星 展 銀 行 （ 香 港 ） 有 限 公 司

DBS BANK (HONG KONG) LIMITED

(Incorporated in Hong Kong with limited liability)

Annual Report 2012

DBS BANK (HONG KONG) LIMITED AND ITS SUBSIDIARIES

CONTENTS

REPORT OF THE DIRECTORS

The directors of DBS Bank (Hong Kong) Limited (the “Bank”) submit their report together with the audited financial statements of the Bank and its subsidiaries (together the “Group”) for the year ended 31 December 2012.

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 24 to the financial statements.

Results and appropriations

The results of the Group for the year ended 31 December 2012 are set out in the consolidated income statement on page 5.

No interim dividend was paid for the year ended 31 December 2012 (2011: Nil).

The directors do not recommend the payment of a final dividend for the year ended 31 December 2012 (2011: 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.

Share capital

Details of the movements in the share capital of the Bank during the year are set out in Note 33 to the financial statements.

Properties and other fixed assets

Details of the movements in properties and other fixed assets during the year are set out in Note 25 to the financial statements.

Donations

Donations made by the Group during the year amounted to HK$775,000 (2011: HK$44,000).

Directors

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

Seah Lim Huat, Peter – Chairman	
Piyush Gupta – Vice Chairman	
J. E. Sebastian Paredes Muirragui – Chief Executive	
Alexander Reid Hamilton	
Dominic Chiu Fai Ho	
Ng Chee Siong, Robert	
Kwok Kwok Chuen	(appointed on 8 October 2012)
Leung Ting Mow, Kenneth	(retired on 23 April 2012)

REPORT OF THE DIRECTORS (CONTINUED)

Directors (continued)

In accordance with Article 90 of the Bank's Articles of Association, Mr. Kwok Kwok Chuen will retire from office at the forthcoming Annual General Meeting and, being eligible, offer himself for re-election.

Further and under Article 98 of the Articles of Association, Mr. Seah Lim Huat, Peter, Mr. Piyush Gupta, Mr. J.E. Sebastian Paredes Muirragui, Mr. Dominic Chiu Fai Ho and Mr. Ng Chee Siong, Robert will retire from office at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-election.

Mr. Leung Ting Mow, Kenneth retired at the Annual General Meeting held on 23 April 2012.

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 a director 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).

DBSH Share Plan

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

Where time-based awards are granted, they will only vest after the satisfactory completion of time-based service conditions. Participants are awarded shares of DBSH, their equivalent cash value or a combination of both as part of their deferred bonus (at the discretion of the CMDC).

A time-based award comprises two elements, namely, the main award and the "retention" award (previously known as "kicker" award). The shares comprised in the "retention" award constitute twenty percent of the shares comprised in the main award. Effective 2010, the deferral period for unvested shares was extended from a 3-year period to a 4-year period showing a more prudent risk management arrangement. Under the new vesting schedule, thirty-three percent of the shares comprised in the main award will vest two years after the date of grant. A further thirty-three percent of the shares comprised in the main award will vest three years after the date of grant. The remainder thirty-four percent of the shares comprised in the main award, together with the shares comprised in the "retention" award, will vest four years after the date of grant. For time-based awards, the fair value of the shares awarded are computed based on the market price of the ordinary shares at the time of the award and is amortized through the income statement over the vesting period.

During the year, a total of 22,465 DBSH share awards were granted to Mr. Seah Lim Huat, Peter pursuant to the DBSH Share Plan and no shares were vested in him under the Share Plan during the year.

During the year, Mr. Piyush Gupta was eligible to receive awards under the Share Plan. A total of 329,040 DBSH share awards were granted to him and a total of 61,020 DBSH shares were vested in him under the Share Plan during the year.

REPORT OF THE DIRECTORS (CONTINUED)

Arrangements to acquire shares (continued)

During the year, Mr. J. E. Sebastian Paredes Muirragui was eligible to receive awards under the Share Plan. A total of 69,901 DBSH share awards were granted to him and no shares were vested in him under the Share Plan 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 subsidiaries of its holding companies a party to any arrangement to enable the directors of the Bank to acquire benefits by means of the acquisition of shares in or debentures of the Bank or any other body corporates.

Management contracts

On 12 November 2002, the Bank entered into a services agreement in relation to certain information technology and related services. The agreement commenced on 12 November 2002 and continues until 12 December 2012. On 31 October 2012, the agreement was renewed and continues until 12 December 2017.

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

Auditor

The financial statements have been audited by PricewaterhouseCoopers who will retire at the forthcoming annual general meeting and eligible, offer themselves for re-appointment.

On behalf of the Board

Seah Lim Huat, Peter
Chairman

Hong Kong, 25 January 2013

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 88, which comprise the consolidated and company balance sheets as at 31 December 2012, and the consolidated income statement, the consolidated statement of comprehensive income, 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 information.

Directors' responsibility for the consolidated financial statements

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

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 about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of consolidated financial statements that give a true and fair view 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 consolidated 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 31 December 2012, 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, 25 January 2013

CONSOLIDATED INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2012
(Expressed in millions of Hong Kong dollars)

	Note	**2012**	2011
		HK$'M	HK$'M
Interest income	4	**6,493**	5,523
Interest expense	5	**(2,229)**	(1,547)
Net interest income		**4,264**	3,976
Net fee and commission income	6	**1,458**	1,317
Net income from financial instruments at fair value through profit or loss	7	**1,140**	1,189
Net income from financial investments	8	**103**	78
Other income	9	**493**	194
Total income		**7,458**	6,754
Total expenses	10	**(3,639)**	(3,491)
Profit before allowances for credit and other losses		**3,819**	3,263
Allowances for credit and other losses	11	**(77)**	(191)
Profit before income tax		**3,742**	3,072
Income tax expense	13	**(515)**	(468)
Profit attributable to shareholders	14	**3,227**	2,604
Dividend	15	**–**	–

The notes on pages 12 to 88 form part of these financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2012
(Expressed in millions of Hong Kong dollars)

	2012 HK$'M	2011 HK$'M
Profit attributable to shareholders	**3,227**	2,604
Other comprehensive income		
Available-for-sale financial investments		
– Net valuation taken to equity	**69**	(6)
– Amortisation of reserve to income statement arising from reclassification of available-for-sale financial investments to loans and receivables	**2**	4
– Transferred to income statement	**(86)**	(33)
– Deferred income tax (charged) / credited to equity	**(7)**	6
Other comprehensive income attributable to shareholders, net of tax	**(22)**	(29)
Total comprehensive income attributable to shareholders	**3,205**	2,575

The notes on pages 12 to 88 form part of these financial statements.

CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER 2012
(Expressed in millions of Hong Kong dollars)

	Note	**2012** **HK$'M**	2011 HK$'M
Assets			
Cash and balances with banks	16	**7,318**	10,843
Placements with and advances to banks	17	**57,951**	23,057
Trading securities	18	**7,577**	8,858
Positive fair values for derivative financial instruments		**5,215**	7,034
Advances to customers less impairment allowances	19	**175,625**	194,062
Financial investments	21	**24,637**	28,163
Other assets	22	**4,157**	4,422
Deferred tax assets	31(b)	**14**	37
Properties and other fixed assets	25	**2,669**	2,653
– Investment properties		**476**	407
– Other properties and fixed assets		**2,193**	2,246
Total assets		**285,163**	279,129
Liabilities			
Deposits and balances from banks		**9,356**	21,945
Trading liabilities	26	**6,450**	6,574
Financial liabilities designated at fair value through profit or loss	27	**1,779**	965
Negative fair values for derivative financial instruments		**5,109**	7,315
Deposits from customers	28	**212,333**	184,970
Certificates of deposit issued	29	**7,283**	16,383
Other liabilities	30	**8,188**	9,476
Current income tax liabilities	31(a)	**143**	251
Amount due to a jointly controlled entity	23	**1,321**	1,244
Subordinated liability	32	**4,186**	4,196
Total liabilities		**256,148**	253,319
Equity			
Share capital	33	**7,000**	7,000
Reserves	34	**22,015**	18,810
Total equity		**29,015**	25,810
Total liabilities and equity		**285,163**	279,129

The notes on pages 12 to 88 form part of these financial statements.

Dominic Chiu Fai Ho
Director

Piyush Gupta
Director

J. E. Sebastian Paredes Muirragui
Director

Alexander Reid Hamilton
Director

BANK LEVEL BALANCE SHEET

AS AT 31 DECEMBER 2012
(Expressed in millions of Hong Kong dollars)

	Note	**2012** **HK$'M**	2011 HK$'M
Assets			
Cash and balances with banks	16	**7,318**	10,843
Placements with and advances to banks	17	**57,948**	23,054
Trading securities	18	**7,577**	8,858
Positive fair values for derivative financial instruments		**5,215**	7,034
Advances to customers less impairment allowances	19	**175,651**	194,089
Financial investments	21	**24,637**	28,163
Other assets	22	**4,154**	4,418
Deferred tax assets	31(b)	**11**	35
Interest in a jointly controlled entity	23	**1**	1
Subsidiaries	24	**152**	149
Properties and other fixed assets	25	**2,668**	2,651
– Investment properties		**476**	407
– Other properties and fixed assets		**2,192**	2,244
Total assets		**285,332**	279,295
Liabilities			
Deposits and balances from banks		**9,356**	21,945
Trading liabilities	26	**6,450**	6,574
Financial liabilities designated at fair value through profit or loss	27	**1,779**	965
Negative fair values for derivative financial instruments		**5,109**	7,315
Deposits from customers	28	**212,333**	184,970
Certificates of deposit issued	29	**7,283**	16,383
Other liabilities	30	**7,215**	8,544
Current income tax liabilities	31(a)	**143**	250
Amount due to a jointly controlled entity	23	**2,641**	2,487
Amounts due to subsidiaries	24	**234**	227
Subordinated liability	32	**4,186**	4,196
Total liabilities		**256,729**	253,856
Equity			
Share capital	33	**7,000**	7,000
Reserves	34	**21,603**	18,439
Total equity		**28,603**	25,439
Total liabilities and equity		**285,332**	279,295

The notes on pages 12 to 88 form part of these financial statements.

Dominic Chiu Fai Ho
Director

Piyush Gupta
Director

J. E. Sebastian Paredes Muirragui
Director

Alexander Reid Hamilton
Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2012
(Expressed in millions of Hong Kong dollars)

	Share capital HK$'M	**Share premium HK$'M**	**Other reserves HK$'M**	**Retained earnings HK$'M**	**Total equity HK$'M**
Balance as at 1 January 2011					
– as previously reported	7,000	595	2,670	12,916	23,181
– adjustments due to change in accounting standard	–	–	16	38	54
As restated at 1 January 2011	7,000	595	2,686	12,954	23,235
Total comprehensive income					
– as previously reported	–	–	(29)	2,598	2,569
– adjustments due to change in accounting standard	–	–	–	6	6
– as restated	–	–	(29)	2,604	2,575
Balance as restated at 31 December 2011	7,000	595	2,657	15,558	25,810
Balance as at 1 January 2012	**7,000**	**595**	**2,657**	**15,558**	**25,810**
Total comprehensive income	**–**	**–**	**(22)**	**3,227**	**3,205**
Balance as at 31 December 2012	**7,000**	**595**	**2,635**	**18,785**	**29,015**

The notes on pages 12 to 88 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2012
(Expressed in millions of Hong Kong dollars)

	Note	**2012 HK$'M**	2011 HK$'M
Cash flows from operating activities			
Profit before income tax		**3,742**	3,072
Adjustments for non-cash items:			
Net gain on disposal of properties and other fixed assets		**(343)**	(111)
Fair value adjustment on investment properties		**(69)**	(39)
Allowances for credit and other losses		**77**	191
Write-off of properties and other fixed assets		**1**	24
Depreciation		**201**	229
Advances written off net of recoveries		**(411)**	(472)
Revaluation for certificates of deposit issued		**62**	186
Amortisation of discount on certificates of deposit issued		**36**	20
Interest expense for certificates of deposit issued		**269**	170
Interest expense for subordinated liability		**59**	30
Profit before changes in operating assets and liabilities		**3,624**	3,300
Increase / (decrease) in:			
Deposits and balances from banks		**(12,589)**	21,162
Trading liabilities		**(124)**	786
Deposits from customers		**28,329**	(3,144)
Amount due to a jointly controlled entity		**77**	83
Other liabilities and negative fair values for derivative financial instruments		**(3,503)**	(246)
(Increase) / decrease in:			
Placements with and advances to banks		**(27,463)**	(3,681)
Trading securities		**3,281**	(1,477)
Financial assets designated at fair value through profit or loss		**–**	39
Advances to customers		**18,767**	(44,061)
Financial investments		**(964)**	2,642
Other assets and positive fair values for derivative financial instruments		**2,084**	737
Net cash generated from / (used in) operating activities before income tax		**11,519**	(23,860)
Hong Kong profits tax paid		**(599)**	(459)
Overseas tax paid		**(8)**	(6)
Net cash generated from / (used in) operating activities		**10,912**	(24,325)

The notes on pages 12 to 88 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2012
(Expressed in millions of Hong Kong dollars)

	Note	2012 HK$'M	2011 HK$'M
Cash flows from investing activities			
Purchase of fixed assets		**(184)**	(85)
Proceeds from disposal of properties and other fixed assets		**378**	161
Net cash generated from investing activities		**194**	76
Cash flows from financing activities			
Interest paid for certificates of deposits issued		**(259)**	(138)
Interest paid for subordinated liability		**(56)**	(28)
Issuance of certificates of deposit	36(a)	**11,105**	25,892
Redemption of certificates of deposit issued	36(a)	**(20,493)**	(15,708)
Net cash (used in) / generated from financing activities		**(9,703)**	10,018
Exchange differences and other adjustments		**28**	(3)
Net change in cash and cash equivalents		**1,431**	(14,234)
Cash and cash equivalents as at 1 January		**25,899**	40,133
Cash and cash equivalents as at 31 December	36(b)	**27,330**	25,899

The notes on pages 12 to 88 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in millions of Hong Kong dollars)

1 General information

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

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

The consolidated financial statements were approved for issue by the Board of Directors on 25 January 2013.

2 Summary of significant accounting policies

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

(a) Basis of preparation

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

The consolidated financial statements are presented in Hong Kong dollars and rounded to the nearest million, unless otherwise stated. They are prepared on the historical cost convention, except for derivative financial instruments, available-for-sale financial assets, financial assets and financial liabilities held at fair value through profit or loss and investment properties, which have been measured at fair value. 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.

(b) Adoption of new and revised accounting standards

On 1 January 2012, the Group adopted the following new or revised HKFRSs that are applicable in the current financial year.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

(b) Adoption of new and revised accounting standards (continued)

Amendments to HKAS 12 Income Taxes

The amendments introduce an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value, where the presumption that the carrying amount of the investment property will be recovered entirely by sale can be rebutted only if the investment property is depreciable and held within a business model whose objective is to consume substantially all of the asset's economic benefits over the life of the asset. Previously, deferred tax was provided against revaluation gains on investment properties on the assumption that the carrying values will be recovered through use. With the adoption of the amendments to HKAS 12, the amount of deferred tax arising on investment properties was reduced. The amendments have been applied retrospectively and the comparative figures have been restated, as summarised below.

	As previously reported HK$'M	Adjustment HK$'M	As restated HK$'M
Consolidated income statement for the year ended 31 December 2011			
Income tax expense	474	(6)	468
Profit attributable to shareholders	2,598	6	2,604
Total comprehensive income	2,569	6	2,575
Consolidated balance sheet as at 31 December 2011			
Deferred tax assets	2	35	37
Deferred tax liabilities	25	(25)	–
Retained earnings	15,514	44	15,558
Properties revaluation reserve	82	16	98
Consolidated balance sheet as at 1 January 2011			
Deferred tax assets	1	25	26
Deferred tax liabilities	29	(29)	–
Retained earnings	12,916	38	12,954
Properties revaluation reserve	82	16	98
Bank level balance sheet as at 31 December 2011			
Deferred tax assets	–	35	35
Deferred tax liabilities	25	(25)	–
Retained earnings	15,269	44	15,313
Properties revaluation reserve	82	16	98
Bank level balance sheet as at 1 January 2011			
Deferred tax assets	–	25	25
Deferred tax liabilities	29	(29)	–
Retained earnings	12,709	38	12,747
Properties revaluation reserve	82	16	98

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

(b) Adoption of new and revised accounting standards (continued)

Amendments to HKFRS 7: Financial Instruments: Disclosures

The amendments require additional disclosures for all transferred financial assets that are not derecognised in their entirety, and those that are derecognised in their entirety but for which the transferor retains continuing involvement existing at the reporting date, irrespective of when the related transfer transaction occurred. The amendments also clarify the conditions under which an entity is deemed to transfer a financial asset.

Please refer to Note 40 for the corresponding disclosures.

A summary of the significant group accounting policies are described below.

General Accounting Policies

(c) Group accounting

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

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

Subsidiaries

Subsidiaries are entities over which the Group has the power to govern the financial and operating policies, so as to obtain benefits from their activities. It is generally accompanied by a shareholding of more than 50% of voting rights. Subsidiaries are consolidated from the date control is transferred to the Group to the date control ceases.

Investment in a jointly controlled entity

A jointly controlled entity is an entity which is jointly controlled by the Group together with one or more parties through contractual arrangements. The Group recognises its interest in jointly controlled entity using the proportionate consolidation method.

Proportionate consolidation involves combining the Group’s share of the 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 a jointly controlled entity are stated at cost less accumulated 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

(d) Foreign currency translation

(i) Functional and presentation currency

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

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 taken to the translation reserve grouped under "Other reserves".

On consolidation, foreign exchange differences arising from the translation of net investments in foreign entities are recognised in other comprehensive income and accumulated under the translation reserve in equity. When a foreign operation is disposed of, such currency translation differences are recognised in the income statement as part of the gain or loss on disposal.

(ii) Foreign currency transactions

Transactions in foreign currencies are measured at exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the exchange rate ruling at the balance sheet date. Foreign exchange differences arising from this translation are recognised in the income statement. Non-monetary assets and liabilities measured at cost in foreign currency are translated using the exchange rate at the date of the transaction.

Income Statement

(e) Revenue recognition

(i) Interest income and interest expense

Interest income and interest expense as presented in Note 4 and 5 respectively represent the interest on all assets and liabilities regardless of the classification and measurement of the asset and liabilities on accrual or at fair value. No interest expense is accrued on the Group's structured investment deposits which are carried at fair value through profit or loss.

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

2 Summary of significant accounting policies (continued)

(e) Revenue recognition (continued)

(ii) Fee and commission income

The Group earns fee and commission income from a diverse range of products and services provided to its customers. Fee and commission income 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 which the related service is provided or credit risk is undertaken. Specifically

– Card related fee and commission income is recognised net of interchange fees paid.
– Income from issued financial guarantees are generally amortised over the duration of the instrument. For loan commitments, revenue is recognised over the period covered by the commitment. Please see Note 2(l) for the accounting policy on such commitments. Loan syndication fee received as payment for arranging a loan is recognised as revenue when the act has been completed, i.e. when the syndication has been finalised and the Group retained no part of the loan package for itself, or retained a part at the same effective interest rate as for the other participants.
– Management and advisory fees are recognised over the period for which the services are provided.

Certain fees are recognised upon the completion of a single transaction. Such fees include underwriting fees, brokerage fees and fees related to completion of corporate finance in general.

Expenses that are required, directly related and incremental to the revenue generation are offset in the net fee and commission income. These typically include brokerage fees paid, card-related expenses, sales commissions but do not include expenses for services delivered over a period (service contracts) and other expenses that are not directly related to any specific transaction. Judgement is required in making these determinations.

(iii) Dividend income

Dividend income is recognised when the right to receive payment is established. This is generally the ex-dividend date for listed equity securities, and usually the date when shareholders have approved the dividend for unlisted equity securities. Dividend income arising from held for trading financial assets is recognised in “Net income from financial instruments at fair value through profit or loss”, while that arising from available-for-sale financial assets is recognised in “Net income from financial investments”.

(iv) Rental income

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

Balance Sheet

(f) Financial assets

Initial recognition

Purchases and sales of all financial assets regardless of the subsequent classification and measurement are recognised on the date that the Group enters into the contractual provisions of the arrangements with counterparties. When the Group acts in a capacity as trustee or other fiduciary capacity without the direct control or direct benefit from the assets, these assets and the corresponding income belonging to a customer are excluded from the financial statements.

Financial assets are initially recognised at fair value plus transaction costs except for financial assets at fair value through profit or loss, for which transaction costs are expensed off immediately. The fair value of a financial asset on initial recognition is usually the transaction price.

Classification and subsequent measurement

The Group attempts to classify and measure financial assets based on the business model in which they are applied and how management monitor performance. The classification is consistently applied within the Group and where allowed by HKAS 39. HKAS 39 mandates the classification and measurement for financial assets based on their nature, which broadly means

– Financial assets (other than derivatives) that are managed mainly for longer term holding and collection of payments are classified as loans and receivables. These assets have fixed or determinable payment, are not quoted in an active market. Loans and receivables are carried at amortised cost and using the effective interest method. The majority of these assets are reported on the balance sheet under “Placements with and advances to banks” and “Advances to customers” but also in other captions. The income from these assets is reported in the income statement mainly as “Interest income”.

– Financial assets that are managed on a fair value basis, are classified as financial assets at fair value through profit or loss. Such assets include instruments held for the purpose of short term selling and market making, or designated under the fair value option if doing so eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise, or if the financial asset contains an embedded derivative that would otherwise need to be separately recorded.

  Financial assets at fair value through profit or loss are reported on the balance sheet mainly under “Trading securities” where these are held either for the purpose of market making and trading purposes. Realised or unrealised gains or losses on such financial assets, except interest income, are taken to “Net income from financial instruments at fair value through profit or loss” in the income statement in the period in which they arise.

– 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 the fair value is positive (“Positive fair values for derivative financial instruments”) and as liabilities when the fair value is negative (“Negative fair values for derivative financial instruments”). Changes in the fair value of derivatives other than those designated as hedges in accordance with Note 2(o) are included in “Net income from financial instruments at fair value through profit or loss”.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

(f) Financial assets (continued)

Classification and subsequent measurement (continued)

In some cases, derivatives may be embedded in financial contracts otherwise carried at amortised cost. Embedded derivatives may be separated from the host contract and accounted for as a standalone derivative instrument at fair value through profit or loss when required by HKAS 39. For such cases, the embedded derivatives are reported on the balance sheet under "Positive / Negative fair values for derivative financial instruments" and are measured at fair value with changes in fair value recognised in "Net income from financial instruments at fair value through profit or loss".

– The Group holds financial assets for the purpose of investment or to satisfy regulatory requirements for the banks' liquidity. Such assets are held for an indefinite period and may be sold in response to needs for liquidity or changes in interest rates, credit spreads, exchange rates or equity prices. These assets are classified as available-for-sale and initially and subsequently measured at fair value. Unrealised gains or losses arising from changes in fair value are recognised in other comprehensive income and accumulated in investments revaluation reserve. When sold or impaired, the accumulated fair value adjustments in the investments revaluation reserves are reclassified to the income statement. Unquoted equity investments classified as available-for-sale for which fair values cannot be reliably determined are carried at cost, less impairment. These assets are presented on the balance sheet under "Financial investments".

Where HKAS 39 does not allow for a classification and measurement that reflect the management of the financial assets (or financial liabilities), the Group may apply hedge accounting where permissible and relevant to better reflect the management. Please see Note 2(o) for details on hedging and hedge accounting.

Reclassification of financial assets

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

Reclassifications are made at fair value as of the reclassification date. The fair value becomes the new cost or amortised cost as applicable. Any gain or loss already recognised in the income statement before the reclassification date is not reversed.

Determination of fair value

The fair value of financial assets is the amount for which they could be exchanged between knowledgeable, willing parties in arm's length transaction. Determining fair value is considered a significant accounting policy for the Group and further details are disclosed in Note 35 on fair value measurement.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

(f) Financial assets (continued)

Offsetting

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

Derecognition

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

The Group enters into certain transactions where it transfers financial assets recognised on its balance sheet but retains either all or a portion of the risks and rewards of the transferred financial assets. If all or substantially all risks and rewards are retained, the transferred financial assets are not derecognised from the balance sheet. Transactions where transfers of financial assets result in the Group retaining all or substantially all risks and rewards include repurchase transactions described in Note 2(i). They also include certain transactions where control over the financial asset is retained, for example by a simultaneous transaction with the same counterparty to which the asset is transferred such as options. In such cases the Group continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

Please refer to Note 40 for disclosures on transfers of financial assets.

(g) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition including cash, balances with banks, placements with and advances to banks and short-term bills and notes classified as trading securities and available-for-sale financial investments which are readily convertible into cash.

(h) Impairment of financial assets

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 allowance is made when there is objective evidence of impairment as a result of the occurrence of loss events that will have an impact on the estimated future cash flows. The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

(h) Impairment of financial assets (continued)

Financial assets carried at amortised cost (continued)

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

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

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

If, in a subsequent period, the amount of the impairment decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment allowances are reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

When a loan is uncollectible, it is written off against the related allowances for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off reduce the amount of the allowances for loan impairment in the income statement.

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 reclassified from the investments revaluation reserve within equity to the income statement. Impairment losses recognised in the income statement on the equity investments are not reversed, until the equity investments are disposed of. A subsequent recovery in the value of an available-for-sale debt instrument whose value has been impaired is reversed through the income statement if there has been an identifiable event that led to the recovery.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

(i) Repurchase agreements

Repurchase agreements (“Repos”) are treated as collateralised borrowing. The amount borrowed is reflected as a liability either as “Deposits from customers”, “Deposits and balances from banks” or “Financial liabilities at fair value through profit or loss”. 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. The amount lent is reflected as an asset either as “Advances to customers”, “Placements with and advances to banks” or “Financial assets at fair value through profit or loss”.

Amounts paid and received in excess of the amounts borrowed and lent on the repos and reverse repos are amortised as interest expense and interest income respectively using the effective interest method.

(j) Properties and other fixed assets

(i) 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.

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

If a property becomes an investment property because its use has changed, any difference resulting between the carrying amount and the fair value of the property at the date of transfer is recognised in properties revaluation reserve under HKAS 16 Property, Plant and Equipment. On subsequent disposal of the investment property, the properties revaluation reserve is transferred to retained earnings.

(ii) Properties

Properties are stated at cost less accumulated impairment losses and accumulated depreciation. Depreciation is calculated using the straight-line method to write down the cost of the assets over their estimated useful lives as follows:

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

(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 using the straight-line method to write down the cost of the assets over their estimated useful lives of between 3 and 8 years.

The estimated useful life and residual values of fixed assets are reviewed on each balance sheet date.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

(j) Properties and other fixed assets (continued)

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

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

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

(k) Financial liabilities

Initial recognition

Financial liabilities are initially recognised at fair value, net of transaction costs incurred, except for financial liabilities at fair value through profit or loss, for which transaction costs are expensed off immediately.

Classification and subsequent measurement

The Group classifies and measures its financial liabilities in accordance with the purpose for which the financial liabilities are incurred and managed. Accordingly,

– Financial liabilities are classified as financial liabilities at fair value through profit or loss if they are incurred for the purpose of repurchasing in the near term (held for trading) or designated by management on initial recognition (designated under the fair value option). These often pertain to short positions in securities for the purpose of ongoing market making, hedging or trading. Financial liabilities such classified are reported on the balance sheet under "Trading liabilities" and "Financial liabilities designated at fair value through profit or loss".

  Financial liabilities classified as fair value through profit or loss are subsequently carried at fair value. Realised or unrealised gains or losses on financial liabilities held for trading and financial liabilities designated under the fair value option, except interest expense, are taken to "Net income from financial instruments at fair value through profit or loss" in the income statement in the period they arise.

– Derivative liabilities are classified as held for trading unless they are designated as hedging instruments and are carried at fair value through profit or loss. Please refer to Note 2(f) for the accounting policy on derivatives.

– Other financial liabilities are carried at amortised cost using the effective interest method. These comprise predominantly the Group's deposit portfolio and other liabilities.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

(k) Financial liabilities (continued)

Determination of fair value

The fair value of financial liabilities is the amount the liability can be settled at. The fair value 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. Where applicable, a valuation reserve or pricing adjustment is applied to arrive at the fair value.

Please refer also to Note 35 for further fair value measurement disclosures.

Derecognition

A financial liability is derecognised from the balance sheet when the obligation specified in the contract is discharged, cancelled or expired.

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

Loan Commitments

Loan commitments are typically not financial instruments and are accounted for depending on its legal terms of conditions. Upon a loan draw-down by the counterparty, the amount of the loan is accounted for under “loans and receivables” as described in Note 2(f).

Loan commitments are not recognised on balance sheet but are disclosed as off-balance sheet in accordance with HKAS 37 Provisions, Contingent Liabilities and Contingent Assets, and form part of the disclosures in Note 38.

Letters of Credit

Letters of credit are recorded off-balance sheet as contingent liabilities upon issuance, and the corresponding payables / receivables to / from the beneficiary / applicant are recorded upon acceptance of the underlying documents.

Financial Guarantees

A financial guarantee is initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the Group’s liability under each guarantee is measured at the higher of the initial measurement less amortisation 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 a financial guarantee is monitored periodically. When there is objective evidence indicating probability of losses occurring, a provision is recognised for the financial guarantee.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

(m) 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 of the obligation can be made.

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

(n) Share capital

Ordinary shares are classified as equity. Incremental external costs directly attributable to the issuance of new ordinary shares are deducted against the share capital account.

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

Other Specific Topics

(o) Hedging and hedge accounting

The Group uses derivative contracts as part of its hedging strategies for hedging interest rate risk arising from maturity mismatches or currency risk from currency mismatch and cash flows in foreign currencies.

In some cases, these hedges are designated as such for accounting purposes in order to modify the recognition of the profit or loss from the instruments in accordance with the items they are intended to hedge. Such designation requires the Group to meet strict requirement for documentation and hedge effectiveness as set out in HKAS 39. For such hedge accounting relationships each entity within the Group documents at the inception the relationship between the hedging instrument and hedged item, including the risk management objective for undertaking various hedge transactions and methods used to assess the effectiveness of the hedge. Each entity within the Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivative is highly effective in offsetting changes in the fair value or cash flows of the hedged item.

Specifically hedge accounting is applied in the following types of hedge relationships.

Fair value hedge

The Group's fair value hedges consist principally of interest rate swaps used for managing the interest rate gaps that naturally arise from its purchases or issues of debt securities, and where a mismatch in the measurement between the derivative (measured at fair value through profit or loss) and the hedged item (measured at amortised cost) exist.

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 income from financial instruments at fair value through profit or loss".

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

(o) Hedging and hedge accounting (continued)

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

Economic hedges which do not qualify for hedge accounting

Some hedging instruments serve as fully or partially effective economic hedges but do not qualify for hedge accounting given the exact nature of the derivatives or due to the inability to prove expected effectiveness of the hedging relationship within the strict requirements outlined by HKAS 39. This includes entering into swaps and other derivatives (e.g. futures, options) to manage interest rate, foreign exchange and other risks. Such hedges are treated in the same way as derivative instruments used for trading purposes, i.e. realised and unrealised gains and losses are recognised in “Net income from financial instruments at fair value through profit or loss”. Similarly, the hedged exposures are typically recorded at fair value through profit or loss, thereby achieving some measure of offset in the income statement.

Derivatives that do not qualify for hedge accounting include some hedges entered into as part of documented interest rate management strategies. The size and direction of changes in fair value of non-qualifying hedges can be volatile from year to year, but do not alter the cash flows expected as part of the documented management strategies for both the non-qualifying hedge instruments and the assets and liabilities to which the documented interest rate strategies relate. Non-qualifying hedges therefore operate as economic hedges of the related assets and liabilities.

Please refer to Note 37 for disclosures on hedging derivatives.

(p) Employee benefits

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

Employee entitlement to annual leave is recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

(q) Share-based compensation

Employee benefits also include share-based compensation, namely, the DBSH Share Option Plan, the DBSH Share Plan and the DBSH Employee Share Plan run by DBSH, the ultimate holding company of the Bank. The details of the Plans are described in Note 42.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

(r) Current and deferred taxes

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

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

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

(s) Leases

(i) Finance leases

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

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

(ii) Operating leases

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Summary of significant accounting policies (continued)

(t) New and revised HKFRSs (which are relevant to the Group's operations) issued but effective for compliance after 2012

The Group is in the process of making an assessment on the impact of the new / revised HKFRS and has not early adopted the following new / revised standards although early adoption in 2012 is permitted by the standard:

HKFRS 7 (Amendment)	Financial Instruments: Disclosures – Offsetting financial assets and financial liabilities
HKFRS 9	Financial Instruments
HKFRS 10	Consolidated Financial Statements
HKFRS 11	Joint Arrangements
HKFRS 12	Disclosure of Interests in Other Entities
HKFRS 13	Fair Value Measurement
HKAS 1 (Amendment)	Presentation of Financial Statements
HKAS 27 (2011)	Separate Financial Statements
HKAS 28 (2011)	Investments in Associates and Joint Venture
HKAS 32 (Amendment)	Financial Instruments: Presentation – Offsetting financial assets and financial liabilities

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 advances to customers. 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 an advance to customer 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.

(Expressed in millions of Hong Kong dollars)

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

(b) Fair value of financial instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction. 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, such as interest rate yield curves, option volatilities and foreign exchange rates. Valuation reserves or pricing adjustments where applicable will be used to converge to fair value.

The determination of fair value is subject to the Valuation Framework approved by the Board Risk Management Committee and the oversight of senior management committees. The Valuation Framework is implemented by the Group through policies and procedures approved by the committees. These policies and procedures facilitate the exercise of judgement in determining the risk characteristics of various financial instruments, discount rates, estimates of future cash flows and other factors used in the valuation process. Judgement may also be applied in adjusting prices for less readily observable external parameters such as through the use of valuation reserves. Other factors such as model assumptions and market dislocations leading to market anomalies can also materially affect these estimates. Please refer to Note 35 for details about the fair value hierarchy of the Group's financial instruments measured at fair value.

The fair value of financial instruments without observable market price may be determined using valuations models. The choice of model requires significant judgement for complex products and is governed by the above Valuation Framework and subject to approval by an independent control function. Models not approved by this function may not be applied. Note 35 provides details of financial instruments that are valued with observable and unobservable parameters (Levels 1 to 3). Instruments designated as Levels 2 and 3 are frequently valued using a valuation technique employing a relevant model.

(c) Income taxes

Judgement is involved in determining the group-wide provision for income taxes. The Group recognises liabilities for expected tax issues based on reasonable estimates of whether additional taxes will be due. Note 31 provides details of the Group's deferred tax assets / liabilities.

(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, arrangement with regulators and advice from legal counsel.

4 Interest income

	2012	2011
	HK$'M	HK$'M
Interest income on listed investments	**423**	483
Interest income on unlisted investments	**214**	397
Other interest income	**5,856**	4,643
	6,493	5,523

Interest income recognised on financial assets that are not at fair value through profit or loss amounted to HK$6,418 million (2011: HK$5,462 million).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

5 Interest expense

	2012 HK$'M	2011 HK$'M
Interest expense on subordinated liability (Note 32)	**59**	30
Other interest expense	**2,170**	1,517
	2,229	1,547

Interest expense recognised on financial liabilities that are not at fair value through profit or loss amounted to HK$2,202 million (2011: HK$1,527 million).

6 Net fee and commission income

	2012 HK$'M	2011 HK$'M
Fee and commission income	**1,709**	1,617
Less: Fee and commission expense	**(251)**	(300)
Net fee and commission income	**1,458**	1,317
Comprising:		
– Wealth management	**458**	344
– Trade and remittances	**377**	375
– Loan-related	**239**	239
– Cards	**234**	212
– Stock broking	**36**	52
– Deposit-related	**22**	20
– Guarantees	**13**	12
– Investment banking	**9**	4
– Others	**70**	59
	1,458	1,317
Of which:		
Fee and commission income arising from:		
– Financial assets or financial liabilities not at fair value through profit or loss	**699**	706
– Trust or other fiduciary activities	**22**	19
Fee and commission expense arising from:		
– Financial assets or financial liabilities not at fair value through profit or loss	**204**	235

Note:
Gross cards fees are net of interchange fees paid

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

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

	2012 **HK$'M**	2011 HK$'M
Net trading income		
– Foreign exchange	**965**	981
– Interest rates, credit and equities	**217**	228
	1,182	1,209
Net loss from financial instruments designated at fair value through profit or loss	**(42)**	(20)
	1,140	1,189

8 Net income from financial investments

	2012 **HK$'M**	2011 HK$'M
Debt securities		
– Available-for-sale	**86**	32
– Loans and receivables	**–**	27
Equity securities	**17**	19
	103	78
Of which dividend income from:		
– Listed investments	**1**	1
– Unlisted investments	**16**	14
	17	15

9 Other income

	2012 **HK$'M**	2011 HK$'M
Fair value adjustment on investment properties (Note 25(a))	**69**	39
Net gain on disposal of properties and other fixed assets	**343**	111
Others	**81**	44
	493	194

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

10 Total expenses

	2012 HK$'M	2011 HK$'M
Employee benefits		
– Salaries and other short term employee benefits	**1,901**	1,736
– Pensions	**113**	103
– Share-based compensation	**31**	30
Premises and equipment expenses excluding depreciation		
– Rental of premises	**201**	196
– Others	**264**	274
Depreciation (Note 25(a))	**201**	229
Auditor's remuneration	**7**	11
Computerisation expenses	**326**	290
Other operating expenses	**595**	622
	3,639	3,491

11 Allowances for credit and other losses

	2012 HK$'M	2011 HK$'M
Individual impairment allowances on advances to customers (Note 20)	**9**	80
Collective impairment allowances on advances to customers (Note 20)	**72**	75
Allowances for other credit related losses	**(4)**	36
	77	191
Individual impairment allowances on advances to customers		
– New allowances	**189**	318
– Releases	**(171)**	(215)
– Recoveries	**(9)**	(23)
	9	80
Collective impairment allowances on advances to customers		
– New allowances	**239**	205
– Releases	**(142)**	(102)
– Recoveries	**(25)**	(28)
	72	75
Allowances for other credit related losses		
– New allowances	**–**	43
– Releases	**(4)**	(7)
	(4)	36

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

12 Directors' emoluments

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

	2012 HK$'M	2011 HK$'M
Fees (Note a)	**2**	2
Salaries, housing and other allowances and benefits in kind (Note b)	**14**	12
Pensions	**1**	–
	17	14

Note:

(a) The Directors' fees are payable in 2013 to eligible persons who acted as Directors of DBS Bank (Hong Kong) Limited during the year ended 31 December 2012. Such fees are subject to the approval of the shareholders of DBS Bank (Hong Kong) Limited.

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

13 Income tax expense

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

	2012 HK$'M	2011 HK$'M
Hong Kong profits tax		
– Current year	**542**	479
– Overprovision in prior years	**(51)**	(11)
Overseas tax		
– Current year	**8**	6
– Overprovision in prior years	**–**	(1)
Current income tax	**499**	473
Deferred income tax (Note 31(b))	**16**	(5)
	515	468

Hong Kong profits tax has been provided at 16.5% (2011: 16.5%) on the estimated assessable profits for the year. Taxation for overseas subsidiaries and branch are charged at the appropriate current rates of taxation ruling in the countries in which they operate.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

13 Income tax expense (continued)

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

	2012 HK$'M	2011 HK$'M
Accelerated depreciation allowances	**2**	(25)
Impairment allowances	**14**	20
Share-based compensation	**(8)**	–
Accrued expenses	**8**	–
	16	(5)

(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% (2011: 16.5%) is as follows:

	2012 HK$'M	2011 HK$'M
Profit before income tax	**3,742**	3,072
Tax calculated at tax rate of 16.5% (2011: 16.5%)	**617**	507
Effect of different tax rates in other countries	**(2)**	(2)
Income not subject to tax	**(59)**	(31)
Expenses not deductible for tax purposes	**9**	12
Overprovision in prior years	**(51)**	(12)
Others	**1**	(6)
Income tax expense	**515**	468

14 Profit attributable to shareholders

The profit attributable to shareholders is dealt with in the financial statements of the Bank to the extent of HK$3,186 million (2011: HK$2,566 million).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

15 Dividend

No dividend was paid for the year ended 31 December 2012 (2011: Nil).

16 Cash and balances with banks

	Group		Bank	
	2012	2011	**2012**	2011
	HK$'M	HK$'M	**HK$'M**	HK$'M
Cash in hand	**381**	399	**381**	399
Balances with central banks	**3,712**	2,760	**3,712**	2,760
Balances with banks	**3,225**	7,684	**3,225**	7,684
	7,318	10,843	**7,318**	10,843

17 Placements with and advances to banks

	Group		Bank	
	2012	2011	**2012**	2011
	HK$'M	HK$'M	**HK$'M**	HK$'M
Remaining maturity				
– Within one month	**22,277**	8,729	**22,274**	8,726
– One year or less but over one month	**35,515**	11,544	**35,515**	11,544
– Over one year	**159**	2,784	**159**	2,784
	57,951	23,057	**57,948**	23,054

Placements with banks with remaining maturity within one month have been reclassified from balances with banks to placements with banks.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

18 Trading securities

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Treasury bills	**4,570**	5,418
Other debt securities	**3,007**	3,440
	7,577	8,858
Of which:		
– Listed in Hong Kong, at fair value	**2,016**	1,547
– Listed outside Hong Kong, at fair value	**469**	456
– Unlisted, at fair value	**5,092**	6,855
	7,577	8,858
Analysed by issuer as follows:		
– Sovereigns	**6,911**	7,250
– Public sector entities	**3**	6
– Banks	**57**	298
– Corporates	**606**	1,304
	7,577	8,858
Analysed by rating agency designation as follows:		
– AAA	**–**	4
– AA- to AA+	**6,831**	7,181
– A- to A+	**155**	716
– BBB to BBB+	**217**	260
– Unrated	**374**	697
	7,577	8,858

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
(Expressed in millions of Hong Kong dollars)

19 Advances to customers less impairment allowances

	Group		Bank	
	2012	2011	**2012**	2011
	HK$'M	HK$'M	**HK$'M**	HK$'M
Advances to customers	**177,152**	195,919	**177,152**	195,919
Less: Impairment allowances				
– Individually assessed (Note 20)	**(899)**	(1,142)	**(899)**	(1,142)
– Collectively assessed (Note 20)	**(628)**	(715)	**(602)**	(688)
	175,625	194,062	**175,651**	194,089
Comprising:				
– Trade bills	**28,250**	39,219	**28,250**	39,219
– Loans	**147,375**	154,843	**147,401**	154,870
	175,625	194,062	**175,651**	194,089

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

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Gross investments in finance leases and hire purchase contracts receivables:		
– Not later than one year	**1,264**	1,381
– Later than one year and not later than five years	**2,597**	2,725
– Later than five years	**7,503**	7,478
	11,364	11,584
Unearned future finance income	**(23)**	(27)
Net investments in finance leases and hire purchase contracts receivables	**11,341**	11,557
The net investments in finance leases and hire purchase contracts receivables are analysed as follows:		
– Not later than one year	**1,251**	1,365
– Later than one year and not later than five years	**2,587**	2,714
– Later than five years	**7,503**	7,478
	11,341	11,557

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

19 Advances to customers less impairment allowances (continued)

The unguaranteed residual values included in the gross investments in finance leases and hire purchase contracts receivables as at 31 December 2012 and 2011 are considered not material for disclosure purposes.

The individual impairment allowances for finance leases and hire purchase contracts receivables amounted to HK$117 million as at 31 December 2012 (2011: HK$137 million).

20 Impairment allowances on advances to customers

	Group		
	Individually assessed HK$'M	**Collectively assessed HK$'M**	**Total HK$'M**
As at 1 January 2012	**1,142**	**715**	**1,857**
Amounts written off	**(261)**	**(184)**	**(445)**
Recoveries of advances written off in previous years	**9**	**25**	**34**
Net charge to consolidated income statement (Note 11)	**9**	**72**	**81**
As at 31 December 2012	**899**	**628**	**1,527**
As at 1 January 2011	1,410	764	2,174
Amounts written off	(371)	(152)	(523)
Recoveries of advances written off in previous years	23	28	51
Net charge to consolidated income statement (Note 11)	80	75	155
As at 31 December 2011	1,142	715	1,857

	Bank		
	Individually assessed HK$'M	**Collectively assessed HK$'M**	**Total HK$'M**
As at 1 January 2012	**1,142**	**688**	**1,830**
Amounts written off	**(261)**	**(162)**	**(423)**
Recoveries of advances written off in previous years	**9**	**21**	**30**
Net charge to income statement	**9**	**55**	**64**
As at 31 December 2012	**899**	**602**	**1,501**
As at 1 January 2011	1,410	737	2,147
Amounts written off	(371)	(132)	(503)
Recoveries of advances written off in previous years	23	23	46
Net charge to income statement	80	60	140
As at 31 December 2011	1,142	688	1,830

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

21 Financial investments

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Available-for-sale	**24,068**	27,263
Loans and receivables	**569**	900
	24,637	28,163

(a) Available-for-sale

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Treasury bills	**11,377**	6,503
Certificate of deposit held	**250**	604
Other debt securities	**12,360**	20,083
Debt securities	**23,987**	27,190
Equity securities	**81**	73
	24,068	27,263
Debt securities		
– Listed in Hong Kong, at fair value	**959**	3,756
– Listed outside Hong Kong, at fair value	**8,145**	7,727
– Unlisted, at fair value	**14,869**	15,693
– Unlisted, at cost	**14**	14
	23,987	27,190
Equity securities		
– Listed in Hong Kong, at fair value	**49**	41
– Unlisted, at cost	**32**	32
	81	73
	24,068	27,263
Analysed by issuer as follows:		
– Sovereigns	**15,824**	13,470
– Public sector entities	**856**	904
– Banks	**5,050**	9,916
– Corporates	**2,324**	2,959
– Others	**14**	14
	24,068	27,263

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

21 Financial investments (continued)

(a) Available-for-sale (continued)

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Analysed by rating agency designation as follows:		
– AAA	**7,853**	10,466
– AA- to AA+	**13,172**	12,759
– A- to A+	**2,061**	3,015
– BBB to BBB+	**479**	548
– Unrated	**422**	402
	23,987	27,190

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

As at 31 December 2012 and 2011, there were no impaired, overdue or rescheduled available-for-sale financial investments.

(b) Loans and receivables

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Debt securities		
– Listed outside Hong Kong	**125**	126
– Unlisted	**444**	774
	569	900
Analysed by issuer as follows:		
– Corporates	**569**	900
Analysed by rating agency designation as follows:		
– A- to A+	**234**	617
– BBB to BBB+	**335**	283
	569	900

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

As at 31 December 2012, the fair value of the above debt securities is HK$582 million (2011: HK$891 million).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

21 Financial investments (continued)

(b) Loans and receivables (continued)

The interest income and exchange loss arising from the above debt securities recognised in the income statement for the year ended 31 December 2012 were HK$38 million (2011: HK$79 million) and HK$1 million (2011: HK$2 million) respectively. Exchange gain or loss arising from these debt securities was managed in conjunction with matched funding where the resulting net exchange gain or loss was insignificant to the income statement.

The fair value gain that would have been recognised in the other comprehensive income if the debt securities had not been reclassified would be HK$28 million (2011: fair value loss of HK$41 million).

The above debt securities are neither past due nor impaired.

22 Other assets

	Group		Bank	
	2012 HK$'M	2011 HK$'M	**2012 HK$'M**	2011 HK$'M
Accrued interest receivables	**478**	635	**478**	635
Acceptances	**2,242**	2,642	**2,242**	2,642
Other accounts	**1,437**	1,145	**1,434**	1,141
	4,157	4,422	**4,154**	4,418

23 Interest in a jointly controlled entity

	Group		Bank	
	2012 HK$'M	2011 HK$'M	**2012 HK$'M**	2011 HK$'M
Unlisted investments, at cost			**1**	1
Amount due to a jointly controlled entity	**1,321**	1,244	**2,641**	2,487

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

	2012 HK$'M	2011 HK$'M
Current assets	**1,323**	1,247
Non-current assets	**3**	4
Current liabilities	**969**	932
Non-current liabilities	**27**	26
Share of income	**160**	151
Share of expenses	**123**	118

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

23 Interest in a jointly controlled entity (continued)

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

24 Subsidiaries

	Bank	
	2012	2011
	HK$'M	HK$'M
Unlisted shares, at cost after impairment loss of HK$2 million (2011: HK$2 million)	**145**	145
Amounts due from subsidiaries	**7**	4
	152	149
Amounts due to subsidiaries	**234**	227

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

(Expressed in millions of Hong Kong dollars)

25 Properties and other fixed assets

(a) Properties and other fixed assets movements

Group

	Freehold land and building HK$'M	Land and buildings HK$'M	Furniture, fixtures and equipment HK$'M	Subtotal HK$'M	Investment properties HK$'M	Total HK$'M
Cost or valuation						
As at 1 January 2012	23	2,707	1,030	3,760	407	4,167
Additions	–	10	174	184	–	184
Disposals	–	(81)	(20)	(101)	–	(101)
Fair value adjustment	–	–	–	–	69	69
As at 31 December 2012	23	2,636	1,184	3,843	476	4,319
Accumulated depreciation and impairment						
As at 1 January 2012	17	788	709	1,514	–	1,514
Charge for the year	–	55	146	201	–	201
Disposals	–	(46)	(19)	(65)	–	(65)
As at 31 December 2012	17	797	836	1,650	–	1,650
Net book value						
As at 31 December 2012	6	1,839	348	2,193	476	2,669
The analysis of cost or valuation of the above assets as at 31 December 2012 is as follows:						
At cost	23	2,636	1,184	3,843	–	3,843
At valuation	–	–	–	–	476	476
	23	2,636	1,184	3,843	476	4,319

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)

(Expressed in millions of Hong Kong dollars)

25 Properties and other fixed assets (continued)

(a) Properties and other fixed assets movements (continued)

Group

	Freehold land and building HK$'M	Land and buildings HK$'M	Furniture, fixtures and equipment HK$'M	Subtotal HK$'M	Investment properties HK$'M	Total HK$'M
Cost or valuation						
As at 1 January 2011	23	2,813	1,020	3,856	368	4,224
Additions	–	5	80	85	–	85
Disposals	–	(111)	(70)	(181)	–	(181)
Fair value adjustment	–	–	–	–	39	39
As at 31 December 2011	23	2,707	1,030	3,760	407	4,167
Accumulated depreciation and impairment						
As at 1 January 2011	17	792	584	1,393	–	1,393
Charge for the year	–	58	171	229	–	229
Disposals	–	(62)	(46)	(108)	–	(108)
As at 31 December 2011	17	788	709	1,514	–	1,514
Net book value						
As at 31 December 2011	6	1,919	321	2,246	407	2,653
The analysis of cost or valuation of the above assets as at 31 December 2011 is as follows:						
At cost	23	2,707	1,030	3,760	–	3,760
At valuation	–	–	–	–	407	407
	23	2,707	1,030	3,760	407	4,167

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

25 Properties and other fixed assets (continued)

(a) Properties and other fixed assets movements (continued)

Bank

	Freehold land and building HK$'M	Land and buildings HK$'M	Furniture, fixtures and equipment HK$'M	Subtotal HK$'M	Investment properties HK$'M	Total HK$'M
Cost or valuation						
As at 1 January 2012	23	2,707	994	3,724	407	4,131
Additions	–	10	174	184	–	184
Disposals	–	(81)	(20)	(101)	–	(101)
Fair value adjustment	–	–	–	–	69	69
As at 31 December 2012	23	2,636	1,148	3,807	476	4,283
Accumulated depreciation and impairment						
As at 1 January 2012	17	788	675	1,480	–	1,480
Charge for the year	–	55	145	200	–	200
Disposals	–	(46)	(19)	(65)	–	(65)
As at 31 December 2012	17	797	801	1,615	–	1,615
Net book value						
As at 31 December 2012	6	1,839	347	2,192	476	2,668
The analysis of cost or valuation of the above assets as at 31 December 2012 is as follows:						
At cost	23	2,636	1,148	3,807	–	3,807
At valuation	–	–	–	–	476	476
	23	2,636	1,148	3,807	476	4,283

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)

(Expressed in millions of Hong Kong dollars)

25 Properties and other fixed assets (continued)

(a) Properties and other fixed assets movements (continued)

Bank

	Freehold land and building HK$'M	Land and buildings HK$'M	Furniture, fixtures and equipment HK$'M	Subtotal HK$'M	Investment properties HK$'M	Total HK$'M
Cost or valuation						
As at 1 January 2011	23	2,813	984	3,820	368	4,188
Additions	–	5	80	85	–	85
Disposals	–	(111)	(70)	(181)	–	(181)
Fair value adjustment	–	–	–	–	39	39
As at 31 December 2011	23	2,707	994	3,724	407	4,131
Accumulated depreciation and impairment						
As at 1 January 2011	17	792	555	1,364	–	1,364
Charge for the year	–	58	166	224	–	224
Disposals	–	(62)	(46)	(108)	–	(108)
As at 31 December 2011	17	788	675	1,480	–	1,480
Net book value						
As at 31 December 2011	6	1,919	319	2,244	407	2,651
The analysis of cost or valuation of the above assets as at 31 December 2011 is as follows:						
At cost	23	2,707	994	3,724	–	3,724
At valuation	–	–	–	–	407	407
	23	2,707	994	3,724	407	4,131

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

25 Properties and other fixed assets (continued)

(b) Operating lease arrangements

As at 31 December, the net book values of the investment properties held by the Group and the Bank are analysed as follows:

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
In Hong Kong held on:		
– Leases of over 50 years	**402**	341
– Leases of between 10 to 50 years	**74**	66
	476	407

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 terms will be renegotiated. None of the leases include contingent rentals.

During the year, HK$10 million (2011: HK$10 million) was recognised as rental income in the income statement in respect of the operating leases.

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

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Not later than one year	**8**	9
Later than one year and not later than five years	**5**	5
	13	14

26 Trading liabilities

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Short positions in securities	**6,450**	6,574

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

27 Financial liabilities designated at fair value through profit or loss

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Structured investment deposits (Note 28)	**1,771**	805
Certificates of deposit issued (Note 29)	**8**	160
	1,779	965

Changes in fair value arising from changes in credit risk are determined as the amount of change in their fair value that is not attributable to changes in market conditions that give rise to market risk. Changes in market conditions that give rise to market risk include changes in benchmark interest rate, foreign exchange rate or index of prices or rates. Changes in fair value arising from changes in credit risk are considered not significant. Net unrealised loss for the financial liabilities designated at fair value through profit or loss amounted to HK$9 million as at 31 December 2012 (2011: HK$5 million).

28 Deposits from customers

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Deposits from customers		
– As stated in the balance sheets	**212,333**	184,970
– Structured investment deposits reported as financial liabilities designated at fair value through profit or loss (Note 27)	**1,771**	805
	214,104	185,775
Analysed by:		
– Demand deposits and current accounts	**20,912**	17,097
– Savings deposits	**69,485**	57,452
– Time, call and notice deposits	**123,707**	111,226
	214,104	185,775

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
(Expressed in millions of Hong Kong dollars)

29 Certificates of deposit issued

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Certificates of deposit issued		
– at amortised cost	**3,803**	12,869
– adjusted for fair value changes under fair value hedge	**3,480**	3,514
As stated in the balance sheets	**7,283**	16,383
Reported as financial liabilities designated at fair value through profit or loss (Note 27)	**8**	160
	7,291	16,543

30 Other liabilities

	Group		Bank	
	2012	2011	**2012**	2011
	HK$'M	HK$'M	**HK$'M**	HK$'M
Accrued interest payable	**449**	379	**442**	372
Short positions in securities	**–**	1,759	**–**	1,759
Acceptances	**2,242**	2,642	**2,242**	2,642
Other liabilities and provisions	**5,497**	4,696	**4,531**	3,771
	8,188	9,476	**7,215**	8,544

31 Taxation

(a) Current income tax liabilities

	Group		Bank	
	2012	2011	**2012**	2011
	HK$'M	HK$'M	**HK$'M**	HK$'M
Hong Kong profits tax payable	**137**	245	**137**	244
Overseas tax payable	**6**	6	**6**	6
	143	251	**143**	250

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

31 Taxation (continued)

(b) Deferred income tax

The movements on the net deferred income tax (liabilities) / assets are as follows:

	Group		Bank	
	2012 **HK$'M**	2011 HK$'M	**2012** **HK$'M**	2011 HK$'M
As at 1 January				
– as previously reported	**(23)**	(28)	**(25)**	(29)
– adjustments due to change in accounting standard	**60**	54	**60**	54
As restated at 1 January	**37**	26	**35**	25
Deferred income tax (charged) / credited to income statement (Note 13(a))	**(16)**	5	**(17)**	4
Deferred income tax (charged) / credited to equity (Note 34(b)(ii))	**(7)**	6	**(7)**	6
As at 31 December	**14**	37	**11**	35

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

	Group		Bank	
	2012 **HK$'M**	2011 HK$'M	**2012** **HK$'M**	2011 HK$'M
Deferred tax assets				
Impairment allowances	**90**	104	**87**	101
Share-based compensation	**8**	–	**8**	–
	98	104	**95**	101
Deferred tax liabilities				
Accelerated depreciation allowances	**52**	50	**52**	49
Accrued expenses	**8**	–	**8**	–
Revaluation of financial investments	**24**	17	**24**	17
	84	67	**84**	66

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

31 Taxation (continued)

(b) Deferred income tax (continued)

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

	Group		Bank	
	2012	2011	**2012**	2011
	HK$'M	HK$'M	**HK$'M**	HK$'M
Deferred tax assets	**98**	104	**95**	101
Deferred tax liabilities	**(84)**	(67)	**(84)**	(66)
	14	37	**11**	35

32 Subordinated liability

On 12 December 2012, the Bank, with the approval of the Hong Kong Monetary Authority ("HKMA"), repaid the US$540,000,000 callable subordinated loan that was issued on 12 December 2006. On the same date, the Bank issued a new subordinated loan of the same amount to its intermediate holding company, DBS Bank Ltd. This subordinated loan will mature on 12 December 2022, with an optional repayment date on 13 December 2017 or any interest payment date thereafter until maturity. Interest is payable quarterly and is charged at USD 3-month LIBOR plus 2.5% per annum. The subordinated loan will be converted into ordinary shares at the point of non-viability as determined by the HKMA. The subordinated loan is Basel III-compliant and qualifies as supplementary capital for the purpose of computing the Bank's capital adequacy ratio.

33 Share capital

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Authorised		
12,000,000,000 ordinary shares of HK$1 each	**12,000**	12,000
Issued and fully paid		
7,000,000,000 ordinary shares of HK$1 each	**7,000**	7,000

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

34 Reserves

	Group		Bank	
	2012 HK$'M	2011 HK$'M	**2012 HK$'M**	2011 HK$'M
(a) Share premium				
As at 1 January and 31 December	**595**	595	**595**	595
(b) Other reserves				
(i) Capital reserve				
As at 1 January and 31 December	**12**	12	**–**	–
(ii) Investments revaluation reserve from available-for-sale financial investments				
As at 1 January	**148**	177	**148**	177
Net valuation taken to equity	**69**	(6)	**69**	(6)
Amortisation of reserve to income statement arising from reclassification of available-for-sale financial investments to loans and receivables	**2**	4	**2**	4
Transferred to income statement	**(86)**	(33)	**(86)**	(33)
Deferred income tax (charged) / credited to equity	**(7)**	6	**(7)**	6
As at 31 December	**126**	148	**126**	148
(iii) Properties revaluation reserve				
As at 1 January				
– as previously reported	**98**	82	**98**	82
– adjustments due to change in accounting standard	**–**	16	**–**	16
As restated at 1 January and as at 31 December	**98**	98	**98**	98
(iv) General reserve				
As at 1 January and 31 December	**2,399**	2,399	**2,285**	2,285
Total other reserves	**2,635**	2,657	**2,509**	2,531

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

34 Reserves (continued)

	Group		Bank	
	2012	2011	**2012**	2011
	HK$'M	HK$'M	**HK$'M**	HK$'M
(c) Retained earnings				
As at 1 January				
– as previously reported	**15,558**	12,916	**15,313**	12,709
– adjustments due to change in accounting standard	**–**	38	**–**	38
As restated at 1 January	**15,558**	12,954	**15,313**	12,747
Profit attributable to shareholders				
– as previously reported	**3,227**	2,598	**3,186**	2,560
– adjustments due to change in accounting standard	**–**	6	**–**	6
– as restated	**3,227**	2,604	**3,186**	2,566
As at 31 December	**18,785**	15,558	**18,499**	15,313
Total reserves	**22,015**	18,810	**21,603**	18,439

The investments revaluation reserve represents the cumulative net change in the fair value of available-for-sale financial investments.

Properties revaluation reserve represents revaluation surplus arising on transfer of the land and buildings to investment properties.

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

As at 31 December 2012, HK$1,295 million (2011: HK$1,304 million) was earmarked as the regulatory reserve from the retained earnings. The regulatory reserve is maintained to satisfy the provisions of the Banking Ordinance for prudential supervision purposes. Movements in the reserve are made directly through retained earnings and in consultation with the Hong Kong Monetary Authority.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

35 Fair value measurement

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

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

(i) 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.

(ii) Advances to customers

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

(iii) Financial investments – loans and receivables

The fair value is set out in Note 21(b).

(iv) 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 deposits and other borrowings with fixed interest rates is based on discounted cash flows using prevailing interest rates with similar remaining maturity.

(v) Certificates of deposit issued

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

(vi) Subordinated liability

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

(b) Fair value of financial assets and liabilities carried at fair value

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

(i) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
(ii) inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices) (Level 2); and
(iii) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

35 Fair value measurement (continued)

(b) Fair value of financial assets and liabilities carried at fair value (continued)

The following table presents the assets and liabilities measured at fair value as at 31 December:

2012	**Group and Bank**			
	Level 1 HK$'M	**Level 2 HK$'M**	**Level 3 HK$'M**	**Total HK$'M**
Assets				
Trading securities	**7,563**	**14**	**–**	**7,577**
Positive fair values for derivative financial instruments	**–**	**5,215**	**–**	**5,215**
Available-for-sale financial investments:				
– Debt securities	**22,819**	**1,082**	**72**	**23,973**
– Equity securities	**49**	**–**	**–**	**49**
Liabilities				
Trading liabilities	**6,450**	**–**	**–**	**6,450**
Financial liabilities designated at fair value through profit or loss	**–**	**1,771**	**8**	**1,779**
Negative fair values for derivative financial instruments	**–**	**5,109**	**–**	**5,109**
Certificates of deposit issued	**–**	**–**	**3,480**	**3,480**

2011	Group and Bank			
	Level 1 HK$'M	Level 2 HK$'M	Level 3 HK$'M	Total HK$'M
Assets				
Trading securities	8,858	–	–	8,858
Positive fair values for derivative financial instruments	–	7,034	–	7,034
Available-for-sale financial investments:				
– Debt securities	24,049	1,876	1,251	27,176
– Equity securities	41	–	–	41
Liabilities				
Trading liabilities	6,574	–	–	6,574
Financial liabilities designated at fair value through profit or loss	–	805	160	965
Negative fair values for derivative financial instruments	–	7,315	–	7,315
Certificates of deposit issued	–	–	3,514	3,514

35 Fair value measurement (continued)

(b) Fair value of financial assets and liabilities carried at fair value (continued)

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

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

Financial instruments are considered Level 3 when at least one input to a valuation technique or model is unobservable. Valuation reserves or pricing adjustments where applicable will be used to converge to fair value.

Securities traded over-the-counter are valued using broker, dealer quotes or any other approved sources. The Group may also use valuation models or discounted cash flow technique to determine the fair value.

Most of the over-the-counter derivatives are priced using valuation models. Where derivative products have been established in the markets for some time, the Group uses models that are widely accepted by the industry.

The valuation techniques and inputs used generally depend on the contractual terms and the risks inherent in the instrument as well as the availability of pricing information in the market. Principal techniques used include discounted cash flows, Black Scholes and other appropriate valuation models. Over-the-counter derivatives which are valued using unobservable inputs that are supported by little or no market activity that are significant to the fair value of the assets or liabilities are classified under Level 3.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

35 Fair value measurement (continued)

(b) Fair value of financial assets and liabilities carried at fair value (continued)

The following table presents the changes in Level 3 instruments for the financial year ended 31 December:

2012	**Group and bank**								
		Fair value gains or losses							
	Opening balance HK$'M	**Profit or loss HK$'M**	**Other comprehensive income HK$'M**	**Purchases/ Issues HK$'M**	**Sales HK$'M**	**Settlement HK$'M**	**Transfer into Level 3 HK$'M**	**Transfer out of Level 3 HK$'M**	**Closing balance HK$'M**
Assets									
Trading securities	–	–	–	–	–	–	–	–	–
Available-for-sale financial investments									
– Debt securities	1,251	–	(13)	–	–	(1,045)	–	(121)	72
Liabilities									
Financial liabilities designated at fair value through profit or loss	160	(2)	–	–	–	(150)	–	–	8
Certificates of deposit issued	3,514	66	–	–	–	(100)	–	–	3,480

2011	Group and bank								
		Fair value gains or losses							
	Opening balance HK$'M	Profit or loss HK$'M	Other comprehensive income HK$'M	Purchases/ Issues HK$'M	Sales HK$'M	Settlement HK$'M	Transfer into Level 3 HK$'M	Transfer out of Level 3 HK$'M	Closing balance HK$'M
Assets									
Trading securities	2	–	–	–	–	–	–	(2)	–
Available-for-sale financial investments									
– Debt securities	785	–	11	494	–	(79)	621	(581)	1,251
Liabilities									
Financial liabilities designated at fair value through profit or loss	325	2	–	150	–	(317)	–	–	160
Certificates of deposit issued	3,348	186	–	1,232	–	(1,252)	–	–	3,514

The Group classifies financial instruments in Level 3 when there is reliance on at least one unobservable input to the valuation model attributing to a significant contribution to the instrument value. Economic hedges entered into for Level 2 exposures may be classified within a different category (i.e. Level 1) and similarly, hedges entered for Level 3 exposures may also be classified within a different category (i.e. Level 1 and / or 2) . The effects are presented gross in the table.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
(Expressed in millions of Hong Kong dollars)

36 Notes to consolidated cash flow statement

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

	Share capital and share premium HK$'M	**Certificates of deposit issued HK$'M**	**Subordinated liability HK$'M**
Balance as at 1 January 2011	7,595	6,152	4,199
Cash inflow from financing activities	–	25,892	–
Cash outflow from financing activities	–	(15,708)	–
Revaluation	–	186	–
Amortisation of discount	–	20	–
Exchange differences and other adjustments	–	1	(3)
Balance as at 31 December 2011	**7,595**	**16,543**	**4,196**
Cash inflow from financing activities	**–**	**11,105**	**–**
Cash outflow from financing activities	**–**	**(20,493)**	**–**
Revaluation	**–**	**62**	**–**
Amortisation of discount	**–**	**36**	**–**
Exchange differences and other adjustments	**–**	**38**	**(10)**
Balance as at 31 December 2012	**7,595**	**7,291**	**4,186**

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

	2012 HK$'M	2011 HK$'M
Cash and balances with banks	**7,318**	10,843
Placements with and advances to banks repayable with original maturity within three months	**16,160**	8,729
Bills and notes repayable with original maturity within three months	**3,852**	6,327
	27,330	25,899

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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

37 Derivative financial instruments and hedging activities (continued)

(a) Derivatives (continued)

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

2012	**Group and Bank**			
Derivatives held for trading	**Contract/ notional amount HK$'M**	**Credit risk-weighted amount HK$'M**	**Positive fair value HK$'M**	**Negative fair value HK$'M**
Foreign exchange derivatives				
– Forwards	**204,548**	**3,102**	**2,003**	**1,999**
– Swaps	**122,321**	**328**	**711**	**721**
– Options purchased	**115,851**	**3,737**	**1,416**	**–**
– Options written	**114,678**	**–**	**–**	**1,413**
	557,398	**7,167**	**4,130**	**4,133**
Interest rate derivatives				
– Futures	**54**	**–**	**1**	**1**
– Swaps	**33,815**	**521**	**706**	**735**
– Options purchased	**1,412**	**–**	**6**	**–**
– Options written	**1,412**	**–**	**–**	**6**
	36,693	**521**	**713**	**742**
Equity derivatives	**489**	**7**	**3**	**3**
Total derivatives held for trading	**594,580**	**7,695**	**4,846**	**4,878**
Derivatives designated and qualified as fair value hedges				
Interest rate derivatives				
– Swaps	**5,788**	**74**	**378**	**252**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

37 Derivative financial instruments and hedging activities (continued)

(a) Derivatives (continued)

2011	Group and Bank			
Derivatives held for trading	Contract/ notional amount HK$'M	Credit risk-weighted amount HK$'M	Positive fair value HK$'M	Negative fair value HK$'M
Foreign exchange derivatives				
– Forwards	187,370	2,359	2,075	2,123
– Swaps	86,015	90	311	492
– Options purchased	152,980	6,991	3,298	–
– Options written	151,795	–	–	3,350
	578,160	9,440	5,684	5,965
Interest rate derivatives				
– Futures	218	–	1	1
– Swaps	122,061	581	1,038	1,042
– Options purchased	852	–	12	–
– Options written	852	–	–	12
	123,983	581	1,051	1,055
Equity derivatives	234	2	1	1
Total derivatives held for trading	702,377	10,023	6,736	7,021
Derivatives designated and qualified as fair value hedges				
Interest rate derivatives				
– Swaps	5,963	64	314	308

The above tables include derivatives and embedded derivatives. The amounts (except credit-risk weighted amounts) are shown on a gross basis and do not take into account the effect of bilateral netting arrangements. The positive and negative fair values of embedded derivatives included in above amounted to HK$9 million and HK$21 million respectively (2011: HK$16 million and HK$14 million respectively). The contract or notional 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 31 December 2012 and 2011 are the amounts which have been taken into account the effect of bilateral netting arrangements and have been calculated in accordance with the Banking (Capital) Rules.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

37 Derivative financial instruments and hedging activities (continued)

(b) Hedging activities

As at 31 December 2012, the Group has interest rate swap agreements in place with a notional amount of HK$5,788 million (2011: HK$5,963 million) to hedge the exposure arising from changes in the fair value as a result of market interest rate fluctuation of certain financial investments and certificates of deposit issued. The hedging derivatives and hedged items have similar critical terms.

The gains on the hedging instruments are HK$96 million (2011: HK$140 million). The losses on the hedged items attributable to the hedged risk are HK$95 million (2011: HK$138 million).

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	
	2012	2011
	HK$'M	HK$'M
Direct credit substitutes	**1,046**	957
Transaction-related contingencies	**978**	1,116
Trade-related contingencies	**9,604**	8,172
Other commitments with an original maturity of not more than one year	**4,003**	2,425
Other commitments with an original maturity of more than one year	**405**	163
Other commitments which are unconditionally cancellable	**127,892**	112,232
	143,928	125,065
Credit risk-weighted amount	**13,141**	11,847

In October 2012, the Group entered into a five-year outsourcing agreement 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 the service company could require the Group to pay termination cost on early termination of the contract. The exact amount of termination cost cannot be reliably determined as it is dependent upon business volumes over the period of the contract and on the timing of the termination itself.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

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	
	2012	2011	**2012**	2011
	HK$'M	HK$'M	**HK$'M**	HK$'M
Expenditure contracted but not provided for	**73**	65	**73**	65
Expenditure authorised but not contracted for	**28**	28	**28**	28
	101	93	**101**	93

(b) Lease commitments

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

	Group and Bank			
	2012		2011	
	Properties	**Others**	Properties	Others
	HK$'M	**HK$'M**	HK$'M	HK$'M
Not later than one year	**190**	**8**	179	10
Later than one year and not later than five years	**311**	**–**	340	4
Later than five years	**83**	**–**	135	–
	584	**8**	654	14

40 Securities pledged and transfers of financial assets

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

40 Securities pledged and transfers of financial assets (continued)

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

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Secured liabilities – short positions in securities (Notes 26 and 30)	**6,450**	8,333
Assets pledged as security		
– Treasury bills	**4,683**	5,318
– Other securities	**1,756**	3,036
	6,439	8,354

The assets pledged as security included financial assets at fair value through profit or loss of HK$5,532 million (2011: HK$6,672 million).

As at 31 December 2012, the Group has HK$6,652 million (2011: HK$7,937 million) of transferred financial assets under securities lending transactions on the balance sheet, which are mostly classified as available-for-sale financial investments.

The fair value of the transferred securities and associated liabilities approximate the carrying amounts.

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 Hong Kong Risk Executive Committee, the Hong Kong Credit Risk Committee, the Hong Kong Market & Liquidity Risk Committee and the Hong Kong Operational Risk 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 in line with the Group's risk governance framework.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(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 Hong Kong Credit Risk Committee serves as the executive forum for overseeing various aspects of credit risk taking including framework, limits management, policies, processes, methodologies and systems.

Exposure to credit risk 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.

The risk management of the exposures is conducted through the credit application 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 assess the level of credit risk accepted by the Group. Business units and credit risk managers 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 process 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, amongst other things, the size, nature of the proposed transactions and credit quality. 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:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(a) Credit risk (continued)

(i) Collateral

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 in the 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.

The maximum exposure to credit risk for financial assets recognised on the balance sheet is the carrying amount. For contingent liabilities, the maximum exposure to credit risk is the maximum amount the Group would have to pay if the instrument is called upon. For undrawn facilities, the maximum exposure to credit risk is the full amount of the undrawn credit facilities granted to customers. Refer to Note 38 for the contractual amounts of each significant class of contingent liabilities and commitments.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(a) Credit risk (continued)

Analysis of collateral

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

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

Balances with banks, placements with and advances to banks, trading securities and financial investments
Collateral is generally not sought for these assets.

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

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

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

Advances to customers by credit quality

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Neither past due nor impaired	**173,219**	191,373
Past due but not impaired	**2,554**	2,779
Impaired	**1,379**	1,767
	177,152	195,919

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

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		
2012	**Pass HK$'M**	**Special mention HK$'M**	**Total HK$'M**
Manufacturing	**8,744**	**1,733**	**10,477**
Building and construction	**27,655**	**740**	**28,395**
Housing loans	**37,345**	**30**	**37,375**
General commerce	**58,081**	**5,053**	**63,134**
Transportation, storage and communication	**11,388**	**616**	**12,004**
Financial institutions, investments and holding companies	**1,444**	**13**	**1,457**
Professionals and private individuals (except housing loans)	**14,551**	**19**	**14,570**
Others	**5,574**	**233**	**5,807**
	164,782	**8,437**	**173,219**

	Group and Bank		
2011	Pass HK$'M	Special mention HK$'M	Total HK$'M
Manufacturing	10,661	1,762	12,423
Building and construction	27,552	657	28,209
Housing loans	44,970	3	44,973
General commerce	69,826	4,544	74,370
Transportation, storage and communication	9,788	549	10,337
Financial institutions, investments and holding companies	1,735	10	1,745
Professionals and private individuals (except housing loans)	14,381	34	14,415
Others	4,778	123	4,901
	183,691	7,682	191,373

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
(Expressed in millions of Hong Kong dollars)

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

2012	**Past due**				
Group and Bank	**Less than 1 month HK$'M**	**1-2 months HK$'M**	**2-3 months HK$'M**	**More than 3 months HK$'M**	**Total HK$'M**
Manufacturing	**71**	**8**	**2**	**–**	**81**
Building and construction	**358**	**1**	**6**	**–**	**365**
Housing loans	**885**	**33**	**3**	**–**	**921**
General commerce	**481**	**49**	**9**	**–**	**539**
Transportation, storage and communication	**14**	**1**	**–**	**–**	**15**
Financial institutions, investments and holding companies	**–**	**–**	**–**	**–**	**–**
Professionals and private individuals (except housing loans)	**311**	**6**	**–**	**304**	**621**
Others	**11**	**1**	**–**	**–**	**12**
	2,131	**99**	**20**	**304**	**2,554**

2011	Past due				
Group and Bank	Less than 1 month HK$'M	1-2 months HK$'M	2-3 months HK$'M	More than 3 months HK$'M	Total HK$'M
Manufacturing	104	11	2	–	117
Building and construction	656	26	1	–	683
Housing loans	717	19	6	–	742
General commerce	224	50	3	–	277
Transportation, storage and communication	355	5	–	–	360
Financial institutions, investments and holding companies	–	–	–	–	–
Professionals and private individuals (except housing loans)	267	4	–	296	567
Others	25	8	–	–	33
	2,348	123	12	296	2,779

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(a) Credit risk (continued)

Advances to customers by credit quality (continued)

(iii) Impaired advances to customers

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Manufacturing	**447**	538
Building and construction	**110**	138
Housing loans	**62**	52
General commerce	**600**	695
Transportation, storage and communication	**24**	21
Financial institutions, investments and holding companies	**121**	–
Professionals and private individuals (except housing loans)	**15**	119
Others	**–**	204
	1,379	1,767

	Group and Bank			
	2012		2011	
	HK$'M	**% of gross advances to customers**	HK$'M	% of gross advances to customers
Gross impaired advances	**1,379**	**0.78**	1,767	0.90
Individual impairment allowances	**(899)**		(1,142)	
	480		625	
Impaired advances covered by collateral	**472**		634	

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(a) Credit risk (continued)

Analysis of individual impairment allowances

	Group and Bank				
	As at 1 January 2012 HK$'M	**Amounts written off HK$'M**	**Recoveries of advances written off in previous years HK$'M**	**Net charge to income statement HK$'M**	**As at 31 December 2012 HK$'M**
Manufacturing	**394**	**(45)**	**1**	**(2)**	**348**
Building and construction	**49**	**(13)**	**–**	**3**	**39**
Housing loans	**–**	**–**	**3**	**(3)**	**–**
General commerce	**427**	**(66)**	**2**	**2**	**365**
Transportation, storage and communication	**7**	**–**	**–**	**(3)**	**4**
Financial institutions, investments and holding companies	**–**	**–**	**–**	**102**	**102**
Professionals and private individuals (except housing loans)	**131**	**(109)**	**–**	**9**	**31**
Others	**134**	**(28)**	**3**	**(99)**	**10**
	1,142	**(261)**	**9**	**9**	**899**

	Group and Bank				
	As at 1 January 2011 HK$'M	Amounts written off HK$'M	Recoveries of advances written off in previous years HK$'M	Net charge to income statement HK$'M	As at 31 December 2011 HK$'M
Manufacturing	429	(57)	13	9	394
Building and construction	44	(6)	–	11	49
Housing loans	2	–	6	(8)	–
General commerce	569	(199)	2	55	427
Transportation, storage and communication	5	(4)	–	6	7
Financial institutions, investments and holding companies	7	(7)	1	(1)	–
Professionals and private individuals (except housing loans)	194	(65)	–	2	131
Others	160	(33)	1	6	134
	1,410	(371)	23	80	1,142

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(a) Credit risk (continued)

Analysis of collective impairment allowances

	Group		
	As at 1 January 2012 HK$'M	**Additions/ (Releases) HK$'M**	**As at 31 December 2012 HK$'M**
Manufacturing	**77**	**(28)**	**49**
Building and construction	**117**	**(32)**	**85**
Housing loans	**9**	**(4)**	**5**
General commerce	**254**	**(35)**	**219**
Transportation, storage and communication	**29**	**8**	**37**
Financial institutions, investments and holding companies	**7**	**(3)**	**4**
Professionals and private individuals (except housing loans)	**197**	**13**	**210**
Others	**25**	**(6)**	**19**
	715	**(87)**	**628**

	Group		
	As at 1 January 2011 HK$'M	Additions/ (Releases) HK$'M	As at 31 December 2011 HK$'M
Manufacturing	79	(2)	77
Building and construction	143	(26)	117
Housing loans	14	(5)	9
General commerce	286	(32)	254
Transportation, storage and communication	31	(2)	29
Financial institutions, investments and holding companies	4	3	7
Professionals and private individuals (except housing loans)	177	20	197
Others	30	(5)	25
	764	(49)	715

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(a) Credit risk (continued)

Analysis of collective impairment allowances (continued)

	Bank		
	As at 1 January 2012 HK$'M	**Additions/ (Releases) HK$'M**	**As at 31 December 2012 HK$'M**
Manufacturing	**77**	**(28)**	**49**
Building and construction	**117**	**(32)**	**85**
Housing loans	**9**	**(4)**	**5**
General commerce	**254**	**(35)**	**219**
Transportation, storage and communication	**29**	**8**	**37**
Financial institutions, investments and holding companies	**7**	**(3)**	**4**
Professionals and private individuals (except housing loans)	**170**	**14**	**184**
Others	**25**	**(6)**	**19**
	688	**(86)**	**602**

	Bank		
	As at 1 January 2011 HK$'M	Additions/ (Releases) HK$'M	As at 31 December 2011 HK$'M
Manufacturing	79	(2)	77
Building and construction	143	(26)	117
Housing loans	14	(5)	9
General commerce	286	(32)	254
Transportation, storage and communication	31	(2)	29
Financial institutions, investments and holding companies	4	3	7
Professionals and private individuals (except housing loans)	150	20	170
Others	30	(5)	25
	737	(49)	688

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

Market risk affects the economic values of financial instruments held by the Group, and arises from changes in interest rate yields, foreign exchange rates, equity prices, credit spreads and changes in the correlations and volatilities of these risk factors.

The Group manages 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 also manages banking book interest rate risk arising from mismatches in the interest rate profile of assets, liabilities and capital instruments (and associated hedges), including basis risk arising from different interest rate benchmarks, interest rate re-pricing risk, yield curve risks and embedded optionality. To optimise its income and balance sheet management, the Group deploys funds in debt securities or in the interbank market. All types of foreign exchange risk (including structural foreign exchange risk arising from the Group's strategic investments) are risk managed as part of the trading book.

The Group's market risk framework sets out the overall approach towards market risk management and this is supplemented with policies which articulate the standards relating to limit setting, independent valuation model validation, risk monitoring and valuation.

The Board Risk Management Committee establishes the Group's risk appetite for market risk. The Hong Kong Market and Liquidity Risk Committee, which reports to the Hong Kong Risk Executive Committee, oversees the Group's market risk management infrastructure, sets market risk control limits and provides enterprise-wide oversight of all market risks and their management.

The independent market risk management function, which is supported by DBS Bank Ltd. in terms of model analytics, risk architecture and report production, reports to the Senior Risk Executive and is responsible for day-to-day market risk monitoring and analysis.

The principal market risk appetite measures for market risk are Tail Value-at-Risk ("TVaR") and stress loss. The TVaR is supplemented by risk control measures, such as sensitivities to risk factors as well as loss triggers for management action.

The Group's Value-at-Risk ("VaR") methodology uses a historical simulation approach to forecast the Group's potential loss from market risk. The TVaR metric is derived by averaging the losses beyond the chosen confidence interval. The TVaR is calculated using a one-day time horizon and a 95% confidence interval. TVaR risk factor scenarios are aligned to parameters and market data that are used for valuation. The scenarios are maintained in the risk system and are used to compute TVaR (in Singaporean Dollars "SG$") daily for each business unit and at Group level.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(b) Market risk (continued)

(i) Daily TVaR for trading book market risk

Average TVaR for trading book market risk for 2012 was S$1.0 million compared with S$1.2 million for 2011. The decrease in the average TVaR for trading book market risk was driven by a decline in market volatility. The Group's interest rates trading business is the major contributor of the trading book's TVaR and its significant exposures are in USD and CNY.

The following table shows the period-end, average, high and low daily TVaR (at a 95% confidence level over a one-day holding period) for the trading book market risk:

Group	**As at**	**1 January 2012 to 31 December 2012 ***		
SG$'million	**31 December 2012**	**Average**	**High**	**Low**
Total	**0.4**	**1.0**	**1.8**	**0.4**
	As at	1 January 2011 to 31 December 2011 *		
	31 December 2011	Average	High	Low
Total	1.4	1.2	1.8	0.7

* Using a 1-year historical observation period

Back-testing is a procedure used to verify the predictive power of the value-at-risk (VaR) calculations involving comparison of actual daily profits and losses adjusted to remove non-modeled items such as new trades, fees and commission income with the estimates from the VaR model. Trading book VaR is back-tested against the corresponding profit and loss to monitor its predictive power.

Although VaR provides valuable insights, no single measure can capture all aspects of market risk. In addition, historical simulation VaR works on the implicit assumption that historical movements will be good predictor for future observations and this assumption has been proven vulnerable for tail scenarios. Therefore, regular stress testing is carried out using a combination of historical and hypothetical scenarios, to monitor the Group's vulnerability to unexpected and extreme shocks.

The Group charges valuation reserves for less liquid positions. There is no explicit application of market liquidity horizons in the Group's VaR methodology. However, the Group is following the developments in market risk regulatory capital framework as well as industry initiatives and will plan for enhancements as more clarity is gained on the topic.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(b) Market risk (continued)

(ii) Monthly total TVaR for market risk

The Group has a comprehensive risk appetite framework for all types of market risk, including interest rate risk in the banking book (except immaterial equity risk in the banking book), in line with its internal capital adequacy assessment process. The Group level monthly total TVaR associated with this framework is tabulated below, showing the period-end, average, high and low TVaR (at a 95% confidence level over a one-day holding period).

Group	**As at**	**1 January 2012 to 31 December 2012**		
SG$'million	**31 December 2012**	**Average**	**High**	**Low**
Total	**2.2**	**4.2**	**6.9**	**2.2**

	As at	1 January 2011 to 31 December 2011		
	31 December 2011	Average	High	Low
Total	6.6	7.4	8.5	6.6

Main risk drivers for the banking book are HKD and USD interest rate positions. The economic value impact of changes in interest rates is simulated under various assumptions for the banking book. The simulated economic value changes are negative HK$341 million and HK$683 million (2011: negative $405 million and $807 million) based on parallel shocks to all yield curves of 100 basis points and 200 basis points respectively. The reported figures are based on the worst case of an upward and downward parallel shift in the yield curves.

Equity risk in the banking book

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 31 December 2012 and 2011 were not material and were held for long term investment purpose. They were reported as financial investments in Note 21 to the financial statements and are subject to the accounting and valuation policies set out in Notes 2(f) and 2(h) to the financial statements.

41 Financial risk management (continued)

(c) Liquidity risk

Funding liquidity risk (or liquidity risk) is the risk arising from an inability to meet obligations when they come due. The Group's liquidity obligations arise from withdrawals of deposits, repayments of borrowed funds at maturity, and commitments to extend credit and support working capital needs. The Group seeks to manage its liquidity in a manner that ensures that its liquidity obligations would continue to be honored under normal as well as adverse circumstances.

The Board Risk Management Committee is responsible for approving the principles and standards under the Group's liquidity risk management framework, as well as defining the Group's tolerance towards liquidity risk. The Hong Kong Risk Executive Committee, which reports to the Board Risk Management Committee and is supported by the Hong Kong Market & Liquidity Risk Committee, provides liquidity risk control across the Group and its management. On a business and tactical level, the Hong Kong Asset and Liability Committee is the primary committee responsible for ensuring the group-wide management of liquidity is in accordance with the liquidity risk management framework and policies.

In practice, the Group employs a range of strategies to manage its liquidity. These include maintaining an adequate liquidity reserve, maintaining diversified sources of liquidity, and having robust internal control processes. In the event of a potential or actual crisis, the Group has in place a set of liquidity contingency and recovery plans to ensure that decisive actions are taken to ensure the Group's ongoing viability.

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

To complement the maturity mismatch analysis in its objective to manage liquidity within the tolerance statement, liquidity risk control measures, such as liquidity-related ratios and balance sheet analysis, are performed for more granular monitoring and control over the liquidity profile of the Group and across locations.

The Group has participated in the quantitative impact studies coordinated by the Bank of International Settlements since 2010 on the new Basel III liquidity reporting requirements, and is on track to comply with the reporting requirements when implemented.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(c) Liquidity risk (continued)

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

2012	Group							
	Repayable on demand HK$'M	Less than 1 month HK$'M	3 months or less but over 1 month HK$'M	1 year or less but over 3 months HK$'M	5 years or less but over 1 year HK$'M	After 5 years HK$'M	Undated HK$'M	Total HK$'M
Assets								
– Cash and balances with banks	7,318	–	–	–	–	–	–	7,318
– Placements with and advances to banks	–	22,277	29,361	6,154	159	–	–	57,951
– Trading securities	–	2,693	1,328	1,309	2,217	30	–	7,577
– Advances to customers	7,552	20,469	23,880	40,961	33,594	48,019	1,150	175,625
– Financial investments								
– Debt securities classified as available-for-sale	–	2,945	7,213	8,294	4,841	680	14	23,987
– Debt securities classified as loans and receivables	–	–	234	–	335	–	–	569
– Equity securities	–	–	–	–	–	–	81	81
– Others	119	5,317	2,307	135	66	9	4,102	12,055
Total assets	14,989	53,701	64,323	56,853	41,212	48,738	5,347	285,163
Liabilities								
– Deposits and balances from banks	1,122	3,269	1,751	3,055	159	–	–	9,356
– Trading liabilities	–	2,156	1,602	1,547	1,126	19	–	6,450
– Financial liabilities designated at fair value through profit or loss	–	193	774	809	3	–	–	1,779
– Deposits from customers	90,466	58,016	42,617	21,233	1	–	–	212,333
– Certificates of deposit issued	–	1,007	–	574	3,244	2,458	–	7,283
– Subordinated liability	–	–	–	–	–	4,186	–	4,186
– Others	684	10,174	569	861	197	28	2,248	14,761
Total liabilities	92,272	74,815	47,313	28,079	4,730	6,691	2,248	256,148

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(c) Liquidity risk (continued)

2011	Group							
	Repayable on demand HK$'M	Less than 1 month HK$'M	3 months or less but over 1 month HK$'M	1 year or less but over 3 months HK$'M	5 years or less but over 1 year HK$'M	After 5 years HK$'M	Undated HK$'M	Total HK$'M
Assets								
– Cash and balances with banks	10,843	–	–	–	–	–	–	10,843
– Placements with and advances to banks	–	8,729	9,086	2,458	2,784	–	–	23,057
– Trading securities	–	100	5,070	1,472	1,928	288	–	8,858
– Advances to customers	7,806	32,432	20,932	38,983	37,286	55,517	1,106	194,062
– Financial investments								
– Debt securities classified as available-for-sale	–	4,825	7,220	4,520	9,527	1,084	14	27,190
– Debt securities classified as loans and receivables	–	–	157	158	585	–	–	900
– Equity securities	–	–	–	–	–	–	73	73
– Others	274	7,338	2,721	97	140	15	3,561	14,146
Total assets	18,923	53,424	45,186	47,688	52,250	56,904	4,754	279,129
Liabilities								
– Deposits and balances from banks	511	3,654	4,915	12,076	789	–	–	21,945
– Trading liabilities	–	5,171	362	300	692	49	–	6,574
– Financial liabilities designated at fair value through profit or loss	–	41	202	281	289	152	–	965
– Deposits from customers	74,647	53,590	42,764	13,330	639	–	–	184,970
– Certificates of deposit issued	–	3,553	3,413	3,274	3,657	2,486	–	16,383
– Subordinated liability	–	–	–	–	–	4,196	–	4,196
– Others	668	12,888	981	1,814	152	27	1,756	18,286
Total liabilities	75,826	78,897	52,637	31,075	6,218	6,910	1,756	253,319

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(c) Liquidity risk (continued)

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

2012	Group					
	Repayable on demand HK$'M	3 months or less HK$'M	1 year or less but over 3 months HK$'M	5 years or less but over 1 year HK$'M	After 5 years HK$'M	Total HK$'M
Financial assets						
– Cash and balances with banks	7,318	–	–	–	–	7,318
– Placements with and advances to banks	–	51,763	6,240	160	–	58,163
– Trading securities	–	4,033	1,350	2,240	31	7,654
– Advances to customers	8,240	45,091	43,142	38,420	56,925	191,818
– Financial investments						
– Debt securities classified as available-for-sale	–	10,235	8,556	5,047	605	24,443
– Debt securities classified as loans and receivables	–	243	15	340	–	598
– Others	14	5,299	532	1,074	375	7,294
	15,572	116,664	59,835	47,281	57,936	297,288
Financial liabilities						
– Deposits and balances from banks	1,122	5,059	3,117	160	–	9,458
– Trading liabilities	–	3,764	1,570	1,108	18	6,460
– Financial liabilities designated at fair value through profit or loss	–	966	805	3	–	1,774
– Deposits from customers	90,468	100,958	21,467	1	–	212,894
– Certificates of deposit issued	–	1,062	696	3,676	2,312	7,746
– Subordinated liability	–	29	91	584	5,300	6,004
– Others	682	8,518	1,265	1,170	328	11,963
	92,272	120,356	29,011	6,702	7,958	256,299
Derivatives settled on a gross basis						
– Foreign exchange contracts						
– inflow	–	107,753	54,544	30,699	–	192,996
– outflow	–	107,639	54,489	30,719	–	192,847
Contingent liabilities and commitments						
– Contingent liabilities	–	11,628	–	–	–	11,628
– Commitments	75,104	57,196	–	–	–	132,300
	75,104	68,824	–	–	–	143,928

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(c) Liquidity risk (continued)

2011	Group					
	Repayable on demand HK$'M	3 months or less HK$'M	1 year or less but over 3 months HK$'M	5 years or less but over 1 year HK$'M	After 5 years HK$'M	Total HK$'M
Financial assets						
– Cash and balances with banks	10,843	–	–	–	–	10,843
– Placements with and advances to banks	–	17,869	2,518	2,845	–	23,232
– Trading securities	–	5,188	1,538	2,018	299	9,043
– Advances to customers	8,539	54,342	41,218	42,549	65,692	212,340
– Financial investments						
– Debt securities classified as available-for-sale	–	11,724	5,400	9,886	1,061	28,071
– Debt securities classified as loans and receivables	–	172	182	599	–	953
– Others	16	7,957	1,008	1,603	661	11,245
	19,398	97,252	51,864	59,500	67,713	295,727
Financial liabilities						
– Deposits and balances from banks	511	8,606	12,164	797	–	22,078
– Trading liabilities	–	5,542	318	687	45	6,592
– Financial liabilities designated at fair value through profit or loss	–	243	286	310	177	1,016
– Deposits from customers	74,647	97,363	13,601	661	–	186,272
– Certificates of deposit issued	–	7,002	3,441	4,181	2,479	17,103
– Subordinated liability	–	15	51	382	4,196	4,644
– Others	666	11,746	2,726	1,729	629	17,496
	75,824	130,517	32,587	8,747	7,526	255,201
Derivatives settled on a gross basis						
– Foreign exchange contracts						
– inflow	–	64,137	55,898	7,949	–	127,984
– outflow	–	64,332	55,901	7,952	–	128,185
Contingent liabilities and commitments						
– Contingent liabilities	–	10,245	–	–	–	10,245
– Commitments	68,250	46,570	–	–	–	114,820
	68,250	56,815	–	–	–	125,065

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(c) Liquidity risk (continued)

The balances in the above table will not agree with 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 future interest payments.

Customer assets and liabilities (including non-maturing savings / current deposits) are represented on a contractual basis or in a period when they can legally be withdrawn. On a behavioural basis for liquidity risk analysis, the assets and liabilities cash flows may differ from contractual basis.

For the purpose of liquidity risk management, the Group actively monitors and manages its liquidity positions within a 1-year period. A conservative view is adopted in the behavioural profiling of assets, liabilities and off-balance sheet commitments that have exhibited cash flow patterns that differ significantly from the actual contractual maturity profile.

The table below shows the Group's behavioural net and cumulative maturity mismatch between assets and liabilities over a 1-year period under a normal scenario without incorporating growth projections:

HK$'M*	Less than 7 days	7 days to 1 month	1 to 3 months	3 to 12 months
2012				
Net liquidity mismatch	**17,331**	**9,401**	**38,163**	**13,328**
Cumulative mismatch	**17,331**	**26,732**	**64,895**	**78,223**
2011				
Net liquidity mismatch	14,156	(4,003)	9,453	8,488
Cumulative mismatch	14,156	10,153	19,606	28,094

* Positive indicates a position of liquidity surplus. Negative indicates a liquidity shortfall that has to be funded.

The behavioural assumptions used to determine the maturity mismatch between assets and liabilities are updated from time to time. As such, the information presented above is not directly comparable across past balance sheet dates.

(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 reputational 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 and key risk indicator monitoring. 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

41 Financial risk management (continued)

(d) Operational risk (continued)

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

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

The Bank is required to compute its capital adequacy 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 Bank complied with the capital requirements imposed by the Hong Kong Monetary Authority throughout 2012 and 2011.

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, derivative financial instruments, contingent liabilities and commitments.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(a) Holding companies and fellow subsidiaries (continued)

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

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

	DBS Bank Ltd.		Fellow subsidiaries	
	2012 HK$'M	2011 HK$'M	**2012 HK$'M**	2011 HK$'M
Interest income	**347**	90	**–**	3
Interest expense	**(333)**	(88)	**(2)**	(2)
Net fee and commission income	**13**	2	**(7)**	(10)
Net gain / (loss) from financial instruments at fair value through profit and loss	**967**	(11)	**–**	–
Other income	**24**	24	**6**	6
Total expenses (charged) / recovered	**(55)**	(87)	**22**	20

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

	Group		Bank	
	2012 HK$'M	2011 HK$'M	**2012 HK$'M**	2011 HK$'M
Cash and balances with banks	**46**	66	**46**	66
Placements with and advances to banks	**45,730**	17,105	**45,727**	17,102
Positive fair values for derivative financial instruments	**2,398**	3,301	**2,398**	3,301
Other assets	**222**	56	**222**	56
	48,396	20,528	**48,393**	20,525
Deposits and balances from banks	**5,053**	18,952	**5,053**	18,952
Negative fair values for derivative financial instruments	**3,144**	4,192	**3,144**	4,192
Subordinated liability	**4,186**	4,196	**4,186**	4,196
Other liabilities	**123**	74	**123**	74
	12,506	27,414	**12,506**	27,414

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(a) Holding companies and fellow subsidiaries (continued)

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

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Exchange rate contracts	**310,067**	330,278
Interest rate contracts	**25,211**	97,930
Equity contracts	**214**	87
	335,492	428,295

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

As at 31 December 2012, total contingent liabilities and commitments with DBS Bank Ltd. and fellow subsidiaries amounted to HK$ 3,485 million (2011: HK$1,743 million).

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

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Deposits from customers	**316**	316

(vi) Balances with fellow subsidiaries as at 31 December

	Group		Bank	
	2012	2011	**2012**	2011
	HK$'M	HK$'M	**HK$'M**	HK$'M
Other assets	**186**	72	**186**	72
Deposits and balances from banks	**219**	66	**219**	66
Deposits from customers	**868**	576	**868**	576
Other liabilities	**93**	7	**93**	7
	1,180	649	**1,180**	649

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(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 receivables are included under "Advances to customers" in the Bank's balance sheet. Under the Agreement, all the income, expenses and loan impairment allowances on the Compass cards are recorded in the books of HDCL. The income and expenses, assets and liabilities of HDCL are recognised by the Group through proportionate consolidation on a line-by-line basis.

As at 31 December 2012, the amount due from the Bank to the jointly controlled entity is HK$2,641 million (2011: HK$2,487 million), of which HK$1,720 million (2011: HK$1,630 million) 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 31 December 2012 paid and payable to HDCL is HK$57 million (2011: HK$53 million). Gross service fee income from HDCL to the Bank for the year ended 31 December 2012 is HK$95 million (2011: HK$89 million).

(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 of the Bank and DBSH Group and key management personnel of the Bank and their close family members. These transactions, including deposit taking, loans and credit card facilities, are made in the ordinary course of business and on commercial terms, and are not material.

(ii) Compensation of directors and key management personnel

	Group and Bank	
	2012	2011
	HK$'M	HK$'M
Salaries, other short term employee benefits and directors' fee (Note)	**72**	61
Pension	**3**	2
Share-based compensation	**16**	12
	91	75

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

(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).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(d) DBSH Share Option Plan (continued)

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 Ltd, 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 (the “CMDC”) of DBSH, and are exercisable after the first anniversary of the date of the grant up to the date of expiration of the options. The fair value of options granted is determined using the Binomial model.

The DBSH Share Option Plan expired on 19 June 2009 and the Option Plan was neither extended nor replaced. The termination of this Option Plan will, however, not affect the rights of holders of any outstanding existing options.

The following table sets out the fair value of the outstanding time-based awards and the movement during the year.

	2012		2011	
	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 1 January	**809,895**	**13.44**	1,579,966	14.19
Movements during the year:				
– Exercised	**(480,644)**	**12.81**	(344,509)	12.64
– Forfeited	**(8,632)**	**14.90**	(611)	15.07
– Expired	**(117)**	**15.07**	(431,384)	16.83
– Transferred in due to staff relocation	**198,447**	**12.66**	6,433	14.89
Balance as at 31 December	**518,949**	**13.71**	809,895	13.44
Additional information:				
Outstanding options exercisable as at 31 December	**518,949**	**13.71**	809,895	13.44
Weighted average remaining contractual life of options outstanding as at 31 December	**1.1 years**		1.8 years	
Range of exercise price of options outstanding as at 31 December	**SG$10.40-SG$15.07**		SG$10.40-SG$15.07	

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(d) DBSH Share Option Plan (continued)

In 2012, 480,644 options (2011: 344,509) were exercised at their contractual exercise prices. During the year, the weighted average market price of DBSH shares was SG$14.14 (2011: SG$14.10).

DBSH options	Number of unissued ordinary shares	During the year				Number of unissued ordinary shares	Exercise price per share	Expiry date
	1 January 2012	Transfer in	Transfer out	Exercised	Forfeited/ Expired	31 December 2012	SGD	
Mar 2002	25,761	24,703	–	(50,464)	–	–	14.73	28 Mar 2012
Aug 2002	67,695	3,529	–	(71,224)	–	–	12.27	16 Aug 2012
Dec 2002	11,763	–	–	(11,763)	–	–	11.47	18 Dec 2012
Feb 2003	201,967	94,460	–	(167,389)	–	129,038	10.40	24 Feb 2013
Mar 2004	390,457	53,053	–	(139,511)	(4,398)	299,601	14.73	02 Mar 2014
Mar 2005	112,252	22,702	–	(40,293)	(4,351)	90,310	15.07	01 Mar 2015
	809,895	198,447	–	(480,644)	(8,749)	518,949		

(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 CMDC appointed to administer the Share Plan from time to time. The awards could be performance-based and / or time-based.

Where time-based awards are granted, they will only vest after the satisfactory completion of time-based service conditions. Participants are awarded DBSH shares, their equivalent cash value or a combination of both as part of their deferred bonus (at the discretion of the CMDC).

A time-based award comprises two elements, namely, the main award and the "retention" award (previously known as "kicker" award). The shares comprised in the "retention" award constitute twenty percent of the shares comprised in the main award. Effective 2010, the deferral period for unvested shares was extended from a 3-year period to a 4-year period showing a more prudent risk management arrangement. Under the new vesting schedule, thirty-three percent of the shares comprised in the main award will vest two years after the date of grant. A further thirty-three percent of the shares comprised in the main award will vest three years after the date of grant. The remainder thirty-four percent of the shares comprised in the main award, together with the shares comprised in the "retention" award, will vest four years after the date of grant. For 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(e) DBSH Share Plan (continued)

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

	Group and Bank	
	2012	2011
Balance as at 1 January	**750,225**	767,507
Granted	**446,079**	311,699
Vested	**(278,717)**	(257,435)
Forfeited	**(107,011)**	(71,546)
Balance as at 31 December	**810,576**	750,225

The weighted average fair value of the shares granted during the year is SG$14.10 (2011: SG$14.48).

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 DBSH ordinary shares (the "shares"), their equivalent cash value or a combination of both (at the discretion of the CMDC), when time-based conditions are met. The ESP awards are granted at the absolute discretion of the CMDC.

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. Similar to the DBSH Share Plan, effective from the 2010 grant, shares will vest at thirty-three percent two years after the date of grant. A further thirty-three percent will vest three years after the date of grant and the remainder thirty-four percent four years after the date of grant. In specific cases where the award form part of an employee's annual performance remuneration, an addition "retention" award which constitute 20% of the shares given in the main award will be granted. The shares in the "retention" award will vest four years after the date of grant. The fair value of the shares awarded are computed based on the market price of 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(f) DBSH Employee Share Plan (continued)

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

	Group and Bank	
	2012	2011
Balance as at 1 January	**278,600**	213,340
Granted	**147,062**	152,800
Vested	**(65,850)**	(60,467)
Forfeited	**(18,502)**	(27,073)
Balance as at 31 December	**341,310**	278,600

The weighted average fair value of the shares granted during the year is SG$14.10 (2011: SG$14.48).

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 31 December		Maximum balance during the year	
	2012 HK$'M	2011 HK$'M	**2012 HK$'M**	2011 HK$'M
Aggregate amount outstanding in respect of principal and interest	**–**	–	**–**	–

UNAUDITED SUPPLEMENTARY INFORMATION

(Expressed in millions of Hong Kong dollars)

The following disclosures are prepared in accordance with the Banking (Disclosure) Rules.

1 Capital adequacy

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 capital adequacy ratios as at 31 December 2012 and 2011 were compiled in accordance with the Banking (Capital) Rules issued by the Hong Kong Monetary Authority under Section 98A of the Hong Kong Banking Ordinance.

The Bank adopts the Foundation Internal Ratings-Based ("IRB") approach for the calculation of the risk-weighted assets for credit risk. The Bank also uses the Standardised approaches for the calculation of risk-weighted assets for market risk and operational risk.

The Bank uses the IRB approach for calculating the credit risks for the majority of its exposures and uses Standardised approach for certain exposures being exempted from the IRB approach for credit risk calculation.

Capital requirements 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)

(Expressed in millions of Hong Kong dollars)

1 Capital adequacy (continued)

The following table sets forth details of capital resources and capital adequacy ratios for the Bank.

	2012 HK$'M	2011 HK$'M
Core capital		
Paid up ordinary share capital	**7,000**	7,000
Share premium	**595**	595
Reserves	**16,012**	13,430
Profit and loss account	**3,118**	2,521
Deduct:		
Deferred tax assets	**(35)**	–
	26,690	23,546
Deductions from core capital	**(236)**	(204)
Core capital after deductions	**26,454**	23,342
Supplementary capital		
Reserves attributable to fair value gains on revaluation of holdings of land and buildings	**195**	164
Reserves attributable to fair value gains on revaluation of holdings of available-for-sale equities and debt securities	**67**	74
Regulatory reserve	**103**	82
Collective impairment allowances	**78**	75
Term subordinated liability	**4,186**	4,196
	4,629	4,591
Deductions from supplementary capital	**(236)**	(205)
Supplementary capital after deductions	**4,393**	4,386
Total capital base before deductions	**31,319**	28,137
Deductions from core capital and supplementary capital	**(472)**	(409)
Total capital base after deductions	**30,847**	27,728
Risk-weighted assets	**184,510**	191,661
Capital adequacy ratio		
Core capital ratio	**14.3%**	12.2%
Supplementary capital ratio	**2.4%**	2.3%
Total capital adequacy ratio	**16.7%**	14.5%

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

2 Capital requirements for different types of risk

The following table indicates the capital requirements for different types of risk on each exposure class as at 31 December:

	2012 HK$'M	2011 HK$'M
Credit risk:		
IRB approach		
Retail exposures:		
Residential mortgages	**364**	382
Qualifying revolving retail exposures	**1,297**	1,119
Small business retail exposures	**–**	–
Other retail exposures to individuals	**610**	549
Wholesale exposures:		
Sovereign exposures	**285**	315
Bank exposures	**2,419**	2,461
Corporate exposures	**7,136**	8,107
Other exposures	**354**	332
	12,465	13,265
Standardised approach		
On-balance sheet		
Public sector entity exposures	**11**	13
Bank exposures	**4**	5
Corporate exposures	**572**	490
Regulatory retail exposures	**73**	54
Other exposures which are not past due exposures	**352**	269
Past due exposures	**28**	33
Off-balance sheet		
Off-balance sheet exposures other than over-the-counter derivative transactions	**29**	32
Over-the-counter derivative transactions	**6**	2
	1,075	898
Total capital requirements for credit risk	**13,540**	14,163
Market risk:		
Standardised approach		
Interest rate exposures	**161**	234
Foreign exchange exposures	**132**	25
Total capital requirements for market risk	**293**	259
Total capital requirements for operational risk	**928**	911
Total capital requirements	**14,761**	15,333

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

3 Credit risk assessed using IRB approach

(a) Internal rating system and process

Nature of exposures within IRB approach

Retail exposures comprise residential mortgages, qualifying revolving retail exposures, small business retail exposures and other retail exposures to individuals. These exposures are categorised into asset classes under the Retail IRB approach.

Wholesale exposures comprise sovereign, bank, corporate, corporate small business (which are assessed under Foundation IRB approach) and specialised lending (which is assessed under the supervisory slotting criteria approach).

Other exposures mainly comprise premises, equipment and other fixed assets and notes and coins, which are assessed under specific risk-weight approach.

Structure and control mechanisms for internal rating systems

The Bank adopts various rating systems for the different asset classes under Internal Ratings Based Approach ("IRBA"). There is a robust governance process for the development and approval of a credit risk model. Credit risk models developed are validated by an independent risk unit in the Bank to ensure they are fit for purpose. The models are placed through a rigorous review process prior to endorsement by the Hong Kong Credit Risk Committee of the Bank and the Group Credit Risk Committee of DBSH. The models have also been approved by the Board Risk Management Committee of the Bank and the Board Risk Management Committee of DBSH before use.

To ensure the adequacy and robustness of these rating systems on a continual basis, the Bank conducts regular performance monitoring on these rating systems and reports the results to the Hong Kong Credit Risk Committee and the Board Risk Management Committee of the Bank. This process will highlight any material deterioration in the credit systems for management's attention. On an annual basis, an independent risk unit conducts formal validation for each of the rating systems. The validation processes are also subject to an independent review by Internal Audit. In addition to the above, review upon requested by regulator will also been conducted on these rating systems.

Use of internal estimates

The internal credit risk ratings produced by credit rating models are used to calculate the IRB approach capital requirements. In addition, the ratings from the credit models are used as the basis to support the underwriting of credit, monitoring the performance of the portfolios, reporting, stress testing, risk rating migration and to facilitate the calculation for risk based pricing.

Definitions of variables

The group-wide credit risk rating framework incorporates Probability of Default ("PD") of a counterparty and loss severity expressed in terms of Exposure-at-Default ("EAD") and Loss Given Default ("LGD").

PD expressed as a percentage, measures the probability that a borrower will default within one year.

LGD expressed as a percentage, is an estimate of the severity of the loss that the Bank will experience per unit of exposure in the event that the borrower defaults.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

3 Credit risk assessed using IRB approach (continued)

(a) Internal rating system and process (continued)

EAD is the expected amount of the exposure upon the default of the borrower, which is the sum of the on-balance sheet amounts and / or credit equivalent of the off-balance sheet amounts multiplied by a credit conversion factor determined in accordance with the Banking (Capital) Rules.

Methods and data for estimation and validation of the PD, LGD and EAD

For retail exposures, facilities / borrowers with homogenous nature of facility utilisation, payment history, delinquency trend and other transaction characteristics are segmented into homogenous risk pools. PD is estimated by each risk pool based on long run average of historical internal default experience with appropriate adjustment to reflect adverse economic condition to ensure conservatism for capital calculation. The LGD is estimated by dividing the loss by EAD. Loss represents the written-off or specific provision amounts plus collection costs at the end of LGD workout period after netting off recoveries. The LGD is calibrated to reflect adverse economic condition to ensure conservatism for capital calculation. For retail non-revolving exposures, EAD estimation is based on the sum of current outstanding. For retail revolving exposures, EAD estimation is referring to projected further draw down prior to defaults based on historical experience.

For wholesale exposures (including corporate, bank and sovereign exposures), PD generated by models and / or rating templates for individual counterparty is reviewed by credit risk managers. An Adjusted Counterparty Risk Rating (“ACRR”) is assigned by taking the counterparty’s PD and mapping it to the Bank’s internal ACRR scale. The Bank applies the LGD determined by reference to the supervisory LGD estimates provided by the Hong Kong Monetary Authority (“HKMA”) based on the nature of the collateral for its Foundation IRB portfolios and subordination. These supervisory LGD estimates are used in the computation of risk-weights and regulatory capital calculations for the portfolios. EAD estimation is subject to parameters set by the HKMA.

ACRR is estimated using a 11-grade scale expanded into 19 risk ratings to provide greater rating granularity that corresponds more closely to the Standard & Poor’s (“S&P”) rating scale. 14 of which are non-default ratings representing varying degrees of strength of financial condition, and 5 are default ratings. These scales are used group-wide for all distinct borrowers.

For specialised lending exposure, rating is assigned based on the borrower and transaction characteristics. The Bank uses supervisory slotting criteria approach in rating its regulatory specialised lending exposure by adopting the specialised lending rating templates. For income-producing real estate specialised lending exposure, the Bank adopts a credit scoring framework to enable a granular assessment of credit risk for the real estate financing activities aligning with the context of Hong Kong real estate market and the DBSH’s real estate lending policies.

Model validation process enables the Bank to reaffirm the continuing appropriateness of the models. The model validation process involves quantitative and qualitative assessment of the model, data, systems and governance, which involves: i) quantitative validation to assess a model’s discriminatory power, calibration and ratings stability analysis; ii) qualitative validation to address issues on model design, data integrity and internal use of a model. To ensure the models are reliable, an independent validation is conducted by Risk Management Group and an independent review on the validation process is carried out by Internal Audit.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

3 Credit risk assessed using IRB approach (continued)

(a) Internal rating system and process (continued)

The credit risk ratings for the wholesale exposures have been mapped to likely corresponding external rating equivalents. A description of the risk rating is provided in the following table to give a qualitative explanation of the risk benchmarks:

DBS Probability of Default (PD) Grade (ACRR)	Description of Risk Ratings	Internal Classification	Likely Corresponding HKMA Classification	S&P's Likely Ratings
1	Taking into account the impact of relevant economic, social or geopolitical conditions, capacity to meet its financial commitment is exceptional	Exceptional	Pass	AAA
2	Taking into account the impact of the relevant economic, social or geopolitical conditions, capacity to meet its financial commitment is excellent	Excellent	Pass	AA+, AA, AA-
3	More susceptible to adverse economic, social, geopolitical conditions and other circumstances. Capacity to meet its financial commitment is strong	Strong	Pass	A+, A, A-
4A / 4B	Adequate protection against adverse economic, social or geopolitical conditions or changing circumstances. More likely to lead to a weakened capacity of the obligor to meet its financial commitment	Good	Pass	BBB+ / BBB
5	Relatively worse off than an obligor rated “4B” but exhibits adequate protection parameters	Satisfactory	Pass	BBB-
6A / 6B	Satisfactory capacity to meet its financial commitment but capacity may become inadequate due to adverse business, financial, economic, social or geopolitical conditions and changing circumstances	Acceptable	Pass	BB+ / BB
7A / 7B	Marginal capacity to meet its financial commitment but capacity may become inadequate or uncertain due to adverse business, financial, economic, social or geopolitical conditions and changing circumstances	Marginal	Pass	BB-
8A	Sub-marginal capacity to meet its financial commitment. Adverse business, financial, or economic conditions will likely impair the obligor’s capacity or willingness to meet its financial commitment	Sub-Marginal	Pass	B+
8B / 8C	Low capacity to meet its financial commitment. Adverse business, financial, or economic condition will likely impair the obligor’s capacity or willingness to meet its financial commitment	Special Caution	Special Mention	B / B-
9	Vulnerable to non-payment and is dependent upon favourable business, financial, and economic conditions for the obligor to meet its financial commitment. Likely to have little capacity to meet its financial commitment under adverse conditions	Sub-Performing	Sub-Standard (Non-Defaulting)	CCC – C
10 and Above	An obligor rated “10” and above is in default (as defined under Basel II)	Default	Sub-Standard and Below (Defaulting)	D

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

3 Credit risk assessed using IRB approach (continued)

(b) Summary of credit exposures by IRB calculation approach

The following table summarises the Bank's credit exposures as at 31 December:

	2012 HK$'M	2011 HK$'M
Retail exposures:		
Retail IRB approach		
Residential mortgages	**38,578**	45,623
Qualifying revolving retail exposures	**54,782**	49,796
Small business retail exposures	**33**	36
Other retail exposures to individuals	**9,121**	8,538
Wholesale exposures:		
Foundation IRB approach		
Sovereign exposures	**23,232**	24,901
Bank exposures	**100,133**	73,308
Corporate exposures	**67,801**	76,649
Supervisory slotting criteria approach		
Specialised lending	**17,849**	17,689
Other exposures:		
Specific risk-weight approach	**5,076**	4,470
	316,605	301,010

(c) Retail exposures

Retail portfolios are categorised into asset classes under the Retail IRB approach, namely residential mortgages, qualifying revolving retail exposures, small business retail exposures and other retail exposures to individuals.

Within each asset class, exposures are managed on a portfolio basis. Each account is assigned to a risk pool, taking into consideration factors such as borrower characteristics and collateral type. Loss estimates are based on historical default and realised losses within a defined period. Business-specific credit risk policies and procedures including underwriting criteria, scoring models, approving authorities, frequency of asset quality and business strategy reviews; as well as systems, processes and techniques to monitor portfolio performance against benchmarks are in place. Risk models are being used for associated retail exposures to update risk level of each loan on a monthly basis, reflecting the broad usage of risk models in portfolio quality reviews in accordance with Basel II principles.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

3 Credit risk assessed using IRB approach (continued)

(c) Retail exposures (continued)

The following tables summarise the Bank's retail credit exposures by expected loss percentage ("EL%") range as at 31 December:

Residential mortgages

EL% range	**2012 Exposure amount HK$'M**	2011 Exposure amount HK$'M
Up to 0.10%	**37,552**	44,563
> 0.10% to 0.50%	**–**	–
> 0.50%	**994**	1,035
Default	**32**	25
	38,578	45,623

Qualifying revolving retail exposures

EL% range	**2012 Exposure amount HK$'M**	2011 Exposure amount HK$'M
Up to 5%	**52,359**	47,481
> 5%	**2,363**	2,274
Default	**60**	41
	54,782	49,796

Small business retail exposures

EL% range	**2012 Exposure amount HK$'M**	2011 Exposure amount HK$'M
Up to 0.3%	**33**	36

Other retail exposures to individuals

EL% range	**2012 Exposure amount HK$'M**	2011 Exposure amount HK$'M
Up to 0.3%	**5,266**	5,092
> 0.3%	**3,804**	3,383
Default	**51**	63
	9,121	8,538

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

3 Credit risk assessed using IRB approach (continued)

(d) Wholesale exposures

Wholesale exposures comprise sovereign, bank, corporate, corporate small business (which are assessed under Foundation IRB approach) and specialised lending (which is assessed under the supervisory slotting criteria approach).

Sovereign exposures are risk rated using internal risk rating models and guidelines in line with Foundation IRB portfolios. Country-specific macro economic risk factors, political risk factors, social risk factors and liquidity risk factors are reviewed objectively in the sovereign rating models to assess the sovereign credit risk in a disciplined and systematic approach.

Bank exposures are assessed using a bank rating model covering various credit risk factors such as capital levels and liquidity, asset quality, earnings, management and market sensitivity. The risk ratings derived are benchmarked against external credit risk ratings to ensure that the internal rating systems are well aligned and appropriately calibrated.

Corporate credits are assessed using approved models and reviewed by credit risk managers taking into consideration of relevant credit risk factors. Credit factors considered in the risk assessment process include the obligor's financial standing and outlook, industry and economic conditions, market position, access to capital and management strength. The Counterparty Risk Rating assigned to smaller business borrowers is primarily based on the borrower's financial position and strength, which are assessed via the use of a validated quantitative tool. This is supplemented by expert judgement of qualitative factors such as management strength by credit officers.

Credit ratings under the Foundation IRB portfolios are reviewed on an annual basis at a minimum unless credit conditions require more frequent assessment. The Counterparty Risk Rating process is reinforced by the Facility Risk Rating Framework which considers other exposure risk mitigations, such as collateral, third party guarantees and transfer risks.

A default is considered to have occurred with regard to a particular obligor when either or both of the two following events have taken place.

– Subjective default: Obligor is unlikely to pay its credit obligations in full, without recourse by the Bank to actions such as realising security (if held).
– Technical default: Obligor is past due more than 90 days on any credit obligation to the Bank.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

3 Credit risk assessed using IRB approach (continued)

(d) Wholesale exposures (continued)

The following tables summarise the Bank's wholesale exposures as at 31 December:

Sovereign exposures

2012

Credit Risk Rating	**PD range (%)**	**Exposure amount HK$'M**	**Exposure-weighted average risk-weight (%)**
1-3	**0.00 – 0.10**	**23,232**	**15**

2011

Credit Risk Rating	PD range (%)	Exposure amount HK$'M	Exposure-weighted average risk-weight (%)
1-3	0.00 – 0.10	24,901	16

Bank exposures

2012

Credit Risk Rating	**PD range (%)**	**Exposure amount HK$'M**	**Exposure-weighted average risk-weight (%)**
1-3	**0.03 – 0.10**	**63,873**	**16**
4A / 4B	**0.10 – 0.33**	**28,482**	**49**
5	**0.33 – 0.47**	**5,566**	**66**
6A / 6B	**0.47 – 1.11**	**1,361**	**87**
7A-9	**1.11 – 99.99**	**851**	**116**
Total		**100,133**	

2011

Credit Risk Rating	PD range (%)	Exposure amount HK$'M	Exposure-weighted average risk-weight (%)
1-3	0.03 – 0.10	35,276	17
4A / 4B	0.10 – 0.33	22,117	50
5	0.33 – 0.47	5,774	66
6A / 6B	0.47 – 1.11	5,862	88
7A-9	1.11 – 99.99	4,279	114
Total		73,308	

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

3 Credit risk assessed using IRB approach (continued)

(d) Wholesale exposures (continued)

Corporate exposures

2012

Credit Risk Rating	**PD range (%)**	**Exposure amount HK$'M**	**Exposure-weighted average risk-weight (%)**
1-3	**0.03 – 0.10**	**2,097**	**17**
4A / 4B	**0.10 – 0.33**	**989**	**53**
5	**0.33 – 0.47**	**2,335**	**68**
6A / 6B	**0.47 – 1.11**	**7,850**	**87**
7A-9	**1.11 – 99.99**	**53,515**	**116**
10A-11	**100**	**1,015**	**106**
Total		**67,801**	

2011

Credit Risk Rating	PD range (%)	Exposure amount HK$'M	Exposure-weighted average risk-weight (%)
1-3	0.03 – 0.10	505	22
4A / 4B	0.10 – 0.33	900	52
5	0.33 – 0.47	2,560	69
6A / 6B	0.47 – 1.11	7,724	86
7A-9	1.11 – 99.99	63,664	114
10A-11	100	1,296	113
Total		76,649	

Specialised lending

Specialised lending IRB portfolios represent real estate finance adopting the supervisory slotting criteria specified under the Banking (Capital) Rules. The supervisory slotting criteria guidelines under the supervisory rating categories are used to determine the risk-weights to calculate the credit risk-weighted exposures.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

3 Credit risk assessed using IRB approach (continued)

(d) Wholesale exposures (continued)

2012

Obligor grade	**Exposure amount HK$'M**	**Exposure-weighted average risk-weight (%)**
Strong	**3,179**	**60**
Good	**8,862**	**89**
Satisfactory	**5,740**	**122**
Weak	**68**	**265**
Default	**–**	**–**
Total	**17,849**	

2011

Obligor grade	Exposure amount HK$'M	Exposure-weighted average risk-weight (%)
Strong	694	71
Good	9,343	92
Satisfactory	7,462	122
Weak	152	265
Default	38	–
Total	17,689	

(e) Policies for establishing provisions

The policies are set out in Note 2(h) to the financial statements, which describe the Group's accounting policies on the assessment of individual and collective impairment allowances on the financial assets.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

3 Credit risk assessed using IRB approach (continued)

(f) Comparison of rating estimates against actual outcome

Comparison of actual loss against expected loss

Actual loss refers to impairment allowances made in the Bank's income statement during the year.

Exposure classes	**Actual loss for the year ended 31 December 2012 HK$'M**	**Expected loss as at 31 December 2011 HK$'M**
Residential mortgages	**–**	**34**
Qualifying revolving retail exposures	**80**	**478**
Small business retail exposures	**–**	**–**
Other retail exposures to individuals	**60**	**284**
Sovereign exposures	**–**	**37**
Bank exposures	**–**	**92**
Corporate exposures	**38**	**1,109**
	178	**2,034**

Exposure classes	Actual loss for the year ended 31 December 2011 HK$'M	Expected loss as at 31 December 2010 HK$'M
Residential mortgages	–	18
Qualifying revolving retail exposures	68	496
Small business retail exposures	–	–
Other retail exposures to individuals	40	197
Sovereign exposures	–	16
Bank exposures	–	30
Corporate exposures	161	1,136
	269	1,893

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

3 Credit risk assessed using IRB approach (continued)

(f) Comparison of rating estimates against actual outcome (continued)

Comparison of actual default rate against estimated probability of default

Exposure classes	**Actual percentage of default for the year ended 31 December 2012 %**	**Estimated 1-year probability of default as at 31 December 2011 %**
Residential mortgages	**0.05**	**0.55**
Qualifying revolving retail exposures	**0.55**	**1.01**
Small business retail exposures	**–**	**0.29**
Other retail exposures to individuals	**3.69**	**5.54**
Sovereign exposures	**–**	**0.02**
Bank exposures	**–**	**0.63**
Corporate exposures	**0.89**	**3.41**

Exposure classes	Actual percentage of default for the year ended 31 December 2011 %	Estimated 1-year probability of default as at 31 December 2010 %
Residential mortgages	0.03	0.18
Qualifying revolving retail exposures	0.49	1.22
Small business retail exposures	–	0.29
Other retail exposures to individuals	3.05	4.43
Sovereign exposures	–	0.02
Bank exposures	–	0.60
Corporate exposures	0.93	3.64

The actual default rate is measured by using the number of obligors or number of accounts defaulted, depending on the exposure class for the annual reporting period whereas the estimated probability of default is the long run average default rate estimated for 2012 and 2011.

Expected loss is a Basel II measure of expected future losses based on IRB models where PDs are more through-the-cycle and LGDs are on a downturn basis, floored by regulatory minimums. Actual loss is an accounting construct which includes impairment allowances and charge-offs for loans originated in prior years which defaulted in 2012 and 2011 respectively. The two measures of loss are therefore not directly comparable.

Comparative of rating estimates against actual outcome comparison is not applicable for small business retail exposures and other retail exposures to individuals as the credit risk of these exposures were not assessed using IRB approach prior to 2011.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

4 Credit risk assessed using Standardised approach

The following table indicates the exposure amounts and risk-weighted amounts for each class of exposure under the Standardised approach as at 31 December:

2012

	Total exposures HK$'M	Total exposures after credit risk mitigation HK$'M	Risk-weighted amount after credit risk mitigation HK$'M
On-balance sheet			
Sovereign exposures	–	33	–
Public sector entity exposures	–	652	130
Bank exposures	50	50	50
Corporate exposures	7,695	7,151	7,151
Regulatory retail exposures	1,615	1,213	910
Other exposures which are not past due exposures	5,760	4,400	4,400
Past due exposures	253	253	354
	15,373	13,752	12,995
Off-balance sheet			
Off-balance sheet exposures other than over-the-counter derivative transactions	563	366	365
Over-the-counter derivative transactions	154	73	72
	717	439	437

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

4 Credit risk assessed using Standardised approach (continued)

2011

	Total exposures HK$'M	Total exposures after credit risk mitigation HK$'M	Risk-weighted amount after credit risk mitigation HK$'M
On-balance sheet			
Sovereign exposures	–	78	–
Public sector entity exposures	–	836	167
Bank exposures	56	56	56
Corporate exposures	7,068	6,128	6,128
Regulatory retail exposures	1,310	904	678
Other exposures which are not past due exposures	5,495	3,365	3,365
Past due exposures	335	335	406
	14,264	11,702	10,800
Off-balance sheet			
Off-balance sheet exposures other than over-the-counter derivative transactions	477	402	401
Over-the-counter derivative transactions	109	29	29
	586	431	430

Total exposures in the above table refer to principal amounts or credit equivalent amounts, as applicable, net of individual impairment allowances.

The exposure amounts and risk-weighted amounts in the above table do not take into account the credit assessment ratings assigned by the External Credit Assessment Institutions.

5 Credit risk mitigation

Credit risk mitigation techniques are taken into account when analysing credit risk-weighted asset amounts. Amounts are adjusted for recognised collateral or recognised guarantees allowed under the Banking (Capital) Rules.

Recognised collateral includes both financial and physical assets. Financial collateral consists of mainly cash deposits, debt securities and shares, while physical collateral includes land and buildings.

Eligible credit protection is also used to abate credit losses in the event that the exposure defaults. The policies and procedures on credit risk mitigation techniques are set out in Note 41(a) to the financial statements. The Bank adopts the comprehensive approach for credit risk mitigation and the impact on PD or LGD is based on the same guidelines for Foundation IRB portfolios.

As at 31 December 2012 and 2011, the credit and market risks concentrations within the credit risk mitigation used by the Bank are under a minimal level.

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

5 Credit risk mitigation (continued)

Total exposures covered by recognised collateral or guarantees under Foundation IRB approach and Standardised approach as at 31 December:

2012

	Exposure amount covered by recognised collateral HK$'M	Exposure amount covered by recognised guarantee HK$'M
Foundation IRB approach		
Corporate exposures	23,209	5,455
Bank exposures	11	–
	23,220	5,455
Standardised approach		
Corporate exposures	514	30
Regulatory retail exposures	399	3
Other exposures which are not past due exposures	708	652
Past due exposures	20	11
Off-balance sheet exposures other than over-the-counter derivative transactions	198	–
Over-the-counter derivative transactions	81	–
	1,920	696
Total	25,140	6,151

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

5 Credit risk mitigation (continued)

2011

	Exposure amount covered by recognised collateral HK$'M	Exposure amount covered by recognised guarantee HK$'M
Foundation IRB approach		
Corporate exposures	24,035	2,937
Bank exposures	6	–
	24,041	2,937
Standardised approach		
Corporate exposures	869	71
Regulatory retail exposures	399	7
Other exposures which are not past due exposures	1,293	836
Past due exposures	68	18
Off-balance sheet exposures other than over-the-counter derivative transactions	76	–
Over-the-counter derivative transactions	80	–
	2,785	932
Total	26,826	3,869

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

6 Counterparty credit risk-related exposures

The analysis of the credit equivalent amounts and risk-weighted amounts after taking into account the recognised collateral and effect of valid bilateral netting agreements for over-the-counter derivative contracts as at 31 December is as follows:

	2012 HK$'M	2011 HK$'M
Exposures under IRB approach		
Positive fair values	**4,992**	6,999
Potential future exposures	**7,788**	6,602
Gross credit equivalent amounts	**12,780**	13,601
Comprising:		
– Bank exposures	**6,645**	6,354
– Corporate exposures	**6,135**	7,247
Gross credit equivalent amount	**12,780**	13,601
Less : Effects of netting arrangement	**(4,453)**	(4,860)
Credit equivalent amount after netting	**8,327**	8,741
Less: Collateral amount		
– Recognised financial collateral	**(322)**	(19)
– Other eligible collateral	**(489)**	(14)
	7,516	8,708
Exposures under Standardised approach		
Positive fair values	**47**	46
Potential future exposures	**107**	62
Gross credit equivalent amounts	**154**	108
Comprising:		
– Exchange rate contracts	**133**	82
– Interest rate contracts	**3**	18
– Equity contracts	**18**	8
	154	108
Less: Recognised financial collateral	**(81)**	(80)
	73	28

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

6 Counterparty credit risk-related exposures (continued)

	2012 **HK$'M**	2011 HK$'M
Exposures under IRB approach		
Risk-weighted amount		
– Bank exposures	**380**	240
– Corporate exposures	**7,317**	9,818
	7,697	10,058
Exposures under Standardised approach		
Risk-weighted amount		
– Exchange rate contracts	**66**	27
– Equity contracts	**6**	2
	72	29
	7,769	10,087

There are no outstanding repo-style transactions and credit derivative contracts which create exposures to counterparty credit risk as at 31 December 2012 (2011: Nil).

The current exposure method is used for calculating the Bank's net credit exposure and regulatory capital for counterparty exposures, using the mark-to-market exposures with an appropriate add-on factor for potential future exposures.

7 Liquidity ratio

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

	2012	2011
Average liquidity ratio	**40.3%**	33.4%

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)

(Expressed in millions of Hong Kong dollars)

8 Segmental information

(a) Segmental information by class of business

	Group			
2012	**Commercial and consumer banking HK$'M**	**Treasury HK$'M**	**Others HK$'M**	**Total HK$'M**
Total income	**6,684**	**223**	**551**	**7,458**
Profit before impairment allowances for credit and other losses	**3,253**	**64**	**502**	**3,819**
Profit before income tax	**3,103**	**64**	**575**	**3,742**
Operating assets	**175,364**	**101,887**	**7,912**	**285,163**
2011				
Total income	6,004	413	337	6,754
Profit before impairment allowances for credit and other losses	2,663	254	346	3,263
Profit before income tax	2,800	257	15	3,072
Operating assets	194,585	77,208	7,336	279,129

Commercial and consumer 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)

(Expressed in millions of Hong Kong dollars)

8 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			
	Banks HK$'M	**Public sector entities HK$'M**	**Others HK$'M**	**Total HK$'M**
2012				
Asia Pacific excluding Hong Kong	**89,810**	**3,908**	**11,651**	**105,369**
North and South America	**2,201**	**2,894**	**352**	**5,447**
Europe	**1,906**	**10**	**1,398**	**3,314**
Others	**92**	**155**	**1,101**	**1,348**
	94,009	**6,967**	**14,502**	**115,478**
2011				
Asia Pacific excluding Hong Kong	73,356	2,083	13,749	89,188
North and South America	2,321	2,295	537	5,153
Europe	1,969	7	451	2,427
Others	111	159	1,379	1,649
	77,757	4,544	16,116	98,417

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)

(Expressed in millions of Hong Kong dollars)

9 Advances to customers

(a) Advances to customers by loan usage

	Bank			
	2012		2011	
	Outstanding balance HK$'M	**Balance covered by collateral HK$'M**	Outstanding balance HK$'M	Balance covered by collateral HK$'M
Loans for use in Hong Kong				
Industrial, commercial and financial				
– Property development	**2,296**	**2,296**	2,108	2,100
– Property investment	**28,758**	**27,988**	30,294	29,363
– Financial concerns	**1,343**	**1,048**	1,701	1,297
– Stockbrokers	**13**	**13**	12	8
– Wholesale and retail trade	**17,090**	**11,852**	17,352	13,617
– Manufacturing	**10,100**	**7,550**	11,770	8,582
– Transport and transport equipment	**10,896**	**10,564**	10,816	10,395
– Recreational activities	**35**	**33**	28	28
– Information technology	**290**	**86**	114	86
– Others	**5,871**	**4,653**	5,431	4,118
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	**663**	**663**	851	851
– Loans for the purchase of other residential properties	**33,647**	**33,647**	39,688	39,688
– Credit card advances	**7,022**	**–**	6,408	–
– Others	**7,733**	**2,460**	8,039	2,946
	125,757	**102,853**	134,612	113,079
Trade finance	**46,326**	**10,548**	56,914	10,355
Loans for use outside Hong Kong	**5,069**	**2,139**	4,393	2,598
	177,152	**115,540**	195,919	126,032

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

9 Advances to customers (continued)

(b) Overdue advances to customers

The overdue advances are analysed as follows:

	Bank			
	2012		2011	
	HK$'M	**% of gross advances to customers**	HK$'M	% of gross advances to customers
Six months or less but over three months	**130**	**0.07**	180	0.09
One year or less but over six months	**192**	**0.11**	134	0.07
Over one year	**1,021**	**0.58**	1,209	0.62
	1,343	**0.76**	1,523	0.78
Individual impairment allowances made in respect of the above overdue advances	**855**		967	
Current market value of collateral held against the covered portion of the above overdue advances	**1,037**		1,233	
Covered portion of the above overdue advances	**560**		688	
Uncovered portion of the above overdue advances	**783**		835	

(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			
	2012		2011	
	HK$'M	**% of gross advances to customers**	HK$'M	% of gross advances to customers
Rescheduled advances	**261**	**0.15**	326	0.17

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

9 Advances to customers (continued)

(d) Repossessed assets

As at 31 December 2012, repossessed assets of the Bank amounted to HK$29 million (2011: HK$52 million).

(e) Non-bank Mainland exposures

Bank	**On-balance sheet exposures HK$'M**	**Off-balance sheet exposures HK$'M**	**Total HK$'M**	**Individual impairment allowances HK$'M**
2012				
Mainland entities	**5,751**	**863**	**6,614**	**21**
Companies and individuals outside Mainland where the credit is granted for use in Mainland	**5,210**	**1,834**	**7,044**	**227**
Other counterparties where the exposures are considered to be non-bank Mainland exposures	**7**	**6**	**13**	**–**
	10,968	**2,703**	**13,671**	**248**
2011				
Mainland entities	5,872	585	6,457	21
Companies and individuals outside Mainland where the credit is granted for use in Mainland	5,178	1,679	6,857	244
Other counterparties where the exposures are considered to be non-bank Mainland exposures	56	23	79	–
	11,106	2,287	13,393	265

UNAUDITED SUPPLEMENTARY INFORMATION (CONTINUED)

(Expressed in millions of Hong Kong dollars)

10 Currency concentration

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

	USD HK$'M	CNY HK$'M	AUD HK$'M	Others HK$'M	Total HK$'M
2012					
Hong Kong dollar equivalents					
Spot assets	**68,691**	**25,976**	**6,667**	**7,260**	**108,594**
Spot liabilities	**(63,618)**	**(16,764)**	**(8,494)**	**(9,876)**	**(98,752)**
Forward purchases	**165,491**	**116,027**	**3,453**	**12,107**	**297,078**
Forward sales	**(170,345)**	**(125,096)**	**(1,005)**	**(9,397)**	**(305,843)**
Net options position	**(43)**	**(1)**	**(468)**	**(89)**	**(601)**
Net long non-structural position	**176**	**142**	**153**	**5**	**476**
Net structural position	**–**	**31**	**–**	**(46)**	**(15)**
2011					
Hong Kong dollar equivalents					
Spot assets	69,872	32,824	6,637	8,777	118,110
Spot liabilities	(57,780)	(28,548)	(10,062)	(15,614)	(112,004)
Forward purchases	130,174	115,895	4,150	8,545	258,764
Forward sales	(141,881)	(120,101)	(643)	(1,723)	(264,348)
Net options position	(35)	–	19	60	44
Net long non-structural position	350	70	101	45	566
Net structural position	–	31	–	(40)	(9)

Structural foreign exchange positions arising from capital investments outside Hong Kong, mainly in Chinese Renminbi and Macau Pataca.

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.

CORPORATE GOVERNANCE REPORT

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

1 Board and Management Committees

Under the corporate governance structure of 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 of the Bank within its terms of reference. Its main duties include, inter alia, review of the Bank's financial statements before submission to the Board of Directors, recommendations to the Board on the appointment, re-appointment and removal of the external auditor, approval of remuneration and terms of engagement of the external auditor, review of the external auditor's audit plan, audit report and evaluation of internal accounting controls, approval of hiring including appointment, removal, evaluation and remuneration of Head of Audit, review of the scope and results of internal audits, and effectiveness of internal audit procedures, as well as the adequacy of internal financial, operational and compliance controls, accounting policies and systems. The Board Audit Committee comprises three independent non-executive directors of the Bank.

(b) Board Risk Management Committee

The Board Risk Management Committee is authorised by the Board to provide oversight of the Bank's risk governance and related matters. According to the revised Terms of Reference approved by the Board in February 2012, the principal duties include, inter alia, oversight of the Internal Capital Adequacy Assessment Process ("ICAAP") and review of ICAAP's overall risk appetite statement and size of operating buffer to be maintained above the regulatory minimum, for approval by the Board, and review and endorsement of the approach to the allocation of internal capital.

In addition, the Committee reviews and recommends risk strategy and risk appetite to the Board, and approves the Bank's overall and specific risk governance frameworks. It also oversees the establishment and the operation of an independent risk management system for managing the Bank's overall risks, and the adequacy of the risk management function. The Committee obtains assurance that risk management activities are effective and that such activities have sufficient independence, status and visibility. It monitors the types of risk exposure and approaches used to measure and manage risks, and reviews risk reporting on significant risks and risk capital adequacy.

The Committee obtains assurance that the Bank is on track to meet the Basel Capital Accord requirements according to the plans approved by the Committee. It is also responsible for setting entity level risk-taking authority in relation to credit risk, market risk, liquidity risk, as well as underwriting and investment risks relating to non-strategic investments (including traded equity and private equity). It also determines the quantum of the house credit limit.

The Committee comprises three directors, a majority of whom (including the Chairman) are non-executive directors.

CORPORATE GOVERNANCE REPORT (CONTINUED)

1 Board and Management Committees (continued)

(c) 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 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's strategy. The Committee 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. Chaired by the Chief Executive Officer of the Bank, members of the Committee comprise senior management staff in Hong Kong.

(d) Hong Kong Risk Executive Committee

The Hong Kong Risk Executive Committee provides oversight of all risk types (including those not covered by any committee for a specific risk) and their interactions across all business / support units of the Hong Kong entities, and establishes the overall local risk architecture direction and priorities in line with those established by DBS Group Holdings Ltd. ("DBSH"). It performs risk review on business mandates, all matters involving Special Purpose Vehicles and transactions presenting heightened or complex risk impact. The Hong Kong Risk Executive Committee comprises the Chief Executive Officer of the Bank, the Senior Risk Executive of Hong Kong and representatives from key business units and support units.

(e) Hong Kong Asset and Liability Committee

The Asset & Liability Committee of DBS Hong Kong ("HK ALCO") oversees asset and liability management activities, including strategies to enhance the quality of net interest income, liquidity management and structural FX management for Hong Kong country and including Macau. HK ALCO also reviews DBS Bank (Hong Kong) Limited's capital position and adequacy; assesses capital deployment, and approves risk capital quantification methodologies. HK ALCO comprises the Chief Executive Officer of the Bank and representatives from the relevant business units and support units and others nominated by the Chairman of HK ALCO.

(f) Hong Kong Credit Risk Committee

The Hong Kong 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. The Hong Kong Credit Risk Committee identifies and monitors credit risk portfolio, special loan and asset review situations, specific credit concentrations and trends. In respect of continually determining the suitability of DBS Hong Kong's credit risk management strategy and framework as well as Internal Ratings-Based ("IRB") systems in meeting the standards under Basel Capital Accord, the Hong Kong Credit Risk Committee exercises active oversight to ensure the continuing appropriateness of the rating systems, the parameterization process and the stress testing process. The members of the Hong Kong Credit Risk Committee are the Chief Credit Officer, Hong Kong, representatives from relevant credit, business, risk management and other units.

CORPORATE GOVERNANCE REPORT (CONTINUED)

1 Board and Management Committees (continued)

(g) Hong Kong Market & Liquidity Risk Committee

The Hong Kong Market & Liquidity Risk Committee ("HK MLRC") provides comprehensive and location-wide oversight, direction and counsel relating to the management of market and liquidity risks. It serves as an executive forum for discussions and decisions on all aspects of market and liquidity risks and their management. It maintains oversight on effectiveness of market and liquidity risk management infrastructure, including framework, policies, people, processes, information, methodologies and systems on market and liquidity risks. It sets standards and provides necessary guidance on the establishment and maintenance of the location-wide liquidity contingency plan. The HK MLRC comprises senior management from Risk Management, representatives from relevant business units and support units and others nominated by the Chairman of the HK MLRC.

(h) Hong Kong Operational Risk Committee

The Hong Kong Operational Risk Committee provides comprehensive and location-wide oversight, direction and counsel relating to the management of operational risks. It monitors and reviews the effectiveness of operational risk management framework, policies, processes, methodologies and infrastructures. It performs top-down assessment and monitors critical operational risk exposures and provides direction for resolution of critical operational risk issues and monitors issue resolution. The Hong Kong Operational Risk Committee comprises the senior management from Risk Management, representatives from the relevant business units, support units and others nominated by the Chairman of the Hong Kong Operational Risk Committee.

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" ("CG-1") dated 21 September 2001 issued by the Hong Kong Monetary Authority ("HKMA").

The HKMA issued a revised version of the Supervisory Policy Manual module on the CG-1 as a statutory guideline under section 7 (3) of the Banking Ordinance on 3 August 2012. The Bank is taking steps to bring the relevant corporate governance policies and practices into line with the guidance according to the timeline set by the HKMA.

2 Disclosure on Remuneration pursuant to the HKMA Supervisory Policy Manual CG-5 "Guideline on a Sound Remuneration System"

(a) Design and implementation of the remuneration system

DBS Bank (Hong Kong) Limited adopts the remuneration policy and practices formulated by DBS Group Holdings Ltd ("DBSH"). Please refer to the Corporate Governance Report in the Annual Report of DBSH for details of the Board Compensation and Management Development Committee and major characteristics of the remuneration system.

CORPORATE GOVERNANCE REPORT (CONTINUED)

2 Disclosure on Remuneration pursuant to the HKMA Supervisory Policy Manual CG-5 "Guideline on a Sound Remuneration System" (continued)

(b) Aggregate quantitative information on remuneration for senior management and key personnel for the year ended 31 December 2012 are as follows:

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

Breakdown of remuneration awarded	**2012**	2011
Number of senior management	10	9
Number of key personnel	1	1
	HK$'M	HK$'M
Fixed remuneration		
• Cash based	31	25
• Share based	–	–
• Other	–	–
Variable remuneration (Note i)		
• Cash based	32	31
• Share based	21	23
• Other	–	–
	84	79

Breakdown of deferred remuneration	**2012** **HK$'M**	2011 HK$'M
• Outstanding – vested	–	–
• Outstanding – unvested	43	29
• Awarded during the year	21	23
• Paid out during the year	8	9
• Reductions in current year due to ex-post adjustment – explicit (Note ii)	–	–
• Reductions in current year due to ex-post adjustment – implicit (Note iii)	–	(2)

In 2012, there was one case of sign-on award being paid to senior management or key personnel which amount to HK$66,125 (2011: Nil).

No senior management or key personnel has been awarded with new guaranteed bonus or severance payments in 2012 (2011: Nil).

Note
(i) Cash and share based variable remuneration are subject to the approval of the DBSH Board of Directors.
(ii) Examples of explicit ex-post adjustments include malus, clawbacks, or similar reversals or downward revaluation of awards.
(iii) Examples of implicit ex-post adjustments include fluctuations in the value of shares or performance units.

3 Internal Audit

Internal Audit is an independent function that reports functionally to the Board Audit Committee and administratively to the Bank Chief Executive Officer. 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 Internal Audit deems necessary. The Board Audit Committee approves the hiring of Head of Internal Audit including appointment, removal, evaluation, annual compensation and salary adjustment. Administratively, the Bank Chief Executive Officer facilitates the day-to-day operations of the internal audit function, including budgeting, management accounting and human resource administration. Internal Audit has unfettered access to any and all of the Bank's documents, records, properties and personnel including the Chairman of the Bank's Board of Directors and Board Audit Committee.

The primary role of Internal Audit is to assist the Board and Executive Management to meet the agreed strategic and operational objectives of the Bank and its subsidiaries. This is achieved by providing an independent appraisal of the adequacy and effectiveness of the risk management, control and governance processes in operation throughout the Bank.

Internal Audit also maintains a quality assurance and improvement programme that covers all aspects of the internal audit activity. The programme includes ongoing monitoring and external and internal assessments of internal audit activity, which 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.

The professional competence of the Bank'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 Bank'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 Internal Audit encompasses the examination and evaluation of the reliability, adequacy and effectiveness of the Bank's system of internal controls, risk management procedures, governance processes and the quality of performance in carrying out assigned responsibilities. This includes reviewing the timeliness and accuracy of recording transactions and proper safeguarding of assets. Internal Audit may also conduct consulting services only at the request of management in accordance with Group Internal 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 senior management. All audit reports are copied to the Board 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. Internal 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 Bank'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 Board Audit Committee, which ensures that high-risk outstanding issues are dealt with in a timely manner.