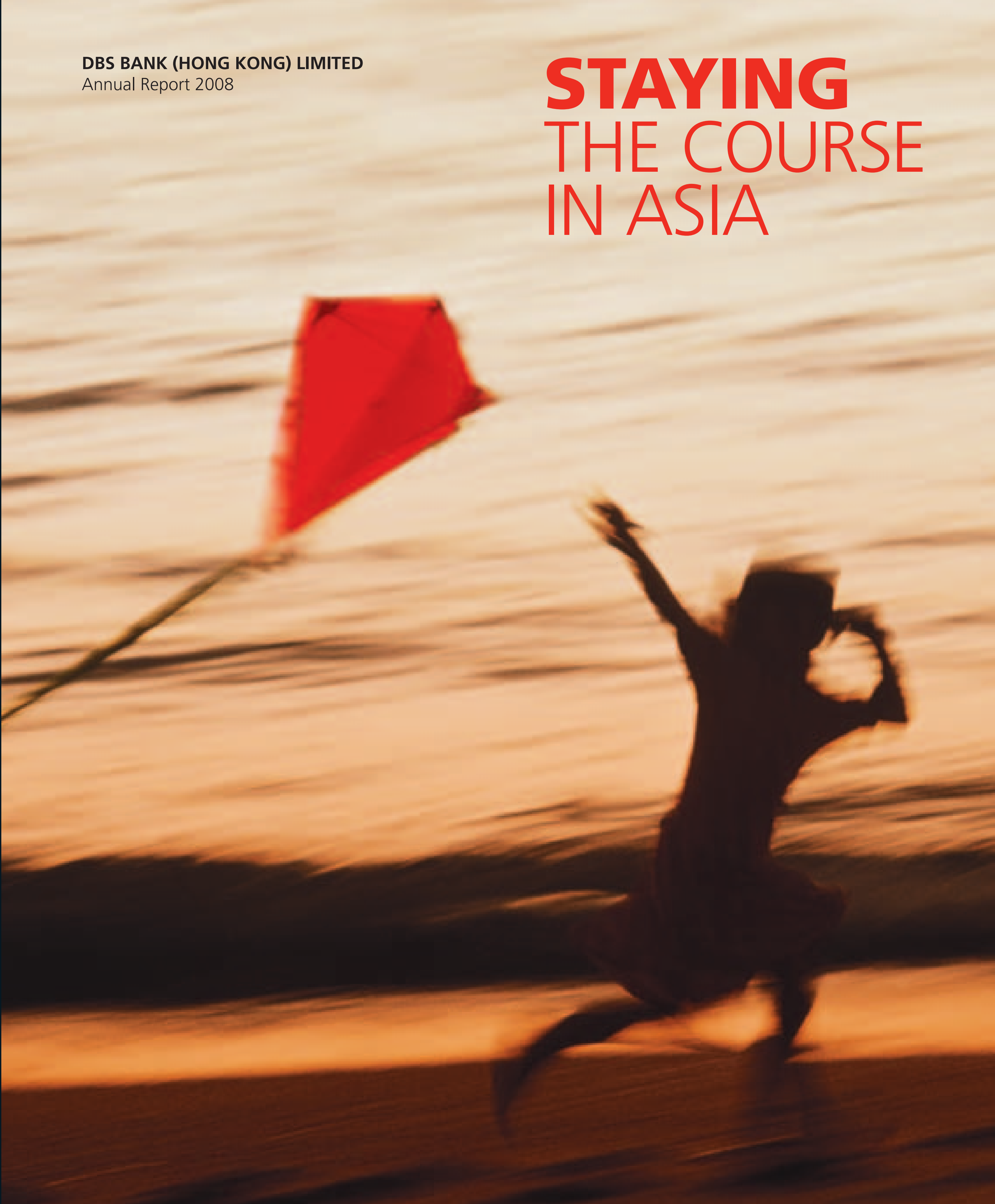
DBS BANK (HONG KONG) LIMITED
Annual Report 2008

STAYING THE COURSE IN ASIA



DBS. Living, Breathing Asia

DBS

CONTENTS

STAYING THE COURSE IN ASIA

2008 was a very challenging year globally and Asia was not spared. As a bank born and bred in Asia, DBS has benefited from Asia's rise, and shares today in its challenges.

Despite the current crisis, we believe in the resilience of Asia and have confidence in its potential. We are standing by our customers through this downturn, and our commitment to all our stakeholders to deliver sustainable growth remains unshaken.

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 31st December 2008.

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 23 to the financial statements.

Results and appropriations

The results of the Group for the year ended 31st December 2008 are set out in the consolidated income statement on page 5.

An interim dividend of HK$0.6538 per share totalling HK$3,400,000,000 was paid on 25th February 2008 for the year ended 31st December 2008 (2007: An interim dividend of HK$0.25 per share totalling HK$1,300,000,000 was paid).

The directors do not recommend the payment of a final dividend for the year ended 31st December 2008 (2007: Nil).

Reserves

Details of the movements in the reserves of the Bank and the Group during the year are set out in Note 34 to the financial statements.

Fixed assets

Details of the movements in fixed assets during the year are set out in Note 24 to the financial statements.

Donations

Donations made by the Group during the year amounted to HK$1,328,000 (2007: HK$65,600).

Directors

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

Wong Kwong Shing, Frank – Chairman	(resigned on 31st August 2008)
Kwa Chong Seng – Chairman	(appointed on 22nd October 2008)
Yip Yok Tak, Amy – Chief Executive	
Chan Tak Kin – Deputy Chief Executive	(resigned on 24th November 2008)
Cheng Wai Chee, Christopher	
Alexander Reid Hamilton	
Leung Ting Mow, Kenneth	
Lo Chung Wing, Victor	
Wong Kai Yuan, Jeanette	(appointed on 22nd October 2008)

REPORT OF THE DIRECTORS (CONTINUED)

Directors (continued)

In accordance with Article 90 of the Bank's Articles of Association, Mr. Kwa Chong Seng and Ms. Wong Kai Yuan, Jeanette retire from office at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-election.

In accordance with Article 98 of the Bank's Articles of Association, Ms. Yip Yok Tak, Amy and Mr. Lo Chung Wing, Victor retire from office at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-election.

Directors' interests in contracts

No 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 had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Arrangements to acquire shares

The following were arrangements which subsisted at the end of the year or at any time during the year which enabled the directors of the Bank to acquire benefits by means of the acquisition of shares of DBS Group Holdings Ltd. ('DBSH'), the ultimate holding company of the Bank, or to be awarded shares of DBSH (or their equivalent cash value).

(a) DBSH Share Option Plan

The DBSH Share Option Plan (the 'Option Plan') was adopted by the shareholders of DBSH at an Extraordinary General Meeting held on 18th September 1999 under which options to subscribe for DBSH ordinary shares could be granted to DBSH Group executives.

At the beginning of the year, Mr. Wong Kwong Shing, Frank, Mr. Chan Tak Kin and Ms. Wong Kai Yuan, Jeanette have outstanding options granted under the Option Plan.

During the year, no options were granted to directors of the Bank and Mr. Chan Tak Kin had acquired shares in DBSH by exercising options granted pursuant to the Option Plan before the date of his resignation.

(b) DBSH Share Plan

The DBSH Share Plan (the 'Share Plan'), as amended, was adopted by the shareholders of DBSH at an Extraordinary General Meeting held on 18th September 1999 under which DBSH ordinary shares, their equivalent cash value or a combination of both, could be granted to DBSH Group executives, when prescribed DBSH Group performance targets are met over a three-year period or after the satisfactory completion of time-based service conditions.

During the year, Mr. Wong Kwong Shing, Frank, Ms. Yip Yok Tak, Amy, Mr. Chan Tak Kin and Ms. Wong Kai Yuan, Jeanette were eligible to receive awards under the Share Plan. No awards were granted to the directors of the Bank during the year.

Apart from the above, at no time during the year was the Bank or any of its subsidiaries or its holding companies or any subsidiary 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 corporate.

REPORT OF THE DIRECTORS (CONTINUED)

Management contracts

On 12th November 2002, an Information Technology Outsourcing Agreement (the 'IBM Agreement') was entered into between the Bank and IBM China / Hong Kong Limited ('IBM') in relation to the provision by IBM of certain information technology and related services to the Bank. The IBM Agreement was in line with the spirit of the Master Agreement (the 'IBM Master Agreement') dated 12th November 2002 entered into between DBS Bank Ltd., the Bank's holding company, and IBM Singapore Pte. Limited. The IBM Agreement commenced on 12th November 2002 and continues until 23:59 (Singapore Time) on 11th November 2012, unless terminated earlier pursuant to the terms of the IBM Master Agreement.

On 1st April 2004, a Management Country Agreement (the 'JLL Agreement') was entered into between the Bank and Jones Lang LaSalle Limited ('JLL') in relation to the provision by JLL of certain property management and related services to the Bank in Hong Kong. The JLL Agreement was in line with the spirit of the Master Agreement (the 'JLL Master Agreement') dated 1st April 2004 entered into between DBS Bank Ltd., and Jones Lang LaSalle Property Consultants Pte. Ltd. The initial term of the JLL Agreement covered the period from 1st April 2004 to 31st December 2006, or for so long as the JLL Master Agreement remains in effect, unless terminated earlier or extended under the terms of the JLL Agreement, whichever is earlier in time. The JLL Agreement has been extended to 31st March 2009.

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, being eligible, offer themselves for re-appointment.

On behalf of the Board

Kwa Chong Seng
Chairman

Hong Kong, 11th February 2009

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF DBS BANK (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability)

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 5 to 78, which comprise the consolidated and company balance sheets as at 31st December 2008, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Bank and of the Group as at 31st December 2008 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 11th February 2009

CONSOLIDATED INCOME STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER 2008

	Note	**2008** **HK$'000**	2007 HK$'000
Interest income	4	**8,528,210**	11,814,280
Interest expense	5	**(4,193,721)**	(6,898,263)
Net interest income		**4,334,489**	4,916,017
Net fee and commission income	6	**1,271,342**	1,600,422
Net income from financial instruments at fair value through profit or loss	7	**719,433**	453,605
Net gain on disposal of available-for-sale financial investments		**345,212**	24,715
Other income	8	**228,763**	76,472
Total income		**6,899,239**	7,071,231
Total expenses	9	**(3,581,476)**	(3,179,702)
Profit before impairment allowances for credit losses		**3,317,763**	3,891,529
Impairment allowances for credit losses	10	**(1,233,514)**	(374,766)
Profit before income tax		**2,084,249**	3,516,763
Income tax expense	12	**(255,368)**	(593,673)
Profit attributable to shareholders	13	**1,828,881**	2,923,090
Dividend	14	**3,400,000**	1,300,000

CONSOLIDATED BALANCE SHEET

AS AT 31ST DECEMBER 2008

	Note	**2008** **HK$'000**	2007 HK$'000
Assets			
Cash and balances with banks	15	**21,719,787**	36,339,915
Placements with and advances to banks		**17,124,092**	17,753,028
Trading securities	16	**3,039,097**	7,575,988
Financial assets designated at fair value through profit or loss	17	**25,054**	–
Positive replacement values		**2,505,551**	2,749,958
Advances to customers less impairment allowances	18	**132,384,605**	122,412,304
Financial investments	20	**33,569,441**	36,142,338
Other assets	21	**3,408,453**	6,258,152
Deferred income tax assets	31(b)	**138,597**	58,465
Fixed assets	24	**1,178,454**	1,200,488
Lease premium for land	25	**1,936,861**	2,032,933
Total assets		**217,029,992**	232,523,569
Liabilities			
Deposits and balances from banks		**1,028,875**	804,768
Trading liabilities	26	**2,926,871**	7,519,879
Financial liabilities designated at fair value through profit or loss	27	**4,492,998**	6,987,963
Negative replacement values		**3,620,044**	3,095,364
Deposits from customers	28	**176,896,443**	181,069,821
Certificates of deposit issued	29	**1,838,648**	617,795
Other liabilities	30	**5,670,462**	9,672,747
Current income tax liabilities	31(a)	**24,578**	338,293
Amount due to a jointly controlled entity	22	**808,203**	720,766
Subordinated liability	32	**4,185,027**	4,212,621
Total liabilities		**201,492,149**	215,040,017
Equity			
Share capital	33	**5,200,000**	5,200,000
Reserves	34	**10,337,843**	12,283,552
Total equity		**15,537,843**	17,483,552
Total liabilities and equity		**217,029,992**	232,523,569

Kwa Chong Seng
Director

Yip Yok Tak, Amy
Director

Wong Kai Yuan, Jeanette
Director

Wong Wai Nar, Doris
Secretary

BALANCE SHEET

AS AT 31ST DECEMBER 2008

	Note	2008 HK$'000	2007 HK$'000
Assets			
Cash and balances with banks	15	**21,717,366**	36,336,988
Placements with and advances to banks		**17,124,092**	17,753,028
Trading securities	16	**3,039,097**	7,575,988
Financial assets designated at fair value through profit or loss	17	**25,054**	–
Positive replacement values		**2,505,551**	2,749,958
Advances to customers less impairment allowances	18	**132,408,237**	122,437,315
Financial investments	20	**33,569,441**	36,142,338
Other assets	21	**3,407,340**	6,256,759
Deferred income tax assets	31(b)	**139,328**	60,468
Interest in a jointly controlled entity	22	**500**	500
Subsidiaries	23	**162,612**	172,692
Fixed assets	24	**1,158,374**	1,172,936
Lease premium for land	25	**1,936,861**	2,032,933
Total assets		**217,193,853**	232,691,903
Liabilities			
Deposits and balances from banks		**1,028,875**	804,768
Trading liabilities	26	**2,926,871**	7,519,879
Financial liabilities designated at fair value through profit or loss	27	**4,492,998**	6,987,963
Negative replacement values		**3,620,044**	3,095,364
Deposits from customers	28	**176,896,443**	181,069,821
Certificates of deposit issued	29	**1,838,648**	617,795
Other liabilities	30	**5,079,426**	9,126,683
Current income tax liabilities	31(a)	**20,695**	337,082
Amount due to a jointly controlled entity	22	**1,616,405**	1,441,531
Amounts due to subsidiaries	23	**226,163**	242,335
Subordinated liability	32	**4,185,027**	4,212,621
Total liabilities		**201,931,595**	215,455,842
Equity			
Share capital	33	**5,200,000**	5,200,000
Reserves	34	**10,062,258**	12,036,061
Total equity		**15,262,258**	17,236,061
Total liabilities and equity		**217,193,853**	232,691,903

Kwa Chong Seng *Director*	**Yip Yok Tak, Amy** *Director*
Wong Kai Yuan, Jeanette *Director*	**Wong Wai Nar, Doris** *Secretary*

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31ST DECEMBER 2008

	Share capital HK$'000	Share premium HK$'000	Capital reserve HK$'000	Investments revaluation reserve HK$'000	General reserve HK$'000	Retained earnings HK$'000	Total equity HK$'000
Balance as at 1st January 2007	5,200,000	595,503	11,636	(133,151)	2,398,792	7,724,220	15,797,000
Change in fair value of available-for-sale financial investments	–	–	–	93,470	–	–	93,470
Exchange differences arising from translation of net investments in overseas branches and subsidiaries	–	–	–	–	–	1,056	1,056
Profit attributable to shareholders	–	–	–	–	–	2,923,090	2,923,090
Reserve transferred to income statement upon disposal of available-for-sale financial investments	–	–	–	(23,437)	–	–	(23,437)
Deferred income tax	–	–	–	(7,627)	–	–	(7,627)
Dividend	–	–	–	–	–	(1,300,000)	(1,300,000)
Balance as at 31st December 2007	**5,200,000**	**595,503**	**11,636**	**(70,745)**	**2,398,792**	**9,348,366**	**17,483,552**
Change in fair value of available-for-sale financial investments	**–**	**–**	**–**	**(274,856)**	**–**	**–**	**(274,856)**
Exchange differences arising from translation of net investments in overseas branch and subsidiaries	**–**	**–**	**–**	**–**	**–**	**439**	**439**
Profit attributable to shareholders	**–**	**–**	**–**	**–**	**–**	**1,828,881**	**1,828,881**
Amortisation of reserve to income statement due to reclassification of available-for-sale financial investments to loans and receivables	**–**	**–**	**–**	**8,313**	**–**	**–**	**8,313**
Reserve transferred to income statement upon disposal of available-for-sale financial investments	**–**	**–**	**–**	**(210,474)**	**–**	**–**	**(210,474)**
Impairment of available-for-sale financial investments transferred to income statement	**–**	**–**	**–**	**25,808**	**–**	**–**	**25,808**
Deferred income tax	**–**	**–**	**–**	**76,125**	**–**	**–**	**76,125**
Dividend	**–**	**–**	**–**	**–**	**–**	**(3,400,000)**	**(3,400,000)**
Unclaimed dividend forfeited	**–**	**–**	**–**	**–**	**–**	**55**	**55**
Balance as at 31st December 2008	**5,200,000**	**595,503**	**11,636**	**(445,829)**	**2,398,792**	**7,777,741**	**15,537,843**

CONSOLIDATED CASH FLOW STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER 2008

	Note	**2008** **HK$'000**	2007 HK$'000
Net cash (outflow) / inflow from operating activities	36(a)	**(12,036,639)**	27,454,853
Investing activities			
Purchase of fixed assets		**(217,197)**	(34,083)
Proceeds from disposal of fixed assets and lease premium for land		**261,074**	24,254
Disposal of Mainland branches		**–**	(588,947)
Net cash inflow / (outflow) from investing activities		**43,877**	(598,776)
Financing activities			
Dividend paid		**(3,400,000)**	(1,300,000)
Interest paid for certificates of deposit issued		**(31,078)**	(102,858)
Interest paid for subordinated liability		**(159,919)**	(312,796)
Issuance of certificates of deposit	36(b)	**1,709,112**	–
Redemption of certificates of deposit issued	36(b)	**(740,976)**	(2,228,315)
Redemption of subordinated liability		**–**	(2,041,120)
Net cash outflow from financing activities		**(2,622,861)**	(5,985,089)
(Decrease) / increase in cash and cash equivalents		**(14,615,623)**	20,870,988
Cash and cash equivalents at 1st January		**44,719,834**	23,848,846
Cash and cash equivalents at 31st December	36(c)	**30,104,211**	44,719,834

NOTES TO THE FINANCIAL STATEMENTS

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, Central, 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 6 Shenton Way, DBS Building Tower One, Singapore 068809.

The consolidated financial statements are presented in thousands of units of Hong Kong dollars (HK$’000), unless otherwise stated. The consolidated financial statements have been approved for issue by the Board of Directors on 11th February 2009.

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 have been prepared in accordance with Hong Kong Financial Reporting Standards (‘HKFRSs’ is a collective term which includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (‘HKASs’) and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants (‘HKICPA’), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial investments, financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss and investment properties. In addition, the carrying amounts of assets and liabilities that are designated as hedged items in a fair value hedge are adjusted for fair value changes attributable to the hedged risks.

The preparation of financial statements in conformity with HKFRSs requires management to exercise judgement, use estimates and make assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. 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.

The adoption of new / revised HKFRSs

In 2008, the Group adopted the new / revised standards and interpretations of HKFRSs as set out below, which are relevant to its operations.

HKAS 39 (Amendment)	Financial Instruments: Recognition and Measurement – Reclassification of Financial Assets
HKFRS 7 (Amendment)	Financial Instruments: Disclosures – Reclassification of Financial Assets
HK(IFRIC)-Int 11	HKFRS 2 Group and Treasury Share Transactions

The adoption of the above standards and interpretation did not result in substantial changes to the Group’s accounting policies, which are consistent with those used in the previous financial year except for the following changes:

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

In accordance with HKAS 39 (Amendment), the Group may choose to reclassify a non-derivative trading financial asset out of the held for trading category if the financial asset is no longer held for the purpose of selling it in the near term. Financial assets other than loans and receivables are permitted to be reclassified out of the held for trading category only in rare circumstances arising from a single event that is unusual and highly unlikely to recur in the near term. In addition, the Group may choose to reclassify financial assets that would meet the definition of loans and receivables out of the held-for-trading or available-for-sale categories if the Group has the intention and ability to hold these financial assets for the foreseeable future or until maturity at the date of reclassification.

Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortised cost as applicable, and no reversals of fair value gains or losses recorded before reclassification date are subsequently made. Effective interest rates for financial assets reclassified to loans and receivables category are determined at the reclassification date. Further increases in estimates of cash flows adjust effective interest rates prospectively.

With the adoption of HKAS 39 (Amendment) and HKFRS 7 (Amendment), the Group reclassified certain financial assets from available-for-sale category to loans and receivables category. The Group has reviewed those available-for-sale assets that meet the definition of loans and receivables and where the Group has the intention and ability to hold for the foreseeable future and reclassified these amounts to the loans and receivables category. In accordance with the transitional provisions of HKAS 39 (Amendment) and HKFRS 7 (Amendment), the reclassifications have been applied retrospectively, the earliest dating back to 1st July 2008.

New and revised HKFRSs (which are relevant to the Group's operations) issued but not yet effective

The Group has not early adopted the following new / revised standards and interpretations:

HKAS 1 (Revised) – Presentation of Financial Statements (effective for financial periods beginning on or after 1st January 2009). The revised standard will prohibit the presentation of items of income and expenses (that is, 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity. All non-owner changes in equity will be required to be shown in a performance statement. Where entities restate or reclassify comparative information, they will be required to present a restated balance sheet as at the beginning comparative period in addition to the current requirement to present balance sheets at the end of the current period and comparative period. The adoption of this revised standard will affect the presentation of the Group's financial statements.

HKAS 1 (Amendment) – Presentation of Financial Statements (effective for financial periods beginning on or after 1st January 2009). The amendment is part of the International Accounting Standards Board's ('IASB') annual improvements project published in May 2008. The amendment clarifies that some rather than all financial assets and liabilities classified as held for trading in accordance with HKAS 39 Financial Instruments: Recognition and Measurement are examples of current assets and liabilities respectively. The Group will apply HKAS 39 (Amendment) from 1st January 2009. It is not expected to have material impact on the Group's financial statements.

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

The following are other new/revised HKFRSs, which will take effect for the financial periods on or after 1st January 2009. There is no expected material impact on the Group's financial statements from the adoption of these new/revised accounting changes:

HKFRS 2 (Amendment)	Share-based Payment
HKFRS 5 (Amendment)	Non-current Assets Held for Sale and Discontinued Operations
HKFRS 8	Operating Segments
HKAS 19 (Amendment)	Employee Benefits
HKAS 23 (Revised)	Borrowing Costs
HKAS 23 (Amendment)	Borrowing Costs
HKAS 27 (Revised)	Consolidated and Separate Financial Statements
HKAS 32 (Amendment)	Financial Instruments: Presentation
HKAS 36 (Amendment)	Impairment of Assets
HKAS 38 (Amendment)	Intangible Assets
HKAS 39 (Amendment)	Financial Instruments: Recognition and Measurement
HK(IFRIC)-Int 13	Customer Loyalty Programmes

There are a number of minor amendments to HKFRS 7 Financial Instruments: Disclosures, HKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, HKAS 10 Events after the Reporting Period and HKAS 18 Revenue, which are part of the IASB's annual improvements project published in May 2008 (not addressed above). These amendments are unlikely to have an impact on the Group's financial statements.

(b) Consolidation

The consolidated financial statements incorporate the financial statements of the Bank, its subsidiaries and its interest in a jointly controlled entity.

Subsidiaries

Subsidiaries are companies in which the Group has the power to govern the financial and operating policies to obtain benefits from their activities and this is generally accompanied by a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Investment in jointly controlled entities

A jointly controlled entity is an entity which is jointly controlled by the Group together with one or more parties through contractual arrangements.

The investment is accounted for by proportionate consolidation which involves combining the Group's share of jointly controlled entity's income, expenses, assets and liabilities on a line-by-line basis with similar items in the Group's financial statements.

Investment cost at Bank level

Investments in subsidiaries and jointly controlled entities are stated at cost less impairment losses in the Bank's balance sheet. On disposal of investments in subsidiaries and jointly controlled entities, the difference between the net proceeds and the carrying amounts of the investments is taken to the income statement.

2 Summary of significant accounting policies (continued)

(b) Consolidation (continued)

Intra-group transactions

All intra-group transactions, balances, income and expenses are eliminated on consolidation. Profits resulting from transactions between the Group and jointly controlled entities are eliminated to the extent of the Group's interest in these companies. Losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

(c) Financial instruments

Financial instruments are classified according to the purpose for which the assets were acquired or the liabilities were incurred. Management determines the classification at initial recognition and re-evaluates the designation at every reporting date, with the exception that the designation of financial assets or financial liabilities at fair value through profit or loss is not revocable.

The classification of financial instruments is as follows:

(i) Financial instruments at fair value through profit or loss

This category has two sub-categories: financial assets and financial liabilities held for trading, and those designated at fair value through profit or loss at initial recognition. Financial assets and financial liabilities are classified as held for trading if it is acquired or incurred principally for the purpose of short term selling or repurchasing.

Financial instruments designated under the fair value option are financial instruments containing one or more embedded derivatives that significantly modify the cash flows resulting from those financial instruments, and which would otherwise be accounted for separately.

Derivatives are also categorised as held for trading unless they are designated as hedging instruments.

(ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that are classified as held for trading, and those that the Group upon initial recognition designates as at fair value through profit or loss, available-for-sale; or those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration.

(iii) Available-for-sale financial investments

Available-for-sale financial investments are non-derivatives that are either designated in this category or not classified in any other categories. These financial investments are those intended to be held for an indefinite period of time, and may be sold in response to the needs for liquidity or changes in interest rates, exchange rates or equity prices.

(iv) Other financial liabilities

Other financial liabilities are recognised initially at fair value net of transaction costs incurred. Other financial liabilities are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the other financial liabilities using the effective interest method.

2 Summary of significant accounting policies (continued)

(c) Financial instruments (continued)

Recognition and derecognition

The Group recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. Purchases and sales of investments are recognised on trade-date – the date on which the Group commits to purchase or sell the asset.

Financial assets are de-recognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership. Financial liabilities are removed or derecognised from the balance sheet when the obligation specified in the contract is discharged, cancelled or expired.

Initial measurement

Financial instruments are initially recognised at fair value plus transaction costs that are directly attributable to the acquisition of the financial asset or the issue of the financial liability, except for financial instruments at fair value through profit or loss, for which transactions costs are expensed off immediately.

Subsequent measurement

Available-for-sale financial investments and financial instruments at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are carried at amortised cost using the effective interest method, less impairment allowances. Unquoted investments classified as available-for-sale for which fair values cannot be reliably determined are carried at cost, less impairment allowances.

Realised and unrealised gains and losses arising from changes in the fair value of the financial instruments at fair value through profit or loss are taken into 'net income from financial instruments at fair value through profit or loss' in the income statement in the period in which they arise. Unrealised gains and losses arising from changes in the fair value of investments classified as available-for-sale are recognised in the investments revaluation reserve, except for hedged item as mentioned in Note 2(k). When investments classified as available-for-sale are sold or impaired, the accumulated fair value adjustments in the investments revaluation reserve are taken to the income statement.

Other financial liabilities, except for hedged items as mentioned in Note 2(k), are carried at amortised cost using the effective interest method.

Determination of fair value

The fair values of financial instruments traded in active markets are based on quoted market prices at the balance sheet date. The quoted market prices used for financial assets held by the Group are the current bid prices. If the market for a financial asset is not active, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and option pricing models refined to reflect the issuer's specific circumstances. The fair value of financial liabilities is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

2 Summary of significant accounting policies (continued)

(d) Recognition of day one profit or loss

Where the transaction price is different to the fair value determined using valuation models for which not all inputs are market observable prices or rates, such financial instrument is initially recognised at transaction price, which is the best indicator of fair value. The difference between the transaction price and model value is not recognised immediately in the income statement. This difference, commonly referred to as 'day one profit or loss', is released to the income statement on the earlier of the following: (i) amortisation over the life of the transaction; (ii) when all the market inputs become observable; or (iii) on derecognition.

(e) Impairment

Financial assets carried at amortised cost

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. Impairment allowances are 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.

The criteria that the Group uses to determine that there is objective 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 entity would not otherwise consider; and
- High probability of bankruptcy or other financial reorganisation of the borrower.

Individual impairment allowances are assessed using the discounted cash flow method. The 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.

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.

2 Summary of significant accounting policies (continued)

(e) Impairment (continued)

Available-for-sale financial investments

The Group assesses at each balance sheet date whether there is objective evidence that an available-for-sale financial investment is impaired. In the case of an equity investment, a significant or prolonged decline in the fair value of security below its cost is considered in determining whether the asset is impaired. When there is objective evidence of an impairment of an available-for-sale financial investment, the cumulative loss – measured as the difference between the amortised cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement – is removed from the investments revaluation reserve within equity and recognised in the income statement. Impairment losses recognised in the income statement on the equity investments is not reversed through the income statement, until the equity investment is disposed of. A subsequent recovery in the value of an available-for-sale debt security whose value is impaired is reversed through the income statement if there has been an identifiable event that led to the recovery.

(f) Leases

(i) Hire purchase contracts and 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 '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 accounting 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. Rentals applicable to such operating leases net of any incentives received from the lessor are charged to the income statement on a straight-line basis over the lease term. The Group's interests in leasehold land are also accounted for as operating leases.

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

(g) Sale and repurchase agreements

Repurchase agreements ('Repos') are treated as collateralised borrowing and the amount borrowed is shown as a liability and included in 'Deposits from customers' or 'Deposits and balances from banks'. The securities sold under repos are treated as pledged assets and remain on the balance sheet at amortised cost or fair value depending on their classification. Reverse repurchase agreements ('Reverse repos') are treated as collateralised lending and the amount lent is shown as an asset and included in 'Advances to customers' or 'Placements with and advances to banks'. The difference between the amount received and the amount paid under repos and reverse repos is amortised as interest expense and interest income respectively on an effective interest basis.

2 Summary of significant accounting policies (continued)

(h) Properties and other fixed assets

(i) Properties

Properties are stated at cost less accumulated impairment losses and accumulated depreciation. Depreciation is calculated to write off the assets over their estimated useful lives on a straight-line basis as follows:

Freehold land	Not depreciated
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

(ii) Investment properties

Investment properties are carried at fair value, representing estimated open market value determined by independent qualified valuers. The changes in fair value are recognised in the income statement. Deferred income tax is recognised for the change in fair value of investment properties and charged to the income statement.

Investment properties include land held under operating leases and self-owned buildings.

Land held under operating leases are classified and accounted for as investment property when the rest of the definition of investment property is met. The operating lease is accounted for as if it were a finance lease.

(iii) Furniture, fixtures and equipment

Furniture, fixtures and equipment are stated at cost less accumulated impairment losses and accumulated depreciation. Depreciation on furniture, fixtures and equipment is calculated to write off the assets on a straight-line basis over their estimated useful lives of between 3 and 8 years.

(iv) Impairment

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that properties, furniture, fixtures and equipment are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount (being the higher of the fair value less cost to sell and the value-in-use). Such impairment losses are recognised in the income statement.

(v) Gain or loss on disposal

The gain or loss on disposal of a fixed asset is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the income statement.

2 Summary of significant accounting policies (continued)

(i) Lease premium for land

Leasehold properties held for own use should be split into a lease of land and building in proportion to the relative fair values of the leasehold interests in the land element and the building element of the lease at the inception of the lease. Leasehold land premium that is up-front payment to acquire long-term interest in leasehold land is stated at cost and amortised over the period of the lease.

(j) Provisions and other liabilities

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 can be made.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

(k) Derivative financial instruments and hedge accounting

Derivatives are initially recognised at fair value at the date on which a derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are classified as assets when fair value is positive (‘positive replacement values’) and as liabilities when fair value is negative (‘negative replacement values’).

Changes in the fair value of derivatives other than those designated as fair value hedges, cash flow hedges or hedges of net investments in foreign operations are recognised in ‘net trading income’.

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

For derivatives designated as hedging instruments, each entity within the Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, including its risk management objective for undertaking various hedge transactions and methods used to assess effectiveness of the hedge. Each entity within the Group also documents its assessment, both at the hedge inception and on an ongoing basis, of whether the derivative is highly effective in offsetting changes in fair values or cash flows of hedged item.

(i) Fair value hedge

For a qualifying fair value hedge, the changes in the fair value of the 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 for which the effective interest method is used, is amortised to the income statement over the period to maturity of the hedged item.

2 Summary of significant accounting policies (continued)

(k) Derivative financial instruments and hedge accounting (continued)

(ii) Cash flow hedge

The effective portion of changes in the fair value of a derivative designated and qualified as a hedge of future cash flows is recognised directly in equity, and taken to the income statement in the periods when the hedged item affects profit or loss. 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 equity remains until the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss in equity is recognised immediately in the income statement.

(iii) Hedge of net investments in a foreign operation

Hedges of net investments in the Group's foreign operations are accounted for in a manner similar to cash flow hedges. The gain or loss from the derivative relating to the effective portion of the hedge is recognised in equity. Gain or loss relating to the ineffective portion of the hedge is recognised immediately in the income statement. On disposal of the foreign operation, the cumulative gain or loss in equity is taken to the income statement under 'net trading income'.

(l) Offsetting financial instruments

Certain financial assets and liabilities offset each other and the net amount is reported in the balance sheet when there is a legally enforceable right to set off the recognised amount and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(m) Interest income and expense

Interest income and expenses are recognised on a time-proportionate basis using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The calculation includes significant fees and transaction costs that are an integral part of the effective interest rate, and premiums or discounts. No interest expense is accrued on the Group' structured investment deposits which are carried at fair value through profit or loss.

When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and thereafter amortising the discount as interest income using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(n) 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 is recognised on the completion of a transaction. For a service that is provided over a period of time, fee and commission income is recognised over the period of which the related service is provided or credit risk is undertaken.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2 Summary of significant accounting policies (continued)

(o) Dividend income

Dividend income is recognised when the right to receive payment is established and is included in the income statement under 'other income'.

(p) Employee benefits

(i) Bonus plans

Liabilities for bonus plans due wholly within twelve months after the balance sheet date are recognised when the Group has a present or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made.

(ii) Pension obligations

The Group offers a mandatory provident fund scheme and participates in a defined contribution plan, the assets of which are generally held in separate trustee-administered funds. These pension plans are generally funded by payments from employees and the Group.

The Group's contributions to the mandatory provident fund scheme and defined contribution plan are expensed as incurred and are reduced by contributions forfeited by those employees who leave the scheme or the plan prior to vesting fully in the contributions.

(iii) Share-based compensation

There are a Share Option Plan, a Share Plan and an Employee Share Plan run by DBSH, the ultimate holding company of the Bank. Under the Share Option Plan, share options are granted to eligible staff. Under the Share Plan and the Employee Share Plan, ordinary shares in DBSH are given free of charge to eligible employees subject to DBSH Group meeting prescribed performance targets and/or after the satisfactory completion of time-based service conditions.

These share based payment 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.

(q) Taxation

Current income tax for current and prior periods is recognised at 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 balance sheet date.

Deferred income tax is provided, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Taxation rates enacted or substantively enacted by the balance sheet date are used in the determination of deferred income tax.

Deferred income tax liabilities are generally recognised for all taxable temporary differences. Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

2 Summary of significant accounting policies (continued)

(q) Taxation (continued)

Deferred income tax is provided on temporary differences arising from investments in subsidiaries and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not be reversed in the foreseeable future.

Deferred income tax assets and liabilities are credited or charged in the income statement, except when they relate to items credited or charged directly to reserves, in which case the deferred income tax assets and liabilities are also dealt with in reserves.

(r) Foreign currencies

(i) Functional and presentation currency

Items in the financial statements of the Bank and each of the Group's subsidiaries are translated using their functional currency, being the currency of the primary economic environment in which the entity operates. The financial statements are presented in Hong Kong dollar, which is the functional and presentation currency of the Bank and the Group.

(ii) Foreign currency transactions

Transactions in foreign currencies are translated at foreign exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into Hong Kong dollars at foreign exchange rates ruling at that date. Foreign exchange differences arising from translation are recognised in the income statement. Non-monetary assets and liabilities measured at cost in foreign currencies are translated using foreign exchange rates at the dates of the transactions. Non-monetary assets and liabilities measured at fair value in foreign currencies are translated to Hong Kong dollars at foreign exchange rates ruling at the dates the fair value was determined.

(iii) Foreign operations

The results and financial positions of the Group's operations whose functional currency is not Hong Kong dollars are translated into Hong Kong dollars in the following manner:

– Assets and liabilities are translated at the exchange rate ruling at the balance sheet date;
– Income and expenses in the income statement are translated at an average exchange rate approximating the exchange rates at the dates of the transactions; and
– All resulting exchange differences are dealt with as a movement in retained earnings.

(s) Financial guarantees

A financial guarantee is initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the initial measurement, less amortisation calculated to recognise in the income statement the fee income earned over the period of the financial guarantee and the best estimate of the expenditure required to settle any financial obligation arising at the balance sheet date.

The exposure to potential losses associated with financial guarantees is monitored periodically. When there is objective evidence indicating probability of losses occurring, a provision is recognised for the financial guarantee.

2 Summary of significant accounting policies (continued)

(t) Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the shareholders. Dividends for the year that are declared after the balance sheet date are dealt with in the subsequent events note.

(u) 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 and treasury bills that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

(v) Fiduciary activities

Assets and income belonging to customers for whom the Group acts in a fiduciary capacity as nominee, trustee or agent, are excluded from the financial statements.

3 Critical accounting estimates and judgements in applying accounting policies

The Group makes certain assumptions and estimates in the process of applying the Group's accounting policies. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

(a) Impairment allowances

The Group establishes, through charges against profit, impairment allowances in respect of estimated loss in loans and receivables. The allowances consist of individual impairment allowances and collective impairment allowances. The overall impairment allowances should represent the aggregate amount by which management considers it necessary to write down its loan portfolio in order to state it in the balance sheet at its estimated ultimate net realisable value.

In determining individual impairment allowances, management considers objective evidence of impairment. When a loan is impaired, an individual impairment allowance is assessed by a discounted cash flow method, measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the effective interest rate. The quantum of the allowance is also impacted by the collateral value and this in turn, may be discounted in certain circumstances to recognise the impact of forced sale or quick liquidation.

In determining collective impairment allowances, management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows.

The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

3 Critical accounting estimates and judgements in applying accounting policies (continued)

(b) Fair value of financial instruments

Fair value is defined as the value at which positions could be closed or sold in a transaction with a willing and knowledgeable counterparty. 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, including interest rate yield curves, option volatilities and currency rates. Management exercises judgement in determining the risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experience and other factors used in the valuation process. Judgement may also be applied in estimating prices for less readily observable external parameters. Other factors such as model assumptions, market dislocations and unexpected correlations can also materially affect these estimates and the resulting fair value estimates.

(c) Income taxes

When applying the relevant tax rules, there are certain transactions and computations for which the ultimate tax determination is uncertain during the ordinary course of business. In these circumstances, 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. Where the final tax outcome of these matters is different from the amounts that were initially recognised, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

(d) Provisions

Judgement is needed to determine if provision for compensation to certain customers who had bought structured investments from the Group should be recorded in accordance with the requirements in HKAS 37 Provisions, Contingent Liabilities and Contingent Assets. In making this judgement, the Group evaluates the likelihood and estimated amount of outflow of resources which will be required to settle the obligation with reference to factors such as historical settlement experience and advice from legal counsel.

4 Interest income

	2008 **HK$'000**	2007 HK$'000
Interest income on listed investments	**663,136**	598,213
Interest income on unlisted investments	**1,206,589**	1,633,289
Other interest income	**6,658,485**	9,582,778
	8,528,210	11,814,280

Included in interest income is HK$17,115,000 (2007: HK$15,932,000) with respect to the time value of the impaired advances to customers released from the impairment allowances (Note 19) and HK$8,395,430,000 (2007: HK$11,557,175,000) with respect to interest income recognised on financial assets that are not at fair value through profit or loss.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

5 Interest expense

	2008	2007
	HK$'000	HK$'000
Interest expense on subordinated liability maturing after five years	**152,781**	246,758
Other interest expense	**4,040,940**	6,651,505
	4,193,721	6,898,263

Interest expense recognised on financial liabilities that are not at fair value through profit or loss amounted to HK$4,081,052,000 (2007: HK$6,621,845,000).

6 Net fee and commission income

	2008	2007
	HK$'000	HK$'000
Fee and commission income	**1,675,695**	1,962,779
Fee and commission expense	**(404,353)**	(362,357)
Net fee and commission income	**1,271,342**	1,600,422
Comprising:		
– Wealth management	**329,244**	627,941
– Trade and remittances	**351,203**	360,873
– Credit card	**204,418**	196,391
– Loan-related	**129,438**	122,171
– Stock broking	**54,301**	82,752
– Investment banking	**18,251**	24,528
– Deposit-related	**23,822**	22,156
– Guarantees	**13,452**	7,874
– Others	**147,213**	155,736
	1,271,342	1,600,422
Of which:		
Fee and commission income arising from:		
– Financial assets or financial liabilities not at fair value through profit or loss	**788,498**	718,381
– Trust or other fiduciary activities	**28,898**	35,436
Fee and commission expense arising from:		
– Financial assets or financial liabilities not at fair value through profit or loss	**391,930**	333,672

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

7 Net income from financial instruments at fair value through profit or loss

	2008	2007
	HK$'000	HK$'000
Net trading income		
– Foreign exchange	**780,234**	636,959
– Interest rates, credit and equities	**(476,847)**	436,107
	303,387	1,073,066
Net gain/(loss) from financial instruments designated at fair value through profit or loss	**416,046**	(619,461)
	719,433	453,605

8 Other income

	2008	2007
	HK$'000	HK$'000
Fair value adjustment on investment properties (Note 24(a))	**(6,800)**	34,066
Net gain on disposal of fixed assets and lease premium for land	**201,008**	15,024
Dividend income from listed investments	**2,432**	2,572
Dividend income from unlisted investments	**13,105**	11,447
Others	**19,018**	13,363
	228,763	76,472

9 Total expenses

	2008	2007
	HK$'000	HK$'000
Employee benefits		
– Salaries and other short term employee benefits	**1,609,305**	1,575,226
– Pensions	**80,592**	75,157
– Share based payments	**14,149**	21,822
Premises and equipment expenses excluding depreciation		
– Amortisation of lease premium for land (Note 25)	**43,445**	47,598
– Rental of premises	**173,382**	148,325
– Others	**255,902**	218,974
Depreciation (Note 24(a))	**159,798**	143,799
Auditor's remuneration	**9,198**	10,214
Computerisation expenses	**269,010**	294,438
Other operating expenses	**966,695**	644,149
	3,581,476	3,179,702

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

10 Impairment allowances for credit losses

	2008 HK$'000	2007 HK$'000
Impairment allowances for credit losses		
– Individual impairment allowances on advances to customers (Note 19)	**1,020,322**	242,703
– Collective impairment allowances on advances to customers (Note 19)	**186,701**	132,063
– Impairment allowances on available-for-sale financial investments	**26,491**	–
	1,233,514	374,766
Individual impairment allowances on advances to customers		
– New allowances	**1,207,117**	433,807
– Releases	**(169,977)**	(154,040)
– Recoveries	**(16,818)**	(37,064)
	1,020,322	242,703
Collective impairment allowances on advances to customers		
– New allowances	**300,485**	215,977
– Releases	**(78,622)**	(43,686)
– Recoveries	**(35,162)**	(40,228)
	186,701	132,063
Impairment allowances on available-for-sale financial investments		
– New allowances	**26,491**	–

11 Directors' emoluments

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

	2008 HK$'000	2007 HK$'000
Fees	**1,120**	992
Salaries, housing and other allowances and benefits in kind	**17,685**	18,438
Pensions	**308**	304
	19,113	19,734

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

12 Income tax expense

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

	2008 HK$'000	2007 HK$'000
Hong Kong profits tax		
– Current year	**276,314**	555,899
– Overprovision in prior years	**(25,375)**	–
Overseas tax		
– Current year	**8,411**	17,670
– Underprovision in prior years	**25**	3,254
Current income tax	**259,375**	576,823
Deferred income tax (Note 31(b))	**(4,007)**	16,850
	255,368	593,673

Hong Kong profits tax has been provided at 16.5% (2007: 17.5%) 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:

	2008 HK$'000	2007 HK$'000
Accelerated depreciation allowances	**4,876**	9,011
Impairment allowances	**(6,295)**	1,175
Fair value adjustment on investment properties	**(2,588)**	5,962
Tax losses	**–**	702
	(4,007)	16,850

(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% (2007: 17.5%) is as follows:

	2008 HK$'000	2007 HK$'000
Profit before income tax	**2,084,249**	3,516,763
Tax calculated at tax rate of 16.5% (2007: 17.5%)	**343,901**	615,434
Effect of different tax rates in other countries	**(3,133)**	(3,712)
Effect of change in tax rate	**2,511**	–
Income not subject to tax	**(95,123)**	(90,672)
Expenses not deductible for tax purposes	**32,538**	69,435
(Overprovision)/underprovision in prior years	**(25,350)**	3,254
Others	**24**	(66)
Income tax expense	**255,368**	593,673

13 Profit attributable to shareholders

The profit attributable to shareholders is dealt with in the financial statements of the Bank to the extent of HK$1,801,226,000 (2007: HK$2,899,775,000).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

14 Dividend

An interim dividend of HK$3,400,000,000 or HK$0.6538 per share was paid for the year ended 31st December 2008. An interim dividend of HK$1,300,000,000 or HK$0.25 per share was paid for the year ended 31st December 2007.

15 Cash and balances with banks

	Group		Bank	
	2008 HK$'000	2007 HK$'000	**2008 HK$'000**	2007 HK$'000
Cash in hand	**504,056**	330,694	**504,056**	330,694
Balances with central banks	**227,365**	309,222	**227,365**	309,222
Balances with banks	**18,437,962**	34,240,133	**18,435,541**	34,237,206
Trade bills	**2,550,404**	1,459,866	**2,550,404**	1,459,866
	21,719,787	36,339,915	**21,717,366**	36,336,988

16 Trading securities

	Group and Bank	
	2008 HK$'000	2007 HK$'000
Treasury bills	**579,711**	4,415,663
Other debt securities	**2,459,386**	3,160,325
	3,039,097	7,575,988
Of which:		
– Listed in Hong Kong, at fair value	**1,847,343**	2,598,587
– Unlisted, at fair value	**1,191,754**	4,977,401
	3,039,097	7,575,988
Analysed by issuer as follows:		
– Sovereigns	**2,946,637**	7,525,557
– Public sector entities	**2,645**	1,490
– Banks	**89,815**	48,941
	3,039,097	7,575,988
Analysed by rating agency designation as follows:		
– AA- to AA+	**2,949,282**	7,527,047
– A- to A+	**81,502**	48,941
– BBB to BBB+	**8,313**	–
	3,039,097	7,575,988

The ratings referred 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.

17 Financial assets designated at fair value through profit or loss

This is a debt security issued by a bank with a rating of BBB under Standard & Poor's rating designation and is listed in Hong Kong.

18 Advances to customers less impairment allowances

	Group		Bank	
	2008	2007	**2008**	2007
	HK$'000	HK$'000	**HK$'000**	HK$'000
Advances to customers	**135,007,041**	124,097,593	**135,007,041**	124,097,593
Impairment allowances				
– Collectively assessed (Note 19)	**(958,586)**	(889,195)	**(934,954)**	(864,184)
– Individually assessed (Note 19)	**(1,663,850)**	(796,094)	**(1,663,850)**	(796,094)
	132,384,605	122,412,304	**132,408,237**	122,437,315

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

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Gross investments in finance leases and hire purchase contracts receivables:		
– Not later than one year	**2,348,994**	2,308,652
– Later than one year and not later than five years	**4,018,231**	3,553,102
– Later than five years	**7,972,703**	7,406,281
	14,339,928	13,268,035
Unearned future finance income	**(95,995)**	(103,870)
Net investments in finance leases and hire purchase contracts receivables	**14,243,933**	13,164,165
The net investments in finance leases and hire purchase contracts receivables are analysed as follows:		
– Not later than one year	**2,293,902**	2,249,105
– Later than one year and not later than five years	**3,977,424**	3,508,991
– Later than five years	**7,972,607**	7,406,069
	14,243,933	13,164,165

The unguaranteed residual values included in the gross investments in finance leases and hire purchase contracts receivables as at 31st December 2008 and 2007 are not considered to be material.

The individual impairment allowances for finance leases and hire purchase contracts receivables amounted to HK$140,182,000 as at 31st December 2008 (2007: HK$99,465,000).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

19 Impairment allowances on advances to customers

	Group		
	Individually assessed HK$'000	Collectively assessed HK$'000	Total HK$'000
As at 1st January 2008	**796,094**	**889,195**	**1,685,289**
Amounts written off	**(152,266)**	**(152,472)**	**(304,738)**
Recoveries of advances written off in previous years	**16,818**	**35,162**	**51,980**
Net charge to consolidated income statement (Note 10)	**1,020,322**	**186,701**	**1,207,023**
Discounting effect released from impairment allowances (Note 4)	**(17,115)**	**–**	**(17,115)**
Exchange differences	**(3)**	**–**	**(3)**
At 31st December 2008	**1,663,850**	**958,586**	**2,622,436**
As at 1st January 2007	742,090	913,124	1,655,214
Amounts written off	(179,716)	(172,241)	(351,957)
Recoveries of advances written off in previous years	37,064	40,228	77,292
Net charge to consolidated income statement (Note 10)	242,703	132,063	374,766
Discounting effect released from impairment allowances (Note 4)	(15,932)	–	(15,932)
Disposal of Mainland branches	(30,330)	(23,979)	(54,309)
Exchange differences	215	–	215
At 31st December 2007	796,094	889,195	1,685,289

	Bank		
	Individually assessed HK$'000	Collectively assessed HK$'000	Total HK$'000
As at 1st January 2008	**796,094**	**864,184**	**1,660,278**
Amounts written off	**(152,266)**	**(125,940)**	**(278,206)**
Recoveries of advances written off in previous years	**16,818**	**29,062**	**45,880**
Net charge to income statement	**1,020,322**	**167,648**	**1,187,970**
Discounting effect released from impairment allowances	**(17,115)**	**–**	**(17,115)**
Exchange differences	**(3)**	**–**	**(3)**
At 31st December 2008	**1,663,850**	**934,954**	**2,598,804**
As at 1st January 2007	742,090	886,718	1,628,808
Amounts written off	(179,716)	(141,566)	(321,282)
Recoveries of advances written off in previous years	37,064	33,935	70,999
Net charge to income statement	242,703	109,076	351,779
Discounting effect released from impairment allowances	(15,932)	–	(15,932)
Disposal of Mainland branches	(30,330)	(23,979)	(54,309)
Exchange differences	215	–	215
At 31st December 2007	796,094	864,184	1,660,278

20 Financial investments

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Available-for-sale	**27,768,497**	36,142,338
Loans and receivables	**5,800,944**	–
	33,569,441	36,142,338

(a) *Available-for-sale*

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Treasury bills	**3,489,912**	3,004,235
Certificates of deposit held	**963,190**	3,108,123
Other debt securities	**23,248,631**	29,954,469
Debt securities	**27,701,733**	36,066,827
Equity securities	**66,764**	75,511
	27,768,497	36,142,338
Debt securities		
– Listed in Hong Kong, at fair value	**917,004**	1,821,277
– Listed outside Hong Kong, at fair value	**8,720,598**	7,895,084
– Unlisted, at fair value	**18,049,810**	26,336,145
– Unlisted, at cost	**14,321**	14,321
	27,701,733	36,066,827
Equity securities		
– Listed in Hong Kong, at fair value	**35,257**	74,497
– Unlisted, at fair value	**2,107**	–
– Unlisted, at cost	**29,400**	1,014
	66,764	75,511
	27,768,497	36,142,338
Analysed by issuer as follows:		
– Sovereigns	**3,978,431**	4,198,619
– Public sector entities	**380,141**	744,356
– Banks	**20,877,884**	27,008,459
– Corporates	**2,517,720**	4,176,583
– Others	**14,321**	14,321
	27,768,497	36,142,338

20 Financial investments (continued)

(a) Available-for-sale (continued)

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Analysis of debt securities by rating agency designation as follows:		
– AAA	**3,439,541**	3,402,487
– AA- to AA+	**12,557,537**	16,125,084
– A- to A+	**8,848,700**	11,091,533
– BBB to BBB+	**2,127,124**	4,366,907
– Unrated	**728,831**	1,080,816
	27,701,733	36,066,827

The ratings referred 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.

The carrying amount of impaired debt securities as at 31st December 2008 was HK$198,000 (2007: No impaired debt securities). The interest element of the debt securities has been overdue for less than 3 months. No collateral is held by the Group in respect of the impaired debt securities. The impairment loss transferred from investments revaluation reserve to income statement amounted to HK$25,808,000 (2007: Nil).

(b) Loans and receivables

During the year, the Group reclassified debt securities amounting to HK$6,322,429,000 from available-for-sale category to loans and receivables category. The Group had the intention and ability to hold these assets for the foreseeable future at the date of reclassification.

	Group and Bank
	2008
	HK$'000
Debt securities	**5,800,944**
Of which:	
– Listed in Hong Kong	**184,471**
– Listed outside Hong Kong	**1,243,431**
– Unlisted	**4,373,042**
	5,800,944
Analysed by issuer as follows:	
– Banks	**4,641,419**
– Corporates	**1,159,525**
	5,800,944
Analysed by rating agency designated as follows:	
– AA- to AA+	**1,722,410**
– A- to A+	**3,344,512**
– BBB to BBB+	**734,022**
	5,800,944

20 Financial investments (continued)

(b) Loans and receivables (continued)

The ratings referred 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 31st December 2008, the fair value of the reclassified debt securities is HK$5,660,712,000 (2007: No such reclassification permitted).

The interest income and exchange gain recognised in the income statement during 2008 and before the reclassification were HK$124,474,000 and HK$96,158,000 respectively (2007: HK$136,705,000 and a gain of HK$84,102,000 respectively). The interest income and exchange loss recognised in the income statement after the reclassification were HK$98,774,000 and HK$587,741,000 respectively. The exchange gain or loss arising from these debt securities were managed in conjunction with matched funding where the resulting net exchange gain or loss was insignificant to the income statement.

The fair value loss recognised in the investments revaluation reserve during 2008 and before the reclassification was HK$30,308,000 (2007: HK$21,763,000). The fair value loss that would have been recognised in the investments revaluation reserve if the debt securities had not been reclassified would be HK$210,406,000 (2007: No such reclassification permitted).

At the time of reclassification, the effective interest rates ranged from 2.52% to 9.43% and the amounts of cash flows expected to be recovered were HK$7,030,127,000.

The above reclassified debt securities are neither past due nor impaired.

21 Other assets

	Group		Bank	
	2008	2007	**2008**	2007
	HK$'000	HK$'000	**HK$'000**	HK$'000
Accrued interest receivables	**672,795**	844,503	**672,795**	844,503
Other accounts	**2,735,658**	5,413,649	**2,734,545**	5,412,256
	3,408,453	6,258,152	**3,407,340**	6,256,759

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

22 Interest in a jointly controlled entity

	Group		Bank	
	2008	2007	**2008**	2007
	HK$'000	HK$'000	**HK$'000**	HK$'000
Unlisted investments, at cost			**500**	500
Amount due to a jointly controlled entity	**808,203**	720,766	**1,616,405**	1,441,531

The Group's interest in the jointly controlled entity is as follows:

	2008	2007
	HK$'000	HK$'000
Current assets	**809,167**	721,909
Non-current assets	**20,080**	27,551
Current liabilities	**617,027**	558,293
Non-current liabilities	**731**	2,002
Share of income	**137,457**	139,823
Share of expenses	**115,133**	123,692

Details of the jointly controlled entity are as follows:

Name of company	**Country of incorporation**	**Place of operation**	**Particulars of issued shares**	**Interest held**	**Principal activities**
Hutchison DBS Card Limited	British Virgin Islands	Hong Kong	500,000 class A shares of HK$1 each 500,000 class B shares of HK$1 each	50%	Provision of credit card services

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

23 Subsidiaries

	Bank	
	2008 **HK$'000**	2007 HK$'000
Unlisted shares, at cost after impairment of HK$2,215,000 (2007: HK$2,215,000)	**144,979**	144,973
Amounts due from subsidiaries	**17,633**	27,719
	162,612	172,692
Amounts due to subsidiaries	**226,163**	242,335

During the year, the subsidiaries have maintained deposit accounts with the Bank under its normal course of business. The other amounts due from / to subsidiaries are repayable on demand and are interest free.

Details of the principal subsidiaries which are wholly and directly owned by the Bank are as follows:

Name of company	Place of operation and incorporation	Particulars of issued share capital	Principal activities
DBS Corporate Services (Hong Kong) Limited	Hong Kong	500,000 shares of HK$1 each	Provision of corporate services
Ting Hong Nominees Limited	Hong Kong	10,000 shares of HK$1 each	Provision of nominee, trustee and agency services
Overseas Trust Bank Nominees Limited	Hong Kong	50,000 shares of HK$1 each	Provision of nominee services
DBS Trustee H.K. (Jersey) Limited	Jersey	100,000 shares of £1 each	Provision of trustee and trust administration services

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

24 Fixed assets

(a) Fixed assets movements

Group

	Freehold properties HK$'000	Buildings HK$'000	Investment properties HK$'000	Furniture, fixtures and equipment HK$'000	Total HK$'000
Cost or valuation					
As at 1st January 2008	23,413	717,613	145,000	1,220,520	2,106,546
Additions	–	5,606	–	295,706	301,312
Disposals	(446)	(78,197)	–	(554,704)	(633,347)
Fair value adjustment (Note 8)	–	–	(6,800)	–	(6,800)
At 31st December 2008	22,967	645,022	138,200	961,522	1,767,711
Accumulated depreciation and impairment					
As at 1st January 2008	17,044	299,785	–	589,229	906,058
Charge for the year (Note 9)	96	32,379	–	127,323	159,798
Disposals	(430)	(76,462)	–	(399,707)	(476,599)
At 31st December 2008	16,710	255,702	–	316,845	589,257
Net book value					
At 31st December 2008	6,257	389,320	138,200	644,677	1,178,454
The analysis of cost or valuation of the above assets at 31st December 2008 is as follows:					
At cost	22,967	645,022	–	961,522	1,629,511
At valuation – 2008	–	–	138,200	–	138,200
	22,967	645,022	138,200	961,522	1,767,711

The fair value of the investment properties has been determined based on valuations performed by A.G. Wilkinson & Associates. The fair value represents the estimated amount at which the asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

24 Fixed assets (continued)

(a) Fixed assets movements (continued)

Group

	Freehold properties HK$'000	Buildings HK$'000	Investment properties HK$'000	Furniture, fixtures and equipment HK$'000	Total HK$'000
Cost or valuation					
As at 1st January 2007	23,374	768,513	110,934	1,199,142	2,101,963
Additions	39	6,334	–	318,055	324,428
Disposals	–	(5,858)	–	(276,858)	(282,716)
Disposal of Mainland branches	–	(51,376)	–	(19,845)	(71,221)
Fair value adjustment (Note 8)	–	–	34,066	–	34,066
Exchange adjustments	–	–	–	26	26
At 31st December 2007	23,413	717,613	145,000	1,220,520	2,106,546
Accumulated depreciation and impairment					
As at 1st January 2007	16,942	314,360	–	698,408	1,029,710
Charge for the year (Note 9)	102	33,662	–	110,035	143,799
Disposals	–	(2,954)	–	(211,580)	(214,534)
Disposal of Mainland branches	–	(45,283)	–	(7,638)	(52,921)
Exchange adjustments	–	–	–	4	4
At 31st December 2007	17,044	299,785	–	589,229	906,058
Net book value					
At 31st December 2007	6,369	417,828	145,000	631,291	1,200,488
The analysis of cost or valuation of the above assets at 31st December 2007 is as follows:					
At cost	23,413	717,613	–	1,220,520	1,961,546
At valuation – 2007	–	–	145,000	–	145,000
	23,413	717,613	145,000	1,220,520	2,106,546

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

24 Fixed assets (continued)

(a) Fixed assets movements (continued)

Bank

	Freehold properties HK$'000	Buildings HK$'000	Investment properties HK$'000	Furniture, fixtures and equipment HK$'000	Total HK$'000
Cost or valuation					
As at 1st January 2008	23,413	717,613	145,000	1,181,943	2,067,969
Additions	–	5,606	–	295,148	300,754
Disposals	(446)	(78,197)	–	(553,520)	(632,163)
Fair value adjustment	–	–	(6,800)	–	(6,800)
At 31st December 2008	22,967	645,022	138,200	923,571	1,729,760
Accumulated depreciation and impairment					
As at 1st January 2008	17,044	299,785	–	578,204	895,033
Charge for the year	96	32,379	–	120,477	152,952
Disposals	(430)	(76,462)	–	(399,707)	(476,599)
At 31st December 2008	16,710	255,702	–	298,974	571,386
Net book value					
At 31st December 2008	6,257	389,320	138,200	624,597	1,158,374
The analysis of cost or valuation of the above assets at 31st December 2008 is as follows:					
At cost	22,967	645,022	–	923,571	1,591,560
At valuation – 2008	–	–	138,200	–	138,200
	22,967	645,022	138,200	923,571	1,729,760

The fair value of the investment properties has been determined based on valuations performed by A.G. Wilkinson & Associates. The fair value represents the estimated amount at which the asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

24 Fixed assets (continued)

(a) Fixed assets movements (continued)

Bank

	Freehold properties HK$'000	Buildings HK$'000	Investment properties HK$'000	Furniture, fixtures and equipment HK$'000	Total HK$'000
Cost or valuation					
As at 1st January 2007	23,374	768,513	110,934	1,157,888	2,060,709
Additions	39	6,334	–	309,150	315,523
Disposals	–	(5,858)	–	(265,276)	(271,134)
Disposal of Mainland branches	–	(51,376)	–	(19,845)	(71,221)
Fair value adjustment	–	–	34,066	–	34,066
Exchange adjustments	–	–	–	26	26
At 31st December 2007	23,413	717,613	145,000	1,181,943	2,067,969
Accumulated depreciation and impairment					
As at 1st January 2007	16,942	314,360	–	682,080	1,013,382
Charge for the year	102	33,662	–	103,919	137,683
Disposals	–	(2,954)	–	(200,161)	(203,115)
Disposal of Mainland branches	–	(45,283)	–	(7,638)	(52,921)
Exchange adjustments	–	–	–	4	4
At 31st December 2007	17,044	299,785	–	578,204	895,033
Net book value					
At 31st December 2007	6,369	417,828	145,000	603,739	1,172,936
The analysis of cost or valuation of the above assets at 31st December 2007 is as follows:					
At cost	23,413	717,613	–	1,181,943	1,922,969
At valuation – 2007	–	–	145,000	–	145,000
	23,413	717,613	145,000	1,181,943	2,067,969

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

24 Fixed assets (continued)

(b) Operating lease arrangements

The Group leases out investment properties under operating leases. The leases typically run for an initial period of one to five years, and may contain an option to renew the lease after that date at which time all terms will be renegotiated. None of the leases include contingent rentals.

During the year, HK$5,918,000 (2007: HK$4,536,000) was recognised as rental income in the income statement in respect of operating leases.

All of the investment properties held by the Group and the Bank are located in Hong Kong with leasehold periods of over 50 years.

At 31st December, the Group and the Bank had future aggregate minimum lease receipts under non-cancellable operating leases as follows:

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Not later than one year	**5,964**	5,964
Later than one year and not later than five years	**4,477**	10,441
	10,441	16,405

25 Lease premium for land

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Net book value at 1st January	**2,032,933**	2,086,721
Disposals	**(52,627)**	(6,190)
Amortisation (Note 9)	**(43,445)**	(47,598)
Net book value at 31st December	**1,936,861**	2,032,933

The Group's interests in leasehold land represent prepaid operating lease payments and their net book values are analysed as follows:

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
In Hong Kong held on :		
– Leases of over 50 years	**279,581**	309,902
– Leases of between 10 to 50 years	**1,657,280**	1,723,031
	1,936,861	2,032,933

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

26 Trading liabilities

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Trading liabilities		
– Short positions in securities	**2,926,871**	7,519,879

27 Financial liabilities designated at fair value through profit or loss

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Financial liabilities designated at fair value through profit or loss		
– Structured investment deposits (Note 28)	**4,190,380**	6,556,839
– Certificates of deposit issued (Note 29)	**302,618**	431,124
	4,492,998	6,987,963

Changes in fair value arising from changes in credit risks 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. Change in fair value arising from change in credit risks is considered not significant. Net unrealised gain for the financial liabilities designated at fair value through profit or loss amounted to HK$1,043,311,000 as at 31st December 2008 (2007: HK$395,787,000).

28 Deposits from customers

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Deposits from customers		
– As stated in the balance sheets	**176,896,443**	181,069,821
– Structured investment deposits reported as financial liabilities designated at fair value through profit or loss (Note 27)	**4,190,380**	6,556,839
	181,086,823	187,626,660
Analysed by:		
– Demand deposits and current accounts	**11,646,608**	10,198,081
– Savings deposits	**43,250,773**	38,299,049
– Time, call and notice deposits	**126,189,442**	139,129,530
	181,086,823	187,626,660

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

29 Certificates of deposit issued

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Certificates of deposit issued		
– at amortised cost	**505,720**	6,445
– at fair value under fair value hedge	**1,332,928**	611,350
As stated in the balance sheets	**1,838,648**	617,795
Reported as financial liabilities designated at fair value through profit or loss (Note 27)	**302,618**	431,124
	2,141,266	1,048,919

30 Other liabilities

	Group		Bank	
	2008	2007	**2008**	2007
	HK$'000	HK$'000	**HK$'000**	HK$'000
Accrued interest payable	**403,149**	566,928	**393,977**	557,205
Short positions in securities	**–**	1,252,741	**–**	1,252,741
Other liabilities and provisions	**5,267,313**	7,853,078	**4,685,449**	7,316,737
	5,670,462	9,672,747	**5,079,426**	9,126,683

31 Taxation

(a) Current income tax liabilities

	Group		Bank	
	2008	2007	**2008**	2007
	HK$'000	HK$'000	**HK$'000**	HK$'000
Hong Kong profits tax payable	**15,906**	325,885	**12,462**	325,587
Overseas tax payable	**8,672**	12,408	**8,233**	11,495
	24,578	338,293	**20,695**	337,082

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

31 Taxation (continued)

(b) Deferred income tax

The movements on the deferred income tax assets are as follows:

	Group		Bank	
	2008	2007	**2008**	2007
	HK$'000	HK$'000	**HK$'000**	HK$'000
At 1st January	**58,465**	82,942	**60,468**	84,125
Deferred income tax credited / (charged) to income statement (Note 12(a))	**4,007**	(16,850)	**2,735**	(16,030)
Deferred income tax credited / (charged) to equity (Note 34(c))	**76,125**	(7,627)	**76,125**	(7,627)
At 31st December	**138,597**	58,465	**139,328**	60,468

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

	Group		Bank	
	2008	2007	**2008**	2007
	HK$'000	HK$'000	**HK$'000**	HK$'000
Deferred income tax assets				
Impairment allowances	**147,154**	140,859	**144,659**	138,701
Revaluation of financial investments	**90,641**	14,516	**90,641**	14,516
	237,795	155,375	**235,300**	153,217
Deferred income tax liabilities				
Accelerated depreciation allowances	**76,137**	71,261	**72,911**	67,100
Fair value adjustment on investment properties	**23,061**	25,649	**23,061**	25,649
	99,198	96,910	**95,972**	92,749

Deferred income tax assets and liabilities are offset when there is a legally enforceable right of set off 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 balance sheet:

	Group		Bank	
	2008	2007	**2008**	2007
	HK$'000	HK$'000	**HK$'000**	HK$'000
Deferred income tax assets	**237,795**	155,375	**235,300**	153,217
Deferred income tax liabilities	**(99,198)**	(96,910)	**(95,972)**	(92,749)
	138,597	58,465	**139,328**	60,468

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

32 Subordinated liability

The subordinated loan ('Loan') with principal amount of US$540,000,000 was obtained by the Bank from its intermediate holding company, DBS Bank Ltd., on 12th December 2006. The Loan will mature on 12th December 2016 with an optional repayment date on 13th December 2011. Interest is payable quarterly and is charged at USD 3-month LIBOR plus 0.35% per annum before the optional repayment date and subsequently at USD 3-month LIBOR plus 0.85%.

33 Share capital

	2008 **HK$'000**	2007 HK$'000
Authorised, issued and fully paid		
5,200,000,000 shares of HK$1.00 each	**5,200,000**	5,200,000

A members' resolution was passed on 8th January 2009 to increase the Bank's authorised share capital from HK$5,200,000,000 to HK$12,000,000,000 by the creation of an additional 6,800,000,000 ordinary shares of HK$1 each, ranking pari passu with the existing ordinary shares of the Bank in all respects. Pursuant to the allotment mandate granted by the members, a board resolution was passed on 8th January 2009 to approve an allotment of 1,800,000,000 shares of HK$1 each at par to its immediate holding company, DHB Limited. The 1,800,000,000 shares were issued and allotted on 20th January 2009 and the issued and paid up share capital of the Bank was increased from HK$5,200,000,000 to HK$7,000,000,000.

34 Reserves

	Group		Bank	
	2008	2007	**2008**	2007
	HK$'000	HK$'000	**HK$'000**	HK$'000
(a) Share premium				
At 1st January and 31st December	**595,503**	595,503	**595,503**	595,503
(b) Capital reserve				
At 1st January and 31st December	**11,636**	11,636	**–**	–
(c) Investments revaluation reserve				
At 1st January	**(70,745)**	(133,151)	**(70,745)**	(133,151)
Change in fair value of available-for-sale financial investments	**(274,856)**	93,470	**(274,856)**	93,470
Amortisation of reserve to income statement due to reclassification of available-for-sale financial investments to loans and receivables	**8,313**	–	**8,313**	–
Reserve transferred to income statement upon disposal of available-for-sale financial investments	**(210,474)**	(23,437)	**(210,474)**	(23,437)
Impairment of available-for-sale financial investments transferred to income statement	**25,808**	–	**25,808**	–
Deferred income tax (Note 31(b))	**76,125**	(7,627)	**76,125**	(7,627)
At 31st December	**(445,829)**	(70,745)	**(445,829)**	(70,745)
(d) General reserve				
At 1st January and 31st December	**2,398,792**	2,398,792	**2,283,928**	2,283,928
(e) Retained earnings				
At 1st January	**9,348,366**	7,724,220	**9,227,375**	7,626,513
Profit attributable to shareholders	**1,828,881**	2,923,090	**1,801,226**	2,899,775
Dividend (Note 14)	**(3,400,000)**	(1,300,000)	**(3,400,000)**	(1,300,000)
Exchange differences arising from translation of net investments in overseas branch and subsidiaries	**439**	1,056	**–**	1,087
Unclaimed dividend forfeited	**55**	–	**55**	–
At 31st December	**7,777,741**	9,348,366	**7,628,656**	9,227,375
Total reserves	**10,337,843**	12,283,552	**10,062,258**	12,036,061

34 Reserves (continued)

The investments revaluation reserve does not represent realised profits and is not available for distribution.

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

As at 31st December 2008, HK$416,822,000 (2007: HK$405,194,000) 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 Hong Kong Monetary Authority.

35 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. The bases of arriving at their fair values are as follows:

(a) Placements with and advances to 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.

(b) Advances to customers

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

(c) Deposits from banks and 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 fixed interest-bearing deposits and other borrowings is based on discounted cash flows using prevailing interest rates with similar remaining maturity.

(d) 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.

(e) 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

36 Notes to consolidated cash flow statement

(a) Reconciliation of profit before income tax to net cash (outflow) / inflow from operating activities

	2008 HK$'000	2007 HK$'000
Profit before income tax	**2,084,249**	3,516,763
Net gain on disposal of fixed assets and lease premium for land	**(201,008)**	(15,024)
Fair value adjustment on investment properties	**6,800**	(34,066)
Impairment allowances for credit losses	**1,233,514**	374,766
Discounting effect released from impairment allowances	**(17,115)**	(15,932)
Write-off of fixed assets	**106,495**	1,674
Depreciation	**159,798**	143,799
Amortisation of lease premium for land	**43,445**	47,598
Advances written off net of recoveries	**(252,758)**	(274,665)
Revaluation for certificates of deposit issued	**124,185**	16,696
Amortisation of discount on certificates of deposit issued	**80**	65
Interest expense for certificates of deposit issued	**38,525**	92,176
Interest expense for subordinated liability	**152,781**	256,967
Profit before changes in operating assets and liabilities	**3,478,991**	4,110,817
Net decrease / (increase) in cash and balances with banks	**706,281**	(2,160,743)
Net decrease in placements with and advances to banks	**2,638,475**	3,603,479
Net decrease in trading securities	**1,627,880**	745,819
Net increase in financial assets designated at fair value through profit or loss	**(25,054)**	–
Net increase in advances to customers	**(10,909,448)**	(10,526,471)
Net decrease in financial investments	**2,292,893**	8,767,143
Net decrease / (increase) in other assets and positive replacement values	**3,094,106**	(5,367,716)
Net increase in deposits and balances from banks	**224,107**	1,092,802
Net (decrease) / increase in trading liabilities	**(4,593,008)**	864,210
Net (decrease) / increase in deposits from customers	**(6,539,837)**	22,700,485
Net increase in amount due to a jointly controlled entity	**87,437**	46,936
Net (decrease) / increase in other liabilities and negative replacement values	**(3,516,781)**	4,095,625
Exchange differences and other adjustments	**(29,591)**	21,591
Cash (outflow) / inflow from operating activities before income tax	**(11,463,549)**	27,993,977
Hong Kong profits tax paid	**(562,988)**	(530,011)
Overseas tax paid	**(12,172)**	(9,113)
Hong Kong profits tax refunded	**2,070**	–
Net cash (outflow) / inflow from operating activities	**(12,036,639)**	27,454,853

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

36 Notes to consolidated cash flow statement (continued)

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

	Share capital and share premium HK$'000	**Certificates of deposit issued HK$'000**	**Subordinated liability HK$'000**
Balance as at 1st January 2007	5,795,503	3,260,239	6,233,157
Cash outflow from financing activities	–	(2,228,315)	(2,041,120)
Revaluation	–	16,696	–
Amortisation of discount	–	65	–
Effect of foreign exchange movements	–	234	20,584
Balance as at 31st December 2007	**5,795,503**	**1,048,919**	**4,212,621**
Cash inflow from financing activities	**–**	**1,709,112**	**–**
Cash outflow from financing activities	**–**	**(740,976)**	**–**
Revaluation	**–**	**124,185**	**–**
Amortisation of discount	**–**	**80**	**–**
Effect of foreign exchange movements	**–**	**(54)**	**(27,594)**
Balance as at 31st December 2008	**5,795,503**	**2,141,266**	**4,185,027**

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

	2008 HK$'000	2007 HK$'000
Cash and balances with banks repayable with original maturity within three months	**18,781,880**	32,695,727
Placements with and advances to banks repayable with original maturity within three months	**10,247,553**	8,238,014
Treasury bills repayable with original maturity within three months	**1,074,778**	3,786,093
	30,104,211	44,719,834

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

37 Derivative financial instruments and hedging activities

(a) Derivatives

The Group uses financial instruments 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:

2008	**Group and Bank**			
Derivatives held for trading	**Contract/ notional amount HK$'000**	**Credit risk weighted amount HK$'000**	**Fair value assets HK$'000**	**Fair value liabilities HK$'000**
Exchange rate contracts				
– Forwards	**74,550,994**	**532,755**	**333,554**	**270,547**
– Swaps	**65,805,627**	**196,195**	**351,564**	**243,703**
– Options purchased	**109,887,175**	**1,422,476**	**496,069**	**–**
– Options written	**109,528,812**	**–**	**–**	**494,524**
	359,772,608	**2,151,426**	**1,181,187**	**1,008,774**
Interest rate contracts				
– Futures	**2,173,863**	**–**	**4,264**	**8,423**
– Swaps	**61,075,909**	**397,421**	**1,114,496**	**1,088,344**
– Options purchased	**748,869**	**687**	**10,002**	**–**
– Options written	**748,869**	**–**	**–**	**10,002**
	64,747,510	**398,108**	**1,128,762**	**1,106,769**
Equity contracts	**7,992,236**	**142,239**	**1,175,565**	**1,175,565**
Credit derivative contracts	**852,505**	**–**	**16,382**	**4,495**
Total derivatives held for trading	**433,364,859**	**2,691,773**	**3,501,896**	**3,295,603**
Derivatives designated and qualified as fair value hedges				
Interest rate contracts				
– Swaps	**4,336,213**	**34,914**	**130,140**	**383,492**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

37 Derivative financial instruments and hedging activities (continued)

(a) Derivatives (continued)

2007	Group and Bank			
Derivatives held for trading	Contract/ notional amount HK$'000	Credit risk weighted amount HK$'000	Fair value assets HK$'000	Fair value liabilities HK$'000
Exchange rate contracts				
– Forwards	113,639,502	1,008,364	351,772	309,986
– Swaps	100,462,064	273,568	169,870	167,675
– Options purchased	140,193,481	2,197,424	760,676	–
– Options written	141,093,445	–	–	760,760
	495,388,492	3,479,356	1,282,318	1,238,421
Interest rate contracts				
– Futures	7,309,522	–	1,421	1,998
– Swaps	86,575,026	143,198	898,912	853,193
– Options purchased	3,359,926	540	4,741	–
– Options written	3,359,926	–	–	4,741
	100,604,400	143,738	905,074	859,932
Equity contracts	26,583,054	473,373	1,017,662	1,017,545
Credit derivative contracts	–	–	–	–
Total derivatives held for trading	622,575,946	4,096,467	3,205,054	3,115,898
Derivatives designated and qualified as fair value hedges				
Interest rate contracts				
– Swaps	1,115,085	17,251	10,065	23,949

The above table includes derivatives and embedded derivatives. The amounts are shown on a gross basis and do not take into account the effect of bilateral netting arrangements. The fair value assets and fair value liabilities of embedded derivatives included in above amounted to HK$1,126,485,000 and HK$59,051,000 respectively (2007: HK$465,161,000 and HK$44,483,000 respectively). The contract amounts of these instruments indicate the volume of transactions outstanding as at the balance sheet date; they do not represent amounts at risk.

The credit risk weighted amounts as at 31st December 2008 and 2007 are the amounts which have been calculated in accordance with the Banking (Capital) Rules.

37 Derivative financial instruments and hedging activities (continued)

(b) Hedging activities

At 31st December 2008, the Group has interest rate swap agreements in place with a notional amount of HK$4,336,213,000 (2007: HK$1,115,085,000) to hedge the exposure arising from changes in the fair value as a result of market interest rate fluctuation of certain available-for-sale financial investments and certificates of deposit issued. The hedging derivatives and hedged items have similar critical terms.

The losses on the hedging instruments are HK$241,645,000 (2007: losses of HK$17,736,000). The gains on the hedged items attributable to the hedged risk are HK$243,887,000 (2007: gains of HK$17,579,000).

38 Contingent liabilities and commitments

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

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Direct credit substitutes	**1,193,846**	1,186,065
Transaction-related contingencies	**776,339**	678,840
Trade-related contingencies	**5,093,182**	5,857,805
Forward forward deposits placed	**12,941,296**	13,381,189
Other commitments with an original maturity of not more than one year	**1,460,137**	1,494,457
Other commitments with an original maturity of more than one year	**60,262**	90,252
Other commitments which are unconditionally cancellable	**94,494,846**	89,002,484
	116,019,908	111,691,092
Credit risk weighted amount	**4,846,801**	5,215,336

In November 2002, the Group entered into a ten-year outsourcing agreement with IBM with respect to the provision of information technology and related support to the Group's operation in Hong Kong. There are various termination clauses contained within the agreement that under certain circumstances IBM could require the Group to pay a penalty on early termination of the contract. The exact amount of penalty 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.

In February 2002, the Bank entered into a ten-year Life Insurance Bancassurance Distribution Agreement ('Agreement') with Aviva Life Insurance Company Limited. Under the Agreement, the Bank has to pay a termination fee if the Bank terminates the Agreement. The amount of termination fee payable as at 31st December 2008 is determined in accordance with the schedule of termination fees included in the Agreement, and ranges from HK$38,000,000 to HK$64,000,000, depending on when the Agreement is terminated.

39 Capital and lease commitments

(a) *Capital commitments*

Capital commitments outstanding at the balance sheet date but not yet incurred are as follows:

	Group		Bank	
	2008	2007	**2008**	2007
	HK$'000	HK$'000	**HK$'000**	HK$'000
Expenditure contracted but not provided for	**161,412**	42,515	**159,027**	42,515
Expenditure authorised but not contracted for	**36,464**	446,201	**35,629**	446,201
	197,876	488,716	**194,656**	488,716

Capital commitments relating to the jointly controlled entity were HK$3,220,000 (2007: Nil).

(b) *Lease commitments*

At the balance sheet date, the total future minimum lease payments under non-cancellable operating leases were payable as follows:

	Group and Bank			
	2008		2007	
	Properties	**Others**	Properties	Others
	HK$'000	**HK$'000**	HK$'000	HK$'000
Within 1 year	**193,180**	**10,786**	185,990	12,394
After 1 year but within 5 years	**357,816**	**8,431**	377,774	13,779
Over 5 years	**301,541**	**–**	298,541	–
	852,537	**19,217**	862,305	26,173

40 Assets pledged as security

The Group has liabilities secured by assets deposited with central depositories to facilitate settlement operations. The aggregate amount of secured liabilities and the nature and carrying amounts of the assets pledged as security are as follows:

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Secured liabilities – short positions in securities (Notes 26 and 30)	**2,926,871**	8,772,620
Assets pledged as security		
– Treasury bills	**641,205**	6,828,192
– Other securities	**2,317,871**	4,112,518
	2,959,076	10,940,710

41 Financial risk management

Risk governance

Under the Group's risk governance framework, the Board of Directors, through the Board Risk Management Committee, oversees the establishment of robust enterprise-wide risk management policies and processes. Where necessary, the Group sets risk appetite limits to guide risk-taking.

Management is accountable to the Board for ensuring the effectiveness of risk management and adherence to the risk appetite limits. To provide risk oversight, senior management risk committees are mandated to focus on specific risk areas. These oversight committees are the Greater China Market Risk Committee, the Greater China Credit Risk Committee, the Hong Kong Asset and Liability Committee, the Greater China Operational Risk Committee and the Greater China Commitments and Conflicts Committee.

On a day-to-day basis, business units have primary responsibility for risk management. In partnership with the business units, independent control functions provide senior management with a timely assessment of key risk exposures and the associated management responses. These units also recommend risk appetite and control limits for approval which is in line with the Group's risk governance framework.

(a) Credit risk

Credit risk is the potential earnings volatility caused by obligors' inability to fulfill their contractual debt obligations. Senior management sets the overall direction and policy for managing credit risk at the Group level. In so doing, it directs the risk appetite and underwriting activities for various countries, industries and counterparties taking into account factors such as prevailing business and economic conditions. The Core Credit Risk Policy and the accompanying supplemental policies set forth the principles by which the Group conducts its credit risk underwriting activities. The Greater China Credit Risk Committee serves as the executive forum for overseeing various aspects of credit risk taking including framework, limit management, policies, processes, methodologies and systems.

Exposure to credit risks arises from lending, sales and trading as well as derivative activities. Lending exposures are typically represented by the notional value or principal amount of on balance sheet financial instruments. Financial guarantees and standby letters of credit, which represent undertakings that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans even though they are of contingent nature. Documentary and commercial letters of credit, which are undertakings by the Group on behalf of customers, are usually collateralised by the underlying shipments of goods to which they relate and therefore exhibit different risk characteristics from direct borrowing. Commitments to extend credit include unused portions of loan commitments, guarantees or letters of credit. The majority of unused commitments are contingent upon customers observing or meeting certain credit terms and conditions.

The credit exposure of a derivative transaction is based on the positive mark-to-market value to the Group, which in general is only a fraction of the derivative contract or notional amount used to express the volume of instruments. This credit exposure, together with potential exposures from market movements, is managed as part of the overall lending limits to the counterparties. Credit exposures on these instruments are usually unsecured, except where the Group enters into collateralised margin transactions with counterparties. The Group currently uses the current exposure method for the purpose of providing capital for such counterparty exposures. Internally, the Bank measures counterparty credit exposure using the mark-to-market exposure with an appropriate add-on for future potential exposures.

41 Financial risk management (continued)

(a) Credit risk (continued)

The risk management of the exposures is conducted through credit granting process which includes the assessment of repayment likelihood and the establishment of appropriate credit limits. The Group uses various internal and external risk rating systems (credit scorecards, customer risk grading and credit bureau scores) to control the level of credit risk accepted by the Group. Business units and credit approvers have the responsibility to ensure that credits are properly assessed and classified. Business units also assume the responsibility to ensure all crucial information is included in the application for the purpose of assessment and approval.

The Group adopts a multi-level credit approval process requiring loan approval at successively higher levels and / or committees (as delegated) depending on, among other things, the size and nature of the proposed transactions. Exposures are monitored against credit limits and other control limits (such as large exposures and concentration limits) by credit management units at the transaction and the portfolio levels, as appropriate.

In addition to the consideration of the primary recourse to the obligor for the credit risk underwritten, the employment of various credit risk mitigation techniques such as appropriate credit structuring, and posting of collateral and / or third party support as well as the use of credit derivatives to hedge or transfer risk to other third parties form an integral part of the credit risk management process. Some specific mitigation measures are outlined below:

(i) Collaterals

Where possible, the Group takes collateral as a secondary recourse to the borrower. The collateral includes cash, marketable securities, properties, trade receivables, inventory, equipment and other physical and financial collateral. The Group may also take fixed and floating charges on assets of borrowers. It has put in place policies which govern the determination of eligibility of various collateral to be considered for credit risk mitigation which includes the minimum operational requirements that are required for the specific collateral to be considered as effective risk mitigations. For collateral taken for global financial market operations, the collateral is marked to market on a mutually agreed period with the respective counterparties. For collateral taken for commercial banking, the collateral is revalued periodically ranging from daily to annually, depending on the type of collateral. In general, the Group considers the collateral it has taken as well diversified.

(ii) Master netting arrangements

The Group further manages its credit exposure by entering into master netting arrangements with counterparties where it is appropriate and feasible to do so. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities as transactions are usually accounted for individually on a gross basis. However, 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.

(iii) Other risk mitigating factors

In addition, the Group also uses guarantees, credit derivatives and credit insurance as credit risk mitigating factors. Whilst the Group may accept guarantees from any counterparty, it sets a threshold internally for considering guarantors to be eligible for credit risk mitigation. Credit derivatives are used as credit risk mitigating factors mainly in structured transactions and for global financial market operations.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(a) Credit risk (continued)

Maximum exposure to credit risk

The maximum exposure to credit risk is limited to the amounts on the balance sheet as well as commitments to extend credit and contingencies, without taking into account the fair value of any collateral and master netting arrangements. The analysis below shows the maximum exposure to credit risk for the various on- and off-balance sheet items.

	Group	
	2008	2007
	HK$'000	HK$'000
Balances with banks	**21,215,731**	36,009,221
Placements with and advances to banks	**17,124,092**	17,753,028
Trading securities	**3,039,097**	7,575,988
Financial assets designated at fair value through profit or loss	**25,054**	–
Positive replacement values	**2,505,551**	2,749,958
Advances to customers less impairment allowances	**132,384,605**	122,412,304
Financial investments	**33,502,677**	36,142,338
Other assets	**3,408,453**	6,258,152
Contingent liabilities	**7,063,367**	7,722,710
Commitments	**108,956,541**	103,968,382
	329,225,168	340,592,081

Advances to customers by credit quality

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Neither past due nor impaired	**127,243,719**	116,209,079
Past due but not impaired	**4,772,734**	6,069,743
Impaired	**2,990,588**	1,818,771
	135,007,041	124,097,593

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(a) Credit risk (continued)

Advances to customers by credit quality (continued)

(i) Analysis of advances to customers that were neither past due nor impaired by reference to the loan gradings under the Hong Kong Monetary Authority guidelines

	Group and Bank		
2008	**Pass HK$'000**	**Special mention HK$'000**	**Total HK$'000**
Manufacturing	**9,605,301**	**947,299**	**10,552,600**
Building and construction	**22,430,439**	**419,284**	**22,849,723**
Housing loans	**40,192,794**	**27,046**	**40,219,840**
General commerce	**23,365,872**	**2,637,226**	**26,003,098**
Transportation, storage and communication	**10,940,030**	**88,502**	**11,028,532**
Financial institutions, investments and holding companies	**603,541**	**–**	**603,541**
Professionals and private individuals (except housing loans)	**11,060,823**	**195,026**	**11,255,849**
Others	**4,538,578**	**191,958**	**4,730,536**
	122,737,378	**4,506,341**	**127,243,719**

	Group and Bank		
2007	Pass HK$'000	Special mention HK$'000	Total HK$'000
Manufacturing	8,586,291	576,258	9,162,549
Building and construction	15,619,681	294,381	15,914,062
Housing loans	38,607,509	86,904	38,694,413
General commerce	22,500,203	1,600,110	24,100,313
Transportation, storage and communication	9,973,629	48,006	10,021,635
Financial institutions, investments and holding companies	768,170	–	768,170
Professionals and private individuals (except housing loans)	12,538,029	150,773	12,688,802
Others	4,780,626	78,509	4,859,135
	113,374,138	2,834,941	116,209,079

41 Financial risk management (continued)

(a) Credit risk (continued)

Advances to customers by credit quality (continued)

(ii) Advances to customers that were past due but not impaired

2008	**Past due**				
Group and Bank	**Less than 1 month HK$'000**	**1-2 months HK$'000**	**2-3 months HK$'000**	**More than 3 months HK$'000**	**Total HK$'000**
Manufacturing	**415,208**	**40,304**	**67,102**	**–**	**522,614**
Building and construction	**707,411**	**61,106**	**8,541**	**–**	**777,058**
Housing loans	**940,046**	**75,505**	**8,037**	**–**	**1,023,588**
General commerce	**1,016,489**	**186,065**	**142,085**	**–**	**1,344,639**
Transportation, storage and communication	**445,510**	**3,897**	**–**	**–**	**449,407**
Financial institutions, investments and holding companies	**8,554**	**2,180**	**–**	**–**	**10,734**
Professionals and private individuals (except housing loans)	**310,309**	**12,915**	**1,901**	**174,458**	**499,583**
Others	**108,823**	**36,288**	**–**	**–**	**145,111**
	3,952,350	**418,260**	**227,666**	**174,458**	**4,772,734**

2007	Past due				
Group and Bank	Less than 1 month HK$'000	1-2 months HK$'000	2-3 months HK$'000	More than 3 months HK$'000	Total HK$'000
Manufacturing	756,310	92,445	45,453	–	894,208
Building and construction	777,699	11,342	120,145	–	909,186
Housing loans	1,411,468	118,117	24,477	–	1,554,062
General commerce	1,195,691	72,498	59,679	–	1,327,868
Transportation, storage and communication	479,848	9,311	29	–	489,188
Financial institutions, investments and holding companies	1,985	–	–	–	1,985
Professionals and private individuals (except housing loans)	345,749	38,697	2,488	177,718	564,652
Others	305,756	18,717	4,121	–	328,594
	5,274,506	361,127	256,392	177,718	6,069,743

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

The fair value of collateral pledged for the advances to customer that were past due but not impaired amounted to HK$5,304,724,000 as at 31st December 2008 (2007: HK$7,145,331,000).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(a) Credit risk (continued)

Advances to customers by credit quality (continued)

(iii) Impaired advances to customers

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Manufacturing	**687,969**	388,978
Building and construction	**178,775**	166,507
Housing loans	**155,949**	240,277
General commerce	**1,266,881**	807,544
Transportation, storage and communication	**29,789**	24,951
Financial institutions, investments and holding companies	**7,003**	714
Professionals and private individuals (except housing loans)	**368,902**	58,097
Others	**295,320**	131,703
	2,990,588	1,818,771

	Group and Bank			
	2008		2007	
	HK$'000	**% of gross advances to customers**	HK$'000	% of gross advances to customers
Gross impaired advances	**2,990,588**	**2.22**	1,818,771	1.47
Individual impairment allowances	**(1,663,850)**		(796,094)	
	1,326,738		1,022,677	
Impaired advances covered by collateral	**1,142,021**		983,839	

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

Renegotiated advances

The renegotiated advances are those advances which are renegotiated at non-commercial terms and currently classified as 'Neither past due nor impaired' or 'Past due but not impaired'. There are no outstanding renegotiated advances as at 31st December 2008 (2007: Nil).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(a) *Credit risk (continued)*

Analysis of individual impairment allowances

	Group and Bank							
	As at 1st January 2008 HK$'000	Amounts written off HK$'000	Recoveries of advances written off in previous years HK$'000	Net charge to income statement HK$'000	Discounting effect released from impairment allowances HK$'000	Disposal of Mainland branches HK$'000	Exchange differences HK$'000	At 31st December 2008 HK$'000
Manufacturing	292,057	(21,727)	518	306,000	(3,938)	–	–	572,910
Building and construction	59,124	(4,242)	–	3,502	(1,023)	–	–	57,361
Housing loans	14,192	(1,963)	15,487	(21,049)	(892)	–	–	5,775
General commerce	247,858	(51,793)	429	212,680	(7,251)	–	–	401,923
Transportation, storage and communication	12,648	(10,713)	200	15,285	(170)	–	–	17,250
Financial institutions, investments and holding companies	120	–	128	2,031	(40)	–	–	2,239
Professionals and private individuals (except housing loans)	54,987	(50,077)	8	309,821	(2,111)	–	–	312,628
Others	115,108	(11,751)	48	192,052	(1,690)	–	(3)	293,764
	796,094	(152,266)	16,818	1,020,322	(17,115)	–	(3)	1,663,850

	Group and Bank							
	As at 1st January 2007 HK$'000	Amounts written off HK$'000	Recoveries of advances written off in previous years HK$'000	Net charge to income statement HK$'000	Discounting effect released from impairment allowances HK$'000	Disposal of Mainland branches HK$'000	Exchange differences HK$'000	At 31st December 2007 HK$'000
Manufacturing	211,100	(106,980)	69	221,390	(3,407)	(30,330)	215	292,057
Building and construction	64,148	(5,778)	–	2,213	(1,459)	–	–	59,124
Housing loans	33,593	(4,904)	20,986	(33,378)	(2,105)	–	–	14,192
General commerce	217,119	(30,882)	2,796	65,899	(7,074)	–	–	247,858
Transportation, storage and communication	8,646	(101)	186	4,136	(219)	–	–	12,648
Financial institutions, investments and holding companies	2,075	(77)	220	(2,092)	(6)	–	–	120
Professionals and private individuals (except housing loans)	68,604	(5,009)	–	(8,099)	(509)	–	–	54,987
Others	136,805	(25,985)	12,807	(7,366)	(1,153)	–	–	115,108
	742,090	(179,716)	37,064	242,703	(15,932)	(30,330)	215	796,094

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(a) Credit risk (continued)

Analysis of collective impairment allowances

	Group		
	As at 1st January 2008 HK$'000	**Addition/ (Releases) HK$'000**	**At 31st December 2008 HK$'000**
Manufacturing	**116,382**	**12,285**	**128,667**
Building and construction	**68,324**	**82,074**	**150,398**
Housing loans	**59,739**	**(37,922)**	**21,817**
General commerce	**351,334**	**16,029**	**367,363**
Transportation, storage and communication	**65,928**	**30,127**	**96,055**
Financial institutions, investments and holding companies	**573**	**2,376**	**2,949**
Professionals and private individuals (except housing loans)	**186,535**	**(37,177)**	**149,358**
Others	**40,380**	**1,599**	**41,979**
	889,195	**69,391**	**958,586**

	Group		
	As at 1st January 2007 HK$'000	Addition/ (Releases) HK$'000	At 31st December 2007 HK$'000
Manufacturing	137,518	(21,136)	116,382
Building and construction	58,452	9,872	68,324
Housing loans	78,948	(19,209)	59,739
General commerce	355,371	(4,037)	351,334
Transportation, storage and communication	81,030	(15,102)	65,928
Financial institutions, investments and holding companies	1,119	(546)	573
Professionals and private individuals (except housing loans)	163,008	23,527	186,535
Others	37,678	2,702	40,380
	913,124	(23,929)	889,195

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(a) Credit risk (continued)

Analysis of collective impairment allowances (continued)

	Bank		
	As at 1st January 2008 HK$'000	**Addition/ (Releases) HK$'000**	**At 31st December 2008 HK$'000**
Manufacturing	**116,382**	**12,285**	**128,667**
Building and construction	**68,324**	**82,074**	**150,398**
Housing loans	**59,739**	**(37,922)**	**21,817**
General commerce	**351,334**	**16,029**	**367,363**
Transportation, storage and communication	**65,928**	**30,127**	**96,055**
Financial institutions, investments and holding companies	**573**	**2,376**	**2,949**
Professionals and private individuals (except housing loans)	**161,524**	**(35,798)**	**125,726**
Others	**40,380**	**1,599**	**41,979**
	864,184	**70,770**	**934,954**

	Bank		
	As at 1st January 2007 HK$'000	Addition/ (Releases) HK$'000	At 31st December 2007 HK$'000
Manufacturing	137,518	(21,136)	116,382
Building and construction	58,452	9,872	68,324
Housing loans	78,948	(19,209)	59,739
General commerce	355,371	(4,037)	351,334
Transportation, storage and communication	81,030	(15,102)	65,928
Financial institutions, investments and holding companies	1,119	(546)	573
Professionals and private individuals (except housing loans)	136,602	24,922	161,524
Others	37,678	2,702	40,380
	886,718	(22,534)	864,184

Geographical concentration

Over 90% of the gross advances to customers and the related impaired advances, overdue advances, individual impairment allowances and collective impairment allowances were located in Hong Kong after taking into account the transfer of risk. In general, transfer of risk applies when an advance is guaranteed by a party in a country which is different from that of the counterparty.

41 Financial risk management (continued)

(b) Market risk

(i) Trading market risk

Trading market risk arises from the impact on trading positions of changes in:
- foreign exchange rates;
- interest rate yields and credit spreads.

It also includes the impact from changes in the correlations and volatilities of the above risk factors.

The Group manages trading market risk in the course of market-making, structuring and packaging products for investors and other clients, as well as to benefit from market opportunities.

The Group's policies and processes for managing trading market risk are approved by senior management and comprise the following elements:
- trading book policy and valuation framework;
- types of market risk to be covered, and the risk metrics and methodologies to be used to capture such risks;
- roles and responsibilities of relevant functions in managing trading market risks;
- determination of the Group's trading market risk appetite by the Board of Directors and allocation of risk limits to risk-takers;
- independent monitoring of market risk appetite and control limits;
- assurance of valuation models and validation of risk models; and
- new product process through which risk issues are identified and addressed before a new product is launched.

The Greater China Market Risk Committee ('GCMRC') serves as the executive forum for overseeing various aspects of market risk taking including framework, limit management, policies, processes, methodologies and systems. The roles, functions and compositions of the Greater China Market Risk Committee are disclosed in Note 1 of the unaudited supplementary information.

The principal market risk appetite measures for trading market risk are Value-at-Risk ('VaR') and stress loss. This is complemented at the level of risk-taking units by more granular risk and loss limits such as risk sensitivity-based limits, and management action triggers to measure and control trading exposures.

The Group's trading VaR methodology uses a historical simulation approach (at a 99% confidence level over a one-day holding period, using a 2-year historical observation period) to forecast the Group's trading market risk. The Group computes VaR (in Singaporean Dollars 'SG$') daily. VaR is back-tested against the profit or loss of the trading book in line with policy in order to monitor its predictive power.

Although VaR provides valuable insights, no single risk measure can capture all aspects of trading market risk. To complement the VaR measure, regular stress testing is carried out.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(b) Market risk (continued)

(i) Trading market risk (continued)

The following table shows the year end, average, highest and lowest daily VaR for the trading market risk:

Group	**As at**	**1st January 2008 to 31st December 2008**		
SG$'million	**31st December 2008**	**Average**	**Highest**	**Lowest**
Total	**1.6**	**1.1**	**2.9**	**0.4**

	As at	1st January 2007 to 31st December 2007		
SG$'million	31st December 2007	Average	Highest	Lowest
Total	1.7	1.0	2.1	0.2

(ii) Non-trading market risk

Non-trading market risk arises from changes in foreign exchange rates, interest rates and equity prices. Non-trading market risk arises in the course of (a) the Group's management of funds arising from banking intermediation and (b) the Group's banking business and investments; specifically, from mismatches in the interest rate profile of assets and liabilities, from the effect of exchange rate movements on the Group's earnings, capital accounts and investments denominated in foreign currencies and from the effect of changes in equity prices on the carrying value of investments in major stakes.

To optimise its income and balance sheet management, the Group deploys funds in debt securities or in the interbank market. Derivatives may be used to hedge non-trading market risk. These investments are subject to Board and senior management limits on the portfolio size, credit quality and product concentrations. The market risks arising in the course of managing surplus funds are monitored using risk sensitivity measures and valuation action triggers.

Senior management committees oversee non-trading market risk and allocate core limits to risk taking units. The Hong Kong Asset and Liability Committee ('HKALCO') is responsible for managing the risks, including the setting of operational limits and guidelines to refine risk management.

Below is an assessment of the sensitivity of market risks on non-trading positions. The actual results may differ from the sensitivity impact as the Group manages factors such as changes in volumes, margins (for interest rate risk) and future business strategies, the impact of which is not captured in the sensitivity assessment.

41 Financial risk management (continued)

(b) Market risk (continued)

(ii) Non-trading market risk (continued)

Interest rate risk

Interest rate risk arising from mismatches in the interest rate profile of assets, liabilities and capital instruments (and associated hedges) has several aspects: basis risk arising from different interest rate benchmarks, interest rate re-pricing risk, yield curve risks and embedded optionality. To monitor this risk, the Group uses various tools, including sensitivity analysis and income scenario simulations.

The Group manages and monitors the sensitivity of the net interest income ('NII') of its consolidated non-trading positions. The Group's consolidated non-trading interest rate risk is mainly in USD and HKD. The NII simulation analysis is as follows:

	Increase /decrease in basis points	Sensitivity of net interest income
		HK$'000
Change in 2009 projected net interest income	**+25**	**200,057**
	-25	**(179,610)**
Change in 2008 projected net interest income	+25	114,220
	-25	(96,760)

Currency risk

Non-trading foreign exchange exposure covers the foreign exchange risk arising from foreign investments and foreign currency earnings. Foreign currency loans and investments in fundable currencies are generally funded in the same foreign currencies. However, positions arising from investments in currencies which have high hedging costs or which are illiquid or controlled, will be reviewed by HKALCO and may be managed with alternative strategies or left unhedged. This foreign exchange risk is monitored using foreign exchange net open position reports. The Group's non-trading foreign exchange exposures as at 31st December 2008 and 2007 were not material.

Equity risk

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 non-trading portfolio as at 31st December 2008 and 2007 were not material and were held for long term investment purpose. They were reported as financial investments in Note 20 to the financial statements and are subject to the accounting and valuation policies set out in Notes 2(c) and 2(e) to the financial statements.

41 Financial risk management (continued)

(c) Liquidity risk

Liquidity risk is the potential earnings volatility arising from being unable to fund portfolio assets at reasonable rates over required maturities. Liquidity obligations arise from withdrawals of deposits, repayments of purchased funds at maturity, extensions of credit and working capital needs. The Group seeks to manage its liquidity to meet its obligations under normal as well as adverse circumstances, and to take advantage of arising lending and investment opportunities.

The primary tool of monitoring liquidity is the maturity mismatch analysis, which is monitored over successive time bands and across functional currencies. This is tested under normal and adverse market scenario conditions.

The Hong Kong Asset and Liability Committee is the primary party responsible for liquidity management based on guidelines approved by the Board Risk Management Committee. Limits are set on maturity mismatches over books under normal and stress scenarios, liquidity ratios and deposit concentration risks. As part of the liquidity management, the Group will set limits to ensure that the funding requirements will not exceed the available funding and liquid assets available for both normal and stress scenarios.

As part of its liquidity risk management, the Group focuses on a number of components, including maintaining sufficient liquid assets, maintaining diversified source of liquidity, preserving necessary funding capacity and contingency planning.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(c) Liquidity risk (continued)

The carrying amounts of assets and liabilities analysed by the remaining period as at 31st December to the contractual maturity dates is as follows:

	Group							
2008	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
HK$'million								
Assets								
– Cash and balances with banks	3,427	16,324	1,665	304	–	–	–	21,720
– Placements with and advances to banks	–	–	11,798	3,061	2,265	–	–	17,124
– Trading securities	–	86	95	1,314	1,288	256	–	3,039
– Financial assets designated at fair value through profit or loss	–	–	–	–	25	–	–	25
– Gross advances to customers	8,445	15,975	14,877	13,249	27,751	51,494	3,216	135,007
– Financial investments								
– Debt securities classified as available-for-sale	–	1,678	2,258	5,895	15,816	2,040	14	27,701
– Debt securities classified as loans and receivables	–	–	134	501	4,554	612	–	5,801
– Equities	–	–	–	–	–	–	67	67
– Others	261	183	80	58	277	51	5,636	6,546
Total assets	12,133	34,246	30,907	24,382	51,976	54,453	8,933	217,030
Liabilities								
– Deposits and balances from banks	953	75	–	–	–	–	–	1,028
– Trading liabilities	–	114	410	1,021	936	446	–	2,927
– Financial liabilities designated at fair value through profit or loss	–	330	388	1,211	2,069	495	–	4,493
– Deposits from customers	54,918	70,154	42,288	9,536	–	–	–	176,896
– Certificates of deposit issued	–	–	6	188	504	1,141	–	1,839
– Subordinated liability	–	–	–	–	–	4,185	–	4,185
– Others	8	3,016	1,672	628	45	15	4,740	10,124
Total liabilities	55,879	73,689	44,764	12,584	3,554	6,282	4,740	201,492

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(c) Liquidity risk (continued)

2007	Group							
HK$'million	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
Assets								
– Cash and balances with banks	2,139	33,117	835	249	–	–	–	36,340
– Placements with and advances to banks	–	–	12,627	4,197	929	–	–	17,753
– Trading securities	–	3,156	699	1,568	1,702	451	–	7,576
– Gross advances to customers	8,466	16,215	14,055	12,255	23,491	47,525	2,091	124,098
– Financial investments classified as available-for-sale								
– Debt securities	–	1,842	2,163	13,459	17,112	1,476	14	36,066
– Equities	–	–	–	–	–	–	76	76
– Others	221	4,732	141	194	239	33	5,055	10,615
Total assets	10,826	59,062	30,520	31,922	43,473	49,485	7,236	232,524
Liabilities								
– Deposits and balances from banks	385	420	–	–	–	–	–	805
– Trading liabilities	–	2,508	1,264	2,138	1,196	414	–	7,520
– Financial liabilities designated at fair value through profit or loss	–	–	852	1,471	1,964	2,701	–	6,988
– Deposits from customers	48,502	94,035	32,780	5,727	26	–	–	181,070
– Certificates of deposit issued	–	–	350	261	7	–	–	618
– Subordinated liability	–	–	–	–	–	4,213	–	4,213
– Others	1	8,335	736	399	31	16	4,308	13,826
Total liabilities	48,888	105,298	35,982	9,996	3,224	7,344	4,308	215,040

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(c) Liquidity risk (continued)

The contractual undiscounted cash flow projections of the Group's financial liabilities, derivatives, contingent liabilities and commitments analysed by the remaining period as at 31st December to the contractual maturity dates is as follows:

2008	Group					
HK$'million	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
Financial liabilities						
– Deposits and balances from banks	953	76	–	–	–	1,029
– Trading liabilities	–	535	1,063	993	398	2,989
– Financial liabilities designated at fair value through profit or loss	–	1,014	1,966	2,290	477	5,747
– Deposits from customers	54,926	112,935	9,700	–	–	177,561
– Certificates of deposit issued	–	14	244	710	1,250	2,218
– Subordinated liability	–	26	47	442	4,586	5,101
– Others	–	4,567	1,422	1,001	157	7,147
	55,879	119,167	14,442	5,436	6,868	201,792
Derivatives settled on a gross basis						
– Foreign exchange contracts						
– outflow	–	79,805	52,819	1,130	257	134,011
– inflow	–	(79,928)	(52,822)	(1,133)	(257)	(134,140)
	–	(123)	(3)	(3)	–	(129)
Contingent liabilities and commitments						
– Contingent liabilities	–	7,063	–	–	–	7,063
– Commitments	50,949	58,008	–	–	–	108,957
	50,949	65,071	–	–	–	116,020

The balances in the above table will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(c) Liquidity risk (continued)

2007 HK$'million	Group 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
Financial liabilities						
– Deposits and balances from banks	385	420	–	–	–	805
– Trading liabilities	–	3,788	2,230	1,305	423	7,746
– Financial liabilities designated at fair value through profit or loss	–	940	1,709	2,687	3,075	8,411
– Deposits from customers	48,503	127,613	5,905	27	–	182,048
– Certificates of deposit issued	–	353	270	7	–	630
– Subordinated liability	–	59	185	924	5,155	6,323
– Others	–	9,157	332	364	40	9,893
	48,888	142,330	10,631	5,314	8,693	215,856
Derivatives settled on a gross basis						
– Foreign exchange contracts						
– outflow	–	112,749	84,735	14,306	35	211,825
– inflow	–	(112,773)	(84,739)	(14,303)	(35)	(211,850)
	–	(24)	(4)	3	–	(25)
Contingent liabilities and commitments						
– Contingent liabilities	–	7,723	–	–	–	7,723
– Commitments	51,820	52,148	–	–	–	103,968
	51,820	59,871	–	–	–	111,691

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(d) Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events, including legal risk, but does not include strategic or reputation risk. An Operational Risk Management Framework, approved by the Board Risk Management Committee, has been developed with the objective to ensure that operational risks are properly identified, monitored, managed and reported in a structured, systematic and consistent manner.

To manage and control operational risk, the Framework encompasses various tools including, control self-assessment, risk event management, key risk indicator monitoring and process risk mapping. Risk events, including any significant incidents that may impact the Group's reputation, are required to be reported based on certain thresholds established. Key risk indicators with pre-defined escalation triggers are employed to facilitate risk monitoring in a forward looking manner. A process risk mapping framework was developed to identify the key risks and controls of key products / services in an end-to-end transaction cycle.

A key component of the Framework is a set of Core Operational Risk Standards which provides guidance on the baseline controls to ensure a controlled and sound operating environment. Each new product or service introduced is subject to 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. Major operational risk mitigation programmes include Business Continuity Management and Global Insurance Programme. On an annual basis, the Chief Executive Officer provides an attestation to the Board of Directors on the state of business continuity management, including any residual risks.

The Greater China Operational Risk Committee oversees the operational risk management infrastructure, including the Framework, policies, processes, information, methodologies and systems. The Committee also performs regular review of the operational risk profiles and approves corporate operational risk policies.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(e) Capital management

The Bank'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 following table sets forth details of capital resources and capital adequacy ratios for the Bank. The Banking Ordinance and the Banking (Capital) Rules set out the current requirements relating to the minimum capital adequacy ratios for an authorized institution incorporated in Hong Kong and the methodology for calculating these ratios. The Bank complied with the capital requirements imposed by the Hong Kong Monetary Authority throughout 2008 and 2007.

	2008 **HK$'000**	2007 HK$'000
Core capital		
Paid up ordinary share capital	**5,200,000**	5,200,000
Share premium	**595,503**	595,503
Reserves (eligible for inclusion in core capital)	**7,572,039**	8,111,942
Profit and loss account	**1,805,439**	2,871,670
Deduct:		
Deferred tax assets	**(139,328)**	(60,468)
	15,033,653	16,718,647
Deductions from core capital	**(95,183)**	(112,511)
Core capital after deductions	**14,938,470**	16,606,136
Supplementary capital		
Reserve on revaluation of holding of land and buildings	**62,893**	65,953
Reserve on revaluation of holding of securities not held for trading purposes	**(539,178)**	(107,762)
Collective impairment allowances	**934,954**	864,184
Regulatory reserve	**416,822**	405,194
Term subordinated liability	**4,185,027**	4,212,621
	5,060,518	5,440,190
Deductions from supplementary capital	**(95,183)**	(112,512)
Supplementary capital after deductions	**4,965,335**	5,327,678
Total capital base before deductions	**20,094,171**	22,158,837
Deductions from core capital and supplementary capital	**(190,366)**	(225,023)
Total capital base after deductions	**19,903,805**	21,933,814
Risk-weighted assets	**152,410,438**	145,576,302
Capital adequacy ratio		
Core capital ratio	**9.8%**	11.4%
Supplementary capital ratio	**3.3%**	3.7%
Total capital adequacy ratio	**13.1%**	15.1%

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

41 Financial risk management (continued)

(e) Capital management (continued)

The Bank is required to compute its capital adequacy ratio on a combined basis that includes the Bank and its overseas branch. The investments in subsidiaries are deducted from the Bank's core capital and supplementary capital.

The term subordinated liability represents the subordinated loan with principal amount of US$540,000,000 from its intermediate holding company, DBS Bank Ltd., on 12th December 2006. The subordinated loan forms part of the capital base of the Bank with its terms and conditions set out in Note 32 to the financial statements.

42 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 Bank and 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, derivatives, contingent liabilities and commitments.

The Group has policies on lending to related parties which define related parties, credit and reporting processes, requirements and restrictions on such lending. The lending terms and conditions (including interest rates, commissions, fees, etc.) applying to related parties are at arm's length.

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

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

	DBS Bank Ltd.		**Fellow subsidiaries**	
	2008 **HK$'000**	2007 HK$'000	**2008** **HK$'000**	2007 HK$'000
Interest income	**762,409**	1,116,052	**73,895**	57,974
Interest expense	**(267,571)**	(375,891)	**(10,596)**	(81,592)
Net fee and commission income	**(425)**	2,758	**1,020**	1,055
Net income from financial instruments at fair value through profit and loss	**891,673**	1,178,965	**(36,868)**	(59,983)
Other income	**11,288**	7,070	**895**	733
Total expenses (charged) / recovered	**(77,245)**	(138,454)	**40,035**	30,912

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

42 Material related party transactions (continued)

(a) Holding companies and fellow subsidiaries (continued)

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

	Group		Bank	
	2008	2007	**2008**	2007
	HK$'000	HK$'000	**HK$'000**	HK$'000
Cash and balances with banks	**15,672,029**	21,278,608	**15,669,608**	21,275,680
Placements with and advances to banks	**14,510,080**	7,262,871	**14,510,080**	7,262,871
Positive replacement values	**1,210,147**	1,156,705	**1,210,147**	1,156,705
Other assets	**168,439**	173,375	**168,439**	173,375
	31,560,695	29,871,559	**31,558,274**	29,868,631
Deposits and balances from banks	**111,457**	58,427	**111,457**	58,427
Negative replacement values	**2,808,983**	2,139,595	**2,808,983**	2,139,595
Subordinated liability	**4,185,027**	4,212,621	**4,185,027**	4,212,621
Other liabilities	**58,650**	88,981	**58,650**	88,981
	7,164,117	6,499,624	**7,164,117**	6,499,624

(iii) Contract / notional amount of derivative financial instruments with DBS Bank Ltd. and fellow subsidiaries as at 31st December

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Exchange rate contracts	**198,151,048**	290,013,592
Interest rate contracts	**53,838,335**	81,138,474
Equity contracts	**3,379,590**	7,919,440
	255,368,973	379,071,506

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

As at 31st December 2008, the total contingent liabilities and commitments with DBS Bank Ltd. and fellow subsidiaries amounted to HK$13,845,214,000 (2007: HK$15,044,144,000).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

42 Material related party transactions (continued)

(a) Holding companies and fellow subsidiaries (continued)

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

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Deposits from customers	**316,803**	315,866
Other liabilities	**–**	48
	316,803	315,914

(vi) Balances with fellow subsidiaries as at 31st December

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Cash and balances with banks	**10,788**	344,279
Placements with and advances to banks	**2,614,012**	1,443,788
Other assets	**81,492**	46,766
	2,706,292	1,834,833
Deposits and balances from banks	**7,029**	369
Deposits from customers	**2,561,916**	2,620,359
Other liabilities	**80,009**	38,036
	2,648,954	2,658,764

(b) Jointly controlled entity

Under the Joint Venture Agreement (the 'Agreement') between the Bank, Whampoa Limited and Hutchison DBS Card Limited ('HDCL'), the Bank issues and services credit cards under the Compass brand. The Compass credit card receivable balances are included under 'Advances to customers' in the Bank's balance sheet. Under the Agreement, all the revenue, expenses and loan impairment allowances on the Compass cards are recorded in the books of HDCL. The revenues and expenses; assets and liabilities of HDCL are recognised by the Group through proportionate consolidation on a line-by-line basis.

As at 31st December 2008, the amount due from the Bank to the jointly controlled entity is HK$1,616,405,000 (2007: HK$1,441,531,000), of which HK$1,080,000,000 (2007: HK$975,000,000) is interest bearing time deposit and the remaining balance is interest free and repayable on demand. Interest expense on the time deposit for the year ended 31st December 2008 paid and payable to HDCL is HK$58,123,000 (2007: HK$69,910,000). Gross service fee income from HDCL to the Bank for the year ended 31st December 2008 is HK$83,323,000 (2007: HK$87,694,000).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

42 Material related party transactions (continued)

(c) Directors and key management personnel

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

During the year, the Group has banking transactions with directors and key management personnel of the DBSH Group and their close family members, including deposit taking, loans and credit card facilities. These transactions are made in the ordinary course of business and carried out at arm's length commercial terms, and are not material.

(ii) Compensation of directors and key management personnel

	Group and Bank	
	2008	2007
	HK$'000	HK$'000
Salaries, other short term employee benefits and directors' fee	**65,165**	84,450
Pensions	**2,197**	1,763
Share based payments	**4,256**	8,604
Termination benefits	**682**	–
	72,300	94,817

(d) DBSH Share Option Plan

Under the DBSH Share Option Plan (the 'Option Plan'), options to subscribe for DBSH ordinary shares may be granted to the Group executives who hold the rank of Vice President (or equivalent) and above and selected employees below the rank of Vice President (or equivalent).

The exercise price of the granted options is equal to the average of the last dealt prices for DBSH shares, as determined by reference to the daily official list published by the Singapore Exchange Securities Trading Limited, for the three consecutive trading days immediately preceding the date of the grant.

These share options vest over a period in accordance with a vesting schedule determined by the Compensation and Management Development Committee of DBSH, and are exercisable after the first anniversary of the date of the grant up to the date of expiration of the options.

There were no options granted in 2008 and 2007.

42 Material related party transactions (continued)

(d) DBSH Share Option Plan (continued)

The following table sets out the movements of the unissued ordinary shares of DBSH of par value in Singaporean Dollars ('SG$') 1.00 each under outstanding options, the weighted average exercise prices and expiration dates.

	2008		2007	
	Unissued number of ordinary shares under outstanding options	**Weighted average exercise price SG$**	Unissued number of ordinary shares under outstanding options	Weighted average exercise price SG$
Balance as at 1st January	**2,849,425**	**14.07**	4,082,587	14.00
Movements during the year:				
– Exercised	**(755,348)**	**13.59**	(1,130,097)	13.87
– Forfeited	**(15,320)**	**14.08**	(103,065)	13.71
– Transferred out due to staff relocation	**(149,435)**	**14.94**	–	–
Balance as at 31st December	**1,929,322**	**14.18**	2,849,425	14.07
Additional information:				
Outstanding options exercisable as at 31st December	**1,929,322**	**14.18**	2,735,965	14.02
Weighted average remaining contractual life of options outstanding as at 31st December	**4.1 years**		5.0 years	
Range of exercise price of options outstanding as at 31st December	**SG$10.40-SG$22.33**		SG$10.40-SG$22.33	

In 2008, 755,348 options (2007: 1,130,097) were exercised at their contractual exercise prices. During the year, the average market price of DBSH shares was SG$18.59 (2007: SG$21.88).

(e) DBSH Share Plan

Under the DBSH Share Plan (the 'Share Plan'), DBSH ordinary shares (the 'shares') may be granted to the Group executives who hold such rank as may be determined by the Committee appointed to administer the Share Plan from time to time. The awards could be performance-based and / or time-based.

Where performance-based awards are granted, participants are awarded shares of DBSH, their equivalent cash value or a combination of both, when prescribed DBSH Group performance targets are met over a three-year performance period.

Time-based awards will only vest after the satisfactory completion of time-based service conditions. Where time-based awards are granted, participants are awarded shares of DBSH, their equivalent cash value or a combination of both as part of their deferred bonus.

42 Material related party transactions (continued)

(e) DBSH Share Plan (continued)

For performance-based awards, the shares will vest three years after the date of grant following completion of the prescribed performance period, provided the prescribed performance targets are met. A time-based award comprises two elements, namely, the main award and the 'kicker' award. The shares comprised in the 'kicker' award constitute twenty percent of the shares comprised in the main award. Fifty percent of the shares comprised in the main award will vest two years after the date of grant. The remainder fifty percent of the shares comprised in the main award, together with the shares comprised in the 'kicker' award, will vest three years after the date of grant. In the case of both performance-based awards and time-based awards, the fair value of the shares awarded are computed based on the market price of the DBSH ordinary shares at the time of the award and is amortised through the income statement over the vesting period. At each balance sheet date, the Group revises its estimates of the number of shares expected to vest based on non-market vesting conditions and the corresponding adjustments are made to the income statement.

The following table sets out the movements of the shares granted in the current and previous financial years pursuant to the Share Plan and their fair values at grant date. No performance-based awards were granted in 2008 and 2007.

	Group and Bank	
	2008 grant	**2007 grant**
	Number of shares	
Balance as at 1st January 2008	**–**	**126,850**
Granted in 2008	**208,325**	**–**
Forfeited in 2008	**(9,206)**	**(7,595)**
Transferred out due to staff relocation	**–**	**(528)**
Balance as at 31st December 2008	**199,119**	**118,727**
	SG$	**SG$**
Fair value per share at grant date	**17.94**	**23.00**

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

(f) DBSH Employee Share Plan

The DBSH Employee Share Plan (the 'ESP') caters to all employees of the Group who are not eligible to participate in the DBSH Share Option Plan, the DBSH Share Plan or other equivalent plans.

Under the ESP, eligible employees are awarded ordinary shares of DBSH (the 'shares'), their equivalent cash value or combinations of both when prescribed DBSH Group performance targets and / or time based conditions are met. The ESP awards are granted at the absolute discretion of the Compensation and Management Development Committee.

During the current and previous financial years, no performance-based awards have been granted to eligible employees under the ESP.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

42 Material related party transactions (continued)

(f) DBSH Employee Share Plan (continued)

Time-based awards were granted in the current and previous financial years. The time-based awards will only vest after the satisfactory completion of time-based service conditions. Under such awards, the shares will vest at fifty percent two years after the date of grant and the remainder fifty percent three years after the date of grant. The fair value of the shares awarded are computed based on the market price of the ordinary shares of DBSH at the time of the award and is amortised through the income statement over the vesting period. At each balance sheet date, the Group revises its estimates of the number of shares expected to vest based on non-market vesting conditions and the corresponding adjustments are made to the income statement.

The following table sets out the movements of the shares granted in the current and previous financial years pursuant to the ESP and their fair values at grant date.

	Group and Bank	
	2008 grant	**2007 grant**
	Number of shares	
Balance as at 1st January 2008	**–**	**24,900**
Granted in 2008	**65,100**	**–**
Forfeited in 2008	**(5,300)**	**(2,350)**
Balance as at 31st December 2008	**59,800**	**22,550**
	SG$	**SG$**
Fair value per share at grant date	**17.94**	**23.00**

Since the inception of the ESP, no awards have been cash-settled under the ESP.

43 Loans to officers

Particulars of loans made to officers and disclosed pursuant to Section 161B of the Hong Kong Companies Ordinance are as follows:

	Balance outstanding as at 31st December		Maximum balance during the year	
	2008 HK$'000	2007 HK$'000	**2008 HK$'000**	2007 HK$'000
Aggregate amount outstanding in respect of principal and interest	**6,089**	6,489	**6,494**	6,821

UNAUDITED SUPPLEMENTARY INFORMATION

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 Corporate governance

Under the corporate governance structure of DBS Bank (Hong Kong) Limited (the 'Bank'), the role of the Board of Directors is to provide high-level guidance and effective oversight over management. To assist the Board of Directors in fulfilling its responsibilities and in accordance with the best corporate governance practice, the Board Audit Committee and Board Risk Management Committee were established and a number of specialised committees were formed to effectively contribute to the strategic and operational development of the Bank.

The roles, functions and composition of these committees are listed below:

(a) Board Audit Committee

The Board Audit Committee is authorised by the Board of Directors to investigate any activity within its terms of reference. Its main duties include, inter alia, the review of the Bank's financial statements before submission to the Board of Directors, the nomination and appointment of the external auditors, the audit fee, the questions on resignation or dismissal of external auditors, the internal audit programme and consideration of any major findings of internal investigations and management's response. The Board Audit Committee comprises the four independent non-executive directors of the Bank.

(b) Board Risk Management Committee

The Board Risk Management Committee provides comprehensive and bank-wide oversight of all risks and their management. It sets the overall and specific risk governance framework and obtains assurance that risk management activities are effective and that risk management activities have sufficient independence, status and visibility. It sets risk appetite on capital and limits for delegation to the relevant risk committees and units, reviews risk reporting on significant risks and assesses risk on capital adequacy. It is also responsible for obtaining assurance that the Bank is on track in meeting the Basel II requirements according to approved plans. The Board Risk Management Committee comprises the Chairman of the Bank, the Chief Executive Officer and two independent non-executive directors.

(c) Greater China Credit Risk Committee

The Greater China Credit Risk Committee serves as an executive forum for discussion and decisions on all aspects of credit risk and its management. It assesses credit risk taking and risk-return tradeoffs and facilitates communication among the different business units on credit issues and determines the suitability of credit risk management strategy and framework as well as IRB (Internal Ratings-based) systems in meeting the standards under Basel II. The Greater China Credit Risk Committee identifies, measures and monitors credit risk portfolio and specific loan and asset review situations and identifies specific credit concentrations and credit trends affecting the portfolio. Formed under the Greater China Credit Risk Committee, the Approval Sub-Committee approves credit risk related limits and policies and the Regulatory Sub-Committee oversees compliance with credit related regulatory requirements. The members of the Greater China Credit Risk Committee are the Chief Credit Officer of Greater China, Chief Executive Officer of the Bank, representatives from relevant business units, support units and other members nominated by the Chairman of the Greater China Credit Risk Committee.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

1 Corporate governance (continued)

(d) Greater China Market Risk Committee

The Greater China Market Risk Committee provides comprehensive and enterprise-wide oversight, direction and counsel relating to the management of market risk. It serves as an executive forum for discussion and decisions on all aspects of market risk and its management. It maintains oversight on effectiveness of market risk management infrastructure, including framework, policies, people, processes, information, methodologies and systems on market risk. The Greater China Market Risk Committee comprises the Head of Risk Management, representatives from relevant business units and support units and others nominated by the Greater China Market Risk Committee.

(e) Greater China Operational Risk Committee

The Greater China Operational Risk Committee provides comprehensive and enterprise-wide oversight, direction and counsel relating to the management of operational risks. It is responsible for monitoring and reviewing the effectiveness of operational risk management framework, policy, process, methodology 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 Greater China Operational Risk Committee comprises the Head of Risk Management, representatives from the relevant support units and others nominated by the Chairman of the Greater China Operational Risk Committee.

(f) Greater China Commitments and Conflicts Committee

The Greater China Commitments and Conflicts Committee reviews proposed commitments, transactions and other actions proposed by DBS Group in the Greater China region which might have a possible impact on DBS's reputation and standing and resolves all actual / potential conflicts that may arise in the course of DBS Group's financial services activities whether in Singapore or in the Greater China region, including ensuring that DBS Group and its employees do not benefit (or appear to benefit) from the use of confidential information. The Greater China Commitments and Conflicts Committee comprises the Chief Executive Officer of the Bank and representatives from the relevant business units and support units.

(g) Hong Kong Management Committee

The Hong Kong Management Committee is responsible for formulating and implementing DBS's strategy for Hong Kong, as well as the financial and non-financial results of DBS's activities in this geographic segment. Key to its mandate is to provide leadership to the various business and support units in Hong Kong, with a view toward ensuring sound and effective governance, and achieving the targeted financial returns. Toward this end, the Hong Kong Management Committee is responsible for prioritising business development initiatives (as well as the support infrastructure projects necessary to underpin robust growth), and capital allocation, within the context of DBS Group strategy. It is also responsible for ensuring that policies and practices are in place to maintain high corporate governance, risk management and compliance standards in Hong Kong. Members of the Hong Kong Management Committee are senior management in Hong Kong.

(h) Hong Kong Asset and Liability Committee

The Hong Kong Asset and Liability Committee supervises the asset and liability management including the management of liquidity, structural interest rate risk and structural foreign exchange risk activities in Hong Kong and Macau. It manages the net interest income and margin of the region against changing interest and the currency rate conditions, and maturities / duration. It oversees the structure and composition of the balance sheets in the region, as well as the significant off-balance-sheet assets and liabilities. The Hong Kong Asset and Liability Committee comprises the Chief Executive Officer of the Bank and representatives from the relevant business units and support units.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

1 Corporate governance (continued)

During the year, the Bank has complied with, in all material aspects, the guidelines set out in the Supervisory Policy Manual entitled 'Corporate Governance of Locally Incorporated Authorized Institutions' issued by the Hong Kong Monetary Authority.

2 Group audit

Group Audit is an independent function that reports functionally to the Audit Committee and administratively to the DBSH Chief Executive Officer ('CEO'). The functional reporting includes matters relating to Audit Charter, risk assessment and related audit plans, results of internal audit activities and other matters that the Head of Group Audit deems necessary. The Audit Committee approves the hiring of Head of Group Audit including appointment, removal, evaluation, annual compensation and salary adjustment. Administratively, DBSH CEO facilitates the day-to-day operations of the internal audit function, including budgeting, management accounting and human resource administration. Group Audit has unfettered access to any and all of the DBSH's documents, records, properties and personnel including the Chairman of DBSH's Board of Directors and the DBSH Audit Committee.

Group Audit has developed and maintained a quality assurance and improvement programme that covers all aspects of the internal audit activity. Its internal audit activity conforms to the Institute of Internal Auditor's ('IIA') International Standards for the Professional Practice of Internal Auditing. External Quality Assessment Reviews are carried out at least once in every five years by qualified professionals from an external organisation. In the 2008 assessment, Group Audit has been rated with the highest level of conformance (Generally Conforms) to IIA standards.

The professional competence of the Group's internal auditors is maintained or upgraded through training programmes, conferences and seminars that provide updates on auditing techniques, regulations and banking products and services.

An annual audit plan is developed under a structured risk assessment approach that examines all of the Group's activities and entities, their level of inherent risk and control effectiveness against the various risk types. Audit projects are identified and scoped based on this approach and audit resources are focused on the activities deemed to carry higher risks.

The scope of Group Audit encompasses the examination and evaluation of the adequacy and effectiveness of DBSH's system of internal controls, risk management procedures, governance processes and the quality of performance in carrying out assigned responsibilities. Group Audit may also conduct consulting services only at the request of management in accordance with Group Audit's Consulting Framework. Audit work is substantially paperless with the in-house developed computerised audit work paper and resource management system.

The progress of corrective actions on outstanding audit issues is monitored monthly through a centralised Group-wide issue management system. Information on outstanding issues is categorised according to severity and monthly reports are sent to the Audit Committee Chairman, the Chairman of the Board of DBSH, senior management and all Group heads.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

2 Group audit (continued)

All audit reports which are rated as requiring attention are copied to the Audit Committee, the external auditor and senior management. The regulators are also apprised of all relevant audit matters and may request for further information on audit matters at any time.

Group Audit works closely with the external auditor and meets them regularly to discuss matters of mutual interest, to strengthen working relationships and to co-ordinate audit efforts. The external auditor reviews the effectiveness of the Group's internal controls and risk management during an annual statutory audit. Material non-compliance with established practices and procedures and regulations, as well as internal control weaknesses noted during the audit, together with recommendations, are reported to the Audit Committee, which ensures that high-risk outstanding issues are dealt with in a timely manner.

The Head of Audit Greater China in Hong Kong reports directly to the Head of Group Audit in Singapore and the Board Audit Committee in Hong Kong, and administratively to the CEO in Hong Kong.

3 Capital requirements for different types of risk

	2008	2007
	HK$'000	HK$'000
Credit risk	**11,124,413**	10,527,283
Market risk	**145,734**	253,072
Operational risk	**922,688**	865,749
	12,192,835	11,646,104

In accordance with the Banking (Capital) Rules issued under section 98A of the Banking Ordinance for the implementation of the Basel II capital accord, the Bank uses the basic approach for the calculation of the risk weighted assets for credit risk, and the standardised approaches for the calculation of the risk weighted assets for operational risk and market risk.

Capital requirements shown in this note are made by multiplying the Bank's risk-weighted amounts derived from the relevant calculation approach by 8% as defined in the Banking (Disclosure) Rules.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

3 Capital requirements for different types of risk (continued)

(a) Analysis of capital requirements for credit risk

	2008		2007	
	Risk weighted amounts HK$'000	**Capital requirements HK$'000**	Risk weighted amounts HK$'000	Capital requirements HK$'000
On-balance sheet				
Sovereigns	**479,189**	**38,335**	308,558	24,685
Public sector entities	**567,117**	**45,369**	764,119	61,130
Banks	**14,169,399**	**1,133,552**	16,499,817	1,319,985
Cash items	**3,805**	**304**	4,030	322
Residential mortgage loans	**21,540,031**	**1,723,203**	20,895,805	1,671,664
Other exposures	**94,722,134**	**7,577,771**	83,789,656	6,703,173
	131,481,675	**10,518,534**	122,261,985	9,780,959
Off-balance sheet				
Off-balance sheet exposures other than over-the-counter derivative transactions	**4,846,801**	**387,744**	5,215,336	417,227
Over-the-counter derivative transactions	**2,726,687**	**218,135**	4,113,718	329,097
	7,573,488	**605,879**	9,329,054	746,324
Total		**11,124,413**		10,527,283

The gross total positive fair value of the over-the-counter derivative transactions is HK$3,461,798,000 (2007: HK$2,487,361,000). The analysis of the credit equivalent amounts and the risk-weighted amounts for the over-the-counter derivative contracts are as follows:

	2008		2007	
	Credit equivalent amounts HK$'000	**Risk weighted amounts HK$'000**	Credit equivalent amounts HK$'000	Risk weighted amounts HK$'000
Exchange rate contracts	**3,507,227**	**2,151,426**	5,566,177	3,479,356
Interest rate contracts	**1,479,410**	**433,022**	1,190,008	160,989
Equity contracts	**1,544,085**	**142,239**	1,335,677	473,373
	6,530,722	**2,726,687**	8,091,862	4,113,718

The Bank currently uses the current exposure method for the purpose of providing capital for counterparty exposures in accordance with the Banking (Capital) Rules. Internally, the Bank measures counterparty credit exposure using the mark-to-market exposure with an appropriate add-on for future potential exposure.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

3 Capital requirements for different types of risk (continued)

(b) Analysis of capital requirements for market risk

The capital requirements for market risk arising from the trading book positions and certain banking book positions are calculated in accordance with the Banking (Capital) Rules as follows:

	2008	2007
	HK$'000	HK$'000
Interest rate exposures	**123,215**	184,863
Foreign exchange exposures	**22,519**	68,209
	145,734	253,072

4 Interest rate risk exposures in banking book

In accordance with the prudential return 'Interest Rate Risk Exposures' issued by the Hong Kong Monetary Authority, the Bank calculates, on a quarterly basis, the impact on earnings over the next 12 months under a scenario of which interest rate rises 200 basis points.

The impact analysis on earnings under the above scenario by major currencies is as follows:

HK$' million	**2008**	2007
HKD	**392**	14
USD	**(105)**	117

5 Liquidity ratio

The average liquidity ratio for the year, calculated in accordance with the Fourth Schedule of the Banking Ordinance, is as follows:

	2008	2007
Average liquidity ratio	**33.2%**	37.4%

The average liquidity ratio is the simple average of each calendar month's average liquidity ratio for the twelve months of the financial year of the Hong Kong office of the Bank.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

6 Segmental information

(a) Segmental information by class of business

	Group			
2008	**Commercial and retail banking HK$'000**	**Treasury HK$'000**	**Subsidiaries, overseas branches and others HK$'000**	**Total HK$'000**
Total income	**5,760,470**	**706,775**	**431,994**	**6,899,239**
Profit before impairment allowances for credit losses	**2,632,412**	**478,457**	**206,894**	**3,317,763**
Profit before income tax	**1,302,050**	**439,602**	**342,597**	**2,084,249**
Operating assets	**133,753,891**	**75,328,709**	**7,947,392**	**217,029,992**
2007				
Total income	6,532,513	679,430	(140,712)	7,071,231
Profit before impairment allowances for credit losses	3,556,942	501,767	(167,180)	3,891,529
Profit before income tax	3,086,020	497,748	(67,005)	3,516,763
Operating assets	124,230,128	104,337,661	3,955,780	232,523,569

Commercial and retail banking business mainly comprises deposit account services, residential mortgage and other consumer lending, credit card services, corporate lending, trade finance and international banking.

Treasury activities are mainly the provision of foreign exchange services and centralised cash management for deposit taking and lending, trading activities and management of investment securities and the overall funding of the Banking Group.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

6 Segmental information (continued)

(b) Segmental information by booking location

Over 90% of the Group's total income, profit before income tax, total assets, total liabilities, contingent liabilities and commitments are booked in Hong Kong.

(c) Cross-border claims

Analysis of cross-border claims by location and type of counterparty is as follows:

	Group			
HK$' million	**Banks**	**Public sector entities**	**Others**	**Total**
2008				
Asia Pacific excluding Hong Kong	**47,919**	**768**	**6,070**	**54,757**
North and South America	**5,295**	**897**	**629**	**6,821**
Europe	**6,266**	**4**	**542**	**6,812**
Others	**223**	**75**	**902**	**1,200**
	59,703	**1,744**	**8,143**	**69,590**
2007				
Asia Pacific excluding Hong Kong	45,814	660	4,837	51,311
North and South America	3,016	18	1,834	4,868
Europe	26,807	4	489	27,300
Others	5	–	1,161	1,166
	75,642	682	8,321	84,645

The above analysis 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.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

7 Advances to customers

(a) Advances to customers by loan usage

	Bank			
	2008		2007	
	Outstanding balance HK$'000	**Balance covered by collateral HK$'000**	Outstanding balance HK$'000	Balance covered by collateral HK$'000
Loans for use in Hong Kong				
Industrial, commercial and financial				
– Property development	**902,072**	**896,596**	145,300	99,810
– Property investment	**25,620,903**	**24,971,374**	19,030,892	18,748,695
– Financial concerns	**596,693**	**420,307**	629,264	447,930
– Stockbrokers	**24,314**	**22,514**	140,638	37,121
– Wholesale and retail trade	**3,404,739**	**2,491,595**	2,890,889	2,320,828
– Manufacturing	**9,224,981**	**5,067,768**	7,916,983	4,550,610
– Transport and transport equipment	**11,573,354**	**10,915,306**	10,592,289	10,419,489
– Recreational activities	**188**	**188**	56	56
– Information technology	**125,419**	**106,444**	117,402	39,424
– Others	**4,775,759**	**3,696,116**	5,905,484	4,469,353
Individuals				
– Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme or their respective successor schemes	**1,606,199**	**1,606,199**	1,905,707	1,900,937
– Loans for the purchase of other residential properties	**35,463,910**	**35,430,996**	34,720,490	34,669,124
– Credit card advances	**5,112,615**	**–**	5,230,882	–
– Others	**6,310,215**	**2,898,152**	7,529,902	4,916,255
	104,741,361	**88,523,555**	96,756,178	82,619,632
Trade finance	**24,411,494**	**14,152,766**	22,600,311	12,810,187
Loans for use outside Hong Kong	**5,854,186**	**4,598,518**	4,741,104	3,241,262
	135,007,041	**107,274,839**	124,097,593	98,671,081

7 Advances to customers (continued)

(b) Overdue advances to customers

The overdue advances are analysed as follows:

	Bank			
	2008		2007	
	HK$'000	**% of gross advances to customers**	HK$'000	% of gross advances to customers
Six months or less but over three months	**508,450**	**0.38**	276,402	0.22
One year or less but over six months	**580,119**	**0.43**	231,000	0.19
Over one year	**753,987**	**0.56**	650,187	0.52
	1,842,556	**1.37**	1,157,589	0.93
Individual impairment allowances made in respect of the above overdue advances	**1,130,549**		669,322	
Current market value of collateral held against the covered portion of the above overdue advances	**1,290,634**		520,234	
Covered portion of the above overdue advances	**741,876**		316,597	
Uncovered portion of the above overdue advances	**1,100,680**		840,992	

(c) Rescheduled advances

The rescheduled advances (net of those which have been overdue for over three months and reported in item (b) above) are analysed as follows:

	Bank			
	2008		2007	
	HK$'000	**% of gross advances to customers**	HK$'000	% of gross advances to customers
Rescheduled advances	**277,743**	**0.21**	289,247	0.23

(d) Repossessed assets

As at 31st December 2008, repossessed assets of the Bank amounted to HK$256,644,000 (2007: HK$76,553,000).

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

7 Advances to customers (continued)

(e) Non-bank Mainland exposures

Bank	On-balance sheet exposures HK$'000	Off-balance sheet exposures HK$'000	Total HK$'000	Individual impairment allowances HK$'000
2008				
Mainland entities	**191,824**	**24,152**	**215,976**	**20,433**
Companies and individuals outside Mainland where the credit is granted for use in Mainland	**5,713,578**	**1,227,328**	**6,940,906**	**409,802**
Other counterparties where the exposures are considered to be non-bank Mainland exposures	**117,800**	**26,084**	**143,884**	**–**
	6,023,202	**1,277,564**	**7,300,766**	**430,235**
2007				
Mainland entities	120,387	64,828	185,215	15,915
Companies and individuals outside Mainland where the credit is granted for use in Mainland	5,274,468	1,368,685	6,643,153	127,630
Other counterparties where the exposures are considered to be non-bank Mainland exposures	43,899	26,065	69,964	–
	5,438,754	1,459,578	6,898,332	143,545

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

8 Currency concentration

The table below summarises the Group's assets and liabilities at carrying amounts, categorised by currency:

HK$' million	USD	EUR	Others	Total
2008				
Hong Kong dollar equivalents				
Spot assets	**57,475**	**3,409**	**11,227**	**72,111**
Spot liabilities	**(47,328)**	**(3,068)**	**(19,360)**	**(69,756)**
Forward purchases	**63,744**	**1,256**	**15,443**	**80,443**
Forward sales	**(73,126)**	**(1,777)**	**(7,249)**	**(82,152)**
Net options position	**(2)**	**12**	**(9)**	**1**
Net long / (short) non-structural position	**763**	**(168)**	**52**	**647**
Net structural position	**–**	**–**	**(31)**	**(31)**
2007				
Hong Kong dollar equivalents				
Spot assets	69,275	3,217	17,897	90,389
Spot liabilities	(53,224)	(5,007)	(16,555)	(74,786)
Forward purchases	99,344	2,862	8,240	110,446
Forward sales	(114,786)	(1,063)	(9,766)	(125,615)
Net options position	(59)	(18)	107	30
Net long / (short) non-structural position	550	(9)	(77)	464
Net structural position	–	–	(75)	(75)

The net structural position as at 31st December 2008 comprised the Group's unremitted earnings of HK$59,000,000 equivalent (2007: HK$75,000,000) from a Macau Pataca (MOP) investment in Macau, and Renminbi investments of HK$28,000,000 equivalent (2007: Nil) in the Mainland China.

The net options position is calculated based on the delta-weighted position as set out in the prudential return 'Foreign Currency Position' issued by the Hong Kong Monetary Authority.