

Hang Seng Bank Limited
Macau Branch

*Financial disclosure
for the year ended 31 December 2014*

Balance sheet as of 31 December 2014 (audited)

(Expressed in Macau Patacas)

| <i>Assets</i> | <i>Assets gross amount</i> | <i>Provisions, amortisation and devaluation</i> | <i>Assets net amount</i> |
|---|--------------------------------|---|------------------------------|
| Cash | 13,613,376.70 | - | 13,613,376.70 |
| Deposits with AMCM | 954,465,763.06 | - | 954,465,763.06 |
| Cheques and bills receivables | 31,410,345.04 | - | 31,410,345.04 |
| Current deposits with other local credit institutions | 811,769,736.86 | - | 811,769,736.86 |
| Current deposits with other overseas credit institutions | 1,030,283,013.46 | - | 1,030,283,013.46 |
| Gold and silver | - | - | - |
| Other current assets | - | - | - |
| Loans and advances to customers | 8,977,456,026.52 | - | 8,977,456,026.52 |
| Placement with local credit institutions | 50,000,000.00 | - | 50,000,000.00 |
| Call and time deposits with overseas credit institutions | 881,591,608.85 | - | 881,591,608.85 |
| Equity securities, bonds and shareholdings | - | - | - |
| Applications & resources consigned to the bank | - | - | - |
| Debtors | - | - | - |
| Other investment | - | - | - |
| Financial investment | - | - | - |
| Immovable properties | - | - | - |
| Equipments | 9,013,745.91 | 8,210,869.69 | 802,876.22 |
| Deferred expenses | - | - | - |
| Organisation costs | - | - | - |
| Immovable properties in progress | - | - | - |
| Other fixed assets | - | - | - |
| Internal and adjustment accounts | 60,054,765.50 | - | 60,054,765.50 |
| Total | 12,819,658,381.90 | 8,210,869.69 | 12,811,447,512.21 |

Balance sheet as of 31 December 2014 (audited) (continued)

(Expressed in Macau Patacas)

| <i>Liabilities</i> | <i>Sub-total</i> | <i>Total</i> |
|---|------------------|-------------------|
| Current deposits | 2,087,853,336.33 | |
| Call deposits | - | |
| Time deposits | 723,952,397.74 | 2,811,805,734.07 |
| Deposits from public sector entities | - | |
| Placement from local credit institutions | - | |
| Placement from other local institutions | - | |
| Foreign currencies debts | 9,360,556,143.55 | |
| Bond debts | - | |
| Creditors of applications & resources consigned to the bank | - | |
| Cheques and bills payable | 9,897,184.11 | |
| Creditors | - | |
| Other liabilities | - | 9,370,453,327.66 |
| Internal and adjustment accounts | 61,022,324.13 | |
| Risk reserve | 11,669,517.00 | |
| Capital | - | |
| Legal reserve | - | |
| Self-constituted reserve | - | |
| Other reserves | 89,061,835.84 | |
| Revaluation reserve | 7,976.85 | 161,761,653.82 |
| Retained earnings | 341,416,630.89 | |
| Profit and loss for the year | 126,010,165.77 | 467,426,796.66 |
| Total | | 12,811,447,512.21 |

Other reserves include general risk reserve of MOP 78,374,415.84. The Branch prepared the annual financial statement and made the loan impairment allowance in accordance with 《Macau Financial Reporting Standard》. The relevant impairment allowance made may be lower than the minimum general risk reserve and special reserve required by 《No.18 / 93 - AMCM notice》.

The Branch has provided an amount equal to the difference between the minimum required reserve and the impairment allowance (after the consideration of the deferred tax of MOP 10,687,420) as statutory provision. The relevant provision added has been stated as “additional provision in accordance with Financial System Act” in the profit and loss account of the summarised financial statements and as an adjustment item between the “profit after taxation” and “profits for the year under AMCM rules” in the income statement of audited financial statement.

Profit and loss account
for the year ended 31 December 2014 (audited)

Operating account

(Expressed in Macau Patacas)

| <i>Debit</i> | <i>Amount</i> | <i>Credit</i> | <i>Amount</i> |
|---|----------------|--|----------------|
| Costs of credit operations | 41,536,527.99 | Income from credit operations | 211,278,515.03 |
| Personnel costs | | Income from banking services | 37,651,776.16 |
| Directors and supervisory committee emoluments | - | Income from other banking services | - |
| Employee remuneration | 16,350,849.47 | Income from securities and equity investments | - |
| Staff benefit costs | 1,656,668.02 | Other banking income | - |
| Other personnel costs | 11,820.60 | Income from non-banking operations | - |
| Third party supply | 304,057.84 | Operation loss | - |
| Third party services | 4,873,821.26 | | |
| Other banking costs | 22,114,508.81 | | |
| Taxation | - | | |
| Costs of non-banking operations | - | | |
| Depreciation allowances | 463,169.64 | | |
| Provision allowances | 1,038,297.85 | | |
| Operating profit | 160,580,569.71 | | |
| | | | |
| Total | 248,930,291.19 | Total | 248,930,291.19 |

Profit and loss account

(Expressed in Macau Patacas)

| <i>Debit</i> | <i>Amount</i> | <i>Credit</i> | <i>Amount</i> |
|---|----------------|-------------------------------------|----------------|
| Operating loss | - | Operating profit | 160,580,569.71 |
| Losses related to previous years | - | Profit related to previous years | - |
| Exceptional losses | - | Exceptional profits | - |
| Profit tax provision | 16,990,524.04 | Provision used up | - |
| Additional provision in accordance with Financial System Act | 17,579,879.90 | Profit and loss for the year (loss) | - |
| Profit and loss for the year (profit) | 126,010,165.77 | | |
| | | | |
| Total | 160,580,569.71 | Total | 160,580,569.71 |

Brief management report on the Branch's activities in Macau

The global economy grew at a modest pace in 2014. Macau's economy grew slower and market continued to reform in the Mainland, which brought challenges to the banking industry. In light of the economic environment, our Branch enhanced efficiency and strategically deployed capital and other resources to further enhance our platform in order to maintain a balanced and sustainable growth.

Building long-term relationships with customers, business partners and our local communities is a vital part of our steady growth of the Branch's business in Macau. Engaging in active dialogue with customers and other stakeholders allows us to respond promptly to market changes and new business opportunities.

During 2014, the principal activities of the Branch were the provision of banking services to both commercial and personal customers including diversified deposit services, trade finance, cross-border renminbi trade service, mortgage loan, corporate lending, remittance & foreign exchange, bills collection, automated teller machines and insurance agency etc. Customer deposits and lending were MOP 2,812 million and MOP 8,977 million respectively at the year-end. Profit after tax was MOP 126 million for the year.

The Branch would like to express sincere appreciation to the support from each Macau government authority, customers, peers, staff and their family members.

Isidorus Fong

Branch Manager

Hang Seng Bank Limited Macau Branch

Summary of the external auditors' report

To the General Manager of Hang Seng Bank Limited, Macau Branch

(Branch of a commercial bank with limited liability incorporated in the Hong Kong Special Administrative Region)

We have audited the financial statements of Hang Seng Bank Limited, Macau Branch ("the Branch") for the year 2014 in accordance with the Auditing Standards and Technical Standards of Auditing issued by the Macau Special Administrative Region. In our report dated 29 April 2015, we expressed an unqualified opinion on the financial statements.

The audited financial statements referred to above comprise the balance sheet as at 31 December 2014, and the income statement, the statement of changes in reserves, and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

The accompanying summarised financial statements prepared by management were derived from the audited financial statements referred to above and the books and records of the Branch. In our opinion, page 1 to page 3 of the summarised financial statements are consistent, in all material respects, with the audited financial statements and the books and records of the Branch.

For a better understanding of the financial position and the results of its operation for the period of the Branch and the scope of our audit, the summarised financial statements should be read in conjunction with the audited financial statements and our independent auditor's report thereon.

Ieong Lai Kun, Registered Auditor

KPMG

Macau, 29 April 2015

Cash flow statement for the year ended 31 December 2014 (audited)

(Expressed in Macau Patacas)

| | <i>Amount</i> |
|--|---|
| Operating activities | |
| Profit before taxation | 160,580,570 |
| Adjustments for: | |
| Net charge for loan impairment | 1,038,298 |
| Interest income | (211,278,515) |
| Interest expense | 41,536,528 |
| Interest received | 198,507,704 |
| Interest paid | (38,075,046) |
| Depreciation | 463,170 |
| | <hr/> |
| Operating profit before changes in working capital | 152,772,709 |
| Increase in loans and advances to customers | (1,639,305,102) |
| Increase in amounts due from Head Office and a related company with original maturity more than three months | (384,211,137) |
| Increase in other assets | (12,806,325) |
| Increase in current, savings and other deposits from customers | 425,294,199 |
| Increase in amounts due to Head Office and a related company | 1,755,774,763 |
| Increase in other liabilities | 18,116,771 |
| | <hr/> |
| Cash generated from operations | 315,635,878 |
| Macau profits tax paid | (12,057,672) |
| Withholding tax refund received | 23,456 |
| | <hr/> |
| Net cash generated from operations | 303,601,662 |
| | <hr style="border-top: 1px dashed black;"/> |
| Investing activities | |
| Purchase of fixed assets | (431,305) |
| Proceeds from redemption of available-for-sale investments | 100,000,000 |
| Payment for purchase of available-for-sale investments | (99,814,850) |
| | <hr/> |
| Net cash flows used in investing activities | (246,155) |
| | <hr style="border-top: 1px dashed black;"/> |
| Net increase in cash and cash equivalents | 303,355,507 |
| Cash and cash equivalents at 1 January | 2,862,651,890 |
| | <hr/> |
| Cash and cash equivalents at 31 December | 3,166,007,397 |
| | <hr style="border-top: 3px double black;"/> |
| Cash and cash equivalents in the cash flow statement | |
| Cash and short-term funds | 1,779,848,877 |
| Amounts due from Head Office and a related company with original maturity within three months | 1,386,158,520 |
| | <hr/> |
| | <hr style="border-top: 3px double black;"/> |
| | 3,166,007,397 |

Off-balance sheet exposures

(a) *Contingent liabilities and commitments (audited)*

(Expressed in Macau Patacas)

| As at 31 December 2014 | Contractual amounts |
|---|---------------------|
| Bank guarantees | 380,989,876 |
| Commitments: | |
| Documentary credits and short-term trade-related transactions | 837,555,152 |
| Acceptance on the trade bills | 620,724,013 |
| Undrawn formal standby facilities, credit lines and other commitments to lend | 3,407,014,449 |
| | 4,865,293,614 |

(b) *Lease commitments (audited)*

The Branch leases a number of properties under operating leases. The leases typically run for a period of one to three years, with an option to renew the leases when all terms are renegotiated. None of the leases includes contingent rentals.

At 31 December 2014, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

(Expressed in Macau Patacas)

| | Contractual amounts |
|--------------------------------------|---------------------|
| Within one year | 946,383 |
| After one year but within five years | 12,000 |
| | 958,383 |

Derivative transactions

The following table gives the notional contract amounts, marked to market value of assets and liabilities, credit equivalent amounts and risk-weighted amounts as at 31 December 2014.

(Expressed in Macau Patacas)

| | <i>Contract amount</i> | <i>Derivative assets</i> | <i>Derivative liabilities</i> | <i>Credit equivalent amounts</i> | <i>Risk-weighted amounts</i> |
|--|------------------------|--------------------------|-------------------------------|----------------------------------|------------------------------|
| Exchange rate contracts – Forward contracts | 834,233,222 | 19,793,994 | 19,793,994 | 16,684,680 | 5,839,638 |
| Interest rate contracts | - | - | - | - | - |
| Equities contracts | - | - | - | - | - |
| Commodities contracts | - | - | - | - | - |
| Others | - | - | - | - | - |

Significant accounting policies (audited)

(a) *Interest income and expense*

Interest income and expense for all interest-bearing financial instruments are recognised as “interest income” and “interest expense” respectively in the income statement on an accruals basis using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Branch estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the Branch that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

For impaired loans, the accrual of interest income based on the original terms of the loan is discounted to arrive at the net present value of impaired loans. Subsequent increase of such net present value of impaired loans due to the passage of time is recognised as interest income.

(b) *Non-interest income*

Fee income is earned from a diverse range of services provided to customers and accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the act is completed;
- income earned from the provision of services is recognised as revenue when the services are provided; and
- income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate and reported in "Interest income".

(c) *Provisions*

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation arising from past events and a reliable estimate can be made as to the amount of the obligation. Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or nonoccurrence, of one or more uncertain future events not wholly within the control of the Branch; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

(d) *Financial investments*

(i) Classification

Available-for-sale investments are financial assets that are not held for trading purposes or held to maturity. Available-for-sale investments include financial assets intended to be held for an indefinite period of time, but which may be sold in response to needs for liquidity or changes in the market environment.

(ii) Recognition

The Branch recognises available-for-sale assets on the date it commits to purchase the assets.

Significant accounting policies (audited) (continued)

(d) *Financial investments (continued)*

(iii) Measurement

Investments are measured initially at fair value, which normally will be equal to the transaction price plus transaction costs that are directly attributable to the acquisition of the financial investment.

Subsequent to initial recognition all available-for-sale assets are measured at fair value, based on their quoted market prices at the balance sheet date without any deduction for estimated future selling costs. Unrealised gains and losses arising from changes in the fair value are recognised directly in the available-for-sale investment revaluation reserve except for foreign exchange gains and losses on monetary items such as debt securities which are recognised in the income statement.

(e) *Derivative financial instruments*

Derivative financial instruments are recognised initially, and are subsequently remeasured, at fair value. Subsequent to initial recognition, derivatives are marked to market with any changes in mark to market taken to the income statement. Derivatives are classified as assets when the fair value is positive and as liabilities when the fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis. Fair values are determined in accordance with note (f).

(f) *Determination of fair value*

The fair value of financial instruments is based on their quoted market prices at the balance sheet date, or date close to balance sheet date, without any deduction for estimated future selling costs. Financial assets are priced at current bid prices, while financial liabilities are priced at current asking prices unless the position is immaterial. In such case, mid rate will be applied for both long and short positions.

If a quoted market price is not available on a recognised stock exchange or from a broker/dealer for non-exchange-traded financial instruments, the fair value of the instrument is estimated using valuation techniques, including use of recent arm's-length market transactions, reference to the current fair value of another instrument that is substantially the same, discounted cash flow techniques, option pricing models or any other valuation technique that provides a reliable estimate of prices obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates, and the discount rate used is a market rate at the balance sheet date applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the balance sheet date. Fair values for unquoted equity investments are estimated, if possible, using applicable price/earnings ratios for similar listed companies adjusted to reflect the specific circumstances of the issuer.

(g) *Impairment of assets*

The carrying amount of the Branch's assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, the carrying amount is reduced to the estimated recoverable amount by means of a charge to the income statement.

(i) Available-for-sale financial assets

At each balance sheet date, an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset or group of assets. Impairment losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the income statement, is reclassified from equity to the income statement.

Significant accounting policies (audited) (continued)

(g) *Impairment of assets (continued)*

(i) Available-for-sale financial assets (continued)

The impairment methodologies for available-for-sale financial assets are set out in more detail below.

Impairment losses on available-for-sale debt securities are recognised within "Loan impairment charges and other credit risk provisions" in the income statement.

When assessing available-for-sale debt securities for objective evidence of impairment at the reporting date, the Branch considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. These events may include a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial reorganisation, or the disappearance of an active market for the debt security because of financial difficulties relating to the issuer. These types of specific event and other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment of a debt security.

For an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in the income statement if, and only if there is objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in the available-for-sale investment revaluation reserve and accumulated separately in equity. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement to the extent of the increase in fair value.

(ii) Other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the premises and equipment (other than properties carried at revalued amounts) may be impaired or an impairment loss previously recognised no longer exists or may have decreased.

If any such indication exists, the asset's recoverable amount is estimated and impairment losses recognized.

- Calculation of recoverable amount

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the assets. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

- Recognition of impairment losses

An impairment loss is recognised in the income statement whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

Significant accounting policies (audited) (continued)

(g) ***Impairment of assets (continued)***

(ii) Other assets (continued)

- Reversals of impairment losses

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognised.

(h) ***Translation of foreign currencies***

Foreign currency transactions during the year are translated into MOP at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into MOP at the foreign exchange rates ruling at the balance sheet date. Any resulting exchange differences are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into MOP using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

(i) ***Related parties***

For the purposes of this financial disclosure, parties are considered to be related to the Branch if the Branch has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Branch and the party are subject to common control or common significant influence.

Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities, which are under the significant influence of related parties of the Branch and post employment benefit scheme. Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Branch, the Bank and its holding companies, directly or indirectly, including any directors (whether executive or otherwise) and Executive Committee members of the Bank and its holding companies.

(j) ***Changes in accounting policies***

During the year, the Branch did not have any changes in accounting policies.

Material related-party transactions

(a) **Policy for related party transactions**

The Branch entered into transactions with its Head Office in the ordinary course of its interbank activities including the acceptance and placement of interbank deposits, correspondent banking transactions and off-balance sheet transactions. The activities were priced at the relevant market rates at the time of the transactions.

(b) **Transactions with Head Office, a related company and an intermediate holding company (audited)**

The aggregate amount of income and expenses arising from these transactions during the year, and the total contract sum of off-balance sheet transactions at the year-end are as follows:

(Expressed in Macau Patacas)

| | Amount |
|---|--------------------|
| Interest income from Head Office and related company | 24,398,548 |
| Interest expenses to Head Office | (20,349,152) |
| Fee and commission paid to Head Office | (10,101,608) |
| Management fee paid to Head Office | (6,114,669) |
| Operating expenses paid to an intermediate holding company, The Hongkong and Shanghai Banking Corporation Limited | (2,798,649) |
| Forward exchange rate contracts | 417,116,611 |
| | <u>417,116,611</u> |

The balances of amounts due from and to Head Office and a related company at the year end are as follows:

(i) Amounts due from Head Office and a related company

(Expressed in Macau Patacas)

| | Amount |
|---|----------------------|
| Placement with Head Office and a related company with remaining maturity: | |
| - within one month | 259,269,564 |
| - three months or less but over one month | 396,318,769 |
| - over three months but less than one year | 226,003,276 |
| Interest-bearing deposits receivable on demand | 1,030,283,014 |
| Interest receivable | 6,691,009 |
| | <u>1,918,565,632</u> |

(ii) Amounts due to Head Office and a related company

(Expressed in Macau Patacas)

| | Amount |
|--|----------------------|
| Deposits repayable on demand | 2,014,718,218 |
| Placement from Head Office | 7,293,537,926 |
| Interest payable | 2,274,081 |
| Interest-free deposits with no fixed term of repayment | 52,300,000 |
| Others | 893,813 |
| | <u>9,363,724,038</u> |

Material related-party transactions (continued)

(c) **Key management personnel remuneration (audited)**

The remuneration of key management personnel, which is included in “staff cost”, is as follows:

(Expressed in Macau Patacas)

| | Amount |
|--------------------|------------------|
| Executive officers | <u>2,185,803</u> |

(d) **Material transaction with key management personnel (audited)**

During the year, the Branch did not provide credit facilities to key management personnel of its Head Office, their close family members and companies controlled or significantly influenced by them.

Credit risk

(a) *Definition of past due or impaired loans*

Past due loans represent loans that have missed the most recent payment date with respect to either principal or interest.

Impaired loans represent there is objective evidence that impairment of a loan or portfolio of loans has occurred. The criteria used by the Branch to determine that there is such objective evidence include:

- known cash flow difficulties experienced by the borrower;
- past due contractual payments of either principal or interest being past due for more than 90 days;
- the probability that the borrower will enter bankruptcy or other financial restructuring;
- a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in the forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and
- a significant downgrading in credit rating by an external rating agency.

(b) *Impairment allowance*

Losses for impaired loans are promptly recognised when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances are assessed either individually for individually significant loans or collectively for loan portfolios with similar credit risk characteristics.

(i) Individually assessed loans

For all loans that are considered individually significant, the Branch assesses on a case-by-case basis whether there is any objective evidence that a loan is impaired.

For those loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

- the Branch's aggregate exposure to the borrower;
- the viability of the borrower's business model and capability to generate cash flow to service their debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors' commitments ranking ahead of, or *pari passu* with, the Branch and the likelihood of other creditors continuing to support the borrower;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding; and
- the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and
- where available, the secondary market price for the debt.

Credit risk (continued)

(b) *Impairment allowance (continued)*

(i) Individually assessed loans (continued)

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at its original effective interest rate and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

(ii) Collectively assessed loans

Impairment allowances are calculated on a collective basis:

- to cover losses which have been incurred but have not yet been identified as loans subject to individual assessment; and
- for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective impairment. This reflects impairment losses that the Branch has incurred as a result of events occurring before the reporting date, which the Branch is not able to identify on an individual loan basis, and that can be reliably estimated. These losses will only be individually identified in the future. As soon as information becomes available which identifies losses on individual loans within the Branch, those loans are removed from the Branch and assessed on an individual basis for impairment. The collective impairment allowance is determined after taking into account:

- historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between a loss occurring and that loss being identified and evidenced by the establishment of an appropriate allowance against the loss on an individual loan; and
- management's judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses at the reporting date is likely to be greater or less than that suggested by historical experience.

Homogeneous groups of loans and advances

Portfolios of small homogeneous groups of loans are collectively assessed using roll rate or historical loss rate methodologies.

(iii) Loan write-offs

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of collateral. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write off may be earlier.

Credit risk (continued)

(b) ***Impairment allowance (continued)***

(iv) Reversals of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognised in the income statement.

(c) ***Credit risk management policy***

Credit risk is the risk that financial loss arises from the failure of a customer or counterparty to meet its obligations under a contract, including settlement risk. It arises principally from lending, trade finance, retail banking, treasury and leasing activities. Hang Seng Bank Limited (“the Bank”) has dedicated standards, policies and procedures in place to control and monitor all such risks.

The Branch undertakes ongoing credit analysis and monitoring at several levels. Special attention is also paid to problem loans. Loan impairment allowances are made promptly where necessary and be consistent with established guidelines. Management regularly performs an assessment of the adequacy of the impairment by conducting a detailed review of the loan portfolio, comparing performance and delinquency statistics against historical trends and undertaking an assessment of current economics conditions. The Branch shares the economic model of the Bank for loans impairment assessment.

Credit risk (continued)

(d) Geographic distribution of exposures

(Expressed in Macau Patacas)

| | <i>Banks</i> | <i>Governments</i> | <i>Public sector entities</i> | <i>Others</i> | <i>Total exposures</i> | <i>Individually impaired loans and advances</i> | <i>Overdue loans and advances[#]</i> | <i>Individually assessed allowances</i> | <i>Collectively assessed allowances</i> |
|-----------------------|--------------|--------------------|-------------------------------|----------------|------------------------|---|---|---|---|
| Loans & commitments* | | | | | | | | | |
| – Macau | - | - | - | 10,841,101,151 | 10,841,101,151 | - | - | - | (9,912,658) |
| – Hong Kong | - | - | - | 775,903,410 | 775,903,410 | - | - | - | (874,096) |
| – Others | - | - | - | 767,465,915 | 767,465,915 | - | - | - | (882,763) |
| | - | - | - | 12,384,470,476 | 12,384,470,476 | - | - | - | (11,669,517) |
| Debt securities | | | | | | | | | |
| – Macau | - | - | - | - | - | - | - | - | - |
| – Hong Kong | - | - | - | - | - | - | - | - | - |
| – Others | - | - | - | - | - | - | - | - | - |
| Financial derivatives | | | | | | | | | |
| – Macau | - | - | - | 417,116,611 | 417,116,611 | - | - | - | - |
| – Hong Kong | - | - | - | 417,116,611 | 417,116,611 | - | - | - | - |
| – Others | - | - | - | - | - | - | - | - | - |
| | - | - | - | 834,233,222 | 834,233,222 | - | - | - | - |

* Undrawn formal standby facilities, credit lines and other commitments to lend are included.

[#] Loans and advances which have been overdue with respect to either principal or interest for periods of more than three months.

Credit risk (continued)

(e) Industry distribution of exposures of loans and advances

(Expressed in Macau Patacas)

| | Gross loans and advances | Individually impaired loans and advances | Overdue loans and advances [#] | Individually assessed allowances | Collectively assessed allowances |
|--|--------------------------|--|---|----------------------------------|----------------------------------|
| Manufacturing | 571,993,325 | - | - | - | (743,516) |
| Electricity, gas and water | - | - | - | - | - |
| Construction and public works | 54,577,000 | - | - | - | (70,943) |
| Trade (wholesale and retail) | 2,290,392,409 | - | - | - | (2,977,210) |
| Restaurants, hotels and related activities | 24,297,775 | - | - | - | (31,584) |
| Transport, warehouse and communications | - | - | - | - | - |
| Individuals for house purchases | 2,375,649,687 | - | - | - | (3,088,033) |
| Individuals for other purposes | - | - | - | - | - |
| Others | 3,660,545,831 | - | - | - | (4,758,231) |
| | <u>8,977,456,027</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>(11,669,517)</u> |

[#] Loans and advances which have been overdue with respect to either principal or interest for periods of more than three months.

(f) Maturity analysis on assets and liabilities

(Expressed in Macau Patacas)

| | Repayable on demand | 1 month or less but not repayable on demand | 3 months or less but over 1 month | 1 year or less but over 3 months | 3 years or less but over 1 year | After 3 years | Indefinite period | Total |
|---|---------------------|---|-----------------------------------|----------------------------------|---------------------------------|---------------|-------------------|---------------|
| Assets | | | | | | | | |
| Loans and advances to customers | 8,016,630 | 2,722,250,001 | 591,894,900 | 437,582,963 | 813,952,964 | 4,403,758,569 | - | 8,977,456,027 |
| Cash and balances with and loans and advances to banks | 2,810,131,891 | 259,269,564 | 396,318,769 | 226,003,276 | - | - | - | 3,691,723,500 |
| Certificates of deposits held | - | - | - | - | - | - | - | - |
| Securities issued by Macao SAR Government and/or AMCM | - | - | 50,000,000 | - | - | - | - | 50,000,000 |
| Other securities | - | - | - | - | - | - | - | - |
| Liabilities | | | | | | | | |
| Deposits and balances of banks and financial institutions | 2,014,718,218 | 2,983,026,784 | 662,329,361 | 3,648,181,781 | - | - | 52,300,000 | 9,360,556,144 |
| Deposits from public sector entities | - | - | - | - | - | - | - | - |
| Deposits from holding and associated companies | - | - | - | - | - | - | - | - |
| Deposits from non-bank customers | 2,087,853,336 | 178,972,585 | 318,976,537 | 226,003,276 | - | - | - | 2,811,805,734 |
| Certificates of deposits issued | - | - | - | - | - | - | - | - |
| Other securities issued | - | - | - | - | - | - | - | - |

Credit risk (continued)

(g) *Overdue loans and advances to banks*

(Expressed in Macau Patacas)

| | <i>Gross loans and advances</i> | <i>% of total loans and advances to banks</i> | <i>Collateral value</i> | <i>Individually impaired allowances</i> |
|--|---------------------------------|---|-------------------------|---|
| Loans and advances to banks which have been overdue with respect to either principal or interest for periods of: | | | | |
| - more than three months but not more than six months | - | - | - | - |
| - more than six months but not more than one year | - | - | - | - |
| - more than one year | - | - | - | - |
| | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |

(h) *Overdue loans and advances to non-bank customers*

(Expressed in Macau Patacas)

| | <i>Gross loans and advances</i> | <i>% of total loans and advances to non-bank customers</i> | <i>Collateral value</i> | <i>Individually impaired allowances</i> |
|---|---------------------------------|--|-------------------------|---|
| Loans and advances to non-bank customers which have been overdue with respect to either principal or interest for periods of: | | | | |
| - more than three months but not more than six months | - | - | - | - |
| - more than six months but not more than one year | - | - | - | - |
| - more than one year | - | - | - | - |
| | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |

(i) *Overdue other assets*

(Expressed in Macau Patacas)

| | <i>Trade bills</i> | <i>Debt securities</i> | <i>Others</i> | <i>Total</i> |
|---|--------------------|------------------------|---------------|--------------|
| Other assets which have been overdue with respect to either principal or interest for periods of: | | | | |
| - more than three months but not more than six months | - | - | - | - |
| - more than six months but not more than one year | - | - | - | - |
| - more than one year | - | - | - | - |
| | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |

Market risk

Market risk is the risk of market variables, such as foreign exchange rates, interest rates, equity and commodity prices that will move and result in profits and losses to the Branch. The Branch's market risk arises from customer-related business and from position taking.

Market risk is managed within risk limits approved by the Head Office. Risk limits are set by product and risk type with market liquidity being a principal factor in determining the level of limits set.

Interest rate risk

Interest rate risks comprise those originating from treasury activities as well as the structural interest rate exposures. Structural interest rate risk arises from the differing repricing characteristics of commercial banking assets and liabilities, including non-interest bearing liabilities. Structural interest rate risks were transferred to Treasury of Head Office based on contractual or behavioural maturity directly or through the Asset and Liability Management Committee ("ALCO") Book of Head Office.

Treasury manages interest rate risks within the limits approved by Head Office and under the monitoring of ALCO.

The estimates and associated assumptions regarding to loan prepayments and behaviour of non-maturity deposits are based on historical experience and various other factors that are believed to be reasonable.

Interest rate risks are measured and monitored by Treasury on an ongoing basis. Besides, the branch prepares, monitors and submits interest rate risk return to AMCM quarterly in accordance with the guideline based on circular no. 051/B/2008-DSB/AMCM .

Operational risk

The Bank's established framework for operational risk management includes identification and vigorous assessment of operational risks inherent in processes, activities and products and adequate management information on analysis of operational loss events and data. The Operational Risk Management Committee in Head Office oversees the implementation of this framework at the Branch's level.

Operational risk is mitigated by well-established internal control system, adequate insurance cover, back up systems and contingency business resumption plans.

Foreign exchange risk

The Branch's foreign exchange exposures mainly comprise foreign exchange dealing by Global Markets of Head Office and currency exposures originated by its banking business. Both of them are transferred to Global Markets where they are centrally managed within foreign exchange position limits approved by the Head Office.

Structural foreign exchange limit of MOP50 million and standby limit of MOP5 million arising from capital investment in Macau Branch were granted by ALCO. ALCO is thus fully responsible for the monitoring and management of such limits.

(Expressed in Macau Patacas)

| | <i>Spot assets</i> | <i>Spot liabilities</i> | <i>Forward purchases</i> | <i>Forward sales</i> | <i>Net options position</i> | <i>Net long (or net short) position</i> |
|--------------------------|-----------------------|-------------------------|--------------------------|----------------------|-----------------------------|---|
| Chinese renminbi | 663,211,732 | (661,518,384) | | - | - | 1,693,348 |
| Hong Kong dollars | 7,755,687,117 | (7,756,151,685) | | - | - | (464,568) |
| US dollars | 3,096,647,467 | (3,096,114,042) | | - | - | 533,425 |
| Other foreign currencies | 55,353,103 | (55,322,925) | 417,116,611 | (417,116,611) | - | 30,178 |
| | <u>11,570,899,419</u> | <u>(11,569,107,036)</u> | <u>417,116,611</u> | <u>(417,116,611)</u> | <u>-</u> | <u>1,792,383</u> |

Liquidity risk

Liquidity risk is the risk that the Branch is unable to meet its payment obligations as they fall due. It is the Bank's policy to maintain a strong liquidity position by properly managing the liquidity structure of its assets, liabilities and commitments so that cash flows are appropriately balanced and all funding obligations are comfortably met.

The Bank has established policies and procedures to monitor and control its liquidity position on a daily basis by adopting a cash flow management approach. The liquidity management process is monitored by the local management and oversight by the ALCO of Head Office and is reported to the Executive Committee and the Board of Directors.

Besides, the Branch prepares and monitors daily liquidity ratio in order to comply with the liquidity rule based on notice no. 002/2013-AMCM.

The daily amount of cash in hand and in banks shall not be less than the sum of the following percentages calculated on the average of the basic liabilities classified by terms and assessed in the preceding week:

- (i) 3% of liabilities at sight;
- (ii) 2% of liabilities up to three months excluding liabilities at sight; and
- (iii) 1% of liabilities beyond three months.

The daily amount of the balances of the current accounts in MOP with the AMCM in the name of the Branch shall not be less than 70% of the minimum amount of cash in hand.

| During the annual reporting period of 2014: | |
|---|-------------------|
| The arithmetic mean of the minimum weekly amount of cash in hand that is required to be held | MOP 69,053,869 |
| The arithmetic mean of the average weekly amount of cash in hand | MOP 794,407,847 |
| The arithmetic mean of the specified liquid assets at the end of each month | MOP 1,270,624,947 |
| The average ratio of specified liquid asset to total basic liabilities at the end of each month | 46% |
| The arithmetic mean of one-month liquidity ratio in the last week of each month | 98% |
| The arithmetic mean of three-month liquidity ratio in the last week of each month | 95% |

List of the shareholders with qualifying holdings

Hang Seng Bank Limited

Substantial Interests In Share Capital

The register maintained by the Bank pursuant to the Securities and Futures Ordinance (“SFO”) recorded that, as at 31 December 2014, the following corporations had interests or short positions in the shares or underlying shares (as defined in the SFO) in the Bank set opposite their respective names:

| <u>Name of Corporation</u> | <u>Number of Ordinary Shares in the Bank (Percentage of total)</u> |
|---|--|
| The Hongkong and Shanghai Banking Corporation Limited | 1,188,057,371 (62.14%) |
| HSBC Asia Holdings BV | 1,188,057,371 (62.14%) |
| HSBC Asia Holdings (UK) Limited | 1,188,057,371 (62.14%) |
| HSBC Holdings BV | 1,188,057,371 (62.14%) |
| HSBC Finance (Netherlands) | 1,188,057,371 (62.14%) |
| HSBC Holdings plc | 1,188,057,371 (62.14%) |

The Hongkong and Shanghai Banking Corporation Limited is a wholly-owned subsidiary of HSBC Asia Holdings BV, which is a wholly-owned subsidiary of HSBC Asia Holdings (UK) Limited, which in turn is a wholly-owned subsidiary of HSBC Holdings BV. HSBC Holdings BV is a wholly-owned subsidiary of HSBC Finance (Netherlands), which in turn is a wholly-owned subsidiary of HSBC Holdings plc. Accordingly, The Hongkong and Shanghai Banking Corporation Limited's interests are recorded as the interests of HSBC Asia Holdings BV, HSBC Asia Holdings (UK) Limited, HSBC Holdings BV, HSBC Finance (Netherlands) and HSBC Holdings plc.

The Directors regard HSBC Holdings plc to be the beneficial owner of 1,188,057,371 ordinary shares in the Bank, representing 62.14% of the Bank's share capital.

All the interests stated above represent long positions. As at 31 December 2014, no short positions were recorded in the Register of Interests in Shares and Short Positions required to be kept under section 336 of the SFO.

Names of the members of the company boards

Hang Seng Bank Limited

List of Directors

The members of the board of Directors of Hang Seng Bank Limited are set out below.

Independent Non-executive Chairman

Raymond CH'EN Kuo Fung

Executive Directors

Rose LEE Wai Mun (*Vice-Chairman and Chief Executive*)

Andrew FUNG Hau Chung

Nixon CHAN Lik Sang

Non-executive Directors

Sarah Catherine LEGG

Vincent LO Hong Sui

Kenneth NG Sing Yip

Peter WONG Tung Shun

Independent Non-executive Directors

John CHAN Cho Chak

Henry CHENG Kar Shun

CHIANG Lai Yuen

HU Zulu, Fred

Irene LEE Yun Lien

Eric LI Ka Cheung

Richard TANG Yat Sun

Michael WU Wei Kuo

Consolidated capital ratios

Hang Seng Bank Limited

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

The Bank uses the advanced internal ratings-based approach (“IRB”) to calculate its credit risk for the majority of its non-securitisation exposures. For market risk, the Group uses an internal models approach to calculate its general market risk for the risk categories of interest rate and foreign exchange (including gold bullion) exposures and the standardised (market risk) approach for calculating other market risk positions. For operational risk, the Group uses the standardised (operational risk) approach to calculate its operational risk.

Consolidated capital ratios (continued)

Capital structure

(Figures in HK\$ million)

Common Equity Tier 1 (“CET1”) Capital

| | 2014 |
|---|---------------|
| Shareholders' equity | 120,407 |
| - Shareholders' equity per balance sheet | 139,193 |
| - Additional Tier 1 (“AT1”) perpetual capital instrument | (6,981) |
| - Unconsolidated subsidiaries | (11,805) |
| Regulatory deductions to CET1 capital | (47,201) |
| - Cash flow hedging reserve | - |
| - Changes in own credit risk on fair valued liabilities | (4) |
| - Property revaluation reserves* | (21,784) |
| - Regulatory reserve | (6,229) |
| - Intangible assets | (417) |
| - Defined benefit pension fund assets | (35) |
| - Deferred tax assets net of deferred tax liabilities | (80) |
| - Valuation adjustments | (325) |
| - Significant capital investments in unconsolidated financial sector entities | (8,436) |
| - Excess AT1 deductions | (9,891) |
| Total CET1 Capital | 73,206 |

AT1 Capital

| | |
|---|----------------|
| Total AT1 capital before regulatory deductions | 6,981 |
| - Perpetual capital instrument | 6,981 |
| Regulatory deductions to AT1 capital | (6,981) |
| - Significant capital investments in unconsolidated financial sector entities | (16,872) |
| - Excess AT1 deductions | 9,891 |
| Total AT1 Capital | - |
| Total Tier 1 (“T1”) Capital | 73,206 |

Tier 2 (“T2”) Capital

| | |
|---|----------------|
| Total T2 capital before regulatory deductions | 17,733 |
| - Term subordinated debt | 5,117 |
| - Property revaluation reserves* | 9,803 |
| - Impairment allowances and regulatory reserve eligible for inclusion in T2 capital | 2,813 |
| Regulatory deductions to T2 capital | (17,187) |
| - Significant capital investments in unconsolidated financial sector entities | (17,187) |
| Total T2 Capital | 546 |
| Total Capital | 73,752 |
| Total reserves per balance sheet | 125,138 |

* Includes the revaluation surplus on investment properties which is reported as part of retained profits and related adjustments made in accordance with the Banking (Capital) Rules issued by the HKMA.

Consolidated capital ratios (continued)

(Figures in HK\$ million)

| | <u>2014</u> |
|-----------------------------|----------------|
| Risk-weighted assets | 470,167 |
| Capital ratios | |
| CET1 capital ratio | 15.6% |
| Tier 1 capital ratio | 15.6% |
| Total capital ratio | 15.7% |

Consolidated assets, liabilities and profits positions

Hang Seng Bank Limited

(Figures in HK\$ million)

| | 2014 |
|--|-------------|
| Total assets | 1,263,990 |
| Total liabilities | 1,124,797 |
| Total loans and advances | 658,431 |
| Total customer deposits including current, savings and other deposit accounts and certificates of deposit and other debt securities in issue | 956,520 |
| Pre-tax profit | 18,049 |