjustments are based upon the creditworthiness of the counterparties, magnitude of the current or potential exposure on the underlying transactions, netting and collateral arrangements, and the maturity of the underlying transactions.

Day 1 Profit or Loss (P&L) Reserve

In situations where the market for an instrument is not active and its fair value is established using a valuation model based on significant unobservable market parameters, Day 1 P&L reserve is utilised to defer the P&L arising from the difference between the

transaction price and the model value. A market parameter is defined as being significant when its impact on the Day 1 P&L is greater than an internally determined threshold. The Day 1 P&L reserve is released to profit or loss as the parameters become observable or the transaction closed out or amortised over the duration of the transaction. As at 31 December 2018, there was no Day 1 P&L reserve (31 December 2017: nil).

Bid Offer Adjustments

The Group often holds, at varying points in time, both long or short positions in financial instruments which are valued using mid market levels. Bid offer adjustments are then made to account for close-out costs.

(b) Fair value hierarchy

The fair value hierarchy accords the highest level to observable inputs such as unadjusted quoted prices in active markets for identical assets or liabilities and the lowest level to unobservable inputs. The fair value measurement of each financial instrument is categorised in accordance to the same level of the fair value hierarchy as the input with the lowest level that is significant to the entire measurement. If unobservable inputs are deemed as significant, the financial instrument will be categorised as Level 3.

Financial instruments that are valued using quoted prices in active markets are classified as Level 1 of the valuation hierarchy. These would include government and sovereign securities, listed equities and corporate debt securities which are actively traded. Derivatives contracts which are traded in an active exchange market are also classified as Level 1 of the valuation hierarchy.

Where fair value is determined using quoted market prices in less active markets or quoted prices for similar assets and liabilities, such instruments are generally classified as Level 2. In cases where quoted prices are generally not available, the Group will determine the fair value based on valuation techniques that use market parameters as inputs including but not limited to yield curves, volatilities and foreign exchange rates. The majority of valuation techniques employ only observable market data and so reliability of the fair value measurement is high. These would include corporate debt securities, repurchase, reverse repurchase agreements and most of the Group's over-the-counter derivatives.

The Group classifies financial instruments as Level 3 when there is reliance on unobservable inputs to the valuation model attributing to a significant contribution to the instrument value. These would include all input parameters which are derived from historical data for example asset correlations or certain volatilities as well as unquoted equity securities. The fair value of unquoted equity securities is measured in comparison with recent transactions in the equity of the company in question or comparable companies in similar industries. Level 3 inputs also include all quoted security prices that have not been updated for more than 3 months, quoted proxies in active markets for non-similar asset classes (e.g. bonds valued using credit default swap spreads), as well as prices/valuations that are obtained from

counterparties. Valuation reserves or pricing adjustments where applicable will be used to converge to fair value.

The following table presents assets and liabilities measured at fair value, classified by level of the fair value hierarchies:

In HK\$ millions	Level 1	Level 2	Level 3	Total
2018				
Assets				
Financial assets at fair value through profit or loss				
– Government securities and treasury bills	11,069	–	–	11,069
– Bank and corporate securities	–	1,092	–	1,092
Fair value through other comprehensive income				
– Government securities and treasury bills	21,038	310	–	21,348
– Bank and corporate securities	2,239	128	109	2,476
Derivatives	–	471	–	471
Liabilities				
Financial liabilities at fair value through profit or loss				
– Payable in respect of short sale of securities	2,793	–	–	2,793
– Deposits and balances from customers	–	4,185	–	4,185
Derivatives	–	840	–	840

In HK\$ millions	Level 1	Level 2	Level 3	Total
2017				
Assets				
Financial assets at fair value through profit or loss				
– Government securities and treasury bills	5,561	–	–	5,561
– Bank and corporate securities	–	2	–	2
Available-for-sale financial assets				
– Government securities and treasury bills	14,199	351	–	14,550
– Bank and corporate securities	9,803	111	–	9,914
Derivatives	–	1,188	–	1,188
Liabilities				
Financial liabilities at fair value through profit or loss				
– Payable in respect of short sale of securities	4,395	–	–	4,395
– Deposits and balances from customers	–	1,911	–	1,911
Derivatives	–	883	–	883

During the year, other than the HKFRS 9 transitional adjustment of re-measuring of unquoted equities at cost to fair value and the classification of these equities under Level 3 of the fair value hierarchy, there were no transfers between Level 1, Level 2 and Level 3 financial assets (2017: Nil). The Group's policy is to

recognise transfers between the levels of the fair value hierarchy as at the end of the reporting period during the change occurred.

(c) Fair value of financial assets and liabilities not carried at fair value

For financial assets and liabilities not carried at fair value on the financial statements, the Group has ascertained that their fair values were not materially different from the carrying amounts at year end as shown below. The bases of arriving at their fair values are as follows:

(i) Due from banks

The estimated fair value of placements with and advances to banks is based on the discounted cash flows using the prevailing money market interest rates for placements and advances with similar remaining maturity.

(ii) Loans and advances to customers

The fair value approximates their carrying amount as majority of the loans and advances to customers are on floating rate terms.

(iii) Bank and corporate securities – loans and receivables

The fair values are determined based on independent market quotes, where available. Where market prices are not available, fair values are estimated using discounted cash flow method. The fair value is set out in Note 18.

(iv) Due to banks and Deposits and balances from customers

The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand. The estimated fair value of deposits and other borrowings with fixed interest rates is based on discounted cash flows using prevailing interest rates with similar remaining maturity.

(v) Certificates of deposit issued

The estimated fair value of certificates of deposit issued is based on discounted cash flows using the prevailing money market interest rates with similar remaining maturity.

(vi) Subordinated liability

The fair value of subordinated liability approximates its carrying amount as it is on floating rate term and bears interest at prevailing market interest rate.

31 NOTES TO CONSOLIDATED CASH FLOW STATEMENT

(a) Analysis of changes in financing activities during the year

In HK\$ millions	Subordinated Liability
Balance as at 1 January 2017	4,188
Cash inflow from financing activities	4,216
Cash outflow from financing activities	(4,216)
Exchange differences and other adjustments	32
Balance as at 31 December 2017 and 1 January 2018	4,220
Exchange differences and other adjustments	9
Balance as at 31 December 2018	4,229

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

In HK\$ millions	2018	2017
Cash and balances with central banks	3,028	2,911
Due from banks		
– Balances with banks	4,352	5,770
– Placements with and advances to banks repayable with original maturity within three months	59,308	74,295
Bills and notes repayable with original maturity within three months	6,834	3,008
	73,522	85,984

32 DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

(a) Derivatives

The Group uses financial derivatives to hedge the positions of the Group. It also trades in financial instruments where it takes positions in traded and over-the-counter instruments, including derivatives, to take advantage of short term market movements in bond price, currency and interest rate. The Group places trading limits on the level of exposure that can be taken in relation to both overnight and intra-day market positions. With the exception of specific hedging arrangements, foreign exchange and interest rate exposures associated with these derivatives are normally offset by entering into counterbalancing positions, thereby controlling the variability in the net cash amounts required to liquidate market positions.

The following is a summary of each significant type of derivatives:

In HK\$ millions	Contract/ notional amount	Credit risk- weighted amount	Positive fair values	Negative fair values	In HK\$ millions	Contract/ notional amount	Credit risk- weighted amount	Positive fair values	Negative fair values
2018					2017				
Derivatives held for trading					Derivatives held for trading				
Foreign exchange derivatives					Foreign exchange derivatives				
– Forwards	30,378	126	54	90	– Forwards	33,748	124	99	118
– Swaps	106,504	206	162	394	– Swaps	76,872	290	760	498
– Options purchased	4,258	23	38	4	– Options purchased	4,801	16	21	5
– Options written	4,289	5	4	50	– Options written	5,724	15	5	24
	145,429	360	258	538		121,145	445	885	645
Interest rate derivatives					Interest rate derivatives				
– Swaps	16,531	62	139	166	– Swaps	19,589	80	165	180
– Options purchased	1,274	4	–	–	– Options purchased	1,448	5	1	–
– Options written	1,264	–	–	–	– Options written	1,448	–	–	1
	19,069	66	139	166		22,485	85	166	181
Equity derivatives	1,282	50	28	28	Equity derivatives	1,786	63	57	57
Credit derivatives	6,503	185	9	9	Credit derivatives	–	–	–	–
Commodity derivatives	–	–	–	–	Commodity derivatives	57	2	–	–
Total derivatives held for trading	172,283	661	434	741	Total derivatives held for trading	145,473	595	1,108	883
Derivatives designated and qualified as fair value hedges					Derivatives designated and qualified as fair value hedges				
Interest rate derivatives					Interest rate derivatives				
– Swaps	1,665	6	37	–	– Swaps	2,310	46	80	–
Derivatives designated and qualified as cash flow hedges					Derivatives designated and qualified as cash flow hedges				
Foreign exchange derivatives					Total	147,783	641	1,188	883
– Swaps	5,691	201	–	99					
Total	179,639	868	471	840					

The amounts (except credit-risk weighted amounts) are shown on a gross basis and do not take into account the effect of bilateral netting arrangements. The contract or notional amounts of these instruments indicate the volume of transactions outstanding as at the end of the reporting period; they do not represent amounts at risk.

The credit risk-weighted amounts as at 31 December 2018 and 31 December 2017 are the amounts which have been taken into account the effect of bilateral netting arrangements and have been calculated in accordance with the Banking (Capital) Rules.

(b) Hedging derivatives

The accounting treatment of the hedge derivative transactions varies according to the nature of the hedge and whether the hedge meets the specified criteria to qualify for hedge accounting. Derivatives transacted as economic hedges but do not qualify for hedge accounting are treated in the same way as derivative instruments held for trading purposes.

(c) Hedge accounting

The Group enters into hedging transactions to manage exposures to interest rate and foreign currency risks. Hedge accounting is applied to minimise volatility in earnings arising from changes in interest rate and foreign exchange rates.

Refer to Note 37 for more information on market risk and the Group's risk management practices and Note 2(o) for the Group's accounting policy for hedge accounting.

Fair value hedge

In accordance with the risk management strategy in place, the Group enters into interest rate swaps to mitigate the risk of changes in interest rates on the fair value of the following:

- issued fixed rate debt; and
- a portion of purchased fixed rate bonds.

In such instances, the Group hedges the benchmark interest rate risk component which is an observable and reliably measurable component of interest rate risk. Specifically, the Group has designated fair value hedge relationships, on a hedge-by-hedge basis, to hedge against movements in the benchmark interest rate. This effectively results in the recognition of interest expense (for fixed rate liabilities), or interest income (for fixed rate assets) at floating rates.

The Group manages all other risks derived by these exposures, such as credit risk, but hedge accounting is not applied for those risks.

The Group assesses prospective hedge effectiveness by comparing the changes in fair value of the hedged item resulting from movements in the benchmark interest rate with the changes in fair value of the interest rate swaps used to hedge the exposure. The Group determines the hedge ratio by comparing the notional of the derivative with the principal of the debt issued or the bond asset purchased, or the loan granted.

For all interest rate swaps used for hedging purposes, critical terms match or nearly match those of the underlying hedged items.

The Group has identified the following possible sources of ineffectiveness:

- The use of derivatives as a protection against interest rate risk creates an exposure to the derivative counterparty's credit risk which is not offset by the hedged item. This risk is minimised by entering into derivatives with high credit quality counterparties; or
- Use of different discounting curves when measuring the fair value of the hedged items and hedging instruments. For derivatives the discounting curve used depends on collateralisation and the type of collateral used; or
- Difference in the timing of settlement of hedging instruments and hedged items.

No other significant sources of ineffectiveness were identified in these hedge relationships.

The following table sets out the maturity profile of the hedging instruments used in fair value hedges. The amounts shown in the table reflect the notional amounts of derivatives and the carrying amounts of loans and deposits (if any). Refer to Note 32 for the carrying values of the derivatives.

In HK\$ millions	Less than 1 year	1 to 5 years	More than 5 years	Total
2018				
Derivatives (notional)				
Interest rate swaps	313	1,352	–	1,665
2017				
Derivatives (notional)				
Interest rate swaps	646	1,664	–	2,310

The table below provides information on hedged items relating to fair value hedges

In HK\$ millions	Carrying amounts (including hedge adjustments)	Fair value hedge adjustments included in carrying amounts
2018		
Assets		
Bank and corporate debt securities	538	(10)
Liabilities		
Other debt securities	1,133	17
2017		
Assets		
Bank and corporate debt securities	538	(12)
Liabilities		
Other debt securities	1,822	49

For the year ended 31 December 2018, the net losses on hedging instruments used to calculate hedge effectiveness was HK\$25 million (2017: gains of HK\$46 million). The net gains on hedged items attributable to the hedged risk amounted to HK\$25 million (2017: losses of HK\$45 million). The ineffectiveness arising from these hedges was insignificant (2017: HK\$ 1 million) and recorded in the income statement as "net trading income".

Cash flow hedge

The Group is predominantly exposed to variability in future cash flows due to interest rate movements and foreign currency fluctuations against HKD from the following:

- forecasted interest earnings denominated in foreign currency;
- issued floating or fixed rate foreign currency debt; and
- a portion of purchased floating or fixed rate foreign currency bonds.

In accordance with the Group risk management strategy the Group enters into interest rate swaps, forward contracts or cross currency swaps to protect against the variability of cash flows due to changes in interest rates and/or foreign currency exchange rates. In such instances, cash flow hedge relationships are designated. These are applied on a hedge-by-hedge basis.

The Group also enters into cross currency swaps to mitigate 100% of the risk of fluctuation of coupon and principal cash flows due to changes in foreign currency rates of issued foreign currency debt and a portion of purchased foreign currency bonds. Critical terms of the cross-currency swaps match that of the issued foreign currency debt or purchased foreign currency bonds. In this way the Group exchanges foreign currency interest and principal cash flows, to HKD cash flows.

The Group manages all other risks derived by these exposures, such as credit risk, but they do not apply hedge accounting for these risks.

The Group has identified the following possible sources of ineffectiveness in its cash flow hedge relationships:

- The use of derivatives as a protection against currency and interest rate risk creates an exposure to the derivative counterparty's credit risk which is not offset by the hedged item. This risk is minimised by entering into derivatives with high credit quality counterparties;
- Difference in tenor of hedged items and hedging instruments;
- Difference in timing of settlement of the hedging instrument and hedged item.
- Designation of off-market hedging instruments.

The following table sets out the maturity profile of the hedging instruments used in cash flow hedges. The amounts shown in the table reflect the notional amounts of derivatives and the carrying amounts of loans and deposits. Refer to Note 32 for the carrying values of the derivatives.

In HK\$ millions	Less than 1 year	1 to 5 years	More than 5 years	Total
2018				
Derivatives (notional)				
Currency swaps FX contracts	–	–	5,691	5,691
2017				
Derivatives (notional)				
Currency swaps FX contracts	–	–	–	–

The currency swaps have maturity dates that coincide within the expected occurrence of these transactions. The forecast transactions are expected to occur within seven years from the balance sheet date, and are expected to affect income statements in the same period these cash flow occur.

The ineffectiveness arising from these hedges was insignificant.

Refer to Note 29 for information on the cash flow hedge reserve.

33 CONTINGENT LIABILITIES AND COMMITMENTS

The following is a summary of the contractual amounts of each significant class of contingent liabilities and commitments:

In HK\$ millions	2018	2017
Direct credit substitutes	525	300
Transaction-related contingencies	2,252	1,839
Trade-related contingencies	8,197	10,354
Forward forward deposits placed	2,276	–
Other commitments with an original maturity of not more than one year	9,377	412
Other commitments with an original maturity of more than one year	2,109	2,012
Other commitments which are unconditionally cancellable	150,084	145,409
	174,820	160,326
Credit risk-weighted amount	19,531	15,703

The information is prepared with reference to the Banking (Capital) Rules. For accounting purposes, acceptances are recognised on the statement of financial position in "Other assets" and "Other liabilities" in accordance with HKFRS 9 Financial Instruments. For the purpose of the Banking (Capital) Rules, acceptances are included in the capital adequacy calculation as if they were trade-related contingencies. The contract amount of acceptances included in the table above was HK\$1,993 million (2017: HK\$2,294 million).

In December 2017, the Bank renewed a five-year outsourcing agreement, with respect to the provision of information technology and related support for the Group's operation in Hong Kong. There are various termination clauses contained within the agreement which indicated that under certain circumstances the service company could require the Group to pay termination cost on early termination of the contract. The exact amount of termination cost cannot be reliably determined as it is dependent upon business volumes over the period of the contract and on the timing of the termination itself.

Other than the claims with provisions recognised in other liabilities, the Group is currently being served a number of claims related to the normal commercial activities. It is not probable that a significant liability would arise from these claims.

34 CAPITAL AND LEASE COMMITMENTS

(a) Capital commitments

Capital commitments outstanding at the end of the reporting period but not yet incurred are as follows:

In HK\$ millions	2018	2017
Expenditure contracted but not provided for	109	45
Expenditure authorised but not contracted for	71	54
	180	99

(b) Lease commitments

At the end of the reporting period, the total future minimum lease payments under non-cancellable operating leases are as follows:

In HK\$ millions	2018		2017	
	Properties	Others	Properties	Others
Not later than one year	333	35	323	9
Later than one year and not later than five years	832	25	681	2
Later than five years	562	–	369	–
	1,727	60	1,373	11

Certain non-cancellable operating leases included in the table above were subject to renegotiation and rent adjustment with reference to market rates prevailing at specified agreed dates or according to the special conditions as stipulated in the leases.

35 SECURITIES PLEDGED AND TRANSFERS OF FINANCIAL ASSETS

The Group enters into transactions in the normal course of business by which it transfers financial assets to third parties or group companies. These transfers may give rise to full or partial derecognition of those financial assets.

The financial assets are primarily the debt securities and treasury bills deposited with central depositories to secure the Group's short position in securities and to facilitate settlement operations, and the transferred securities under securities lending arrangements. These transactions are generally conducted under terms that are in accordance with normal market practice. The Group has determined that it retains substantially all the risks and rewards of these securities and therefore has not derecognised them. In respect of securities lending transactions, the counterparty is allowed to transfer those securities lent, but has an obligation to return the securities at maturity.

The aggregate amount of secured liabilities and the nature and carrying amounts of the assets pledged as security are as follows:

In HK\$ millions	2018	2017
Secured liabilities – short positions in securities (Note 26)	2,793	4,395
Assets pledged as security		
– Treasury bills	2,772	5,180
– Other securities	23	37
	2,795	5,217

The assets pledged as security included financial assets at fair value through profit or loss of HK\$2,795 million (2017: HK\$4,397 million).

There were no securities lending transaction outstanding as at 31 December 2018 and 2017.

36 OFFSETTING FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Financial assets and liabilities are presented net when there is a legally enforceable right to set off the recognised amounts, and there is intention to settle them on a net basis or to realise the asset and settle the liability simultaneously. As at 31 December 2018, no financial assets and liabilities were offset on the statement of financial position (2017: nil).

Financial assets and liabilities subject to netting agreement but not offset on the statement of financial position

The Group enters into master netting arrangements with counterparties where it is appropriate and feasible to do so to mitigate counterparty risk. The credit risk associated with favourable contracts is reduced by a master netting arrangement to the extent that if an event of default occurs, all amounts with the counterparty are settled on a net basis. Master netting arrangements do not result in an offset of financial assets and liabilities on the statement of financial position, as the legal right to set off the transactions is conditional upon default.

These agreements include derivative master agreements (including the International Swaps and Derivatives Association (ISDA) Master Agreement, global master repurchase agreements and global securities lending agreements). The collaterals received and posted under these agreements are generally conducted under terms that are in accordance with normal market practice. In these agreements, the counterparty is typically allowed to sell or repledge those non-cash collaterals (i.e. securities) lent or transferred, but has an obligation to return the securities at maturity. If the securities decrease in value, the Group may, in certain circumstances, be required to pay additional cash collateral, and typically the counterparty has recourse only to the securities. Please see Note 37 for additional disclosures. Furthermore, the Group's short position in securities was secured by the deposit of assets under sale and repurchase agreements.

In addition, the Group receives cash and other collaterals such as marketable securities to reduce its credit exposure. The Group also engages in a variety of counterparty credit mitigation strategies in addition to netting and collateral arrangements. Please see Note 37.

The disclosures set out in the tables below pertain to financial assets and liabilities that are not offset in the Group's statement of financial position but are subject to enforceable master netting arrangement or similar agreement that covers similar financial instruments. The disclosures enable the understanding of both the gross and net amounts (for IFRS and US GAAP readers respectively), as well as provide additional information on how such credit risk is mitigated.

In HK\$ millions	Carrying amounts on statement of financial position	Related amounts not offset on statement of financial position		Net amounts ^(b)
		Financial instruments (including non-cash collateral) ^(a)	Cash collateral received / pledged	
2018				
Financial assets				
Positive fair values for financial derivatives	471	292	8	171
Financial liabilities				
Negative fair values for financial derivatives	840	291	105	444
Payable in respect of short sale of securities	2,793	2,793	–	–
Total	3,633	3,084	105	444

In HK\$ millions	Carrying amounts on statement of financial position	Related amounts not offset on statement of financial position		Net amounts ^(b)
		Financial instruments (including non-cash collateral) ^(a)	Cash collateral received / pledged	
2017				
Financial assets				
Positive fair values for financial derivatives	1,188	741	3	444
Financial liabilities				
Negative fair values for financial derivatives	883	741	142	–
Payable in respect of short sale of securities	4,395	4,395	–	–
Total	5,278	5,136	142	–

(a) Amounts under "Financial instruments (including non-cash collateral)" represent the amounts of financial liabilities/assets position and other non-cash collateral that are subject to netting agreement or similar arrangements, capped at the carrying amount of the financial instruments.

(b) Net amounts represent

- Financial instruments that are not subject to netting agreement or similar arrangements; or
- Financial assets/liabilities that are subject to netting agreement or similar arrangements but the Group's counterparty does not have equivalent financial liabilities/assets position with the Group to offset upon default.

37 FINANCIAL RISK MANAGEMENT

Risk governance

Under the risk management approach, the Board of Directors, through the Board Risk Management Committee ("BRMC"), sets risk appetite, oversees the establishment of enterprise-wide risk management policies and processes, and set risk appetite limits to guide the Group's risk-taking.

(a) Credit risk

Credit risk arises from the Group's daily activities in various businesses. These activities include lending to retail, corporate and institutional customers. It includes both the risk of lending as well as the pre-settlement and settlement risk of foreign exchange, derivatives and debt securities.

Credit Risk Management

The Group's approach to credit risk management comprises the following building blocks:

- **Policies**

The dimensions of credit risk and the scope of its application are defined in DBSH's Credit Risk Management Policy. Senior management sets the overall direction and policy for managing credit risk at the enterprise level.

DBSH's Core Credit Risk Policies established for Consumer Banking/Wealth Management and Institutional Banking (herein referred to as "CCRP") set forth the principles by which DBS conducts its credit risk management and control activities. These policies, supplemented by a number of operational policies and standards, ensure consistency in identifying, assessing, underwriting, measuring, reporting and controlling credit risk across DBS, and provide guidance in the formulation of business-specific and/or location-specific credit risk policies and standards.

The operational policies and standards are established to provide greater details on the implementation of the credit principles within the CCRPs and are adapted to reflect different credit environments and portfolio risk profiles.

- **Risk Methodologies**

Credit risk is managed by thoroughly understanding our customers – the businesses they are in, as well as the economies in which they operate.

The assignment of credit risk ratings and setting of lending limits is an integral part of DBS' credit risk management process, and we use an array of rating models for our corporate and retail portfolios.

Wholesale borrowers are assessed individually using both judgmental credit risk models and statistical credit risk models. They are further reviewed and evaluated by experienced credit risk managers who consider the relevant credit risk factors in the final determination of the borrower's risk. For some portfolios within

the SME segment, DBS also uses a programme-based approach to achieve a balanced management of risks and rewards. Retail exposures are assessed using credit scoring models, credit bureau records, and internally and externally available customer behaviour records. Credit extensions are proposed by the business unit, and these are approved by the credit risk function after taking into account independent credit assessments and the business strategies set by senior management.

Pre-settlement credit risk for derivatives arising from a counterparty potentially defaulting on its obligations is quantified by evaluation of the market price plus potential future exposure.

The Group actively monitors and manages its exposure to counterparties in over-the-counter (“OTC”) derivative trades to protect its statement of financial position in the event of a counterparty default. DBSH has a policy to guide handling of specific wrong-way risk transactions.

- **Concentration Risk Management**

The Group’s risk management processes aim to ensure that an acceptable level of risk diversification is maintained across the Group on an ongoing basis. Limits are established and regularly monitored in respect of country exposures and major industry groups, as well as for single counterparty exposures.

- **Country Risk**

Country risk refers to the risk of loss due to events in a specific country (or a group of countries). This includes political, exchange rate, economic, sovereign and transfer risks. The Group manages country risk as part of concentration risk management.

- **Credit Stress Testing**

The Group performs various types of credit stress tests which are directed by the regulators or driven by internal requirements and management. Credit stress tests are performed at a portfolio or sub-portfolio level and are generally meant to assess the impact of changing economic conditions on asset quality, earnings performance, capital adequacy and liquidity.

- **Processes, Systems and Reports**

The end-to-end credit process is continually being reviewed and improved through various front-to-back initiatives involving the business units, the operations units, the Risk Management Group and other key stakeholders.

Non-performing assets

The Group classifies its credit facilities as “Performing Assets” or “Non-performing assets” in accordance with HKMA’s loan classification framework.

Refer to Note 2(h) for the Group’s accounting policies on the impairment of financial assets. In general, impairment allowance is made when there is objective evidence of impairment as a result of the occurrence of loss events that will have an impact on the estimated future cash flows.

When required, the Group will take possession of collateral and dispose of them as soon as practicable. Realised proceeds are used to reduce the outstanding indebtedness.

Credit Risk Mitigants

- **Collateral Received**

Where possible, the Group takes collateral as a secondary recourse to the borrower. This includes, but not limited to, cash, marketable securities, real estate, trade receivables, inventory and equipment, and other physical and/or financial collateral. The Group may also take fixed and floating charges on the assets of borrowers.

Policies are in place to determine the eligibility of collateral for credit risk mitigation. These include requiring specific collateral to meet minimum operational requirements in order to be considered as effective risk mitigants. The Group’s collateral is generally diversified and periodic valuations of collateral are required.

For derivatives, repurchase agreements (repo) and other repo-style transactions with financial market counterparties, collateral arrangements are typically covered under market standard documentation, such as International Swaps & Derivatives Association (ISDA) Agreements and Master Repurchase Agreements. The collateral received is marked-to-market on a frequency the Group and the counterparties mutually agreed upon, governed by internal guidelines with respect to collateral eligibility. In the event of a default, the credit risk exposure is reduced by master-netting arrangements where the Group is allowed to offset what the Group owes a counterparty against what is due from that counterparty in a netting-eligible jurisdiction.

In times of difficulty, the Group will review the customer’s specific situation and circumstances to assist them in restructuring their repayment liabilities.

Maximum exposure to credit risk

The maximum exposure to credit risk for financial assets recognised on the statement of financial position is the carrying amount. For contingent liabilities, the maximum exposure to credit risk is the maximum amount the Group would have to pay if the instrument is called upon. For undrawn facilities, the maximum exposure to credit risk is the full amount of the undrawn credit facilities granted to customers. Refer to Note 33 for the contractual amounts of each significant class of contingent liabilities and commitments.

The Group’s exposures to credit risk, measured using the expected gross credit exposures that will arise upon a default of the end obligor are as shown in the disclosures required under the Banking (Disclosure) Rules.

Analysis of Collateral

Whilst the Group’s maximum exposure to credit risk is the carrying amount of the assets or, in the case of off-balance sheet instruments, the amount guaranteed, committed, accepted or endorsed, the likely exposure may be lower due to offsetting collateral, credit guarantees and other actions taken to mitigate the Group’s exposure.

The description of collateral for each class of financial asset is set out below:

Balances with central banks, government securities and treasury bills, due from banks and bank and corporate debt securities
Collateral is generally not sought for these assets.

Derivatives

The Group maintains collateral agreements and enters into master netting agreements with most of the counterparties for derivative transactions. The impact of netting arrangements recognised for the computation of capital adequacy ratio is shown in the disclosures required under the Banking (Disclosure) Rules.

Loans and advances to customers, contingent liabilities and commitments

Certain loans and advances to customers, contingent liabilities and commitments are typically collateralised to a substantial extent. In particular, residential mortgage exposures are generally fully secured by residential properties. Income-producing real estate, which is a sub-set of the Specialised Lending exposure, are fully secured by the underlying assets financed.

The extent to which credit exposures are covered by eligible collateral under the Banking (Capital) Rules, besides real estate, after the application of the requisite regulatory hair-cuts, is shown in the disclosures required under the Banking (Disclosure) Rules. The amount shown is a sub-set of the actual collateral arrangements entered by the Group as the Banking (Capital) Rules imposes strict legal and operational standards before collateral can be admitted as credit risk mitigants. As a result, certain collateral arrangements which do not meet its criteria will not be included. Certain collateral types which are not permitted as credit risk mitigants for credit exposures under the Standardised Approach are also excluded.

Loans and advances to customers by credit quality

In HK\$ millions	2018				2017
	Stage 1	Stage 2	Stage 3	Total	
Neither past due nor impaired					
– Pass	141,983	16,472	–	158,455	147,533
– Special Mention	152	1,108	–	1,260	2,637
Past due but not impaired ^(a)	2,001	248	–	2,249	3,225
Impaired	–	–	2,505	2,505	2,446
	144,136	17,828	2,505	164,469	155,841

(a) The majority of past due but not impaired assets are classified as "Pass" in 2018

Impaired loans and advances to customers are individually assessed customer advances with objective evidence of impairment.

(i) Analysis of loans and advances to customers that were neither past due nor impaired by reference to the loan gradings under the HKMA guidelines

In HK\$ millions	Pass	Special mention	Total
2018			
Manufacturing	12,683	350	13,033
Building and construction	24,336	147	24,483
Housing loans	24,612	19	24,631
General commerce	50,759	697	51,456
Transportation, storage and communication	11,415	15	11,430
Financial institutions, investments and holding companies	4,838	6	4,844
Professionals and private individuals (except housing loans)	26,605	14	26,619
Others	3,207	12	3,219
	158,455	1,260	159,715

In HK\$ millions	Pass	Special mention	Total
2017			
Manufacturing	11,630	1,010	12,640
Building and construction	23,661	257	23,918
Housing loans	24,216	59	24,275
General commerce	40,004	1,254	41,258
Transportation, storage and communication	11,962	–	11,962
Financial institutions, investments and holding companies	6,262	–	6,262
Professionals and private individuals (except housing loans)	26,589	19	26,608
Others	3,209	38	3,247
	147,533	2,637	150,170

(ii) Loans and advances to customers that were past due but not impaired

In HK\$ millions	Past due				Total
	Less than 1 month	1-2 months	2-3 months	More than 3 months	
2018					
Manufacturing	194	9	1	–	204
Building and construction	162	4	5	–	171
Housing loans	699	45	–	–	744
General commerce	477	143	18	3	641
Transportation, storage and communication	105	13	5	–	123
Financial institutions, investments and holding companies	–	–	–	–	–
Professionals and private individuals (except housing loans)	211	23	8	–	242
Others	84	36	4	–	124
	1,932	273	41	3	2,249

In HK\$ millions	Past due				Total
	Less than 1 month	1-2 months	2-3 months	More than 3 months	
2017					
Manufacturing	110	8	2	1	121
Building and construction	331	8	–	–	339
Housing loans	446	12	–	–	458
General commerce	877	62	6	5	950
Transportation, storage and communication	345	13	5	52	415
Financial institutions, investments and holding companies	–	–	–	–	–
Professionals and private individuals (except housing loans)	281	20	1	318	620
Others	275	40	7	–	322
	2,665	163	21	376	3,225

Loans and advances to customers that were past due by more than 3 months represent individually insignificant advances which are subject to general allowances/collective impairment allowances assessment.

(iii) Impaired loans and advances to customers

In HK\$ millions	2018	2017
Manufacturing	455	499
Building and construction	89	216
Housing loans	15	9
General commerce	1,558	1,488
Transportation, storage and communication	53	6
Financial institutions, investments and holding companies	–	–
Professionals and private individuals (except housing loans)	275	1
Others	60	227
	2,505	2,446

	2018 HK\$'M	% of gross Loans and advances to customers	2017 HK\$'M	% of gross Loans and advances to customers
Gross impaired advances	2,505	1.52	2,446	1.57
Specific allowances/ Individual impairment allowances	(1,107)		(829)	
	1,398		1,617	
Impaired advances covered by collateral	1,069		1,520	

The specific allowances/individual impairment allowances were made after taking into account the value of collateral in respect of the above advances.

Analysis of specific allowances / individual impairment allowances

In HK\$ millions	As at 1 January 2018	Amounts written off	Recoveries of advances written off in previous years	Net charge/ (release) to income statement	Others	As at 31 December 2018
Manufacturing	223	(40)	2	21	–	206
Building and construction	19	(11)	–	6	–	14
Housing loans	–	–	2	(2)	–	–
General commerce	568	(115)	–	273	–	726
Transportation, storage and communication	55	(48)	–	3	38	48
Professionals and private individuals (except housing loans)	115	(218)	62	120	–	79
Others	15	(13)	1	31	–	34
	995	(445)	67	452	38	1,107

In HK\$ millions	As at 1 January 2017	Amounts written off	Recoveries of advances written off in previous years	Net charge/ (release) to income statement	Others	As at 31 December 2017
Manufacturing	203	(35)	2	54	–	224
Building and construction	22	(8)	–	4	–	18
Housing loans	–	–	1	(1)	–	–
General commerce	587	(62)	11	31	(1)	566
Transportation, storage and communication	9	(2)	–	2	–	9
Professionals and private individuals (except housing loans)	1	(1)	16	(15)	–	1
Others	392	(52)	1	(330)	–	11
	1,214	(160)	31	(255)	(1)	829

Analysis of general allowances / collective impairment allowances

In HK\$ millions	As at 1 January 2018	Additions/ (Releases)	As at 31 December 2018
Manufacturing	85	18	103
Building and construction	209	105	314
Housing loans	26	(22)	4
General commerce	192	66	258
Transportation, storage and communication	144	44	188
Financial institutions, investments and holding companies	2	–	2
Professionals and private individuals (except housing loans)	366	(70)	296
Others	22	4	26
	1,046	145	1,191

In HK\$ millions	As at 1 January 2017	Additions/ (Releases)	As at 31 December 2017
Manufacturing	68	5	73
Building and construction	118	6	124
Housing loans	1	2	3
General commerce	236	10	246
Transportation, storage and communication	89	4	93
Financial institutions, investments and holding companies	4	7	11
Professionals and private individuals (except housing loans)	259	(11)	248
Others	28	11	39
	803	34	837

Geographical concentration

The analysis of the Group's gross advances to customers by geographical area is based on the location of the counterparty after taking into account the transfer of risk. In general, transfer of risk applies if the claim is guaranteed by a party in a country which is different from that of the counterparty.

In HK\$ millions	Loans	Trade Finance (including trade bills)	Total
As at 31 December 2018			
Hong Kong	114,675	23,699	138,374
Mainland China	4,784	10,522	15,306
Others	8,287	2,502	10,789
	127,746	36,723	164,469
As at 31 December 2017			
Hong Kong	115,985	20,020	136,005
Mainland China	4,276	7,171	11,447
Others	6,864	1,525	8,389
	127,125	28,716	155,841

Analysis of impaired advances, impairment allowances for loans and trade finance which accounted for 10% or more of the Group's gross advances to customers:

In HK\$ millions	Impaired advances to customers	Specific allowances	General allowances
As at 31 December 2018			
Hong Kong	1,831	652	1,169

In HK\$ millions	Impaired advances to customers	Individual impairment allowances	Collective impairment allowances
As at 31 December 2017			
Hong Kong	1,844	548	728

(b) Market risk

The Group's exposure to market risk is categorised into:

- Trading portfolios: Arising from positions taken for (i) market-making (ii) client-facilitation and (iii) benefiting from market opportunities.
- Non-trading portfolios: Arising from (i) positions taken to manage the interest rate risk of the Group's retail and commercial banking assets and liabilities (ii) debt securities comprising of investments held for yield and/or liquidity risk management (iii) strategic stakes in entities and (iv) structural foreign exchange risk arising mainly from the Group's strategic investments which are denominated in currencies other than the Hong Kong dollar.

The Group uses a variety of financial derivatives such as swaps, forwards and futures, and options for trading and hedging against movements in interest rates, foreign exchange rates, equity prices and other market risks of the Group's (a) investments, (b) maturity mismatches between loans and deposits, (c) structured product issuances, and (d) other assets and liabilities.

Market Risk Management

The Group's approach to market risk management is formulated on the following building blocks:

• Policies

The Group Market Risk Management Policy sets out the Group's overall approach towards market risk management. The Policy is supported by Standards and Guides, which establishes the basic requirements for the market risk management within the Group, and provides more details regarding specific subject matters. The set of Policy, Standards and supporting Guides facilitate the identification, measurement, control, monitoring and reporting of market risk in a consistent manner within the Group. They also set out the overall approach, standards and controls governing market risk stress testing across the Group.

• Risk Methodologies

Value-at-Risk (VaR) is a method that computes the potential losses of risk positions as a result of market movements over a specified time horizon and according to a given level of confidence. Our VaR model is based on historical simulation with a one-day holding period. Expected Shortfall (ES) is used by the Group to monitor

and limit market risk exposures, as well as to monitor net open positions net of hedges. ES is the average of potential losses beyond the given level of confidence. ES is supplemented by risk control metrics such as sensitivities to risk factors and loss triggers for management action.

We conduct backtesting to verify the predictiveness of the VaR model. For backtesting, VaR at the 99% level of confidence and over a one-day holding period is used.

VaR models such as historical simulation VaR permit the estimation of the aggregate portfolio market risk potential loss due to the changes of a range of relevant market risk factors and instruments. VaR models have limitations which include but are not limited to: (i) past changes in market risk factors may not provide adequate predictions of future market movements and (ii) the risk arising from adverse market related events may be understated.

To monitor our vulnerability to unexpected but plausible extreme market risk related events, multiple market risk stress tests are conducted regularly. These cover trading and non-trading portfolios and follow a combination of historical and hypothetical scenarios depicting risk factors movement.

ES and net interest income variability are the key market risk metrics used to manage our assets and liabilities. As an exception, credit risk arising from loans and receivables is managed under the credit risk management framework. We manage banking book interest rate risk arising from mismatches in the interest rate profile of assets, liabilities and capital instruments (and associated hedges), which includes basis risk arising from different interest rate benchmarks, interest rate re-pricing risk, yield curve risks and embedded optionality. Behavioural assumptions are applied in managing interest rate risk of deposits with indeterminate maturities. We measure interest rate risk in the banking book on a weekly basis.

• Processes, Systems and Reports

Robust internal control processes and systems are designed and implemented to support the Group's approach for market risk management. Regular reviews at least annually of these control processes and systems are conducted. These reviews provide senior management with objective and timely assessments of the control processes and systems' appropriateness and effectiveness.

The day-to-day market risk monitoring, control and analysis is managed by the Risk Management Group (RMG) Market and Liquidity Risk unit – an independent risk management function that reports to the Senior Risk Executive. DBS Bank Ltd provides RMG Market and Liquidity Risk with model analytics, risk infrastructure and risk report production support.

Market Risk Metrics

The Group level ES considers both trading and non-trading portfolios. The Group level ES is tabulated below, showing the period-end, average, high and low ES based on the 97.5% levels of confidence.

Group (97.5% ES)

In HK\$ millions	As at 31 Dec 2018	1 Jan 2018 to 31 Dec 2018		
		Average	High	Low
Total	24.7	48.7	89.2	24.7

In HK\$ millions	As at 31 Dec 2017	1 Jan 2017 to 31 Dec 2017		
		Average	High	Low
Total	94.8	105.6	137.8	82.4

Note: ES is computed in Singapore dollars and translated into Hong Kong dollars using the prevailing exchange rates on the reporting dates for presentation purpose.

The average Group level ES in 2018 was lower than that in 2017. The reduction in ES was mainly driven by reduced interest rate risk exposures from non-maturity deposits and increased offsetting exposures in foreign currency bonds.

The following table shows the trading portfolios, the period-end, average, high and low ES:

Trading (97.5% ES)

In HK\$ millions	As at 31 Dec 2018	1 Jan 2018 to 31 Dec 2018		
		Average	High	Low
Total	5.0	2.5	5.3	1.5

In HK\$ millions	As at 31 Dec 2017	1 Jan 2017 to 31 Dec 2017		
		Average	High	Low
Total	1.8	3.8	9.1	1.8

Note: ES is computed in Singapore dollars and translated into Hong Kong dollars using the prevailing exchange rates on the reporting dates for presentation purpose.

In the Group, the main risk factors driving trading portfolios in 2018 were interest rates and foreign exchange. Trading portfolios' average daily ES decreased by HK\$1.3 million, contributed largely by a reduction in interest rates and foreign exchange and credit spread risk exposures.

Trading portfolio experienced 3 backtesting exceptions in 2018.

The key market risk drivers of the Group's non-trading portfolios are HKD and USD interest rate exposures. The economic value impact of changes in interest rates is simulated under various scenarios for the non-trading risk portfolio. The simulated economic value changes are negative HK\$47 million and HK\$51 million (2017: negative HK\$1,032 million and HK\$2,077 million) based on parallel shocks to all yield curves of 100 basis points and 200 basis points respectively. The reported figures are based on the worst case of an upward and downward parallel shift in the yield curves.

Equity price risk arises from the Group's strategic investments which are overseen by the Hong Kong Management Committee. The Group's equity exposures booked in its banking book portfolio as at 31 December 2018 and 2017 were not material and were held for long term investment purpose. They were reported as bank and corporate securities in Note 18 to the financial statements and are subject to the accounting and valuation policies set out in Notes 2(f) and 2(h) to the financial statements.

(c) Liquidity risk

The Group's liquidity risk arises from its obligations to honour withdrawals of deposits, repayments of borrowed funds at maturity, and commitments to extend loans to our customers.

The Group seeks to manage its liquidity in a manner that ensures that its liquidity obligations would continue to be honoured under normal as well as adverse circumstances.

Liquidity Risk Management**Liquidity Management and Funding Strategy**

The Group strives to develop a diversified funding base with access to funding sources across retail and wholesale channels. In particular, the Group has continuously made inroads in growing, deepening and diversifying its deposit base, spanning retail, wealth management, corporate and institutional customers across markets that it operates in. Supplementing the deposit base, the Group continues to maintain access to wholesale channels, to support the growth of its investor base, as well as to increase flexibility and manage funding cost in capitalising on business opportunities.

In deploying the funds, the Group aims to predominantly fund its lending activities via customer deposits and borrowings. In the event where market conditions lead to insufficient or prohibitively expensive customer funding, flexibility is maintained to fund lending growth with duration matched wholesale funding. With increasing diversification of funding sources, optimising the mismatch in fund deployments against sources with respect to pricing, size, currency and tenor remains challenging. To this end, the Group actively makes use of the foreign exchange swap markets in the conversion of funds across currencies to deploy surplus funds, where practicable.

The Assets and Liabilities Committee regularly reviews the balance sheet composition, trends in loans and deposits, utilisation of wholesale funding, momentum in business activities, market competition, economic outlooks, market conditions and other factors that may affect liquidity in the continual refinement of the Group's funding strategy.

Approach to Liquidity Risk Management

The Group's approach to liquidity risk management comprises the following building blocks:

- **Policies**

The Group Liquidity Risk Management Policy sets out the Group's overall approach towards liquidity risk management and describes the range of strategies employed by the Group to manage its liquidity. These include maintaining an adequate counterbalancing capacity to address potential cash flow shortfalls and maintaining diversified sources of liquidity. Counterbalancing capacity includes liquid assets and the capacity to borrow from the money markets as well as forms of managerial interventions that improve liquidity. In the event of a potential or actual crisis, the Group has in place a set of liquidity contingency and recovery plans to ensure that

decisive actions are taken to ensure the Group maintains adequate liquidity.

The Policy is supported by Standards which establish the detailed requirements for liquidity risk identification, measurement, reporting and control within the Group. The set of Policies, Standards and supporting Guides communicate these baseline requirements to ensure consistent application throughout the Group.

- **Risk Methodologies**

The primary measure used to manage liquidity within the tolerance defined by the Board is the cash flow maturity mismatch analysis. The analysis is performed on a regular basis under normal and adverse scenarios. It assesses the adequacy of the counterbalancing capacity to fund or mitigate any cash flow shortfalls that may occur as forecasted in the cash flow movements across successive time bands. To ensure that liquidity is managed in line with the Risk Appetite, core parameters underpinning the performance of the analysis, such as the types of scenarios, the survival period and the minimum level of liquid assets, are pre-specified for monitoring and control at the Group. Any occurrences of forecasted shortfalls that cannot be covered by the counterbalancing capacity would be escalated to the relevant committees for evaluation and action.

Stress testing is performed under the cash flow maturity mismatch analysis, and covers adverse scenarios involving shocks that are general market and/or bank-specific in nature. Stress tests assess the bank's vulnerability when liability run-offs increase, asset drawdown and rollovers increase and / or liquid assets buffer reduces. In addition, ad-hoc stress tests are performed in the formulation of the Group's internal capital adequacy assessment process.

Liquidity risk control measures, such as liquidity-related ratios and balance sheet analysis, are complementary tools to the cash flow maturity mismatch analysis and are performed regularly to obtain deeper insights and finer control over the liquidity profile across the Group. The liquidity risk control measures also include concentration measures on top depositors and wholesale borrowing ratios.

- **Processes, Systems and Reports**

Robust internal control processes and systems underlie the overall approach for identifying, measuring, aggregating, controlling and monitoring liquidity risk across the Group.

The day-to-day liquidity risk monitoring, control, reporting and analysis are managed by the RMG Market and Liquidity Risk unit – an independent risk management function that reports to the Senior Risk Executive.

In HK\$ millions	Repayable on demand	Less than 1 month	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
2017								
Assets								
– Cash and balances with central banks	2,859	–	–	–	–	–	52	2,911
– Government securities and treasury bills, classified as								
– Held-for-trading	–	2,090	667	2,240	266	298	–	5,561
– Available-for-sale	–	5,449	2,157	2,241	4,119	584	–	14,550
– Due from banks	5,770	79,881	21,440	24,068	69,567	–	–	200,726
– Bank and corporate securities								
– Debt securities classified as held-for- trading	–	–	–	–	2	–	–	2
– Debt securities classified as available- for-sale	–	–	78	508	9,319	–	9	9,914
– Debt securities classified as loans and receivables	–	–	–	–	1,150	–	–	1,150
– Equity securities	–	–	–	–	–	–	29	29
– Loans and advances to customers	9,485	38,864	22,670	17,154	31,762	32,418	1,822	154,175
– Others	48	3,457	1,272	228	459	–	3,342	8,806
Total assets	18,162	129,741	48,284	46,439	116,644	33,300	5,254	397,824
Liabilities								
– Due to banks	2,927	2,754	811	24	1,150	–	–	7,666
– Deposits and balances from customers	196,841	56,795	50,356	23,065	426	–	–	327,483
– Certificates of deposit issued	–	–	1,977	1,055	1,157	–	–	4,189
– Subordinated liability	–	–	–	–	4,220	–	–	4,220
– Others	2,893	4,423	1,589	3,090	25	16	3,336	15,372
Total liabilities	202,661	63,972	54,733	27,234	6,978	16	3,336	358,930
Of which:								
Certificates of deposit held included in bank and corporate securities, classified as:								
– Held-for-trading	–	–	–	–	–	–	–	–

The above tables indicate disclosure of contractual maturity of financial liabilities, which approximate the same analysis on an undiscounted basis as total future interest payments are not material relative to the principal amounts. Derivative assets and liabilities are included in “less than 1 month” bucket as they are mainly held for trading.

The table below shows the contractual undiscounted cash flows for derivatives, contingent liabilities and commitments.

In HK\$ millions	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Total
2018						
Derivatives settled on a net basis	–	7	(2)	(3)	(3)	(1)
Derivatives settled on a gross basis						
– Inflow	–	139,242	30,514	13,131	5,983	188,870
– Outflow	–	(139,468)	(30,405)	(12,527)	(5,762)	(188,162)
Contingent liabilities and commitments						
– Contingent liabilities	–	10,974	–	–	–	10,974
– Commitments	78,128	85,718	–	–	–	163,846
	78,128	96,692	–	–	–	174,820
2017						
Derivatives settled on a net basis	–	11	34	21	(3)	63
Derivatives settled on a gross basis						
– Inflow	–	88,700	18,110	7,076	485	114,371
– Outflow	–	(88,491)	(18,099)	(7,072)	(485)	(114,147)
Contingent liabilities and commitments						
– Contingent liabilities	–	12,493	–	–	–	12,493
– Commitments	75,597	72,236	–	–	–	147,833
	75,597	84,729	–	–	–	160,326

The Group actively monitors and manages its liquidity profile based on the cash flow maturity mismatch analysis.

In forecasting the cash flow under the analysis, behavioural profiling is necessary in cases where a product has indeterminate maturity or the contractual maturity does not realistically reflect the expected cash flow. An example would be maturity-indeterminate savings and current account deposits which are generally viewed as a source of stable funding for commercial banks and consistently exhibited stability even under historical periods of stress.

A conservative view is adopted in the Group's behavioural profiling of assets, liabilities and off-balance sheet commitments that have exhibited cash flow patterns that differ significantly from the contractual maturity profile shown in this note.

The table below shows the Group's behavioural net and cumulative maturity mismatch between assets and liabilities over a one-year period under a normal scenario without incorporating growth projections. The Group's liquidity is observed to remain adequate under the maturity mismatch analysis, amidst sustained growth in loans supported by stable sources of funds from deposits gathering.

In HK\$ millions ⁽ⁱ⁾	Less than 7 days	1 week to 1 month	1 to 3 months	3 to 12 months
2018				
Net liquidity mismatch	23,470	13,080	31,037	17,573
Cumulative mismatch	23,470	36,550	67,588	85,160
2017⁽ⁱⁱ⁾				
Net liquidity mismatch	28,555	21,181	25,975	23,759
Cumulative mismatch	28,555	49,736	75,711	99,471

(i) Positive indicates a position of liquidity surplus. Negative indicates a liquidity shortfall that has to be funded.

(ii) As the behavioural assumptions used to determine the maturity mismatch between assets and liabilities are updated from time to time, the information presented above may not be directly comparable across past balance sheet dates.

(d) Operational risk

Operational risk is inherent in our business activities and it may arise from inadequate or failed internal processes, people, systems, or external events.

The Group's objective is to keep operational risk at appropriate levels, taking into account the markets the Bank operates in, the characteristics of the businesses as well as our economic and regulatory environment.

Operational Risk Management

The Group's approach to operational risk management comprises the following building blocks:

- **Policies**

The Group Operational Risk Management ("ORM") Policy sets our overall approach for managing operational risk in a structured, systematic and consistent manner.

There are policies, standards, tools and programmes in place to

govern ORM practices across the Group. These include corporate operational risk policies and standards that are owned by the respective corporate oversight and control functions. The key policies address risk areas relating to technology, compliance, fraud, money laundering, financing of terrorism and sanctions, new product and outsourcing.

- **Risk Methodologies**

The Group adopts the standardised approach to compute operational risk regulatory capital.

To manage and control operational risk, we use various tools including risk and control self-assessment, operational risk event management and key risk indicator monitoring.

The Group's three lines of defence adopt one common risk universe and taxonomy, and a consistent risk assessment approach to manage operational risk. Risk and control self-assessment is conducted by each business or support unit to identify key operational risk and assess the effectiveness of internal controls. When control issues are identified, the units develop action plans and track the resolution of the issues.

Operational risk events are classified in accordance with Basel standards. Such events, including any significant incidents that may impact the Bank's reputation, must be reported based on certain established thresholds. Key risk indicators with pre-defined escalation triggers are employed to facilitate risk monitoring in a forward-looking manner.

Additional methodologies are in place to address subject-specific risks, including, but not limited to, the following:

Technology risk

Information Technology (IT) risk is managed through an enterprise technology risk approach. This covers risk governance, communication, monitoring, assessment, mitigation and acceptance, and is supported by a set of IT policies and standards, control processes and risk mitigation programmes.

Along with the Bank's digital journey and the evolving cyber risk landscape, we have defined a dedicated cybersecurity platform team to address cyber risk in a holistic manner along with the alignment of the Chief Information Security Officer ("CISO") function into the cybersecurity platform.

Compliance risk

Compliance risk refers to the risk of the Group not being able to successfully conduct our business because of any failure to comply with laws, regulatory requirements, industry codes or standards of business and professional conduct applicable to the financial sector.

This includes, in particular, laws and regulations applicable to the licensing and conducting of banking or other financial businesses, financial crime such as anti-money laundering and countering the financing of terrorism, fraud and bribery/corruption. We maintain a compliance programme designed to identify, assess, measure, mitigate and report on such risks through a combination of policy and relevant systems and controls.

The Group also provides relevant training and implements assurance processes. We strongly believe in the need to promote

a strong compliance culture as well, and this is developed through the leadership of our Board and senior management.

Fraud risk

The Group has established minimum standards for our business and support units to prevent, detect, investigate and remediate fraud and related events. This is based on the Fraud Management Programme, through which standards are implemented at the unit and geographical levels. These standards aim to provide end-to-end management for fraud and related issues within the Group.

Money laundering, financing of terrorism and sanctions risks

There are minimum standards for our business and support units to mitigate and manage our actual and/or potential exposure to money laundering, terrorist financing, sanctions, corruption, or other illicit financial activities. Accountabilities have also been established for the protection of the Group's assets and reputation, as well as the interests of our customers and shareholders.

New product and outsourcing risks

Each new product, service or outsourcing initiative is subject to a risk review and sign-off process, where relevant risks are identified and assessed by departments independent of the risk-taking unit proposing the product or service. Variations of existing products or services and outsourcing initiatives are also subject to a similar process.

Other mitigation programmes

To manage business disruptions effectively, business continuity management is vital as part of the Group's risk mitigation programme.

A robust business continuity management programme is in place within essential banking services for unforeseen events or business disruptions. Planning for business resilience includes the identification of key business processes and resources via Business Impact Analysis and documented in the Business Continuity Plan ("BCP").

The Group's BCP aims to minimise the impact of business interruption stemming from severe loss scenarios, and provide a reasonable level of service until normal business operations are resumed. Within the crisis management structure, an incident management process is established which provides guidance on incident severity assessment, roles and responsibilities of process owners and escalation protocols for the effective management of a crisis.

Exercises are conducted annually, simulating different scenarios to test BCPs and crisis management protocol. These scenarios include technology issues affecting essential banking services across the Group, natural disasters with wide geographical impact, safety-at-risk incidents (e.g. terrorism) and other events leading to significant business disruption. The effectiveness of these exercises, as well as the Group's business continuity readiness, our alignment to regulatory guidelines and our disclosure of residual risks, are communicated and attested by senior management to the BRMC on an annual basis.

To mitigate losses from specific unexpected and significant event risks, the Group purchases group-wide insurance policies – under the Group Insurance Programme – from third-party insurers. The Group has acquired insurance policies relating to crime and

professional indemnity, directors and officers liability, cyber, property damage and business interruption, general liability, and terrorism.

• **Processes, systems and reports**

Robust internal control processes and systems are integral to identifying, monitoring, managing and reporting operational risk.

All units are responsible for the day-to-day management of operational risk in their products, processes, systems and activities, in accordance with the various frameworks and policies. The RMG Operational Risk unit and other corporate oversight and control functions oversee and monitor the effectiveness of operational risk management, assess key operational risk issues with the units, and report and/or escalate key operational risks to risk committees with recommendations on appropriate risk mitigation strategies.

The Bank implemented an integrated governance, risk & compliance system with aligned risk assessment methodology, common taxonomy, and unified processes for the three lines of defence.

(e) Capital management

The Group's capital management policies are to diversify its sources of capital, to allocate capital efficiently, guided by the need to maintain a prudent relationship between available capital and the risks of its underlying businesses and to meet the expectations of key constituencies, including investors and regulators.

The Banking Ordinance and the Banking (Capital) Rules set out the current requirements relating to the minimum capital adequacy ratios for an authorised institution incorporated in Hong Kong and the methodology for calculating these ratios.

The Bank is required to compute its capital adequacy ratios on a combined basis that includes the Bank and its overseas branch.

The Bank complied with the capital requirements imposed by the HKMA throughout 2018 and 2017.

38 MATERIAL RELATED PARTY TRANSACTIONS

(a) Holding companies and fellow subsidiaries

The Group's immediate holding company is DHB Limited and the ultimate holding company is DBS Group Holdings Ltd ("DBSH"). DBS Bank Ltd is an intermediate holding company of the Group.

As part of the Group's normal course of business, it enters into various transactions with holding companies and fellow subsidiaries on normal commercial terms. These transactions include interbank placements, taking of deposits, financial derivatives, contingent liabilities and commitments.

The Group has policies on credit processing for its affiliates, as well as transactions with its affiliates and related parties. Affiliate-related transactions must be conducted on an arm's length basis using credit standards, terms and conditions that are comparable to similar transactions with non-affiliates.

Information relating to income and expenses from these transactions during the year and balances outstanding as at 31 December are set out below:

(i) Income and expenses with holding companies and fellow subsidiaries

In HK\$ millions	DBS Group Holdings Ltd		DBS Bank Ltd		Fellow subsidiaries	
	2018	2017	2018	2017	2018	2017
Interest income	-	-	4,354	2,055	64	62
Interest expense	(162)	(155)	(110)	(122)	-	(1)
Net fee and commission income / (expense)	-	-	86	87	(10)	(9)
Net trading (loss) / profit	-	-	(353)	1,071	(3)	1
Other income	-	-	39	37	17	20
Total expenses (charged) / recovered	-	-	(11)	(48)	80	92

(ii) Balances with DBS Bank Ltd as at 31 December

In HK\$ millions	2018	2017
Assets		
Due from banks	213,017	193,042
Derivatives	288	942
Other assets	1,782	977
	215,087	194,961
Liabilities		
Due to banks	7,334	5,149
Derivatives	628	732
Other liabilities	108	204
	8,070	6,085

(iii) Contract / notional amounts of financial derivatives with DBS Bank Ltd and fellow subsidiaries as at 31 December

In HK\$ millions	2018	2017
Foreign exchange contracts	125,776	97,995
Interest rate contracts	14,988	18,066
Equity contracts	640	894
Credit contracts	3,253	-
Commodity contracts	-	29
	144,657	116,984

(iv) Contingent liabilities and commitments with DBS Bank Ltd and fellow subsidiaries

As at 31 December 2018, total contingent liabilities and commitments with DBS Bank Ltd and fellow subsidiaries amounted to HK\$12,046 million (2017: HK\$2,784 million).

(v) Balances with immediate holding company and other intermediate holding companies as at 31 December

In HK\$ millions	2018	2017
Deposits and balances from customers	317	314

(vi) Balances with DBS Group Holdings Ltd as at 31 December

In HK\$ millions	2018	2017
Liabilities		
Subordinated liability	4,229	4,220
Other liabilities	10	7
	4,239	4,227

(vii) Balances with fellow subsidiaries as at 31 December

In HK\$ millions	2018	2017
Due from banks	72	93
Loans and advances to customers	400	476
Bank and corporate securities	1,090	1,150
Other assets	128	186
	1,690	1,905
Due to banks	118	226
Deposits and balances from customers	622	2,180
Other liabilities	188	98
	928	2,504

(b) Directors and key management personnel

(i) Transactions and balances with directors and key management personnel

For the year ended 31 December 2018 and 2017, the Group has banking and non-banking transactions with directors of the Bank and DBSH Group and key management personnel of the Bank and their close family members. These transactions, including the taking of deposit and extension of credit card and other loan facilities, are made in the ordinary course of business and on commercial terms, and are not material.

(ii) Compensation of directors and key management personnel

In HK\$ millions	2018	2017
Salaries, other short term employee benefits and directors' fee (Note)	80	78
Pension	3	3
Share-based compensation	23	24
	106	105

Note:

The directors' fees if any, are payable in 2019 to eligible persons who acted as directors of the Bank during the year ended 31 December 2018. Such fees are subject to the approval of the shareholders of the Bank.

The amount included cash bonus accrued during the year, to be paid in the following year. Such cash bonus is subject to the approval of DBSH's Board of Directors.

39 LOAN TO DIRECTOR AND ENTITY CONNECTED WITH DIRECTOR

Loan to director of the Bank and entity connected with director disclosed pursuant to section 383(1)(d) of the Hong Kong Companies Ordinance and Part 3 of the Companies (Disclosure of Information about Benefits of Directors) Regulation is as follows:

Loan made by the Bank

Name of borrower	Great Maker Limited
Relationship with the Bank	Connected entity of Mr. Ng Chee Siong, Robert, who resigned as an independent non-executive director of the Bank with effect from 29 June 2018
Terms of the loan	
– Duration and repayment terms	Tenor of 4 years with bullet repayment
– Loan amount	HK\$1,300 million
– Interest rate	HIBOR+1.3%
– Security	Properties
Outstanding loan balance	
– At 1 January 2017	HK\$788 million
– At 31 December 2017 and 1 January 2018	HK\$879 million
– At 31 December 2018	HK\$767 million
Maximum balance outstanding	
– During 2017	HK\$879 million
– During 2018	HK\$915 million

As at 31 December 2018 and 2017, there was no impaired and overdue amount on the loan.

40 SHARE BASED COMPENSATION PLANS

The Group participated in various share-based compensation plans operated by the DBSH to foster a culture that aligns employees' interests with shareholders, enable employees to share in the bank's performance and enhance talent retention.

Main Scheme/ Plan	Note
<p>DBSH Share Plan (Share Plan)</p> <ul style="list-style-type: none"> The Share Plan is granted to Group executives as determined by the CMDC appointed to administer the Share Plan from time to time. Participants are awarded shares of DBSH or, at the CMDC's discretion, their equivalent cash value or a combination. Awards consist of main award and retention award (20% of main awards). Dividends on unvested shares are not accrued to employees. The vesting of main award is staggered between 2 – 4 years after grant i.e. 33% will vest 2 years after grant; another 33% will vest on the third year and the remaining 34% plus the retention award will vest 4 years after grant. The awards will lapse immediately upon termination of employment, except in the event of ill health, injury or disability, redundancy, retirement or death. The market price of shares on the grant date is used to estimate the fair value of the shares awarded. Vested and unvested shares are subject to clawback/malus. Conditions that trigger such clawback/malus are in the Corporate Governance section of DBSH's Annual Report. 	40(i)
<p>DBSH Employee Share Plan (ESP)</p> <ul style="list-style-type: none"> The ESP caters to employees not eligible to participate in the above listed Share Plan. Eligible employees are awarded ordinary shares of DBSH, their equivalent cash value or a combination of both (at the discretion of the CMDC), when time-based conditions are met. The awards structure and vesting conditions are similar to DBSH Share Plan. There are no additional retention awards for shares granted to top performers and key employees. However, in specific cases where the award form part of an employee's annual performance remuneration, the retention award which constitutes 20% of the shares given in the main award will be granted. The shares in the retention award will vest 4 years after the date of grant. For such cases, vested and unvested shares are subject to clawback/malus. Conditions that trigger such clawback/malus are in the Corporate Governance section of DBSH's Annual Report. 	40(i)

(i) DBSH Share Plan and DBSH Employee Share Plan

The following table sets out the outstanding awards at the end of each reporting period and the movement during the year:

Number of shares	2018		2017	
	Share Plan	ESP	Share Plan	ESP
Balance at 1 January	1,394,378	448,577	1,530,561	465,505
Granted*	318,282	115,000	321,726	166,500
Transfer	40,242	6,398	2,362	(808)
Vested	(482,628)	(143,251)	(410,986)	(132,814)
Forfeited	(25,108)	(52,365)	(49,285)	(49,806)
Balance at 31 December	1,245,166	374,359	1,394,378	448,577
Weighted average fair value of the shares granted during the year	SG\$26.24	SG\$26.46	SG\$18.50	SG\$18.50

Since the inception of the Share Plan and ESP, no awards have been cash-settled.

* 2018 amounts included adjustments (26,688 shares) made to all unvested share awards following the shareholders' approval for the special dividend of 50 cents per ordinary share at DBSH's Annual General Meeting held on 25 April 2018 in accordance with the terms of the Share Plan and ESP.

41 ACQUISITIONS

On 31 October 2016, DBS Bank Ltd. has agreed to acquire the wealth management and retail banking business of Australia and New Zealand Banking Group in five markets, including Singapore, Hong Kong, China, Taiwan and Indonesia. The acquisition of the business in each jurisdiction is independent of each other. As at 31 December 2017, DBS Bank Ltd. completed the acquisition of the businesses in Singapore, Hong Kong, China and Taiwan.

As part of the acquisition, the Group, being the subsidiary of DBS Bank Ltd, recorded the assets acquired (comprising mainly loans and advances to customers) of USD587 million and the liabilities assumed (comprising mainly deposits and balances with customers) of USD2,942 million. The difference of USD2,355 million was received by the Group in the form of cash for the Hong Kong business integration.

42 BANK LEVEL STATEMENT OF FINANCIAL POSITION

In HK\$ millions	Note	As at 31 December	
		2018	2017*
Assets			
Cash and balances with central banks		3,028	2,911
Government securities and treasury bills		38,289	20,111
Due from banks		222,057	200,726
Derivatives		471	1,188
Bank and corporate securities		9,418	11,095
Loans and advances to customers		162,171	154,175
Other assets		7,893	5,471
Subsidiaries		53	53
Properties and other fixed assets		2,166	1,979
Total assets		445,546	397,709
Liabilities			
Due to banks		9,880	7,666
Deposits and balances from customers		363,672	327,496
Derivatives		840	883
Certificates of deposit issued		5,558	4,189
Other liabilities		23,544	14,489
Amounts due to subsidiaries		68	67
Subordinated liability		4,229	4,220
Total liabilities		407,791	359,010
Equity			
Share capital		8,995	8,995
Reserves	29(b)	28,760	29,704
Total equity		37,755	38,699
Total liabilities and equity		445,546	397,709

* In accordance with the principles of merger accounting, 2017 figures have been restated due to the acquisition of DBS Vickers (Hong Kong) Limited's retail brokerage business. Please refer to note 2(a) for details.

Seah Lim Huat, Peter
Chairman

J.E. Sebastian Paredes Muirragui
Director

DBS Bank (Hong Kong) Limited and its Subsidiaries

CORPORATE GOVERNANCE REPORT (unaudited)

The following information is disclosed as part of the accompanying information to the financial statements and does not form part of the audited financial statements.

1 BOARD AND BOARD COMMITTEES

DBS Bank (Hong Kong) Limited (the "Bank") is fully committed to effective corporate governance in order to ensure its proper functioning and protect the interests of all the Bank's stakeholders. The Bank is subject to, and during the year has complied, in all material aspects, with the guidelines set out in the HKMA Supervisory Policy Manual CG-1 Corporate Governance of Locally Incorporated Authorized Institutions.

The Board of Directors of the Bank (the "Board") directs the Bank in the conduct of its affairs and ensures that corporate responsibility and ethical standards underpin the conduct of the Bank's business. The Board provides sound leadership to the Chief Executive Officer (the "CEO") and Management in setting the strategic vision, direction and long-term goals of the Bank as well as ensuring that adequate resources are available to meet these objectives. The Board bears the ultimate responsibility for the Bank's governance, strategy, risk management, financial performance and key personnel decisions.

To discharge its stewardship and responsibilities in specific areas, the Board may delegate authority to specialized Board committees to more efficiently and effectively contribute to the strategic and operational development of the Bank. The composition, roles and functions of the Board committees of the Bank are set out below.

(a) Board Audit Committee

The Board Audit Committee (the "BAC") comprises four non-executive directors. A majority (three out of four) of the members of the BAC, including its Chairman, are independent non-executive directors ("INED") of the Bank. All members of the BAC are highly experienced in financial and internal control management; most with expertise in audit practices, financial reporting and accounting. The BAC held four meetings during the year ended 31 December 2018.

BAC members for the year ended 31 December 2018	
Mr. Dominic Chiu Fai HO, Chairman	INED
Mr. SEAH Lim Huat, Peter	NED
Mr. KWOK Kwok Chuen	INED
Ms. TSE Sau Ling, Nancy	INED

The key responsibilities of the BAC include:

- monitoring the financial reporting process;
- reviewing the Bank's financial statements prior to submission to the Board for approval;
- overseeing and interacting with the internal and external auditors;
- making recommendations to the Board on the proposals to shareholders on the appointment, re-appointment and removal of the external auditor and approving the remuneration and terms of engagement of the external auditor;

- approving the appointment, removal and remuneration of the Head of Internal Audit;
- reviewing the adequacy and effectiveness of the internal audit function and processes;
- reviewing the independence and objectivity of the external auditor;
- approving the internal and external auditor's audit plans and audit reports;
- ensuring that any observations of internal or external auditors regarding internal control weaknesses or deficiencies are promptly communicated to the BAC and rectified by Management of the Bank; and
- reviewing the adequacy and effectiveness of the Bank's internal controls, such as financial, operational, compliance and information technology controls, as well as accounting policies and systems.

(b) Board Risk Management Committee

The Board Risk Management Committee (the "BRMC") comprises five directors. All of the members of the BRMC, including its Chairman, are non-executive directors ("NED"). A majority (three out of five) of the members of the BRMC, including its Chairman, are independent non-executive directors ("INED") of the Bank. The BRMC members are appropriately qualified to discharge their responsibilities with extensive experience in risk management issues and practices. The BRMC held four meetings during the year ended 31 December 2018.

BRMC members for the year ended 31 December 2018	
Ms. TSE Sau Ling, Nancy (Chairman)*	INED
Mr. SEAH Lim Huat, Peter	NED
Mr. Piyush GUPTA	NED
Mr. Dominic Chiu Fai HO	INED
Mr. YIP Dicky Peter	INED
*With effect from 1 January 2018, Ms. TSE Sau Ling Nancy replaced Mr. SEAH Lim Huat, Peter as the Chairman, Mr. Seah continues to be a member of the BRMC; while Mr. J.E. Sebastian PAREDES MUIRRAGUI ceased to be a member of the BRMC.	

The BRMC has oversight of the Bank's risk governance, risk approaches and risk limits of the Bank to ensure that all risks are effectively managed within the Bank's overall risk governance framework. The BRMC also has oversight of the culture and behavioral standards that promote prudent risk taking and fair treatment of customers and ensure the effectiveness of initiatives designed to influence culture in alignment with the Bank's culture standards. In particular, the principal duties of the BRMC include:

- reviewing and recommending for the Board's approval the risk strategies, key risk policies and risk appetite statement as well as specific risks relevant to the Bank, such as credit, market, liquidity, operational and reputational risks;
- approving the Bank's overall and specific risk governance frameworks, risk authority limits and major risk policies as delegated by the Board;
- approving risk exposures and profile against risk limits and risk strategy in accordance with approved risk appetite and/or guidelines;
- monitoring the quarterly portfolio reviews of total exposures as well as large exposures and asset quality;

- discussing large risk events and subsequent remedial action plans;
- monitoring market developments, such as macro-economic, credit, industry, country risk and stress tests related to these developments;
- overseeing the independence and adequacy of the risk management function;
- reviewing the plans to meet the Basel Capital Accord requirements;
- overseeing the Internal Capital Adequacy Assessment Process, including approving stress scenarios and commensurate results for capital, risk-weighted assets, profit and loss and liquidity;
- obtaining assurance on the sufficiency of the information systems, infrastructure, resources and systems for risk management;
- assessing the risks inherent in new products and services to be launched and approving the new product approval policy;
- reviewing and recommending the effectiveness of culture and behavioural standards to the Board; and
- approving the relevant statements and reports related to the risk culture.

The BRMC supervises the Bank's risk management and risk culture in accordance with the overall risk appetite established by the Board. This risk appetite framework guides Management in the pursuit of the Bank's strategy and business plans and is encapsulated in a formal risk appetite statement which considers capital adequacy, earnings volatility and the various risk types including but not limited to credit risk, country risk, market risk, liquidity risk, operational risk and reputational risk. Risk appetite takes into account potential impact arising from stressed conditions and concentration risk. Portfolio risk limits for the quantifiable risk types are established through a top-down approach and operationalised through a formal framework. Other significant risk aspects are guided by qualitative expression of principles. The risk appetite framework is reviewed annually.

(c) Nominating Committee

Prior to 20 July 2018, the Bank relied on the Nominating Committee ("NC") of DBS Group Holdings Ltd ("DBSH") to perform the nomination committee functions on behalf of the Bank. A majority (three out of five) of the members of the Nominating Committee (including the NC Chairman) are independent directors of DBSH. Please refer to the Corporate Governance Report in the Annual Report of DBSH for details on the functions of the DBSH Nominating Committee. The NC held four meetings during the year ended 31 December 2018.

NC members of DBSH for the year ended 31 December 2018	
Mr. HO Tian Yee, Chairman*	Independent Director
Mr. SEAH Lim Huat, Peter*	Non-Executive and Non-Independent Director
Dr. Bonghan CHO*	Independent Director (from 26 April 2018)
Mrs. OW Foong Pheng	Non-Executive and Non-Independent Director
Mr. TEOH Leong Kay, Danny	Independent Director

* With effect from 16 November 2018:

- (i) Mr. HO Tian Yee replaced Mr. SEAH Lim Huat, Peter as the NC Chairman; Mr. Seah remains as a member of the NC;
- (ii) Mr. Seah was deemed non-independent under the (Singapore) Banking (Corporate Governance) Regulations 2005 as he has served as a DBSH director for more than 9 years; and
- (iii) Ms. GOH Yiu Kiang, Euleen ceased to be a member of the NC.

(d) Compensation and Management Development Committee

Prior to 20 July 2018, the Bank relied on the Compensation and Management Development Committee ("CMDC") of DBSH to perform the remuneration committee functions on behalf of the Bank. A majority (three out of five) of the members of the CMDC (including the CMDC Chairman) are independent directors of DBSH. Please refer to the Corporate Governance Report in the Annual Report of DBSH for details on the functions of the DBSH CMDC. The CMDC held four meetings during the year ended 31 December 2018.

CMDC members of DBSH for the year ended 31 December 2018	
Mr. Andre SEKULIC, Chairman*	Independent Director
Mr. SEAH Lim Huat, Peter*	Non-Executive and Non-Independent Director
Ms. GOH Yiu Kiang, Euleen	Non-Executive and Non-Independent Director
Mr. Nihal KAVIRATNE	Independent Director (from 16 November 2018)
Mr. LIM Tse Chow, Olivier	Independent Director (from 7 November 2017)
*With effect from 16 November 2018, Mr. Andre SEKULIC replaced Mr. SEAH Lim Huat, Peter as the CMDC Chairman, Mr. Seah remains as a member of the CMDC.	
With effect from 25 April 2018, Dr. Bart Joseph BROADMAN ceased to be a member of the CMDC.	

(e) Board Nomination and Remuneration Committee

The Bank established the Board Nomination and Remuneration Committee (the "BNRC") on 20 July 2018, and ceased to rely on the NC and CMDC of DBSH since. The BNRC comprises three directors. All of the members of the BNRC, including its Chairman, are non-executive directors ("NED"). A majority (two out of three) of the members of the BNRC, including its Chairman, are independent non-executive directors ("INED") of the Bank. The BNRC members are appropriately qualified to discharge their responsibilities with relevant expertise and skills. The BNRC held one meeting during the year ended 31 December 2018.

BNRC members for the year ended 31 December 2018	
Mr. LIU Chee Ming (Chairman)	INED
Mr. SEAH Lim Huat, Peter	NED
Mr. KWOK Kwok Chuen	INED

The BNRC oversees the overall remuneration policy of the Bank. It also identifies and nominates suitable individuals to become directors and senior management of the Bank and make

recommendations to the Board for their appointment, reappointment and succession planning; and conducts evaluation on members of the Board. The key responsibilities of the BNRC include:

- reviewing and approving the remuneration policy applicable to the employees of the Bank;
- approving the remuneration packages and any subsequent adjustments of senior management and other key personnel;
- identifying and selecting fit and proper qualified candidates for appointment to the Board and Board committees;
- reviewing nominations for appointments and reasons for resignation or dismissal of senior management;
- making recommendation to the Board on the selection of nominated candidates for directorships and senior management positions and on the re-appointment of directors or succession planning of directors and chief executive officer;
- assessing the performance and effectiveness of the Board and Board committees;
- reviewing regularly the structure, size and composition (including skills, knowledge and experience of members) of the Board and Board committees; and
- determining the independence of the independent non-executive directors in accordance with the regulatory guidelines and other relevant factors.

2 SENIOR MANAGEMENT AND MANAGEMENT COMMITTEES

Senior Management of the Bank consists of a group of highly competent and experienced individuals responsible and accountable to the Board for the sound and prudent day-to-day management of the Bank in accordance with the business strategy, risk appetite and policies approved by the Board. Specialised Management committees are established to oversee and implement business strategies, risk management systems and internal controls. The roles, functions and composition of each of the Management committees are set out below.

(a) Hong Kong Management Committee

The Hong Kong Management Committee (the "HKMC") is responsible for formulating and implementing DBS Group's strategy for Hong Kong, as well as the financial and non-financial results of DBS Group's activities in this geographic segment. It provides leadership to the various business and support units in Hong Kong with a view to ensure sound and effective governance while achieving the targeted financial returns. Towards this end, the HKMC prioritises business development initiatives and support infrastructure projects necessary to underpin robust growth and allocates capital within the context of DBS Group's strategy. The HKMC is also responsible for ensuring that policies and practices are in place to maintain high standards of corporate governance, risk management and compliance in Hong Kong. Chaired by the CEO of the Bank, the HKMC comprises senior management staff in Hong Kong.

(b) Hong Kong Risk Executive Committee

The Hong Kong Risk Executive Committee provides oversight of all risk types (including those without an underlying risk committee oversight), interactions between risk types and cross-risk stress

testing for major downside risk. It reviews, from a risk perspective, existing and new business proposals and establishes overall local risk architecture direction and determine reporting requirements in line with those established by DBS Group. The Hong Kong Risk Executive Committee comprises the CEO of the Bank, the Senior Risk Executive of Hong Kong and representatives from key business units and support units.

(c) Hong Kong Asset and Liability Committee

The Hong Kong Asset and Liability Committee oversees strategies to enhance the quality of net interest income, liquidity management and structural foreign exchange management for Hong Kong. The Hong Kong Asset and Liability Committee also oversees the capital management and planning process, and review the Bank's capital position and adequacy. The Hong Kong Asset and Liability Committee comprises the CEO of the Bank and representatives from the relevant business units and support units.

(d) Hong Kong Credit Risk Committee

The Hong Kong Credit Risk Committee serves as an executive forum for discussions and decisions pertaining to credit risk and its management. It assesses credit risk taking, and reviews and monitors credit risk portfolio, special loan and asset review situations, credit systems, specific credit concentrations and trends, key policy deviations, macroeconomic trends with material impact to the Bank. The Hong Kong Credit Risk Committee exercises active oversight on credit risk related regulatory developments, the use of rating systems and ensure the continuing appropriateness of stress testing. The Hong Kong Credit Risk Committee comprises the Credit Head of the Bank and representatives from relevant business units, credit, risk management and other support units.

(e) Hong Kong Market and Liquidity Risk Committee

The Hong Kong Market and Liquidity Risk Committee provides comprehensive and bank-wide oversight of all market and liquidity risks and their management in trading and banking books. It serves as an executive forum for discussions and decisions on all aspects of market and liquidity risks and their management. It maintains oversight on effectiveness of market and liquidity risk management framework including policies, models, systems, processes, information and methodologies. It sets standards and provides necessary guidance on the establishment and maintenance of the bank-wide liquidity contingency plan. The Hong Kong Market and Liquidity Risk Committee comprises the Market & Liquidity Risk Head of the Bank and representatives from risk management and other relevant business units and support units.

(f) Hong Kong Operational Risk Committee

The Hong Kong Operational Risk Committee provides comprehensive location-wide oversight and direction relating to the management of operational risk. It monitors and reviews the effectiveness of operational risk management, policies, processes, methodologies and infrastructure. It performs top-down assessment and monitors critical operational risk exposures and provides direction for resolution of critical operational risk issues and monitors issue resolution. The Hong Kong Operational Risk Committee comprises the Head of Risk Management Group – Operational Risk, and representatives from key business units and support units.

(g) Hong Kong Risk Culture and Conduct Committee

The Hong Kong Risk Culture and Conduct Committee (“HKRCCC”) provides location-wide oversight and direction relating to the management and implementation of the risk culture and conduct agenda. It oversees and monitors the culture and behavioural standards across the Bank and approves the culture enhancement initiatives and plans of the Bank. Chaired by the CEO of the Bank, the HKRCCC comprises heads of key business units and support units.

(h) Hong Kong Product Oversight Committee

The Hong Kong Product Oversight Committee provides country oversight over the risks associated with new products in Hong Kong. It provides holistic overview of such risks to ensure new products are offered in line with the bank’s strategy and risk appetite, in the interest of protecting the bank’s franchise. The Hong Kong Product Oversight Committee comprises the Senior Risk Executive of Hong Kong and representatives from key business units and support units.

3 DISCLOSURE ON REMUNERATION PURSUANT TO THE HKMA SUPERVISORY POLICY MANUAL CG-5 “GUIDELINE ON A SOUND REMUNERATION SYSTEM”

(a) Design and implementation of the remuneration system

The Bank adopts the remuneration policy and practices formulated by DBSH. Please refer to the Annual Report of DBSH for major characteristics of the remuneration system.

(b) Aggregate quantitative information on remuneration for senior management and key personnel for the year ended 31 December 2018 are as follows:

Senior management is defined as those who are responsible for oversight of the Bank’s strategy or activities or those of the Bank’s material business lines. Key personnel is defined as individual employees whose duties or activities in the course of their employment involve the assumption of material risk or taking on of material exposures on behalf of the Bank.

Breakdown of remuneration awarded ⁽ⁱ⁾	2018	2017
Number of senior management	13	13
Number of key personnel*	10	12
In HK\$ millions		
Fixed remuneration		
• Cash based (non-deferred)	59	62
• Share based	–	–
• Other	–	–
Variable remuneration ⁽ⁱⁱ⁾		
• Cash based (non-deferred)	51	48
• Share based (deferred)	27	22
• Other	–	–
	137	132

*Aligns definition of key personnel to that of DBS Group in 2018

In HK\$ millions	2018	2017
Breakdown of deferred remuneration		
• Outstanding – vested	–	–
• Outstanding – unvested	105	133
• Awarded during the year	27	22
• Paid out during the year	52	28
• Reductions in current year due to ex-post adjustment – explicit ⁽ⁱⁱⁱ⁾	–	–
• Reductions in current year due to ex-post adjustment – implicit ^(iv)	(22)	–

(i) Remuneration figures for senior management and key personnel are aggregated due to data confidentiality.

(ii) Cash and share based variable remuneration are subject to the approval of the DBSH Board of Directors.

(iii) Examples of explicit ex-post adjustments include malus, clawbacks, or similar reversals or downward revaluation of awards.

(iv) Examples of implicit ex-post adjustments include fluctuations in the value of shares or performance units.

No senior management or key personnel has been awarded with new guaranteed bonus or severance payments in 2018 (2017: nil).

No severance payment being paid to senior management or key personnel (2017: nil).

No sign-on award being paid to senior management or key personnel (2017: nil).

4 INTERNAL AUDIT

Internal Audit is independent of the activities it audits. Its objectives, scope of authority and responsibilities are defined in the Hong Kong Audit Charter, which is approved by the BAC. Head of Internal Audit reports functionally to the Head of Group Audit and the Chairman of BAC, as well as administratively to the CEO.

Internal Audit’s responsibilities include:

- (i) Evaluating the reliability, adequacy and effectiveness of the Bank’s risk management and internal controls systems, including whether there is prompt and accurate recording of transactions and proper safeguarding of assets;
- (ii) Providing an objective and independent assessment of the Bank’s credit portfolio quality, the execution of approved credit portfolio strategies and control standards relating to credit management processes;
- (iii) Reviewing whether the Bank complies with laws and regulations and adheres to established policies; and
- (iv) Reviewing whether management is taking appropriate steps to address control deficiencies.

Internal Audit adheres to the Bank’s Code of Conduct and is guided by the Mission Statement in the Audit Charter. They have adopted the Code of Ethics and has aligned its practices with the International Professional Practices Framework established by the Institute of Internal Auditors (IIA). In addition, they have embedded IIA’s 10 Core Principles for the Professional Practice of Internal Auditing into their activity.

Internal Audit has unfettered access to the BAC, the Board and management, as well as the right to seek information and explanation. Internal Audit has an organisational and strategic alignment to the Bank. The Head of Internal Audit has a seat in the Bank's HKMC. He or his delegate attends the business reviews and strategic planning forums.

approach to perform risk assessments and control testing and provide better risk management insights.

Internal Audit adopts a risk-based approach in its auditing activities. An annual audit plan is developed using a structured risk and control assessment framework through which the inherent risk and control effectiveness of each auditable entity in the Bank is assessed. The assessment also covers risks arising from new lines of business, new products and emerging risks from the Bank's operating environment. Audit projects are planned based on the results of the assessment, with priority given to auditing higher risk areas and as required by regulators.

Audit reports containing identified issues and corrective action plans are reported to the BAC and senior management. Progress of the corrective action plans is monitored, and past due action plans are included in regular reports to the senior management and the BAC. In all routine audits, Internal Audit evaluates the control environment and management's control awareness which incorporates risk culture as guided by Financial Stability Board's Guidance on Sound Risk Culture.

Internal Audit apprises regulators and external auditors of all relevant audit matters. It works closely with external auditors to coordinate audit efforts.

QUALITY ASSURANCE & KEY DEVELOPMENTS

In line with leading practices, Internal Audit has a quality assurance and improvement programme (QAIP) that covers all aspects of its audit activity and conforms to the International Standards for the Professional Practice of Internal Auditing. As part of our QAIP programme, internal quality assessment reviews (QAR) are conducted quarterly and external QAR are carried out at least once every five years by qualified professionals from an external organisation.

Since 2014, the internal QAR has been contracted to an independent assessor, KPMG.

In 2018, KPMG was appointed to perform the external QAR. KPMG rated Group Audit (including Hong Kong Internal Audit) as adequate and effective and Generally Conforms¹ to the international standards promulgated by the Institute of Internal Auditors. In addition, KPMG's report indicated their strong endorsement of Internal Audit's leading practices in Agile, Data Analytics and technology advancement.

Internal Audit leverages on the use of data, technology and automation to provide greater insights and to enhance the Bank's audit assurance. Since 2017, Internal Audit has operationalised its Future of Auditing roadmap with the use of digital tools, rule based and predictive analytics, coupled with the continuous monitoring

¹ Definition of Generally Conforms: Internal Audit activity has a charter, policies and processes that are judged to be in accordance with the IIA standards.