

The Hongkong and Shanghai Banking Corporation Limited
New Zealand Banking Group

Disclosure Statement

31 December 2016

HSBC 

Disclosure Statement

For the Year Ended 31 December 2016

Contents	Page
General Disclosures	2
Conditions of Registration	7
Historical Summary of Financial Statements	11
Financial Statements	12
Notes to and forming part of the Financial Statements	17
Directors' and New Zealand Chief Executive Officer's Statements	73
Independent Auditor's Audit Report	74

General Disclosures

Registered Bank

The Hongkong and Shanghai Banking Corporation Limited (“HBAP”)
1 Queen's Road Central
Hong Kong SAR

HBAP was incorporated in Hong Kong in 1866 under the Laws of Hong Kong.

New Zealand Branch

The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch (“Branch”) is defined as the New Zealand business of HBAP (overseas incorporated bank).

New Zealand Head Office:

1 Queen Street
Auckland
New Zealand

New Zealand Banking Group

The New Zealand Banking Group (“Banking Group”) is the New Zealand operations of HBAP and all New Zealand incorporated subsidiaries of HBAP. The entities that have been considered for aggregation to form the Banking Group are detailed in the Notes to the Financial Statements, Note 1: Statement of Accounting Policies.

Overseas Banking Group

The Overseas Banking Group (“HBAP Group”) includes all entities consolidated for the purposes of public reporting of Group financial statements in Hong Kong including HBAP and its subsidiaries and associated companies.

Ultimate Holding Company

The ultimate holding company of HBAP is:

HSBC Holdings plc
8 Canada Square
London E14 5HQ
United Kingdom

Access to parental disclosures

The most recent publicly available financial statements of HBAP Group and HSBC Holdings plc (“Group”) can be found at HSBC Holdings plc’s website, www.hsbc.com/investor-relations.

Ranking of Local Creditors in a Winding-up

Under Section 265(1) (db) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance of the Hong Kong SAR, as amended in 2010, which HBAP is subject to, in the event of a winding up of HBAP, there shall be paid in priority to all other unsecured debts the aggregate amount held on deposit, up to a maximum of HKD 500,000, to each depositor and this Section has no geographic limitation. No other material legislative or regulatory restrictions in Hong Kong SAR exist which would subordinate the claims of any class of New Zealand branch unsecured creditors on the assets of HBAP to those of any other class of unsecured creditors of HBAP in a winding up of HBAP.

Guarantee Arrangements

No material obligations of HBAP that relate to the Branch are guaranteed as at the date of signing this Disclosure Statement.

Government Guarantee

No obligations of HBAP that relate to the Branch are guaranteed under a government guarantee as at the date of signing this Disclosure Statement.

General Disclosures *(continued)*

Other Material Matters

There are no material matters that, if disclosed, would adversely affect the decision of a person to subscribe for Debt Securities of which HBAP and the Banking Group is the issuer.

Pending Proceedings and Arbitration

HBAP is named in and is defending legal actions in various jurisdictions arising from its normal business.

Auditor

New Zealand Banking Group
PricewaterhouseCoopers
PricewaterhouseCoopers Tower
188 Quay Street
Auckland
New Zealand

Overseas Banking Group
PricewaterhouseCoopers
22nd floor
Prince's Building
10 Chater Road
Hong Kong SAR

New Zealand Chief Executive Officer/Responsible Person

The New Zealand Chief Executive Officer, Christopher David Gosse Russell, has been authorised in writing by each Director named below, in accordance with section 82 of the Reserve Bank of New Zealand Act 1989, to sign this Disclosure Statement on the Directors' behalf. Accordingly, Christopher David Gosse Russell is a Responsible Person under the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended) (the "Order").

Christopher David Gosse Russell

Chief Executive Officer New Zealand Branch. Joined the HSBC Group in 2005 and resides in New Zealand. He has a Master of Business Administration from the University of South Australia.

Communications addressed to the responsible person may be sent to:
c/o The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch
PO Box 5947
Wellesley Street
Auckland 1141
New Zealand

Dealings with Responsible Person

No dealings with any Responsible Person or Director, the immediate relative or professional associate of a Responsible Person or Director, have been entered into by HBAP and the Banking Group other than those given in the ordinary course of business.

Board of Directors of HBAP

The Directors of HBAP at the time this Disclosure Statement was signed are:

* **Stuart Thomson Gulliver** (Chairman)

Masters Degree in Jurisprudence, Worcester College, Oxford University, 1980
Executive Director and Group Chief Executive, HSBC Holdings plc

Peter Tung Shun Wong (Deputy Chairman and Chief Executive)

Bachelor of Arts, Indiana University, 1974; Master of Business Administration, Indiana University, 1976
Master of Science, Indiana University, 1979

Laura May Lung Cha, GBS (Deputy Chairman)

Bachelor of Arts, University of Wisconsin-Madison, 1972; Juris Doctor, University of Santa Clara Law School, 1982; and admitted to practice in the State of California and in Federal Courts, 1983
Company Director

General Disclosures *(continued)*

Board of Directors of HBAP *(continued)*

**** Zia Mody** (Deputy Chairman)

Master of Laws, Harvard University, 1979; Bachelor of Arts (Law), Cambridge University, 1978
Partner, AZB & Partners

**** Graham John Bradley**

Bachelor of Arts, LLB (Hons I) from Sydney University, 1971
LLM, Harvard University, 1973
Company Director

Dr Christopher Wai Chee Cheng, GBS, OBE

Bachelor of Business Administration, University of Notre Dame, 1969; Master of Business Administration, Columbia University, 1979; Doctorate in Social Sciences honoris causa, The University of Hong Kong, 2011
Chairman, Wing Tai Properties Limited

Dr Raymond Kuo Fung Ch'ien, GBS, CBE

Bachelor of Arts, Rockford College, 1973; Master of Arts and Doctor of Philosophy (Economics), University of Pennsylvania, 1976 and 1978
Independent Non-executive Chairman, Hang Seng Bank Limited

Irene Yun-lien Lee

Bachelor of Arts (Distinction) in History of Art from Smith College, Northampton, Massachusetts, USA, 1974
Member of Honourable Society of Gray's Inn, UK, 1977
Barrister-at-Law in England and Wales, 1977
Chairman, Hysan Development Company Limited

Rose Wai Mun Lee

Bachelor of Business Administration, University of Hawaii, 1977
Vice-Chairman and Chief Executive, Hang Seng Bank Limited

**** Jennifer Xinzhe Li**

Master of Business Administration, The University of British Columbia, Vancouver, Canada, 1994
Bachelor of Arts, Tsinghua University, Beijing, China, 1990
Chief Financial Officer, Baidu, Inc.

^ Victor Tzar Kuoi Li

B.Sc. and M.Sc., Stanford University, 1986
Managing Director and Deputy Chairman of Cheung Kong Property Holdings Limited, and
Group Co-Managing Director and Deputy Chairman of CK Hutchison Holdings Limited

John Robert Slosar

Bachelor degree in Economics from Columbia University, 1978
Bachelor degree in Economics, subsequently M.A. from University of Cambridge, 1980
Chairman, John Swire & Sons (H.K.) Limited

Kevin Anthony Westley

Bachelor of Arts, University of London, 1970; Chartered Accountant, Institute of Chartered Accountants in England and Wales, 1973
Company Director

Dr Rosanna Yick-Ming Wong, DBE

B.Soc.Sc, University of Hong Kong 1975; MSW, University of Toronto 1979; M.Sc. in Social Policy and Planning, London School of Economics and Political Science, University of London 1983; Diploma in Executive Management, Chinese University of Hong Kong 1985; M.A. and Doctor Degree in Sociology, University of California, Davis 1993 and 1997
Executive Director, The Hong Kong Federation of Youth Groups

General Disclosures *(continued)*

Board of Directors of HBAP *(continued)*

Marjorie Mun Tak Yang, GBS

B.Sc. in Mathematics, Massachusetts Institute of Technology, 1974; and Master of Business Administration, Harvard Business School, 1976

Chairman, Esquel Holdings Inc.

**** Tan Sri Dr Francis Sock Ping Yeoh, CBE**

Bachelor of Science (Hons.) in Civil Engineering, University of Kingston, UK, 1978; Honorary Doctorate of Engineering from University of Kingston, 2004

Managing Director, YTL Corporation Berhad

independent non-executive Director

^ non-executive Director

Country of Residence

With the exception of those denoted with an *, all directors reside in Hong Kong. Stuart Thomson Gulliver resides in the United Kingdom, Zia Mody resides in India, Graham John Bradley resides in Australia, Tan Sri Dr Francis Yeoh Sock Ping resides in Malaysia and Xinzhe Li Jennifer resides in China.

Communications addressed to the Directors may be sent to:
c/o The Hongkong and Shanghai Banking Corporation Limited
GPO Box 64
Hong Kong

Change in Board of Directors for HBAP

Peter James Holland Riley retired as an independent non-executive Director of HBAP on 18 April 2016.

Kevin Anthony Westley was appointed as an independent non-executive Director of HBAP on 01 September 2016.

There have been no other changes in the composition of the Board of Directors since 31 December 2015.

Directors' Policy on Conflicts of Interests

Regulation 100(h) of HBAP's Articles of Association states:

“The office of a Director shall automatically be vacated if the Director acts in contravention of the Company's conflicts of interest policy adopted by the Board from time to time and the Board has resolved that his or her office be vacated.”

Directors' Interests in Contracts

No transactions, arrangements or contracts that were significant in relation to HBAP's business and in which a Director or his or her connected entities had, directly or indirectly, a material interest were entered into by or subsisted with the HBAP's holding companies, its subsidiaries or any fellow subsidiaries during the year.

General Disclosures *(continued)*

Audit Committee

The Banking Group does not have an Audit Committee. The Audit Committee of HBAP, comprising four independent Directors, meets regularly with the Group's senior management and the external auditors to consider and review the Group's financial statements, the nature and scope of audit reviews and the effectiveness of the systems of internal control and compliance. The members of the Audit Committee are Kevin Anthony Westley (Chairman of the Committee), Graham John Bradley, Irene Lee Yun-lien and Xinzhe Jennifer Li.

Credit Rating

HBAP has the following long term debt ratings for non-HK\$ long-term senior unsecured obligations which are payable in New Zealand in New Zealand dollars:

	Current Rating	Previous Rating (if changed in the previous two years)	Date of Change
Moody's Investor Service Inc.	Aa2 (negative outlook)	Aa2 (stable outlook)	17 March 2016
Standard & Poor's Corporation	AA- (stable outlook)	Not changed	-
Fitch IBCA Inc.	AA- (stable outlook)	Not changed	-

Rating scales are:

Credit Ratings	Moody's (a)	S&P (b)	Fitch (b)
Highest quality/Extremely strong capacity to pay interest and principal	Aaa	AAA	AAA
High quality/Very strong	Aa	AA	AA
Upper medium grade/Strong	A	A	A
Medium grade (lowest investment grade)/Adequate	Baa	BBB	BBB
Predominantly speculative/Less near term vulnerability to default	Ba	BB	BB
Speculative, low grade/Great vulnerability	B	B	B
Poor to default/identifiable vulnerability	Caa	CCC	CCC
Highest speculations	Ca	CC	CC
Lowest quality, no interest	C	C	C
Defaulted on obligations		D	D

(a) Moody's - A numeric modifier is applied to each generic rating category from Aa to B, indicating that the counterparty is (1) in the higher end of its letter-rating category, (2) in mid-range, (3) in lower end.

(b) Standard & Poor's and Fitch – Ratings are modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

Conditions of Registration

Conditions of registration for The Hongkong and Shanghai Banking Corporation Limited in New Zealand

These conditions of registration apply on and after 1 October 2016.

The registration of The Hongkong and Shanghai Banking Corporation Limited (“the registered bank”) in New Zealand is subject to the following conditions:

1. That the banking group does not conduct any non-financial activities that in aggregate are material relative to its total activities.

In this condition of registration, the meaning of “material” is based on generally accepted accounting practice.

2. That the banking group’s insurance business is not greater than 1% of its total consolidated assets.

For the purposes of this condition of registration, the banking group’s insurance business is the sum of the following amounts for entities in the banking group:

- (a) if the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the group headed by the entity; and
- (b) if the entity conducts insurance business and its business does not predominantly consist of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total liabilities relating to the entity’s insurance business plus the equity retained by the entity to meet the solvency or financial soundness needs of its insurance business.

In determining the total amount of the banking group’s insurance business –

- (a) all amounts must relate to on balance sheet items only, and must comply with generally accepted accounting practice; and
- (b) if products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets must be considered part of the insurance business.

For the purposes of this condition of registration, –

“insurance business” means the undertaking or assumption of liability as an insurer under a contract of insurance:

“insurer” and “contract of insurance” have the same meaning as provided in sections 6 and 7 of the Insurance (Prudential Supervision) Act 2010.

3. That the business of the registered bank in New Zealand does not constitute a predominant proportion of the total business of the registered bank.
4. That no appointment to the position of the New Zealand chief executive officer of the registered bank shall be made unless:
 - (i) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
 - (ii) the Reserve Bank has advised that it has no objection to that appointment.

Conditions of Registration *(continued)*

5. That The Hongkong and Shanghai Banking Corporation Limited complies with the requirements imposed on it by the Hong Kong Monetary Authority.
6. That, with reference to the following table, each capital adequacy ratio of The Hongkong and Shanghai Banking Corporation Limited must be equal to or greater than the applicable minimum requirement.

Capital adequacy ratio	Minimum requirement on and after 1 January 2015
Common Equity Tier 1 capital	4.5 %
Tier 1 capital	6 %
Total capital	8 %

For the purposes of this condition of registration, the capital adequacy ratios –

- (a) must be calculated as a percentage of the registered bank's risk weighted assets; and
 - (b) are otherwise as administered by the Hong Kong Monetary Authority.
7. That liabilities of the registered bank in New Zealand, net of amounts due to related parties (including amounts due to a subsidiary or affiliate of the registered bank), do not exceed NZ\$15 billion.
 8. That, for a loan-to-valuation measurement period, the total of the business of the registered bank in New Zealand's qualifying new mortgage lending amount in respect of property-investment residential mortgage loans with a loan-to-valuation ratio of more than 60%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of property-investment residential mortgage loans arising in the loan-to-valuation measurement period.
 9. That, for a loan-to-valuation measurement period, the total of the business of the registered bank in New Zealand's qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans with a loan-to-valuation ratio of more than 80%, must not exceed 10% of the total of the qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans arising in the loan-to-valuation measurement period.
 10. That the business of the registered bank in New Zealand must not make a residential mortgage loan unless the terms and conditions of the loan contract or the terms and conditions for an associated mortgage require that a borrower obtain the registered bank's agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.

Conditions of Registration *(continued)*

In these conditions of registration, –

“banking group” means the New Zealand business of the registered bank and its subsidiaries as required to be reported in group financial statements for the group’s New Zealand business under section 461B(2) of the Financial Markets Conduct Act 2013.

“business of the registered bank in New Zealand” means the New Zealand business of the registered bank as defined in the requirement for financial statements for New Zealand business in section 461B(1) of the Financial Markets Conduct Act 2013.

“generally accepted accounting practice” has the same meaning as in section 8 of the Financial Reporting Act 2013.

“liabilities of the registered bank in New Zealand” means the liabilities that the registered bank would be required to report in financial statements for its New Zealand business if section 461B(1) of the Financial Markets Conduct Act 2013 applied.

In conditions of registration 8 to 10,—

“loan-to-valuation ratio”, “non property-investment residential mortgage loans”, “property-investment residential mortgage loans”, “qualifying new mortgage lending amount in respect of property-investment residential mortgage loans”, “qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans”, and “residential mortgage loan” have the same meaning as in the Reserve Bank of New Zealand document entitled “Framework for Restrictions on High-LVR Residential Mortgage Lending ” (BS19) dated October 2016, and where the version of the Reserve Bank of New Zealand document “Capital Adequacy Framework (Standardised Approach)” (BS2A) referred to in BS19 for the purpose of defining these terms is that dated November 2015.

“loan-to-valuation measurement period” means a period of six calendar months ending on the last day of the sixth calendar month, the first of which ends on the last day of March 2017.

Changes to Conditions of Registration since the 30 September 2016 Disclosure Statement

Clauses 8 to 10 of the Conditions of the Registration were amended on 1 October 2016 to modify loan-to-value ratio requirements specific to certain loan characteristics.

CONTENTS

Historical Summary of Financial Statements	11
Statement of Comprehensive Income.....	12
Statement of Changes in Equity	13
Statement of Financial Position.....	14
Statement of Cash Flows.....	15
1. Statement of Accounting Policies	17
2. Risk Management.....	32
3. Operating income	40
4. Operating expenses	41
5. Loan impairment charges	42
6. Segment reporting	42
7. Taxation	44
8. Additional financial disclosures on the statement of financial position	45
9. Debt and equity securities	45
10. Derivative financial instruments	45
11. Advances to customers.....	46
12. Other assets	46
13. Goodwill and intangible assets.....	47
14. Asset quality of advances to customers.....	50
15. Customer deposits	51
16. Debt securities.....	51
17. Other liabilities.....	51
18. Related party transactions	52
19. Fair value of financial instruments.....	54
20. Concentrations of credit and funding risk	57
21. Interest rate risk – repricing schedule.....	60
22. Liquidity risk management.....	61
23. Offsetting financial assets and financial liabilities	65
24. Foreign currency risk exposure	65
25. Additional mortgage information	66
26. Market risk exposures	66
27. Share options.....	67
28. Lease commitments.....	69
29. Contingent liabilities and other commitments.....	70
30. Custodial services, funds management and other fiduciary activities	70
31. Structured entities and marketing and distribution of insurance products.....	70
32. Insurance and non-financial activities.....	71
33. Subsequent event.....	71
34. Capital adequacy ratios of HBAP Group	71
35. Profitability, size and asset quality of HBAP Group.....	72
Directors' and New Zealand Chief Executive Officer's Statements	73

HISTORICAL SUMMARY OF FINANCIAL STATEMENTS**FIVE YEAR COMPARISON**

<i>Dollars in Thousands</i>	<i>Banking Group</i>				
		Audited			
	2016	Year ended 31 December			
		2015	2014	2013	2012
Summary of Financial Results					
Interest income	174,238	230,879	206,493	188,494	203,549
Interest expense	(93,279)	(135,843)	(116,554)	(109,506)	(115,302)
Net interest income	80,959	95,036	89,939	78,988	88,247
Net trading income	8,552	14,704	8,650	17,912	9,140
Other net operating income	34,654	36,632	34,725	39,239	35,419
Net operating income before loan impairment charges	124,165	146,372	133,314	136,139	132,806
Loan impairment (charges) / releases	1,429	35,140	18,046	(42,690)	(17,596)
Net operating income	125,594	181,512	151,360	93,449	115,210
Operating expenses	(61,205)	(63,841)	(58,926)	(58,483)	(58,628)
Operating profit before tax	64,389	117,671	92,434	34,966	56,582
Income tax expense	(18,081)	(33,032)	(25,978)	(9,899)	(15,983)
Profit after tax	46,308	84,639	66,456	25,067	40,599
Head Office Account brought forward	53,793	41,739	(3,691)	13,503	15,392
Retained profit repatriated	(77,290)	(72,585)	(21,026)	(42,261)	(42,488)
Head Office Account carried forward	22,811	53,793	41,739	(3,691)	13,503
Statement of Financial Position					
Total assets	5,086,021	5,591,088	5,308,720	5,155,681	5,045,975
<i>of which: Individually impaired assets</i>	2,833	3,503	121,913	141,964	65,217
Total Liabilities	5,060,948	5,536,733	5,264,771	5,155,380	5,030,627
Total Equity	25,073	54,355	43,949	301	15,348
Head Office Account	22,811	53,793	41,739	(3,691)	13,503

The amounts included in this historical summary have been taken from the audited financial statements of the Banking Group.

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016

<i>Dollars in Thousands</i>	Note	<i>Banking Group</i>	
		<u>12 months ended</u>	
		31.12.16	31.12.15
Interest income	3	174,238	230,879
Interest expense	3	(93,279)	(135,843)
Net interest income		80,959	95,036
Net trading income	3	8,552	14,704
Other net operating income	3	34,654	36,632
Net operating income before loan impairment charges		124,165	146,372
Loan impairment (charges) / releases	5	1,429	35,140
Net operating income		125,594	181,512
Operating expenses	4	(61,205)	(63,841)
Operating profit before tax		64,389	117,671
Income tax expense	7	(18,081)	(33,032)
Profit after tax		46,308	84,639
Other comprehensive income / (expense)			
Items that may be reclassified subsequently to profit or loss:			
Gains / (losses) on cashflow hedges		2,214	(2,357)
Income taxes on cashflow hedges		(619)	659
Gains / (losses) on available-for-sale financial assets		218	51
Income taxes on available-for-sale financial assets		(116)	(15)
Other comprehensive income / (expense) for the year		1,697	(1,662)
Total comprehensive income for the year		48,005	82,977

The accompanying notes form part of and should be read in conjunction with these financial statements.

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016

<i>Dollars in Thousands</i>	<i>Banking Group</i>	
	12 months ended	
	31.12.16	31.12.15
Head Office Account *		
At beginning of the year	53,793	41,739
Repatriation to Head Office	(77,290)	(72,585)
Profit after tax	46,308	84,639
At end of the year	<u>22,811</u>	<u>53,793</u>
Cashflow Hedging Reserve		
At beginning of the year	(1,595)	103
Fair value changes taken to equity	109	(3,137)
Transferred to the income statement	2,105	780
Tax on movements and transfers	(619)	659
At end of the year	<u>-</u>	<u>(1,595)</u>
Available-for-Sale Reserve		
At beginning of the period	521	485
Fair value changes taken to equity	(2,070)	4,160
Transferred to the income statement	2,288	(4,109)
Tax on movements and transfers	(116)	(15)
At end of the year	<u>623</u>	<u>521</u>
Share-based Payment Reserve		
At beginning of the year	1,636	1,622
Transferred to the income statement	171	243
Movement in share-based payment arrangements	(168)	(229)
At end of the year	<u>1,639</u>	<u>1,636</u>
Equity at end of the year	<u>25,073</u>	<u>54,355</u>
Represented by:		
Profit after tax	46,308	84,639
Other comprehensive income	1,697	(1,662)
Total comprehensive income for the year	<u>48,005</u>	<u>82,977</u>
Repatriation to Head Office	(77,290)	(72,585)
Movement in share-based payment reserve	3	14
Equity at beginning of the year	<u>54,355</u>	<u>43,949</u>
	<u>25,073</u>	<u>54,355</u>

* The Head Office account is interest free, repayable at the discretion of the Branch and subordinated to all other debts.

The accompanying notes form part of and should be read in conjunction with these financial statements.

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016

		<i>Banking Group</i>	
<i>Dollars in Thousands</i>	Note	31.12.16	31.12.15
ASSETS			
Cash and demand balances with central banks		597,763	345,799
Advances to banks		8,504	7,601
Debt and equity securities	9	486,972	447,445
Derivative financial instruments	10	161,666	313,918
Advances to customers	11	3,446,783	3,585,997
Amounts due from related parties	18	345,903	854,687
Other assets	12	21,725	18,288
Property, plant and equipment		1,681	997
Goodwill and intangible assets	13	15,024	16,356
Total Assets		5,086,021	5,591,088
LIABILITIES			
Deposits by banks		232,174	185,925
Derivative financial instruments	10	164,101	314,362
Customer deposits	15	3,118,202	3,252,094
Debt securities	16	331,267	843,716
Amounts due to related parties	18	1,173,161	896,759
Other liabilities	17	39,233	36,430
Current tax liabilities		2,726	6,871
Deferred tax liability	7	84	576
Total Liabilities		5,060,948	5,536,733
Net Assets		25,073	54,355
EQUITY			
Head Office Account		22,811	53,793
Cashflow Hedging Reserve		-	(1,595)
Available-for-Sale Reserve		623	521
Share-based Payment Reserve		1,639	1,636
Total Equity		25,073	54,355

The accompanying notes form part of and should be read in conjunction with these financial statements.



Director: Stuart T Gulliver
Date: 27 March 2017



Director: Peter T S Wong
Date: 27 March 2017

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2016

<i>Dollars in Thousands</i>	<i>Banking Group</i>	
	12 months ended	
	31.12.16	31.12.15
<i>Cash flows from / (to) operating activities</i>		
Interest received	176,568	233,150
Fees and commissions	35,493	32,836
Realised trading gain	15,729	20,144
Interest paid	(91,467)	(125,255)
Operating expenses	(60,438)	(60,776)
Taxation paid	(23,455)	(25,003)
Net cash flows from operating activities before changes in operating assets and liabilities	52,430	75,096
Changes in operating assets and liabilities arising from cash flow movements		
Cash was provided net from / applied net (to):		
Advances to customers	143,221	228,946
Amounts due from related parties	508,765	(487,168)
Other assets	(5,123)	(1,185)
Other liabilities	5,075	326
Debt securities issued / (repaid)	(518,981)	89,785
Deposits by banks	45,836	4,332
Customer deposits	(133,892)	71,160
Amounts due to related parties	278,619	(28,357)
Net change in operating assets and liabilities	323,520	(122,161)
Net cash flows from / (to) operating activities	375,950	(47,065)
<i>Cash flows from / (to) investing activities</i>		
Debt securities purchased	(508,199)	(792,697)
Debt securities matured	463,400	842,676
Proceeds from sale of property, plant and equipment	27	-
Acquisition of property, plant and equipment	(1,145)	(698)
Net cash flows to investing activities	(45,917)	49,281
<i>Cash flows to financing activities</i>		
Repatriation to head office	(77,290)	(72,585)
Net cash flows to financing activities	(77,290)	(72,585)
Net increase / (decrease) in cash and cash equivalents	252,743	(70,369)
Effect of exchange rate fluctuations on cash held	(289)	(2,049)
Cash and cash equivalents at beginning of year	352,949	425,367
Cash and cash equivalents at end of year	605,403	352,949

The accompanying notes form part of and should be read in conjunction with these financial statements.

STATEMENT OF CASH FLOWS *(continued)* FOR THE YEAR ENDED 31 DECEMBER 2016

	<i>Banking Group</i>	
	12 months ended	
<i>Dollars in Thousands</i>	31.12.16	31.12.15
<i>Analysis of cash and cash equivalents</i>		
Cash and demand balances with central banks	597,763	345,799
Items in the course of collection from other banks ¹	5	11
Advances to banks – demand	8,499	7,590
Less: items in the course of transmission to other banks ¹	(864)	(451)
	605,403	352,949
 ¹ <i>Items in the course of collection from / to other banks are presented on the balance sheet within Advances to banks and Deposits by banks respectively.</i>		
<i>Reconciliation of profit after tax to net cash flows from operating activities</i>		
Profit after tax	46,308	84,639
<i>Adjustments to reconcile profit after tax to net cash flow from operating activities:</i>		
Change in interest accruals	(5,593)	(409)
Change in fair value of derivative s	6,784	5,296
Depreciation of property, plant and equipment	446	462
Amortisation of intangible asset	1,332	1,745
Amortisation of premium and discounts	9,735	15,501
Change in deferred income and accrued expense	231	(3,201)
Amortisation of share options granted	-	196
(Release) / impairment charge on loans and advances	(1,429)	(35,140)
Discount unwinding on impaired loans and advances	-	(2,233)
(Gain)/ loss on disposal of debt securities	1	-
(Gain) / loss on disposal of property, plant and equipment	(12)	210
Change in current and deferred taxation	(5,373)	8,030
Adjust operating cash flows not included in profit after tax:		
Net change in operating assets and liabilities	323,520	(122,161)
Net cash flows from operating activities	375,950	(47,065)

The accompanying notes form part of and should be read in conjunction with these financial statements.

Notes to and forming part of the Financial Statements

1. Statement of Accounting Policies

GENERAL ACCOUNTING POLICIES

Reporting Entity

These financial statements are for The Hongkong and Shanghai Banking Corporation Limited, New Zealand Banking Group (“Banking Group”).

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the financial years presented, unless otherwise stated.

Intra-group balances are eliminated in preparing the Banking Group’s financial statements (if any). The following entities have been aggregated to form the Banking Group:

The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch

HSBC Nominees (New Zealand) Limited

This New Zealand incorporated entity is the Branch’s nominee company which provides custodian services. HSBC Nominees (New Zealand) Limited is wholly owned by HBAP. Income and expenses of the custodian services business are included in the Branch’s financial statements.

HSBC Investments New Zealand Limited

This New Zealand incorporated entity provided fund management services to customers and commenced trading operations in June 2008. HSBC Investments New Zealand Limited (“HINZ”) was wholly owned by HSBC Asia Pacific Holdings (UK) Limited which is wholly owned by HBAP. The Unit Trusts for which HINZ has acted as Manager were closed on 31 October 2014. As a result, HINZ ceased trading and was struck off on 17 February 2016. This has had no material impact on the Banking Group’s financial statements.

Non-controlled Structured Entities

A structured entity (“SE”) is consolidated when the Banking Group is exposed, or has rights, to variable returns from its involvement with the SE and has the power to affect those returns.

Basis of Reporting

These financial statements are general purpose financial statements prepared in accordance with the requirements of the Financial Markets Conduct Act 2013, the Reserve Bank of New Zealand Act 1989 and the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended) (the “Order”).

These financial statements comply with Generally Accepted Accounting Practice in New Zealand, applicable New Zealand equivalents to International Financial Reporting Standards (“NZ IFRS”) and other authoritative pronouncements of the External Reporting Board, as appropriate for profit-oriented entities. These financial statements also comply with International Financial Reporting Standards, as issued by the International Accounting Standards Board.

Measurement Base

These financial statements are based on the general principles of historical cost accounting, as modified by applying fair value accounting to available-for-sale financial assets, financial assets and financial liabilities at fair value through profit or loss and all financial derivative contracts. They are prepared on a going concern basis and the accrual basis of accounting has been adopted. The presentation currency and functional currency is New Zealand dollars. All amounts are rounded to thousands of New Zealand dollars and all references to “\$” is to New Zealand dollars unless otherwise stated.

Authorisation of financial statements

These financial statements were authorised for issue by the directors of The Hongkong and Shanghai Banking Corporation Limited on 27 March 2017.

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

Particular Accounting Policies

The External Reporting Board (“XRB”) has released a number of standards and amendments which are effective for annual periods beginning after 1 January 2016. These standards and amendments have not been adopted early and are excluded from application to these financial statements. Those which may be relevant to the Banking Group are set out below.

§ NZ IFRS 9 (2014) Financial Instruments

In September 2014, the XRB issued NZ IFRS 9 ‘Financial Instruments’, which is the comprehensive standard to replace NZ IAS 39 ‘Financial Instruments: Recognition and Measurement’, and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

Classification and measurement

The classification and measurement of financial assets will depend on the Banking Group’s business model and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income (‘FVOCI’) or fair value through profit or loss (‘FVPL’). The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of financial assets measured at amortised cost or fair value compared with NZ IAS 39. However, based on an assessment of financial assets performed to date and expectations around changes to balance sheet composition, the Banking Group expects that the overall impact of any change will not be significant.

For financial liabilities designated to be measured at fair value, gains or losses relating to changes in the entity’s own credit risk are to be included in other comprehensive income. The impact of this change is not expected to be significant.

Impairment

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, and lease receivables and certain loan commitments and financial guarantee contracts. At initial recognition, an impairment allowance (or provision in the case of commitments and guarantees) is required for expected credit losses (‘ECL’) resulting from default events that are possible within the next 12 months (‘12-month ECL’). In the event of a significant increase in credit risk, an allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument (‘lifetime ECL’). Financial assets where 12-month ECL is recognised are considered to be ‘stage 1’; financial assets which are considered to have experienced a significant increase in credit risk are in ‘stage 2’; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in ‘stage 3’.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under NZ IAS 39 and the resulting impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with NZ IAS 39.

Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks, but do not explicitly address macro hedge accounting strategies, which are particularly important for banks. As a result, NZ IFRS 9 includes an accounting policy choice to remain with NZ IAS 39 hedge accounting.

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

Hedge accounting (continued)

Based on the analysis performed to date, the Banking Group expects to exercise the accounting policy choice to continue NZ IAS 39 hedge accounting and therefore is not currently planning to change hedge accounting, although it will implement the revised hedge accounting disclosures required by the related amendments to NZ IFRS 7 'Financial Instruments: Disclosures'.

Transition

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The Banking Group does not intend to restate comparatives. The mandatory application date for the standard as a whole is 1 January 2018, but it is possible to apply the revised presentation for certain liabilities measured at fair value from an earlier date. The Banking Group is assessing the impact that the impairment requirements will have on the financial statements.

§ NZ IFRS 15 Revenue from contracts with Customers

In July 2014, the XRB issued NZ IFRS 15 'Revenue from Contracts with Customers'. The original effective date of NZ IFRS 15 has been delayed by one year and the standard is now effective for annual periods beginning on or after 1 January 2018 with early application permitted. NZ IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied. The standard should be applied retrospectively, with certain practical expedients available. The Banking Group has assessed the impact of NZ IFRS 15 and it expects that the standard will have no significant effect, when applied, on the financial statements of the Banking Group.

§ NZ IFRS 16 Leases

In January 2016, the XRB issued NZ IFRS 16 'Leases' with an effective date of annual periods beginning on or after 1 January 2019. NZ IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under NZ IAS 17 'Leases'. Lessees will recognise a 'right of use' asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as in NZ IAS 17. The Banking Group is currently assessing the impact of NZ IFRS 16 and it is not practicable to quantify the effect as at the date of the publication of these financial statements.

The Banking Group has also considered all other standards issued but not yet effective and determined that they will have no material impact on the financial statements.

Changes in Accounting Policies

There were no new standards, interpretations or amendments to standards applied during the year ended 31 December 2016 which had a significant effect on the Banking Group Financial Statements.

Accounting policies have not changed and are the same as those applied by the Banking Group in the Disclosure Statement for the year ended 31 December 2015.

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

Comparative Figures

These financial statements include comparative information as required by NZ IAS 1 and the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended).

From 1 January 2016 we have amended the format of the Statement of Comprehensive Income to include loan impairment charges in net operating income to align with the presentation used by HBAP Group and Group. This format has also been replicated in Note 6 Segment reporting. There has been no change to operating profit before tax.

Critical Accounting Estimates in Applying Accounting Policies

The results of the Banking Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of our consolidated financial statements. The principal accounting policies are described in the next section 'Principal Accounting Policies'.

In the opinion of management, all normal and recurring adjustments considered necessary for a fair presentation of the Banking Group's net income, financial position and cash flows have been made.

The accounting policies that are deemed critical to our results and financial position, in terms of the materiality of the items to which the policies are applied and the high degree of judgement involved, including the use of assumptions and estimation, are discussed below.

Loan impairment

Application of the Banking Group's methodology for assessing loan impairment, as set out in the Principal Accounting Policies, involves considerable judgement and estimation.

For individually assessed loans, judgement is required in determining whether there are indications that an impairment loss may already have been incurred and then estimating the amount and timing of expected cash flows, which form the basis of the impairment loss that is recorded.

For collectively assessed loans, judgement is involved in selecting and applying the criteria for grouping together loans with similar credit characteristics, as well as in selecting and applying the statistical and other models used to estimate the losses incurred for each group of loans in the reporting period. The benchmarking of loss rates, the assessment of the extent to which historical losses are representative of current conditions and the ongoing refinement of modelling methodologies provide a means of identifying changes that may be required, but the process is inherently one of estimation.

Valuation of financial instruments

The best evidence of fair value is a quoted price in an actively traded principal market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. Where a financial instrument has a quoted price in an active market, the fair value of the total holding of the financial instrument is calculated as the product of the number of units and quoted price. The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. Valuation techniques may incorporate assumptions about factors that other market participants would use in their valuations, including:

- the likelihood and expected timing of future cash flows on the instrument. Judgement may be required to assess the counterparty's ability to service the instrument in accordance with its contractual terms. Future cash flows may be sensitive to changes in market rates;
- selecting an appropriate discount rate for the instrument. Judgement is required to assess what a market participant would regard as the appropriate spread of the rate for an instrument over the appropriate risk-free rate;
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

Critical Accounting Estimates in Applying Accounting Policies *(continued)*

Valuation of financial instruments (continued)

A range of valuation techniques is employed, dependent on the instrument type and available market data. Most valuation techniques are based upon discounted cash flow analyses, in which expected future cash flows are calculated and discounted to present value using a discounting curve. Prior to considering credit risk, the expected future cash flows may be known, as would be the case for the fixed leg of an interest rate swap, or may be uncertain and require projection, as would be the case for the floating leg of an interest rate swap. 'Projection' utilises market forward curves, if available. In option models, the probability of different potential future outcomes must be considered. In addition, the value of some products are dependent on more than one market factor, and in these cases it will typically be necessary to consider how movements in one market factor may affect the other market factors. The model inputs necessary to perform such calculations include interest rate yield curves, exchange rates, volatilities, correlations, prepayment and default rates.

The majority of valuation techniques employ only observable market data. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them the measurement of fair value is more judgemental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's inception profit or greater than 5% of the instrument's valuation is driven by unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

The Banking Group's accounting policy for valuation of financial instruments is included in the Principal Accounting Policies.

Goodwill impairment

The review of goodwill for impairment reflects management's best estimate of the future cash flows of the cash-generating units ("CGUs") and the rates used to discount these cash flows, both of which are subject to uncertain factors as follows:

- the future cash flows of the CGUs are sensitive to the cash flows projected for the periods for which detailed forecasts are available and to assumptions regarding the long-term pattern of sustainable cash flows thereafter. Forecasts are compared with actual performance and verifiable economic data, but they reflect management's view of future business prospects at the time of the assessment; and
- the rates used to discount future expected cash flows can have a significant effect on their valuation and are based on the costs of capital assigned to individual CGUs. The cost of capital percentage is generally derived from a Capital Asset Pricing Model, which incorporates inputs reflecting a number of financial and economic variables, including the risk-free interest rate in the country concerned and a premium for the risk of the business being evaluated. These variables are subject to fluctuations in external market rates and economic conditions beyond management's control, are subject to uncertainty and require the exercise of significant judgement.

A decline in a CGU's expected cash flows and/or an increase in its cost of capital reduces the CGU's estimated recoverable amount. If this is lower than the carrying value of the CGU, a charge for impairment of goodwill is recognised in our income statement for the year.

The accuracy of forecast cash flows is subject to a high degree of uncertainty in volatile market conditions. In such market conditions, management retests goodwill for impairment more frequently than annually to ensure that the assumptions on which the cash flow forecasts are based continue to reflect current market conditions and management's best estimate of future business prospects.

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

PRINCIPAL ACCOUNTING POLICIES

Acceptances & Endorsements

Acceptances and endorsements of bills of exchange are financial instruments used to facilitate trade settlements on behalf of clients. The Banking Group is effectively providing a payment guarantee to a third party.

Acceptances and endorsements of bills of exchange are recognised in the Statement of Financial Position as both assets and liabilities. Both asset and liability are recorded at face value since settlement is within 6 months.

There is no asset impairment test required since clients are required to hold sufficient cash funds to support the underlying transaction.

Advances to Banks, Customers and Related Parties

These include loans and advances originated by the Banking Group which are not classified as either held for trading or designated at fair value. They are recognised when cash is advanced to a borrower and derecognised when either the borrower repays its obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment allowance.

Asset Impairment – Advances to Banks and Customers

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 that are calculated on individual loans and on groups of loans assessed collectively are recorded as charges to the income statement and are recorded against the carrying amount of impaired loans on the balance sheet. Losses which may arise from future events are not recognised.

Individually assessed accounts

The factors considered in determining whether a loan is individually significant for the purposes of assessing impairment include the size of the loan, the number of loans in the portfolio, and the importance of the individual loan relationship, and how this is managed.

Loans that are determined to be individually significant based on the above and other relevant factors will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective methodology.

Loans considered as individually significant are typically to corporate and commercial customers, are for larger amounts and are managed on an individual basis. For these loans, the Banking Group considers on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired. The criteria used to make this assessment include:

- known cash flow difficulties experienced by the borrower;
- 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 realisation;
- 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
- there has been deterioration in the financial condition or outlook of the borrower such that its ability to repay is considered doubtful

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

Asset Impairment – Advances to Banks and Customers *(continued)*

Individually assessed accounts (continued)

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

- the Banking Group's aggregate exposure to the customer;
- the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service 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 group and the likelihood of other creditors continuing to support the company;
- 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;
- the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and
- when available, the secondary market price of the debt.

The determination of the realisable value of security is based on the most recently updated market value at the time the impairment assessment is performed. The value is not adjusted for expected future changes in market prices; though adjustments are made to reflect conditions such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at the loan's original effective interest rate, or an approximation thereof, 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.

Collectively assessed loans and advances

Impairment is assessed collectively to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment or for homogeneous groups of loans that are not considered individually significant. Retail lending portfolios are generally assessed for impairment collectively as the portfolios are generally large homogeneous loan pools.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for a collective impairment assessment. These credit risk characteristics may include the type of business involved, type of products offered, security obtained or other relevant factors. This assessment captures impairment losses that the Banking Group has incurred as a result of events occurring before the balance sheet date, which the Banking Group is not able to identify on an individual loan basis, and that can be reliably estimated. When information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed individually.

The collective impairment allowance is determined after taking into account:

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

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

Asset Impairment – Advances to Banks and Customers *(continued)*

Collectively assessed loans and advances (continued)

Incurred but not yet identified impairment (continued)

The period between a loss occurring and its identification is estimated by local management for each identified portfolio based on economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. As it is assessed empirically on a periodic basis, the estimated period may vary over time as these factors change.

Homogeneous groups of loans and advances

Statistical methods are used to determine collective impairment losses for homogeneous groups of loans not considered individually significant.

The Banking Group adopts a basic formulaic approach based on historical loss rate experience. Management estimates that typically it takes between six and twelve months between a loss occurring and its identification.

The inherent loss within each portfolio is assessed on the basis of statistical models using historical data observations, which are updated periodically to reflect recent portfolio and economic trends. When the most recent trends arising from changes in economic, regulatory or behavioural conditions are not fully reflected in the statistical models, they are taken into account by adjusting the impairment allowances derived from the statistical models to reflect these changes as at the balance sheet date.

Write-offs of loans and advances

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 security. 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.

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, 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.

Past due assets/90 days past due assets

Past due assets are defined as assets where a counterparty has failed to make a payment when contractually due. They are still accruing interest but are in the process of collection and are well-secured by collateral of realisable value equal to or greater than the asset. 90 days past due assets are assets that have been in this state for 90 days or more.

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

Assets & Liabilities – Derecognition

Financial assets are derecognised when the rights to receive cash flows from the investments have expired or where the Banking Group has transferred substantially all the risks and rewards of ownership. Financial liabilities are derecognised when the obligation is discharged or cancelled.

Debt & Equity Securities

Treasury bills, debt securities and equity shares intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale or held-to-maturity. They are recognised on trade date when the Banking Group enters into contractual arrangements to purchase those instruments, and are normally derecognised when either the securities are sold or redeemed.

Available-for-sale securities

Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value and changes therein are recognised in other comprehensive income until they are either sold or become impaired. When available-for-sale financial assets are sold, cumulative gains or losses previously recognised in other comprehensive income are recognised in the income statement.

Interest income is recognised on available-for-sale debt securities using the effective interest rate method, calculated over the asset's expected life. Premiums and/or discounts arising on the purchase of dated investment securities are included in the calculation of their effective interest rates. Dividends are recognised in the income statement when the right to receive payment has been irrevocably established.

Available-for-sale financial assets are assessed at each balance sheet date for objective evidence of impairment. If such evidence exists 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 has an impact which can be reliably measured on the estimated future cash flows of the financial asset, an impairment loss is recognised.

If the available-for-sale financial asset is impaired, the difference between its 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 recognised in the income statement.

In assessing objective evidence of impairment at the reporting date, the Banking Group 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.

Financial difficulties of the issuer, as well as 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.

In addition, the performance of underlying collateral and the extent and depth of market price declines is relevant when assessing objective evidence of impairment of available-for-sale securities. The primary indicators of potential impairment are considered to be adverse fair value movements and the disappearance of an active market for a security, while changes in credit ratings are of secondary importance.

Deposits by Banks, Customers & Related Parties

Deposits by banks, customers, and related parties are recognised when the Banking Group enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at fair value, which is normally the consideration net of directly attributable transaction costs incurred. Subsequent measurement is at amortised cost, using the effective interest rate method to amortise the difference between proceeds net of directly attributable transaction costs and the redemption amount over the expected life of the deposit.

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

Derivative Financial Instruments

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, bonds, interest rates, foreign exchange, credit spreads, commodities and equity or other indices.

Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values of derivatives are obtained either from quoted market prices or by using valuation techniques.

Embedded derivatives are bifurcated from the host contract when their economic characteristics and risks are not clearly and closely related to those of the host non-derivative contract, their contractual terms would otherwise meet the definition of a stand-alone derivative and the combined contract is not held for trading or designated at fair value. The bifurcated embedded derivatives are measured at fair value with changes therein recognised in the income statement.

Derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset for accounting purposes if the offsetting criteria presented in the Offsetting policy are met.

Gains and losses from changes in the fair value of derivatives, including the contractual interest, that do not qualify for hedge accounting are reported in 'Net trading income'.

Hedge accounting

When derivatives are designated as hedges, the Banking Group classifies them as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedges') or (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ('cash flow hedges').

At the inception of a hedging relationship, the Banking Group documents the relationship between the hedging instruments and the hedged items, its risk management objective and its strategy for undertaking the hedge. The Banking Group requires documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items.

Fair value hedge

Fair value hedges in place principally consisted of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates.

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement, along with changes in the fair value of the hedged assets, liabilities or group attributable to the hedged risk. If a hedging relationship no longer meets the criteria for hedge accounting, hedge accounting is discontinued; the cumulative adjustment to the carrying amount of the hedged item is amortised to the income statement on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised, in which case it is recognised in the income statement immediately.

Cash flow hedge

Cash flow hedges in place represent hedges via interest rate swaps of interest rate risk associated with certificates of deposit issued, medium term notes issued, and assets such as certificates of deposit purchased.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income; the ineffective portion is recognised immediately in the income statement within 'Net trading income'.

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

Derivative Financial Instruments *(continued)*

Cash flow hedge *(continued)*

The accumulated gains and losses recognised in other comprehensive income are reclassified to the income statement in the same periods in which the hedged item affects profit or loss. In hedges of forecast transaction that results in recognition of a non-financial asset or liability, previous gains and losses recognised in other comprehensive income are included in the initial measurement of the asset or liability.

When a hedging relationship is discontinued, any cumulative gain or loss recognised in other comprehensive income remains in equity until the forecast transaction is recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss recognised in other comprehensive income is immediately reclassified to the income statement.

Hedge effectiveness testing

To qualify for hedge accounting, NZ IAS 39 requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective, both prospectively and retrospectively, on an on-going basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method the Banking Group adopts for assessing hedge effectiveness will depend on the risk management strategy.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness, the changes in the fair value or cash flows must offset each other in the range of 80%-125% for the hedge to be deemed effective.

For fair value hedge relationships, the Banking Group uses the cumulative dollar offset method or regression analysis as effectiveness testing methodologies. For cash flow hedge relationships, the Banking Group uses the change in variable cash flow method or the cumulative dollar offset method using the hypothetical derivative approach.

Employee Benefits

Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense as the employees render service.

Share-based payments

The Banking Group enters into equity-settled share-based payment arrangements with its employees as compensation for services provided by employees. Equity-settled share-based payment arrangements entitle employees to receive equity instruments of HSBC Holdings plc.

The cost of equity-settled share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted and recognised as an expense on a straight-line basis over the vesting period. The fair value of equity instruments that are made available immediately, with no vesting period attached to the award are expensed immediately.

HSBC Holdings is the grantor of its equity instruments for all share awards across the Group. The Banking Group uses the share-based payment reserve to record the corresponding amount relating to share options granted to employees of the Banking Group and represents an effective capital contribution.

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

Employee Benefits *(continued)*

Share-based payments (continued)

A cancellation that occurs during the vesting period is treated as an acceleration of vesting, and the expense recognised immediately in the income statement for the amount that would otherwise have been recognised over the vesting period.

Fair value is determined by using market prices or appropriate valuation models, taking into account the terms and conditions upon which the equity instruments were granted. Market performance conditions are taken into account when estimating the fair value of equity instruments at the date of grant, so that an award is treated as vesting irrespective of whether the market performance condition is satisfied, provided all other conditions are satisfied.

Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

Where an award has been modified, as a minimum, the expense of the original award continues to be recognised as if it had not been modified. Where the effect of a modification is to increase the fair value of an award or increase the number of equity instruments, the incremental fair value of the award or incremental fair value of the extra equity instruments is recognised in addition to the expense of the original grant, measured at the date of modification, over the modified vesting period.

A cancellation that occurs during the vesting period is treated as an acceleration of vesting, and recognised immediately for the amount that would otherwise have been recognised for services over the vesting period.

Financial Instruments Designated as at Fair Value Through Profit or Loss

A financial instrument, other than one held for trading, is classified in this category if it meets the criteria set out below, and is so designated by management:

- § eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring financial assets or financial liabilities or recognising the gains and losses on them on different bases; or
- § applies to a group of financial assets, financial liabilities or both that is managed and its performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and where information about that group of financial instruments is provided internally on that basis to key management personnel; or
- § relates to financial instruments containing one or more embedded derivatives that significantly modify the cash flows resulting from those financial instruments.

The Banking Group may designate certain financial instruments as at fair value through profit or loss to remove or reduce accounting mismatches in measurement or recognition.

Financial assets and financial liabilities so designated are recognised initially at fair value, with transaction costs taken directly to profit or loss, and are subsequently measured at fair value. Financial assets and financial liabilities are recognised using trade date accounting.

Gains and losses from changes in the fair value of such assets and liabilities are recognised in profit or loss as they arise.

Gains and losses arising from the changes in the fair value of derivatives that are managed in conjunction with financial assets and financial liabilities designated at fair value are included in profit or loss.

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

Financial Instruments – Right to Offset

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

Property, plant and equipment

Leasehold improvements are stated at cost less accumulated depreciation and impairment losses. Depreciation is calculated on a straight-line basis to write off the assets over the unexpired term of the lease, which is generally 5 years.

Equipment, fixtures and fittings are stated at cost less accumulated depreciation and impairment losses. Depreciation is calculated on the straight-line basis to write off the assets over their estimated useful lives, which are generally between 3 and 5 years. Where material parts of an asset have different useful lives, they are accounted for as separate assets.

Foreign Currencies

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the balance sheet date. Any resulting exchange differences are included in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Any foreign exchange component of a gain or loss on a non-monetary item is recognised either in other comprehensive income or in the income statement depending on where the gain or loss on the underlying non-monetary item is recognised.

Intangible Assets

Goodwill

Goodwill represents the difference between the cost of an acquisition and the fair value of the net identifiable assets acquired. Acquisition expenses such as professional fees and legal fees directly attributable to an acquisition are expensed. If the amount of the identifiable assets and liabilities acquired is greater than the cost, the difference is recognised immediately in the income statement.

Goodwill is stated at cost less any accumulated impairment losses.

Goodwill is allocated to cash-generating units ('CGU') for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. Impairment testing is performed at least annually, or whenever there is an indication of impairment, by comparing the recoverable amount with its carrying amount. The carrying amount of a CGU is based on its assets and liabilities, including attributable goodwill. The recoverable amount of an asset is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of the expected future CGU cash flows. If the recoverable amount is less than the carrying value, an impairment loss is charged to the income statement. Goodwill is carried on the balance sheet at cost less accumulated impairment losses.

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

Intangible Assets *(continued)*

Other Intangible Assets

Intangible assets include internally generated computer software and customer relationships purchased. Intangible assets that have an indefinite useful life or are not yet ready for use are tested at least annually for impairment or at each reporting date where there is an indicator of impairment.

Intangible assets that have a finite useful life are stated at cost less amortisation and accumulated impairment losses and are amortised on a straight line basis over their useful lives as follows:

- Customer relationships – 12 years
- Software – 5 years.

Intangible assets are subject to impairment review at each reporting date to determine if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

Interest Income & Expense

Interest income and expense for all financial instruments are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

Interest on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the amount of impairment loss.

Net Fees

The Banking Group earns fee and commission income from a diverse range of services it provides to its customers including fiduciary activities. Fee and commission income is accounted for as follows:

- If the income is earned on the execution of a significant act, it is recognised as revenue when the significant act has been completed (for example, commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as the arrangement for the acquisition of shares or other securities);
- If the income is earned as services are provided, it is recognised as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees); and
- If the income is an integral part of the effective interest rate of a financial instrument, it is recognised as an adjustment to the effective interest rate (for example, loan establishment fees) and recorded in interest income.

Net trading income

Net trading income comprises all gains and losses from changes in foreign exchange rates, changes in the fair value of derivatives and gains or losses from hedge ineffectiveness.

Leases

Leases where substantially all the risks and rewards associated with ownership remain with the lessor, are classified as operating leases. Assets leased under operating leases are not recognised in the Statement of Financial Position. Payments made under operating leases are recognised in profit or loss on a straight line basis over the term of the lease. Lease incentives received are recognised in profit or loss over the lease term as an integral part of the total lease expense.

Notes to and forming part of the Financial Statements *(continued)*

1. Statement of Accounting Policies *(continued)*

Provisions

Provisions for liabilities and charges are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation which has arisen as a result of past events and for which a reliable estimate can be made.

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security and contingent liabilities related to legal proceedings or regulatory matters, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the Banking Group; 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.

Statement of Cash Flows

The Statement of Cash Flows has been prepared using the direct approach modified by the netting of certain items as appropriate to provide more meaningful disclosure in compliance with the standards.

Cash and cash equivalents reflect the balance of cash and liquid assets used in the day-to-day cash management of the Banking Group, which are unconditionally convertible into cash within no more than two working days. For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value.

Taxation

Income tax on the profit or loss for the period comprises current tax and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised directly in other comprehensive income or equity, in which case it is recognised in other comprehensive income.

Current tax is the expected tax payable on the taxable income for the period, calculated using tax rates enacted or substantially enacted by the end of the reporting period, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities offset when a legal right to offset exists and the assets and liabilities relate to income taxes levied by the same taxation authority.

Deferred tax is recognised on temporary differences between the carrying amount of assets and liabilities in the Statement of Financial Position and the amount attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled. Deferred tax assets and liabilities are offset when a legal right to offset exists and the assets and liabilities relate to income taxes levied by the same taxation authority.

Tax related to fair value re-measurement of available-for-sale investments and cash flow hedges, which are charged or credited directly to other comprehensive income, is also credited or charged directly to other comprehensive income and is subsequently recognised in profit or loss when the deferred gain or loss is recognised in profit or loss.

The taxation standard NZ IAS 12 has been applied when transacting business combinations. The standard requires certain tax-effect accounting entries to be passed on acquisition date where there is a difference between the tax cost base and accounting carrying value. A taxable temporary difference arises which results in a deferred tax liability.

Notes to and forming part of the Financial Statements *(continued)*

2. Risk Management

POLICIES

The Banking Group operates risk management policies in accordance with HBAP policies and procedures established by HSBC Holdings plc (“Group”). Systems and procedures are in place to identify, control and report on major risks including credit, market, liquidity and operational risk (including accounting, tax, legal, compliance, information, physical security and fraud risk).

Exposure to these risks is monitored by the Banking Group’s Risk Management Meeting (“RMM”), Asset and Liability Management Committee (“ALCO”) and Executive Committee (“EXCO”). These committees meet on a monthly basis to ensure that risk management systems, controls and procedures are operating effectively. The EXCO and RMM are supported by a dedicated risk function headed by the Chief Risk Officer, who is a member of both EXCO and chairs the RMM and reports to the Chief Executive Officer. The monitoring and review of the Banking Group’s risk management systems is not conducted by a party which is external to the Banking Group or Group. Specific risk management policies and procedures are outlined below.

Credit risk

Credit risk, including concentration of credit risk, intra-day credit risk, credit risk to bank counterparties and related party credit risk, is the risk of financial loss if a customer or counterparty of the Banking Group will be unable or unwilling to meet an obligation that it has entered into with the Banking Group.

Credit risk arises principally from direct lending, trade finance, treasury and other finance activities (including guarantees and derivatives) undertaken by the Banking Group. The Banking Group has policies and procedures for the control and monitoring of all such risks.

The Banking Group’s principal credit risk management procedures and policies, which follow policies established by the Group, include the following:

- Credit policy and guidance must reinforce adherence to the Global lending principles and credit culture, and assists in articulating and communicating risk appetite, which is formulated within the Group’s Risk Appetite Framework at Group, Regional, Country and major business levels.
- Statements of risk appetite developed within this framework – and progress against these are monitored at appropriate forums and committees internally and used to serve as management tools to serve lending discipline and credit management.
- Formulating credit policies which are consistent with the Group credit policy and documenting these in detail in dedicated manuals.
- Establishing and complying with lending guidelines on the group’s attitude towards, and appetite for, lending to specified market sectors and industries.
- Undertaking an objective assessment of risk.
- Controlling exposures to banks and other financial institutions.
- Managing exposures to debt securities by establishing controls in respect of the liquidity of securities held for trading and setting issuer limits for financial investments.
- Controlling cross-border exposures to manage country and cross-border risk through the imposition of country limits, with sub-limits by maturity and type of business.
- Controlling exposures to selected industries. When necessary, restrictions are imposed on new business, or exposures in the group’s operating entities are capped.
- Maintaining and developing risk ratings in order to categorise exposures meaningfully and facilitate focused management of the attendant risks.

HBAP Executive Committee receives regular reports on credit exposures within the Group. These include information on asset concentrations, industry exposures, levels of impairment provisioning and country exposure limits.

Notes to and forming part of the Financial Statements *(continued)*

2. Risk Management *(continued)*

Credit risk *(continued)*

In the Banking Group, local management is responsible for the quality of its credit portfolios. The Banking Group has established a credit process involving delegated approval authorities, credit procedures and regular reviews, the objective of which is to build and maintain risk assets of high quality. Collateral is taken to reduce credit risk where it is considered necessary after local management's credit evaluation of the counterparty.

The Group's credit risk limits to counterparties in the financial and government sectors are managed centrally to optimise the use of credit availability and to avoid excessive risk concentration. The Banking Group remains responsible for its own credit exposures. In addition to the portfolio management undertaken at Group level, the Banking Group manages its own risk concentrations on a market sector, geographical and product basis.

Cross-border risk is controlled through the imposition of country limits, with sub-limits by maturity and type of business. Transactions with higher risk countries are considered on a case-by-case basis.

Special attention is paid to the management of problem loans.

The Banking Group does have legal right of off-set in some instances under certain conditions. At present all balances have been disclosed gross with the conditions giving rise to the legal right of off-set not being present.

Market risk

Market risk is the risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios. Market risk arises on financial instruments which are measured at fair value and those which are measured at amortised cost. The objective of market risk management is to control market risk exposures to achieve an optimal return while maintaining risk at acceptable levels.

The Banking Group monitors market risk separately for trading portfolios and non-trading portfolios. Trading portfolios include positions arising from market making in exchange rates, interest rates, credit and equity derivative instruments, as well as in debt and equity securities. Trading risks arise either from customer related business or from proprietary position taking.

The management of market risk is principally undertaken in Global Markets using risk limits approved by the Group Management Board. Wholesale and Market Risk, a unit within the Group Risk function, develops risk management policies and measurement techniques.

Risk limits are determined for each location and, within location, for each portfolio. Limits are set by product and risk type with market liquidity being a principal factor in determining the level of limits set. Limits are set using a combination of risk measurement techniques, including position limits, sensitivity limits, as well as value at risk limits at a portfolio level. Similarly, option risks are controlled through full revaluation limits in conjunction with limits on the underlying variables that determine each option's value.

The Banking Group is required to assess the market risks which arise on each product in its business and to transfer these risks to either its local Global Markets unit for management, or to separate books managed under the supervision of ALCO. The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to manage such risks professionally. In certain cases where the market risks cannot be adequately captured by the transfer process, simulation modelling is used to identify the impact of varying scenarios on valuations and net interest income from any residual risk positions.

Notes to and forming part of the Financial Statements *(continued)*

2. Risk Management *(continued)*

Market risk *(continued)*

Value at Risk (“VAR”)

One of the principal tools used by the Group to monitor and limit market risk exposure is VAR. VAR is a technique which estimates the potential losses that could occur on risk positions taken due to movements in market rates and prices over a specified time horizon and to a given level of confidence (for Group, 99%). VAR is calculated daily. The use of VAR is integrated into market risk management and is calculated for all trading positions regardless of how the group capitalises those exposures.

The Group uses a historical simulation model which derives plausible future scenarios from historical market data. Potential movements in market prices are calculated with reference to market data from the last two years. The model assumes a 1 day holding period, as this reflects the way the risk positions are managed.

Although a valuable guide to risk, VAR should always be viewed in the context of its limitations. For example:

- § the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- § the use of a 1 day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a 1 day holding period may be insufficient to liquidate or hedge all positions fully;
- § the use of a 99% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;
- § VAR is calculated on the basis of exposures outstanding at close of business and therefore does not necessarily reflect intra-day exposures; and
- § VAR is unlikely to reflect loss potential on exposures that only arise under significant market moves.

The Group recognises these limitations by augmenting the VAR limits with other position and sensitivity limit structures, as well as with stress testing, both on individual portfolios and on a consolidated basis. The Group’s stress testing regime provides senior management with an assessment of the impact of extreme events on the market risk exposures of the Group.

Stress Testing

Stress testing is an important tool that is integrated into our market risk management tool to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. In such abnormal scenarios, losses can be much greater than those predicted by VAR modelling. The risk appetite around potential stress losses is set and monitored against referral limits.

The Group carries out stress testing at a regional level in HBAP and at a global level in Group using data from internal systems. A standard set of scenarios is utilised consistently across all sites within the Group and the overall process is governed by the Group’s Stress Testing Review Group .

The Banking Group does not hold any significant open trading positions. Under current scenarios the potential adverse profit impact is immaterial. This is consistent with the comparable period.

Notes to and forming part of the Financial Statements *(continued)*

2. Risk Management *(continued)*

Market risk *(continued)*

Trading

The Group's control of market risk is based on restricting individual operations to trading within a list of permissible instruments authorised for each site by Group Risk, and enforcing rigorous new product approval procedures. In particular, trading in the more complex derivative products is concentrated in offices with appropriate levels of product expertise and robust control systems.

In addition, at both portfolio and position levels, market risk in trading portfolios is monitored and controlled using a complementary set of techniques such as VAR and present value of a basis point ("PVBP"), together with stress and sensitivity testing and concentration limits. These techniques quantify the impact on capital of defined market movements.

Non-trading

Market risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on optionality in certain product areas, for example, mortgage prepayments and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand, for example, current accounts. In order to manage this risk optimally, market risk in non-trading portfolios is transferred to Global Markets or to separate books and managed under the supervision of ALCO.

The transfer of market risk to books managed by Global Markets or supervised by ALCO is usually achieved by a series of internal deals between the business units and these books. When the behavioural characteristics of a product differ from its contractual characteristics the behavioural characteristics are assessed to determine the true underlying interest rate risk. ALCO regularly monitors all such behavioural assumptions and interest rate risk positions to ensure they comply with interest rate risk limits established by HBAP Executive Committee.

As noted above in certain cases the non-linear characteristics of products cannot be adequately captured by the risk transfer. For example both the flow from customer deposit accounts to alternate investment products and the precise prepayment speeds of mortgages will vary at different interest rate levels. In such circumstances simulation modelling is used to identify the impact of varying scenarios on valuations and net interest income.

Once market risk has been consolidated in Global Markets or ALCO managed books, the net exposure is typically managed through the use of interest rate swaps within agreed limits.

Within the Group, banking entities also monitor the sensitivity of projected net interest income under varying interest rate scenarios. The Group aims through its management of market risk in non-trading portfolios to mitigate the impact of prospective interest rate movements which could reduce future net interest income, whilst balancing the cost of such hedging activities on the current net revenue stream.

Currency risk

The Banking Group's foreign currency exposures comprise those which arise from foreign exchange dealing within Global Markets and currency exposures originated by other banking business. The latter are transferred to Global Markets where they are managed together with exposures which result from dealing within limits approved by HBAP Executive Committee. These exposures are managed on a daily basis.

Foreign currency risk exposure is disclosed in note 24. A sensitivity analysis is not performed as the sensitivity range is immaterial due to the Banking Group FX exposure being materially hedged.

Notes to and forming part of the Financial Statements *(continued)*

2. Risk Management *(continued)*

Interest rate risk

The Banking Group's interest rate exposures comprise those originating in its trading activities and structural interest rate exposures; both are managed under limits described above.

Structural interest rate risk arises primarily from fixed rate loans and liabilities other than those generated by Global Markets business. Each business unit's structural interest rate risk is transferred to Global Markets.

These interest rate positions are regularly monitored by ALCO. While the primary objective of such interest rate risk management is to limit potential adverse effects of interest rate movements on net interest income, the Banking Group also seeks to enhance net interest income, subject to risk limits approved by HBAP Executive Committee.

The Group predominantly uses the PVBP calculation for measuring and monitoring interest rate risk globally. The PVBP calculation, which measures the change in mark to market for a 1 basis point movement in interest rates, provides a useful real-time tool to monitor interest rate risk. PVBP is measured in USD.

The analysis below shows the impact on before tax profit and loss and equity reserves of a 1 basis point increase in interest rates (across all currencies). The opposite impact would be expected for a 1 basis point decrease. Financial instruments recorded at amortised cost are therefore, not included as their reported values are not impacted by interest rate movements. Profit and loss impacts are represented by trading book activities recorded at fair value.

USD PVBP	Audited 31.12.16	Audited 31.12.15
Equity Reserves	(4,297)	17,232
Profit and Loss	(4,348)	(3,374)

Liquidity and funding risk

Liquidity risk is the risk that the Banking Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows. Funding risk (a form of liquidity risk) arises when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.

The objective of the Group's liquidity and funding management framework is to ensure that all foreseeable funding commitments can be met when due, and that access to the wholesale markets is co-ordinated and cost-effective. To this end, the Group maintains a diversified funding base comprising core retail and corporate customer deposits and institutional balances. This is augmented with wholesale funding and portfolios of highly liquid assets diversified by currency and maturity which are held to enable the Group to respond quickly and smoothly to unforeseen liquidity requirements.

The Group requires its operating entities to maintain strong liquidity positions and to manage the liquidity profiles of their assets, liabilities and commitments with the objective of ensuring that their cash flows are balanced appropriately and that all their anticipated obligations can be met when due.

The Group adapts its liquidity and funding risk management framework in response to changes in the mix of business that it undertakes, and to changes in the nature of the markets in which it operates.

Notes to and forming part of the Financial Statements *(continued)*

2. Risk Management *(continued)*

Liquidity and funding *(continued)*

Policies and procedures

Management of liquidity and funding is primarily undertaken locally in HBAP's operating entities in compliance with the Group's liquidity and funding risk framework ('LFRF') and with practices and limits set by the Group Management Board through the Group Risk Management Meeting and approved by the Group Board. These limits vary according to the depth and liquidity of the market in which the entities operate. It is HBAP's general policy that each banking entity should be self-sufficient when funding its own operations. Exceptions are permitted for certain short-term treasury requirements and start-up operations or branches which do not have access to local deposit markets. These entities are funded from HBAP's largest banking operations and within clearly defined internal and regulatory guidelines and limits. These limits place formal restrictions on the transfer of resources between HBAP entities and reflect the broad range of currencies, markets and time zones within which HBAP operates.

The primary responsibility for managing liquidity and funding within the Group's framework and risk appetite resides with the Banking Group ALCO.

The Banking Group's principal liquidity and funding risk management procedures and policies, which follow policies established by the Group, include the following:

- § projecting cash flows under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- § monitoring balance sheet liquidity and funding ratios against internal and regulatory requirements;
- § maintaining a diverse range of funding sources with adequate back-up facilities;
- § managing the concentration and profile of term funding;
- § managing contingent liquidity commitment exposures within pre-determined limits;
- § maintaining debt financing plans;
- § monitoring of depositor concentration in order to avoid undue reliance on large individual depositors and ensuring a satisfactory overall funding mix; and
- § maintaining liquidity and funding contingency plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises, while minimising adverse long-term implications for the business.

Liquidity and funding risk management framework

On 1 January 2016, the Group implemented a new liquidity and funding risk framework ('LFRF'). It uses the liquidity coverage ratio ('LCR') and net stable funding ratio ('NSFR') regulatory framework as a foundation, but adds extra metrics, limits and overlays to address the risks that we consider are not adequately reflected by the regulatory framework. The LFRF is delivered using the following key aspects:

- § standalone management of liquidity and funding by operating entity;
- § operating entity classification by inherent liquidity risk ('ILR') categorisation;
- § minimum LCR requirement depending on ILR categorisation;
- § minimum NSFR requirement depending on ILR categorisation;
- § legal entity depositor concentration limit;
- § three-month and 12-month cumulative rolling term contractual maturity limits covering deposits from banks,
- § deposits from non-bank financial institutions and securities issued;
- § annual individual liquidity adequacy assessment ('ILAA') by principal operating entity;
- § minimum LCR requirement by currency;
- § intraday liquidity; and
- § forward-looking funding assessments.

Notes to and forming part of the Financial Statements *(continued)*

2. Risk Management *(continued)*

Liquidity and funding *(continued)*

ILR categorisation

(Unaudited)

HBAP allocates the Banking Group into one of two categories to reflect their assessment of our inherent liquidity risk, considering political, economic and local regulatory factors and factors specific to our operations, such as the local market, market share and balance sheet strength. The categorisation involves management judgement and is based on the perceived liquidity risk of an operating entity relative to other entities in the group. The categorisation is intended to reflect the possible impact of a liquidity event, not the probability of an event and forms part of our risk appetite. It is used to determine the prescribed stress scenario that HBAP require the Banking Group to be able to withstand and manage to.

Liquidity coverage ratio

(Unaudited)

The LCR metric is designed to promote the short-term resilience of a bank's liquidity profile, and became a minimum regulatory standard from 1 October 2015, under European Commission ('EC') Delegated Regulation 2015/61. It aims to ensure that a bank has sufficient unencumbered high-quality liquid assets ('HQLA') to meet its liquidity needs in a 30-calendar-day liquidity stress scenario. HQLA consist of cash or assets that can be converted into cash at little or no loss of value in markets.

As at 31 December 2016, the Banking Group was within the risk tolerance level established by the Group Board and applicable under the LFRF.

Net stable funding ratio

(Unaudited)

The NSFR requires institutions to maintain sufficient stable funding relative to required stable funding, and reflects a bank's long-term funding profile (funding with a term of more than a year). It is designed to complement the LCR. The European calibration of NSFR is pending following the Basel Committee's final recommendation in October 2014. We calculate NSFR in line with Basel Committee on Banking Supervision publication 295, pending its implementation in Europe.

As at 31 December 2016, the Banking Group was within the risk tolerance level established by the Group Board and applicable under the LFRF.

Depositor concentration and term funding maturity concentration

(Unaudited)

The LCR and NSFR metrics assume a stressed outflow based on a portfolio of depositors within each deposit segment. The validity of these assumptions is challenged if the underlying depositors do not represent a large enough portfolio so that a depositor concentration exists. Deposit concentration is measured and monitored at a legal entity basis. Operating entities are also exposed to term re-financing concentration risk if the current maturity profile results in future maturities being overly concentrated in any defined period.

As at 31 December 2016, the Banking Group was within the risk tolerance levels established by the Board and are applicable under the LFRF.

Notes to and forming part of the Financial Statements *(continued)*

2. Risk Management *(continued)*

Operational risk

Operational risk is the risk to achieving our strategy or objectives as a result of inadequate or failed internal processes, people and systems or from external events. Operational risk is relevant to every aspect of our business and covers a wide spectrum of issues, in particular legal, compliance, security and fraud. Losses arising from breaches of regulation and law, unauthorised activities, error, omission, inefficiency, fraud, systems failure or external events all fall within the definition of operational risk.

Responsibility for minimising operational risk lies with HSBC's staff. All staff are required to manage the operational risks of the business and operational activities for which they are responsible.

HSBC's Operational Risk Management Framework ('ORMF') is our overarching approach for managing operational risk, the purpose of which is to:

- § Identify and manage our operational risks in an effective manner
- § Remain within the operational risk appetite, which helps the organisation understand the level of risk it is willing to accept; and
- § Drive forward-looking risk awareness and assist management focus

Activities to strengthen our risk culture and better embed the use of the ORMF was further implemented in 2016. In particular, the use of the activity-based 'three lines of defence' model, which sets out roles and responsibilities for managing operational risks on a daily basis.

Internal audit

Internal audit is an integral part of the control environment of the Group. It provides management and, through the Audit Committee, the Board with an independent and objective review of the business activities and support functions of the Group. The Banking Group does not have a separate Audit Committee or internal audit function.

The Group's internal audit department has authority of access to all operations, records, property and staff at each location. All employees are required to co-operate fully with and provide full and complete information to the Group's internal auditors in the performance of their assigned duties.

Though some audit cycles are predetermined by regulatory or similar stipulations, in general, audits throughout the Group are carried out on a frequency determined primarily by the risk grading allocated to the business unit at the time of the previous audit, with units considered to represent greater risks being audited at more frequent intervals, with intervals between internal audits never to exceed two years. There are no regulatory stipulations governing the internal audit cycles of the Banking Group.

Access to parental disclosures on risk management processes and capital adequacy requirements

The most recent publicly available disclosures on risk management processes and capital adequacy requirements of HBAP Group and HSBC Holdings plc ("Group") can be found at HSBC Holdings plc's website, www.hsbc.com/investor-relations.

Notes to and forming part of the Financial Statements (continued)

	<i>Banking Group</i>	
<i>Dollars in Thousands</i>	12 months 31.12.16	12 months 31.12.15
3. Operating income		
Interest income:		
Advances to banks	11,969	19,771
Debt securities	14,544	15,947
Advances to customers	145,440	193,601
Related parties – HBAP	1,820	1,258
Related parties – other	462	186
Other	3	116
	<u>174,238</u>	<u>230,879</u>
Interest expense:		
Deposits by banks	(3,599)	(5,941)
Customer deposits	(48,636)	(68,477)
Debt securities	(18,888)	(32,684)
Related parties – HBAP	(21,966)	(28,300)
Related parties – other	(75)	(358)
Other	(115)	(83)
	<u>(93,279)</u>	<u>(135,843)</u>
Other net operating income:		
Fee and commission income		
Lending and credit facility fees	16,626	22,548
Custody and clearing fees	6,184	4,844
Other fees and commissions from:		
– Third parties	13,577	15,909
– Related parties - HBAP	866	320
– Related parties - other	1,410	618
	<u>38,663</u>	<u>44,239</u>
Fee and commission expense		
Brokerage expense	(2,159)	(1,856)
Other fees and commissions to:		
– Third parties	(1,448)	(1,420)
– Related parties - HBAP	(84)	(3,768)
– Related parties - other	(331)	(352)
	<u>(4,022)</u>	<u>(7,396)</u>
Other income		
Gain / (loss) on disposal of property, plant and equipment	12	(211)
Other	1	-
	<u>13</u>	<u>(211)</u>
	<u>34,654</u>	<u>36,632</u>
Net trading income:		
Foreign exchange gains	10,694	11,098
Gains / (losses) on revaluation of derivatives	(240)	4,114
Credit valuation adjustments on derivatives	(74)	(1,344)
Debit valuation adjustments on derivatives	723	644
Loss on de-designation of hedging instruments in cash flow hedge	(2,756)	-
Gain/ (loss) on hedging instrument in fair value hedge	2,493	(3,917)
Gain/ (loss) on hedged item in fair value hedge	(2,,288)	4,109
	<u>8,552</u>	<u>14,704</u>

Total interest income for financial assets that are not held at fair value through profit or loss is \$174 million (2015: \$229 million).

Total interest expense for financial liabilities that are not held at fair value through profit or loss is \$93 million (2015: \$135 million)

Included within interest income from advances to customers is \$nil (December 2015: \$5 million) of interest income from impaired advances to customers.

Notes to and forming part of the Financial Statements (continued)

	Banking Group	
<i>Dollars in Thousands</i>	12 months 31.12.16	12 months 31.12.15
4. Operating expenses		
Rental expense		
Premises	2,093	2,243
Equipment	164	169
	2,257	2,412
Depreciation and amortisation		
Leasehold improvements	120	173
Equipment, fixtures and fittings	326	289
Intangibles	1,332	1,745
	1,778	2,207
Auditors' remuneration		
<i>Fees paid to principal auditor</i>		
Audit and review of financial statements	503	411
Taxation services	20	19
Other services ¹	42	72
Total fees paid to principal auditor	565	502
Staff costs		
Salaries & other staff expenses	27,006	26,866
Defined contribution pension costs	1,925	1,947
Share based payments	284	587
Other	1,818	1,436
	31,033	30,836
Other		
Related party management and technical fees – HBAP	15,028	15,728
Related party management and technical fees – other	2,170	2,231
Donations	90	170
Other operating expenses	8,284	9,755
	25,572	27,884
	61,205	63,841

The average number of persons employed by the Banking Group for the twelve months was 223 (December 2015: 229).

¹ Other services performed by PricewaterhouseCoopers include fees charged for immigration advisory services in 2016 and 2015 and a review of regulatory policies in 2015.

Notes to and forming part of the Financial Statements *(continued)*

<i>Dollars in Thousands</i>	Banking Group	
	12 months 31.12.16	12 months 31.12.15
5. Loan impairment charges		
Individually assessed impairment (charges) / releases		
New charges	(298)	(782)
Releases	15	17,932
Recoveries	1	15,736
	<u>(282)</u>	<u>32,886</u>
Collectively assessed impairment (charge) / release	1,711	2,254
	<u>1,429</u>	<u>35,140</u>

6. Segment reporting

The Banking Group's operating segments are organised into three business segments representing the products and services offered to customers. The Executive Committee, formed of senior management of each business unit, acts as the Banking Group's chief operating decision-maker and assesses the Banking Group's performance on this basis.

Business segments pay and receive interest to and from Global Banking and Markets on an arm's length basis to reflect the allocation of funding costs.

The Banking Group operates primarily in New Zealand and predominately all revenues from and assets held with external customers are generated or held in New Zealand. The Banking Group does not rely on any single major customer for its revenue base.

Business Segments

The Banking Group comprises the following main business segments:

- *Retail Banking and Wealth Management ("RBWM")*
Includes loans, deposits and other transactions with retail customers.
- *Commercial Banking ("CMB")*
Manages the relationships with corporate customers providing loans, deposits and other transactions including trade finance and payment cash management.
- *Global Banking and Markets ("GBM")*
Manages the relationships with institutional customers and undertakes the Banking Group's treasury and investment banking operations.

Reconciling items primarily include income from the investment of retained profits. In 2015, reconciling items also included income from the investment of interest free funding from HBAP provided to support thin capitalisation ratios. This is now allocated to the business segments.

Notes to and forming part of the Financial Statements *(continued)***6. Segment reporting** *(continued)*

The following tables present the segment reporting.

<i>Banking Group</i>						
12 months ended 31.12.16						
<i>Dollars in Thousands</i>	RBWM	CMB	GBM	Total Reportable Segments	Reconciling items	Consolidated
Net interest income	30,713	38,533	12,328	81,574	(615)	80,959
Net trading income	1,708	3,351	3,582	8,641	(89)	8,552
Other net operating income	(207)	25,711	8,209	33,713	941	34,654
Net operating income before loan impairment charges	32,214	67,595	24,119	123,928	237	124,165
Loan impairment (charges) / release	(406)	1,835	-	1,429	-	1,429
Net operating income	31,808	69,430	24,119	125,357	237	125,594
Operating expenses	(21,373)	(28,723)	(10,503)	(60,599)	(606)	(61,205)
Operating profit before tax	10,435	40,707	13,616	64,758	(369)	64,389
Advances to customers	1,353,099	2,093,684	-	3,446,783	-	3,446,783
Customer deposits	1,959,849	910,933	247,420	3,118,202	-	3,118,202

<i>Banking Group</i>						
12 months ended 31.12.15						
<i>Dollars in Thousands</i>	RBWM	CMB	GBM	Total Reportable Segments	Reconciling items	Consolidated
Net interest income	29,537	49,246	7,824	86,607	8,429	95,036
Net trading income	2,016	3,765	8,983	14,764	(60)	14,704
Other net operating income	254	31,111	5,662	37,027	(395)	36,632
Net operating income before loan impairment	31,807	84,122	22,469	138,398	7,974	146,372
Loan impairment (charges) / release	(572)	35,712	-	35,140	-	35,140
Net operating income	31,235	119,834	22,469	173,538	7,974	181,512
Operating expenses	(22,529)	(29,687)	(11,315)	(63,531)	(310)	(63,841)
Operating profit before tax	8,706	90,147	11,154	110,007	7,664	117,671
Advances to customers	1,202,818	2,383,179	-	3,585,997	-	3,585,997
Customer deposits	2,078,997	907,484	265,613	3,252,094	-	3,252,094

Notes to and forming part of the Financial Statements (continued)

<i>Dollars in Thousands</i>	<i>Banking Group</i>	
	12 months 31.12.16	12 months 31.12.15
7. Taxation		
Current tax expense		
Current tax expense	<u>19,192</u>	<u>24,711</u>
	19,192	24,711
Deferred tax expense		
Origination and reversal of temporary differences	<u>(1,111)</u>	<u>8,321</u>
	(1,111)	8,321
Total income tax expense included in profit after tax	<u>18,081</u>	<u>33,032</u>
Reconciliation of effective tax rate		
Operating profit before tax	<u>64,389</u>	<u>117,671</u>
Income tax using the domestic corporation tax rate (28%)	<u>18,029</u>	<u>32,948</u>
Non-deductible expenses	<u>52</u>	<u>84</u>
Under / (over) provided in prior periods	<u>-</u>	<u>-</u>
Other permanent differences	<u>-</u>	<u>-</u>
	<u>18,081</u>	<u>33,032</u>

<i>Dollars in Thousands</i>	<i>Banking Group</i>			
	Balance at 1 January	Credit / (charge) to income statement	(Credit) / Charges to Reserves	Balance at 31 December
Recognised deferred tax assets and liabilities				
2016				
Accelerated capital allowances	684	152	-	836
Provision for loan impairment	1,076	(400)	-	676
Other provisions	900	1,091	-	1,991
Cash flow hedges	619	-	(619)	-
Income deferred for accounting purposes	287	63	-	350
Other intangible assets	(547)	205	-	(342)
Tax deductible premium	<u>(3,595)</u>	<u>-</u>	<u>-</u>	<u>(3,595)</u>
Net deferred tax asset / (liability)	<u>(576)</u>	<u>1,111</u>	<u>(619)</u>	<u>(84)</u>
2015				
Accelerated capital allowances	480	204	-	684
Provision for loan impairment	7,267	(6,191)	-	1,076
Other provisions	771	129	-	900
Cash flow hedges	(40)	-	659	619
Income deferred for accounting purposes	2,956	(2,669)	-	287
Other intangible assets	(753)	206	-	(547)
Tax deductible premium	<u>(3,595)</u>	<u>-</u>	<u>-</u>	<u>(3,595)</u>
Net deferred tax asset / (liability)	<u>7,086</u>	<u>(8,321)</u>	<u>659</u>	<u>(576)</u>

Notes to and forming part of the Financial Statements (continued)

<i>Dollars in Thousands</i>	<i>Banking Group</i>	
	31.12.16	31.12.15
8. Additional financial disclosures on the statement of financial position		
Total interest earning and discount bearing assets	4,866,790	5,237,245
Total interest and discount bearing liabilities	4,632,795	4,947,793
Total liabilities net of amounts due to related parties	3,768,106	4,430,444
Advances to banks pledged as collateral for liabilities in respect of credit support annex obligation to derivative counterparties	-	-
9. Debt and equity securities		
Available-for-sale		
Debt securities	486,950	447,423
Equity shares	22	22
	<u>486,972</u>	<u>447,445</u>

10. Derivative financial instruments

<i>Dollars in Thousands</i>	<i>Banking Group</i>					
	31.12.16			31.12.15		
	Contract amount	Assets	Liabilities	Contract amount	Assets	Liabilities
Related Party						
<i>Trading derivatives</i>						
Exchange rate contracts ¹	3,767,989	39,976	99,425	14,816,198	99,101	185,059
Interest rate contracts	1,276,300	4,744	20,256	1,719,511	6,712	24,471
Total derivatives with related parties		44,720	119,681		105,813	209,530
<i>Related party breakdown</i>						
HBAP Group		44,672	119,609		99,764	208,904
HSBC Bank plc		48	71		5,735	403
Others		-	1		314	223
		44,720	119,681		105,813	209,530
Others						
<i>Trading derivatives</i>						
Exchange rate contracts ¹	3,614,378	94,927	36,364	5,073,799	183,809	91,795
Interest rate contracts	1,276,300	20,296	4,741	1,689,511	23,478	5,649
		115,223	41,105		207,287	97,444
<i>Hedging derivatives</i>						
Cash flow hedging derivatives	-	-	-	702,500	818	3,382
Fair value hedging derivatives	292,700	1,723	3,315	198,700	-	4,006
		1,723	3,315		818	7,388
Total derivatives with other parties		116,946	44,420		208,105	104,832
Total derivative financial instruments		161,666	164,101		313,918	314,362

¹ Cross-currency interest rate swaps are included as exchange rate contracts

Notes to and forming part of the Financial Statements *(continued)***10. Derivative financial instruments** *(continued)***Cashflow hedges**

Principal asset balances of hedged items, on which the expected interest flows cash flows arise are as follows

<i>Dollars in Millions</i>	<i>Banking Group</i>		
	3 months or less	More than 3 months but less than 1 year	5 years or less, but more than one year
Net cash inflows /(outflows) exposure			
Assets	-	-	-
Liabilities	-	-	-
At 31 December 2016	-	-	-
Net cash inflows /(outflows) exposure			
Assets	235	235	50
Liabilities	(448)	(275)	(225)
At 31 December 2015	(213)	(40)	(175)

This table reflects the interest rate repricing profile of the underlying hedged items

During 2016 the Banking Group de-designated its cash flow hedges. Other hedging methods under the Group's risk management framework are now being used to manage the interest rate risk.

<i>Dollars in Thousands</i>	<i>Banking Group</i>	
	31.12.16	31.12.15
11. Advances to customers		
Overdrafts	93,464	136,564
Mortgages	1,320,910	1,166,623
Term lending	1,865,011	2,158,963
Non-eligible bills	159,815	113,192
Money market loans	10,000	14,500
Total gross advances to customers	3,449,200	3,589,842
Provisions for loan impairment	(2,417)	(3,845)
Total net advances to customers	3,446,783	3,585,997
12. Other assets		
Accrued interest receivable – third party	11,768	13,625
Acceptances and endorsements	7,132	3,624
Other	2,825	1,039
	21,725	18,288

Notes to and forming part of the Financial Statements *(continued)***Banking Group***Dollars in Thousands***13. Goodwill and intangible assets**

2016	Goodwill	Customer relationships purchased	Software	Total
Cost				
At 1 January	15,744	8,798	5,060	29,602
At 31 December	15,744	8,798	5,060	29,602
Accumulated amortisation and impairment				
At 1 January	(2,043)	(6,845)	(4,358)	(13,246)
Amortisation charge for the year	-	(733)	(599)	(1,332)
At 31 December	(2,043)	(7,578)	(4,957)	(14,578)
Net carrying value	13,701	1,220	103	15,024
2015				
Cost				
At 1 January	15,744	8,798	5,060	29,602
At 31 December	15,744	8,798	5,060	29,602
Accumulated amortisation and impairment				
At 1 January	(2,043)	(6,112)	(3,346)	(11,501)
Amortisation charge for the year	-	(733)	(1,012)	(1,745)
At 31 December	(2,043)	(6,845)	(4,358)	(13,246)
Net carrying value	13,701	1,953	702	16,356

Goodwill**a) Goodwill arising from the acquisition of AMP Bank Limited's loan and deposit portfolio**

Goodwill arose in 2003 upon acquisition of part of AMP Bank Limited's ("AMP") loan and deposit portfolio.

This goodwill relates entirely to the Banking Group's retail banking business, being the cash-generating unit ("CGU") as defined in NZ IAS 36. The carrying amount that relates to this CGU at 31 December 2016 is \$12.8 million (December 2015: \$12.8 million).

Goodwill is assessed at each reporting date for indicators of impairment as it is not amortised.

The recoverable amount of the CGU is determined based on value-in-use calculations. These calculations use discounted cash flow projections based on profit forecasts approved by management as part of the rolling operating plan process. The rolling operating plan covers a detailed one year time frame, approved by HBAP senior management. Profit forecasts greater than one year are estimated by Banking Group management based on their assessment of sustainable growth, estimated to be equal to average growth in GDP for New Zealand over the last 10 years. The discounted cash flow model has used a two year profit projection, a discount rate (pre tax) of 9.5% (December 2015: 9.7%), average annual growth rates for revenues and direct expenses (as detailed in the following table) supported by December 2016 actual results, and a terminal value of \$186 million (December 2015: \$249 million).

Management forecasting and approval processes were streamlined in 2016. Previously, two year forecasts approved by HBAP senior management and three additional years, estimated by Banking Group management, and supported by forecast growth were available.

Notes to and forming part of the Financial Statements (continued)**13. Goodwill and intangible assets** (continued)**Goodwill** (continued)**a) Goodwill arising from the acquisition of AMP Bank Limited's loan and deposit portfolio** (continued)**Average annual growth rate projections as at 31 December 2016**

	Years 1-2
Revenues	3.2%
Direct Expenses	1.3%

The annual growth rate for revenues and expenses for 2017 is supported by the actual December 2016 results.

Average annual growth rate projections as at 31 December 2015

	Years 1-2	Years 3-5	5 Year Average
Revenues	3.6%	3.9%	3.8%
Direct Expenses	(6.7%)	0.7%	(2.4%)

Key assumptions underlying the valuation relate to management's assessment of balance sheet growth, net interest margins, fee generation, bad debts, operating expenses and terminal value. Management utilise local market data as well as Group expertise and experience to validate key assumptions.

The most significant variable underlying the valuation is the terminal value. Terminal value is calculated using a stable growth model. The key variables used to calculate terminal value are the post-tax discount rate of 6.8% (December 2015: 7.0%) and an annual sustainable growth rate from Year 2 onwards of 1.9% (December 2015: 2.0%) which is equal to the average growth in GDP for New Zealand over the last 10 years. The terminal value would need to reduce by around 104% (December 2015: 119%), all other variables being equal, in order for the CGU's recoverable amount to be equal to its carrying value. As at 31 December 2016 the recoverable amount exceeds the carrying amount by \$194 million (December 2015: \$208 million).

b) Goodwill arising from the acquisition of Westpac Banking Corporation's ("WBC") custody and clearing business in New Zealand

Goodwill arose in September 2006 upon acquisition by the Branch of Westpac Banking Corporation's New Zealand custody and clearing business.

This goodwill relates entirely to the Branch's custody and clearing business, being the cash-generating unit ("CGU") as defined in NZ IAS 36. The carrying value that relates to this CGU at 31 December 2016 is \$0.86 million (December 2015: \$0.86 million).

The goodwill is assessed at each reporting date for indicators of impairment as it is not amortised.

The recoverable amount of the CGU is determined based on value-in-use calculations. These calculations use discounted cash flow projections based on profit forecasts approved by management as part of the rolling operating plan process. The rolling operating plan covers a detailed one year time frame, approved by HBAP senior management. Profit forecasts greater than one year are estimated by Branch management based on their assessment of sustainable growth. The discounted cash flow model has used a four year profit projection, a discount rate (pre-tax) of 11.9% (December 2015: 13.8%), annual growth rate for revenues and direct expenses (as detailed in the following table) supported by December 2016 actual results, and a terminal value of \$61 million (December 2015: \$43 million).

Management forecasting and approval processes were streamlined in 2016. Previously, two year forecasts approved by HBAP senior management and three additional years, estimated by Banking Group management, and supported by forecast growth were available.

Notes to and forming part of the Financial Statements *(continued)***13. Goodwill and intangible assets** *(continued)***Goodwill** *(continued)***b) Goodwill arising from the acquisition of Westpac Banking Corporation's ("WBC") custody and clearing business in New Zealand** *(continued)***Average annual growth rate projections as at 31 December 2016**

	Years 1-2	Years 3-4	4 Year Average
Revenues	1.6%	1.9%	1.4%
Direct Expenses	1.3%	1.9%	1.3%

The net average annual growth rate for revenues and expenses is supported by the actual December 2016 results.

Average annual growth rate projections as at 31 December 2015

	Years 1-2	Years 3-5	5 Year Average
Revenues	4.1%	4.0%	4.0%
Direct Expenses	(1.2%)	(6.2%)	(5.7%)

Key assumptions underlying the valuation relate to management's assessment of customer transaction volumes, share market turnover and value, fee structures, operating expenses and terminal value. Management utilise local market data as well as Group expertise and experience to validate key assumptions.

The most significant variable underlying the valuation is the terminal value. Terminal value is calculated using a stable growth model. The key variables used to calculate terminal value are the post tax discount rate of 8.6% (December 2015: 9.9%) and an annual sustainable growth rate from Year 3 onwards of 1.9% (December 2015: 2.0%) which is equal to the average growth in GDP for New Zealand over the last 10 years. The terminal value would need to reduce by around 125% (December 2015: 128%), all other variables being equal, in order for the CGU's recoverable amount to be equal to its carrying value. As at 31 December 2016 the recoverable amount exceeds the carrying amount by \$76 million (December 2015: \$34 million)

Other Intangible Assets

Other intangible assets primarily represent purchased software, internally generated computer software and customer relationships arising from the Banking Group's acquisition of Westpac Banking Corporation's New Zealand custody and clearing business.

Software is amortised on a straight line basis over 5 years.

Customer relationships are amortised on a straight-line basis over 12 years based on a statistical analysis of expected customer life. The remaining unamortised period at 31 December 2016 is 1 years 8 months (December 2015: 2 years 8 months).

These intangible assets are assessed at each reporting date for indications of impairment.

Notes to and forming part of the Financial Statements (continued)

	Banking Group	
<i>Dollars in Thousands</i>	31.12.16	31.12.15
14. Asset quality of advances to customers		
Neither past due nor impaired		
Grade 1-3: Low-fair risk	3,307,811	3,298,256
Grade 4-5: Watch List	97,410	222,978
Carrying amount	3,405,221	3,521,234
Past due but not impaired		
Less than 30 days	40,212	61,127
At least 30 days but less than 60 days	707	704
At least 60 days but less than 90 days	227	3,274
At least 90 days	-	-
Carrying amount	41,146	65,105
In the current and prior year, there was only one class of impaired financial assets, being advances to customers.		
Gross individually impaired assets ¹		
Balance at the beginning of the year	3,503	121,913
Transfers from performing	2,099	2,110
Transfers to performing	-	(21,686)
Write-offs	-	(441)
Repayment	(2,769)	(98,393)
Balance at the end of the year	2,833	3,503
Total gross loans and advances	3,449,200	3,589,842
Individual provision for loan impairment		
Balance at the beginning of the year	865	20,720
New and additional provisions charged to profit or loss	298	782
Provisions released during the year to profit or loss	(15)	(17,932)
Write-offs	-	(472)
Discount unwind ²	-	(2,233)
Balance at the end of the year	1,148	865
Collective provision for loan impairment		
Balance at the beginning of the year	2,980	5,234
Releases during the year to profit or loss	(1,711)	(2,254)
Balance at the end of the year	1,269	2,980
Total provisions for loan impairment	2,417	3,845
Net loans and advances to customers	3,446,783	3,585,997

¹ Gross individually impaired assets is the pre-allowance balance of individually impaired assets. The actual impairment is reflected within the individual provision for loan impairment as doubtful debts of the gross individually impaired assets.

² The impairment loss on an impaired asset is calculated as the difference between the asset's carrying amount and the estimated future cash flows discounted to its present value using the original effective interest rate for the asset. This discount unwinds as interest income over the period the asset is held.

There are no assets under administration as at 31 December 2016 (December 2015: nil). The aggregate amount as at 31 December 2016 of any undrawn balances on lending commitments to counterparties for whom drawn balances are classified as individually impaired, before deducting allowances for credit impairment loss where applicable, is \$24 thousand (December 2015: \$10 thousand).

Notes to and forming part of the Financial Statements *(continued)*

14. Asset quality of advances to customers *(continued)*

The credit quality of impaired advances is assessed by reference to a standard credit rating system.

Grades 1 and 2 include corporate facilities demonstrating financial condition, risk factors and capacity to repay that are good to excellent, residential mortgages with low to moderate loan to value ratios and other retail accounts which are maintained within product guidelines.

Grade 3 represents satisfactory risk, and includes corporate facilities that require closer monitoring, mortgages with higher loan to value ratios, and other retail exposures which operate outside product guidelines.

Grades 4 and 5 include facilities that require varying degrees of special attention.

Grades 6 and 7 relate to impaired loans and advances.

	<i>Banking Group</i>	
<i>Dollars in Thousands</i>	31.12.16	31.12.15
15. Customer deposits		
Current accounts	1,961,281	2,034,091
Savings and deposit accounts	1,148,129	1,206,649
Other deposit accounts	8,792	11,354
Total customer deposits at amortised cost	<u>3,118,202</u>	<u>3,252,094</u>

The total retail term deposits as at 31 December 2016 were \$1,132 million (December 2015: \$1,201 million).

16. Debt securities

Certificates of deposit issued	131,267	443,716
Medium term notes issued	200,000	400,000
	<u>331,267</u>	<u>843,716</u>

There are no debt securities on demand.

17. Other liabilities

Accrued interest payable	14,788	18,549
Accruals and deferred income	8,495	7,560
Acceptances and endorsements	7,132	3,624
Other	8,818	6,697
	<u>39,233</u>	<u>36,430</u>

Accruals as at 31 December 2016 include \$5.8 million for employee entitlements (December 2015: \$6.1 million).

Notes to and forming part of the Financial Statements *(continued)***18. Related party transactions**

Related party transactions are unsecured and entered into in the normal course of business. During the year there have been dealings between the Banking Group, HBAP and its subsidiaries and associated companies and other members of the ultimate holding company. Dealings include activities such as funding, accepting deposits, derivative transactions together with management and technical fees.

The balances for derivative financial instruments with related parties have been disclosed in Note 10. Transactions with related parties during the year have been disclosed in Notes 3 and 4.

The financial statements of the Banking Group should be read in conjunction with the financial statements of HBAP for the year ended 31 December 2016.

<i>Dollars in Thousands</i>	<i>Banking Group</i>	
	31.12.16	31.12.15
Key management compensation		
(a) Salaries and other short-term benefits	3,058	4,024
(b) Post-employment benefits	179	183
(c) Share-based payments expenses recognised	108	136
	<u>3,345</u>	<u>4,343</u>
Advances to key management		
(d) Advances to key management personnel	<u>3,684</u>	<u>2,783</u>

(e) Shares, options and other incentive plans

(i) *HSBC Holdings Savings-Related Share Option Plan (International)*

The subscription to this share option plan was closed in 2013 and therefore no share option was granted since 2013.

(ii) *HSBC Restricted Share Award Scheme*

Number of options awarded 10,746

The total fair value of the options awarded under the restricted share award scheme is \$104 thousand when converted into NZ dollars at grant date (December 2015: \$61 thousand).

The vesting period of the restricted share awards is staggered over three years.

The fair value of the share option granted under the HSBC Restricted Share Award Scheme is £4.60 (December 2015: £5.83).

Key management personnel represent the members of the New Zealand Executive Committee who are employees of the Banking Group. The EXCO acts as the chief operating decision maker for the Banking Group.

Interest Free Funding

The Banking Group has received an interest free loan from HBAP of \$194 million (December 2015: \$194 million) to support the thin capitalisation ratio imposed under New Zealand tax law. This loan has no repayment terms.

Notes to and forming part of the Financial Statements *(continued)*

	Banking Group	
<i>Dollars in Thousands</i>	31.12.16	31.12.15
18. Related party transactions <i>(continued)</i>		
Amounts due from related parties		
On demand	67,680	21,094
Other short term	278,223	833,593
	<u>345,903</u>	<u>854,687</u>
The Hongkong and Shanghai Banking Corporation Limited (HBAP):		
Hong Kong Branch	321,882	816,881
Singapore Branch	3,962	21,036
Sri Lanka Branch	-	3,736
Tokyo Branch	17,077	6,892
Other	226	182
Other:		
HSBC Bank plc	620	2,732
HUSI Non-Insurance North America	1,112	1,453
HSBC Bank (China) Company	64	1,669
Other	960	106
	<u>345,903</u>	<u>854,687</u>
Amounts due to related parties		
On demand	315,680	246,079
Other short term	232,194	149,543
Long term	625,287	501,137
	<u>1,173,161</u>	<u>896,759</u>
The Hongkong and Shanghai Banking Corporation Limited (HBAP):		
Hong Kong Branch	1,045,762	844,485
Singapore Branch	57,465	3,754
Australia Branch	7,440	587
Philippines Branch	1,765	1,525
Other	2,859	2,197
Other:		
HSBC Bank USA	1,651	11,573
HSBC Bank Plc UK Ops	28,187	9,045
HSBC Bank Canada	3,672	7,129
HSBC Trinkaus and Burkhardt	4,990	2,658
HSBC Bank (Singapore) Ltd	4,825	-
Other	14,545	13,806
	<u>1,173,161</u>	<u>896,759</u>

Notes to and forming part of the Financial Statements *(continued)***19. Fair value of financial instruments****Determination of fair value of financial instruments carried at fair value**

Fair values are determined according to the following hierarchy:

Level 1 – quoted market price

Financial instruments with quoted prices for identical instruments in active markets.

Level 2 – valuation technique using observable inputs

Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

Level 3- valuation technique with significant unobservable inputs

Financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

The table below provides an analysis of the various bases described above which have been deployed for valuing financial assets and financial liabilities measured at fair value.

		<i>Banking Group</i> 31.12.16		
<i>Dollars in Thousands</i>	Level 1	Level 2	Level 3	TOTAL
ASSETS				
Debt and equity securities	361,951	124,999	22	486,972
Derivatives financial instruments	-	161,666	-	161,666
LIABILITIES				
Derivatives financial instruments	-	164,101	-	164,101

		<i>Banking Group</i> 31.12.15		
<i>Dollars in Thousands</i>	Level 1	Level 2	Level 3	TOTAL
ASSETS				
Debt and equity securities	314,450	132,973	22	447,445
Derivatives financial instruments	-	313,918	-	313,918
LIABILITIES				
Derivatives financial instruments	-	314,362	-	314,362

There have been no transfers between levels 1 and 2 in the year to 31 December 2016 (December 2015: Nil).

Notes to and forming part of the Financial Statements *(continued)*

19. Fair value of financial instruments *(continued)*

Methodologies

The methodologies and assumptions used when determining fair value depend on the terms and risk characteristics of the various instruments and include the following:

Cash and demand balances with central banks

For cash and short - term funds the carrying amount is equivalent to the fair value.

Debt securities issued

Fair value for certificates of deposit and medium term notes issued with maturities less than six months is approximated to be the carrying value. For certificates of deposit and medium term notes issued with a maturity greater than six months but less than a year, fair value is determined by using discounted cash flow methods using the interest rates applicable to financial instruments of similar maturity. Inputs applied in getting the fair value of debt securities between 6 and 12 months are observable market-corroborated inputs which include interest rates and forward curves observable at commonly reported intervals, and credit spreads. Debt securities greater than 12 months are fair valued using market-corroborated swap rates.

Debt securities

For available-for-sale securities that are quoted in active markets, fair values are determined by reference to the current quoted bid/offer price. Where quoted market prices are not available, fair value is determined with reference to quoted prices for similar instruments in active markets, or through the use of a valuation model where inputs are observable.

Advances to customers, advances to banks, and amounts due from related parties

Fair values of advances to customers, advances to banks, and amounts due from related parties with maturities of six months or longer have been estimated by discounting cashflows up to the next repricing date with reference to current rates at which similar loans and advances would be made to other borrowers with a similar credit rating and the same maturities. The fair values of advances to customers, advances to banks, and amounts due from related parties with maturities less than six months are approximated to be the carrying value.

Deposits by banks, customer deposits, other accounts and amounts due to related parties

The fair values of deposits and other liabilities with maturities of less than six months are approximated to be the carrying amount. For liabilities with maturities of six months or longer, fair values have been based on quoted market prices, where such prices exist. Otherwise, fair values have been estimated by reference to rates currently offered by the Banking Group for similar liabilities of similar maturities.

Derivative financial instruments

The fair values of exchange rate and interest rate contracts were obtained from quoted market prices or discounted cash flow models. Inputs applied in getting the fair value of derivative financial instruments are market observable inputs which include interest rates and forward curves observable at commonly reported intervals where required.

Other assets and other liabilities

For other assets and other liabilities the carrying amount is considered to be the fair value.

Notes to and forming part of the Financial Statements *(continued)***19. Fair value of financial instruments** *(continued)*

The table below provides an analysis of the various bases described on page 55 which have been deployed for summarising financial assets and financial liabilities fair value which are not carried at fair value where the fair value is different to its carrying value.

<i>Dollars in Thousands</i>	Banking Group				Carrying value
	31.12.16				
	Fair Value			Total	
Level 1	Level 2	Level 3			
ASSETS					
Advances to customers	-	-	3,447,448	3,447,448	3,446,783
LIABILITIES					
Customer deposits	-	3,119,818	-	3,119,818	3,118,202
Debt securities	-	331,381	-	331,381	331,267
Amounts due to related parties	-	1,174,254	-	1,174,254	1,173,161

<i>Dollars in Thousands</i>	Banking Group				Carrying value
	31.12.15				
	Fair Value			Total	
Level 1	Level 2	Level 3			
ASSETS					
Advances to customers	-	-	3,596,102	3,596,102	3,585,997
LIABILITIES					
Customer deposits	-	3,255,005	-	3,255,055	3,252,094
Debt securities	-	843,732	-	843,732	843,716
Amounts due to related parties	-	897,005	-	897,005	896,759

Other financial instruments not carried at fair value are typically short-term in nature and reprice to the current market rates frequently. Accordingly, their carrying amount is a reasonable approximation of fair value. This includes cash and demand balances with central banks, advances to banks and deposits by banks, other assets and other liabilities.

Notes to and forming part of the Financial Statements *(continued)***20. Concentrations of credit and funding risk**

The maximum credit risk of on-balance sheet financial assets is best represented by the carrying amount of the assets, net of any provision for credit impairment. The credit risk exposure does not take into account the fair value of any collateral, in the event of other parties failing to perform their obligations under financial instruments.

<i>Dollars in Thousands</i>	<i>Banking Group</i>	
	31.12.16	31.12.15
On-balance sheet credit exposures		
Cash and demand balances with central banks	597,763	345,799
Advances to banks	8,504	7,601
Debt and equity securities	486,972	447,445
Derivative financial instruments	161,666	313,918
Advances to customers	3,446,783	3,585,997
Amounts due from related parties	345,903	854,687
Other assets	21,437	18,018
	5,069,028	5,573,465
Off-balance sheet credit exposures	2,450,015	2,336,105
Total credit exposures	7,519,043	7,909,570

Concentrations of credit risk exist if a number of counterparties are engaged in similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. The following analysis of financial assets by industry sector is based on categories and definitions used by the Hong Kong Monetary Authority:

Concentrations of credit risk by industry

Individual	1,571,436	1,438,695
Commercial and industrial	2,241,651	2,419,875
Commercial real estate and construction	811,403	824,235
Banks and financial institutions	2,040,080	2,257,200
Agriculture, forestry and mining	65,811	122,339
Transport	146,965	101,052
Energy	89,818	89,833
Government	85,083	78,314
Other	466,796	578,027
	7,519,043	7,909,570

Concentrations of credit risk by geographical area

New Zealand	6,371,082	6,288,566
Hong Kong	338,271	920,913
Australia	200,888	229,298
China	190,453	108,887
Great Britain	91,005	90,224
United States	159,590	89,045
Other Overseas	167,754	182,637
	7,519,043	7,909,570

Notes to and forming part of the Financial Statements *(continued)***20. Concentrations of credit and funding risk** *(continued)***Concentration of Credit Exposures to Individual counterparties**

The Banking Group has no credit exposures equal to or in excess of 10% of HBAP Group's equity, during the current reporting period and the previous corresponding periods. These exposures are based on actual credit exposures and do not include exposures to counterparties if they are booked outside of New Zealand.

	<i>Banking Group</i>	
<i>Dollars in Thousands</i>	31.12.16	31.12.15

Concentrations of funding**Concentrations of funding by product**

Deposits by banks	232,174	185,925
Customer deposits	3,118,202	3,252,094
Debt securities	331,267	843,716
Amounts due to related parties	1,173,161	896,759
	<u>4,854,804</u>	<u>5,178,494</u>

Concentrations of funding by industry

Agriculture, forestry and mining	82,463	50,196
Manufacturing	202,196	268,181
Wholesale and retail trade	176,558	154,336
Accommodation and restaurants	58,610	46,650
Banking and finance	2,003,701	2,414,074
Property and business services	226,875	237,191
Local authorities	7,613	6,543
Individual	1,897,396	1,823,967
Other	199,392	177,356
	<u>4,854,804</u>	<u>5,178,494</u>

Concentrations of funding by geographical area

New Zealand	2,237,443	2,354,655
China	352,348	364,842
Great Britain	177,432	484,862
Hong Kong	1,309,846	1,213,690
Japan	115,334	129,196
Singapore	123,373	60,810
Taiwan	55,486	60,721
United States	214,731	166,052
Other Overseas	268,811	343,666
	<u>4,854,804</u>	<u>5,178,494</u>

Notes to and forming part of the Financial Statements *(continued)***20. Concentration of credit and funding risk** *(continued)*

The Banking Group holds collateral against advances to customers in the form of mortgage interest over property, other registered securities over assets, and guarantees. The Banking Group generally requires a loan to value ratio for customer advances of 80% for mortgages, however this ratio may be varied according to other criteria such as customer income streams, regulatory requirements, mortgage protection insurance and relationship with the Group. Estimates of fair value are based on the value of the collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired.

The following table records collateral held as cash or registered charges over real estate only. Corporate counterparties with strong financial standing may borrow under a General Security Agreement, however these loans are reported as not collateralised. While such mitigants have value, often providing rights in insolvency, their assignable value is not sufficiently certain and they are therefore assigned no value in this disclosure. Loan to value ratios for Residential Mortgage customers is discussed further in Note 25.

<i>Percentage of total gross loans and advances to customers</i>	<i>Banking Group</i>	
	31.12.16	31.12.15
Fully collateralised	55%	46%
Partially collateralised	6%	13%
Not collateralised	39%	41%

Collateral is generally not held over advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity, or over amounts due from related parties.

Other financial assets neither past due nor impaired

There are no other assets, including cash and demand balances with central banks, advances to banks, debt securities, derivative financial instruments, and amounts due from related parties which are considered past due, or impaired at the end of the reporting year (December 2015: Nil).

The credit quality of other financial assets that were neither past due or impaired can be assessed by reference to the internal rating system adopted by the Banking Group and is set out in Note 14. The below schedule excludes accrued interest.

<i>Dollars in Thousands</i>	<i>Banking Group</i>			
	TOTAL	Grade 1-2	Grade 3	Grade 4-5
31 December 2016				
Cash and demand balances with central banks	597,763	597,763	-	-
Advances to banks	8,504	8,504	-	-
Debt and equity securities	486,972	486,972	-	-
Derivative financial instruments	161,666	148,250	12,366	1,050
Amounts due from related parties	345,903	345,903	-	-
31 December 2015				
Cash and demand balances with central banks	345,799	345,799	-	-
Advances to banks	7,601	7,601	-	-
Debt and equity securities	447,445	447,445	-	-
Derivative financial instruments	313,918	297,219	15,432	1,267
Amounts due from related parties	854,687	854,687	-	-

Notes to and forming part of the Financial Statements (continued)**21. Interest rate risk – repricing schedule**

The table below analyses the Banking Group's financial assets and financial liabilities into relevant maturity groupings based on the earlier of residual contractual maturity or next interest repricing date.

<i>Dollars in Millions</i>	Banking Group							<i>Total</i>
	<i>Up to 3 months</i>	<i>Over 3 months and up to 6 months</i>	<i>Over 6 months and up to 1 year</i>	<i>Over 1 year and up to 2 years</i>	<i>Over 2 years</i>	<i>Total interest bearing</i>	<i>Non interest bearing</i>	
31 December 2016								
<i>Financial Assets</i>								
Cash and demand balances with central banks	598	-	-	-	-	598	-	598
Advances to banks	9	-	-	-	-	9	-	9
Debt and equity securities	125	15	191	-	156	487	-	487
Derivative financial instruments	-	-	-	-	-	-	162	162
Advances to customers	2,278	157	369	416	227	3,447	-	3,447
Amounts due from related parties	326	-	-	-	-	326	20	346
Other assets	-	-	-	-	-	-	22	22
<i>Total financial assets</i>	3,336	172	560	416	383	4,867	204	5,071
<i>Financial Liabilities</i>								
Deposits by banks	232	-	-	-	-	232	-	232
Derivative financial instruments	-	-	-	-	-	-	164	164
Customer deposits	2,627	289	140	28	21	3,105	13	3,118
Debt securities	131	-	-	200	-	331	-	331
Amounts due to related parties	965	-	-	-	-	965	208	1,173
Other liabilities	-	-	-	-	-	-	39	39
<i>Total financial liabilities</i>	3,955	289	140	228	21	4,633	424	5,057
<i>Off-balance sheet financial instruments</i>								
Net notional interest rate contracts	-	-	283	(132)	(151)	-	-	-
31 December 2015								
<i>Financial Assets</i>								
Cash and demand balances with central banks	346	-	-	-	-	346	-	346
Advances to banks	8	-	-	-	-	8	-	8
Debt and equity securities	127	-	33	220	67	447	-	447
Derivative financial instruments	-	-	-	-	-	-	314	314
Advances to customers	2,585	257	236	242	266	3,586	-	3,586
Amounts due from related parties	851	-	-	-	-	851	4	855
Other assets	-	-	-	-	-	-	18	18
<i>Total financial assets</i>	3,917	257	269	462	333	5,238	336	5,574
<i>Financial Liabilities</i>								
Deposits by banks	186	-	-	-	-	186	-	186
Derivative financial instruments	-	-	-	-	-	-	314	314
Customer deposits	2,641	352	156	54	28	3,231	21	3,252
Debt securities	394	250	-	-	200	844	-	844
Amounts due to related parties	676	-	11	-	-	687	210	897
Other liabilities	-	-	-	-	-	-	36	36
<i>Total financial liabilities</i>	3,897	602	167	54	228	4,948	581	5,529
<i>Off-balance sheet financial instruments</i>								
Net notional interest rate contracts	157	(173)	115	(142)	(7)	(50)	-	(50)

Notes to and forming part of the Financial Statements (continued)**22. Liquidity risk management**

Liquidity risk is the risk that the Banking Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.

Liquid assets are assets which are readily convertible to cash to meet the Banking Group's liquidity requirement. Liquid assets consist of demand balances with the central bank, government and local government bonds, and registered certificates of deposits issued by other banks. The Banking Group holds the following liquid assets in order to manage its liquidity risk:

<i>Dollars in Thousands</i>	<i>Banking Group</i>	
	31.12.16	31.12.15
Demand balances with the central bank	597,763	345,644
Available-for-sale debt securities	486,950	447,423
	<u>1,084,713</u>	<u>793,067</u>

Maturity Analysis – discounted maturities

The table below analyses the Banking Group's assets and liabilities into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date.

<i>Dollars in Millions</i>	<i>Banking Group</i>							<i>Total</i>
	<i>On Demand</i>	<i>0-1 month</i>	<i>1-3 months</i>	<i>3-12 months</i>	<i>1-5 years</i>	<i>Over 5 years</i>	<i>No specific maturity</i>	
31 December 2016								
<i>Assets</i>								
Cash and demand balances with central banks	598	-	-	-	-	-	-	598
Advances to banks	8	-	-	-	-	-	-	8
Debt and equity securities	-	100	25	206	156	-	-	487
Advances to customers	267	118	150	468	1,246	1,198	-	3,447
Amounts due from related parties	68	278	-	-	-	-	-	346
Other assets	1	18	3	-	-	-	-	22
Intangible assets	-	-	-	-	-	-	15	15
Property, plant and equipment	-	-	-	-	-	-	1	1
<i>Total</i>	<u>942</u>	<u>514</u>	<u>178</u>	<u>674</u>	<u>1,402</u>	<u>1,198</u>	<u>16</u>	<u>4,924</u>
Derivative financial instruments – inflow	-	13	20	131	35	1,468	-	1,667
Derivative financial instruments – (outflow)	-	-	-	(114)	-	(1,391)	-	(1,505)
Derivative financial instruments - assets	-	13	20	17	35	77	-	162
<i>Liabilities</i>								
Deposits by banks	232	-	-	-	-	-	-	232
Customer deposits	1,976	240	423	420	58	2	-	3,119
Debt securities	-	100	31	-	200	-	-	331
Amounts due to related parties	316	232	-	-	625	-	-	1,173
Other liabilities	1	15	14	6	3	-	-	39
Current taxation	-	-	3	-	-	-	-	3
Deferred taxation	-	-	-	-	-	-	-	-
<i>Total</i>	<u>2,525</u>	<u>587</u>	<u>471</u>	<u>426</u>	<u>886</u>	<u>2</u>	-	<u>4,897</u>
Derivative financial instruments – (inflow)	-	-	-	(114)	-	(1,390)	-	(1,504)
Derivative financial instruments – outflow	-	16	20	130	36	1,466	-	1,668
Derivative financial instruments – liabilities	-	16	20	16	36	76	-	164
<i>Net assets</i>	<u>(1583)</u>	<u>(76)</u>	<u>(293)</u>	<u>249</u>	<u>515</u>	<u>1,197</u>	<u>16</u>	<u>25</u>

Notes to and forming part of the Financial Statements (continued)**22. Liquidity risk management** (continued)**Maturity Analysis** (continued)

<i>Dollars in Millions</i>	Banking Group							<i>Total</i>
	<i>On Demand</i>	<i>0-1 month</i>	<i>1-3 months</i>	<i>3-12 months</i>	<i>1-5 years</i>	<i>Over 5 years</i>	<i>No specific maturity</i>	
31 December 2015								
<i>Assets</i>								
Cash and demand balances with central banks	346	-	-	-	-	-	-	346
Advances to banks	8	-	-	-	-	-	-	8
Debt and equity securities	-	108	20	33	275	11	-	447
Advances to customers	295	91	165	509	1,493	1,033	-	3,586
Amounts due from related parties	21	832	2	-	-	-	-	855
Other assets	-	15	3	-	-	-	-	18
Intangible assets	-	-	-	-	-	-	16	16
Property, plant and equipment	-	-	-	-	-	-	1	1
Total	670	1,046	190	542	1,768	1,044	17	5,277
Derivative financial instruments – inflow	-	31	29	605	1,035	1,825	-	3,525
Derivative financial instruments – (outflow)	-	-	-	(520)	(975)	(1,716)	-	(3,211)
Derivative financial instruments - assets	-	31	29	85	60	109	-	314
<i>Liabilities</i>								
Deposits by banks	186	-	-	-	-	-	-	186
Customer deposits	2,038	307	316	496	93	2	-	3,252
Debt securities	-	118	276	250	200	-	-	844
Amounts due to related parties	246	139	-	11	501	-	-	897
Other liabilities	1	9	13	8	5	-	-	36
Current taxation	-	-	7	-	-	-	-	7
Deferred taxation	-	-	-	-	-	-	1	1
Total	2,471	573	612	765	799	2	1	5,223
Derivative financial instruments – (inflow)	-	-	-	(520)	(975)	(1,715)	-	(3,210)
Derivative financial instruments – outflow	-	28	30	610	1,034	1,822	-	3,524
Derivative financial instruments – liabilities	-	28	30	90	59	107	-	314
Net assets	(1,801)	476	(423)	(228)	970	1,044	16	54

Notes to and forming part of the Financial Statements (continued)**22. Liquidity risk management** (continued)**Maturity Analysis – undiscounted cashflows basis**

The table below analyses the Banking Group's financial assets and liabilities into relevant maturity groupings based on their remaining contractual maturities. The amounts in the table below represent all cash flows relating to principal and future interest payments on an undiscounted basis. Therefore they may differ to the carrying amounts on the Statement of Financial Position.

The Banking Group does not manage its liquidity risk on the basis of information below.

<i>Dollars in Millions</i>	Banking Group						<i>No specific maturity</i>	<i>Total</i>
	<i>On Demand</i>	<i>0-1 month</i>	<i>1-3 months</i>	<i>3-12 months</i>	<i>1-5 years</i>	<i>Over 5 years</i>		
31 December 2016								
Financial Assets								
Cash and demand balances with central banks	598	-	-	-	-	-	-	598
Advances to banks	8	-	-	-	-	-	-	8
Debt and equity securities	-	101	32	216	172	-	-	521
Advances to customers	267	128	168	546	1,530	2,078	-	4,717
Amounts due from related parties	68	278	-	-	-	-	-	346
Other assets	1	18	3	-	-	-	-	22
Total non-derivative financial assets	942	525	203	762	1,702	2,078	-	6,212
Derivative financial instruments – held for trading purposes	162	-	-	-	-	-	-	162
Derivative financial instruments – held for hedging purposes (net settled)	-	-	-	-	-	-	-	-
Inflow / (outflow)	-	-	-	-	-	-	-	-
Total undiscounted financial assets	1,104	525	203	762	1,702	2,078	-	6,374
Financial Liabilities								
Deposits by banks	232	-	-	-	-	-	-	232
Customer deposits	1,976	242	430	432	64	2	-	3,146
Debt securities	-	100	33	4	206	-	-	343
Amounts due to related parties	316	233	2	9	638	-	-	1,198
Other liabilities	1	15	14	6	3	-	-	39
Total non-derivative financial liabilities	2,525	590	479	451	911	2	-	4,958
Derivative financial instruments – held for trading purposes	160	-	-	-	-	-	-	160
Derivative financial instruments – held for hedging purposes (net settled)	-	-	-	-	-	-	-	-
(Inflow) / outflow	-	-	1	2	1	-	-	4
Total undiscounted financial liabilities	2,685	590	480	453	912	2	-	5,122
Undrawn loan commitments	567	-	1,226	-	-	-	-	1,793

Notes to and forming part of the Financial Statements (continued)**22. Liquidity risk management** (continued)**Maturity Analysis – undiscounted cashflows basis** (continued)

<i>Dollars in Millions</i>	Banking Group							<i>Total</i>
	<i>On Demand</i>	<i>0-1 month</i>	<i>1-3 months</i>	<i>3-12 months</i>	<i>1-5 years</i>	<i>Over 5 years</i>	<i>No specific maturity</i>	
31 December 2015								
Financial Assets								
Cash and demand balances with central banks	346	-	-	-	-	-	-	346
Advances to banks	8	-	-	-	-	-	-	8
Debt and equity securities	-	108	25	45	292	11	-	481
Advances to customers	295	103	187	603	1,802	1,877	-	4,867
Amounts due from related parties	21	832	2	-	-	-	-	855
Other assets	-	15	3	-	-	-	-	18
Total non-derivative financial assets	670	1,058	217	648	2,094	1,888	-	6,575
Derivative financial instruments – held for trading purposes	313	-	-	-	-	-	-	313
Derivative financial instruments – held for hedging purposes (net settled)	-	-	-	-	-	-	-	-
Inflow / (outflow)	-	-	-	-	-	-	-	-
Total undiscounted financial assets	983	1,058	217	648	2,094	1,888	-	6,888
Financial Liabilities								
Deposits by banks	186	-	-	-	-	-	-	186
Customer deposits	2,038	310	322	512	103	2	-	3,287
Debt securities	-	119	281	258	215	-	-	873
Amounts due to related parties	246	140	2	22	506	-	-	916
Other liabilities	1	9	13	8	5	-	-	36
Total non-derivative financial liabilities	2,471	578	618	800	829	2	-	5,298
Derivative financial instruments – held for trading purposes	307	-	-	-	-	-	-	307
Derivative financial instruments – held for hedging purposes (net settled)	-	-	1	3	3	-	-	7
(Inflow) / outflow	-	-	-	-	-	-	-	-
Total undiscounted financial liabilities	2,778	578	619	803	832	2	-	5,612
Undrawn loan commitments	585	-	1,300	-	-	-	-	1,885

Notes to and forming part of the Financial Statements *(continued)***23. Offsetting financial asset and financial liabilities**

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously (“the offset criteria”). The Banking Group has no financial instruments that meet the offset criteria at 31 December 2016 (2015: nil).

Derivative agreements included in the amounts subject to enforceable netting arrangements but not offset in the balance sheet relate to transactions where:

- the counterparty has an offsetting exposure with the group and a master netting or similar arrangement is in place with a right of set off only in the event of default, insolvency or bankruptcy, or the offset criteria are otherwise not satisfied; and
- cash and non-cash collateral received/pledged in respect of the transactions described above.

<i>Dollars in Millions</i>	Gross amounts presented in the balance sheet	Amounts subject to enforceable netting arrangements but not offset in the balance sheet		Net amount
		Related financial instruments	Cash collateral received	
31 December 2016				
Derivative financial assets	162	(24)	(24)	114
Financial assets	162	(24)	(24)	114
Deposits by banks	232	-	(24)	208
Derivative financial liabilities	164	(24)	-	140
Financial liabilities	396	(24)	(24)	348
31 December 2015				
Derivative financial assets	314	(26)	(25)	263
Financial assets	314	(26)	(25)	263
Deposits by banks	186	-	(25)	161
Derivative financial liabilities	314	(26)	-	288
Financial liabilities	500	(26)	(25)	449

24. Foreign currency risk exposure

The net open position in each foreign currency, detailed in the table below, represents the on-balance sheet assets and liabilities in that foreign currency. The amounts are stated in New Zealand dollar equivalents translated using the spot exchange rates as at the end of the reported period.

<i>Dollars in Millions</i>	<i>Banking Group</i>	
	Audited 31.12.16	Audited 31.12.15
Receivable / (payable)		
AUD	0.1	0.1
GBP	-	(0.1)
USD	-	(0.1)
Other	(0.1)	0.1
	-	-

Notes to and forming part of the Financial Statements *(continued)***25. Additional mortgage information****Residential mortgages by loan-to-value ratio**

Loan to value ratio range	Banking Group			Total
	Principal Amount			
	Does not exceed 80%	Exceeds 80% and not 90%	Exceeds 90%	
<i>Dollars in Thousands</i>				
31 December 2016 (Unaudited)				
Value of exposures on balance sheet	1,311,489	7,440	1,981	1,320,910
Value of exposures off balance sheet	21,304	3	9	21,316
Total value of exposures	1,332,793	7,443	1,990	1,342,226
31 December 2015 (Unaudited)				
Value of exposures on balance sheet	1,153,961	10,587	2,075	1,166,623
Value of exposures off balance sheet	23,382	-	-	23,382
Total value of exposures	1,177,343	10,587	2,075	1,190,005

26. Market risk exposures

Aggregate market risk exposures are derived in accordance with the Capital Adequacy Framework (Standardised Approach) (BS2A) as stated in clauses 2 to 4 of Schedule 9 to the Order.

The period end exposure is the exposure as at the end of the period reported. The peak exposure is the peak end-of-day market risk exposure over the half year accounting period at the close of each business day. The peak is calculated separately for each category of exposure and may not have occurred at the same time.

<i>Dollars in Millions</i>	Banking Group	
	Implied risk weighted Exposure	Notional capital charge
Exposure at 31 December 2016 (Unaudited)		
Interest rate risk	102.00	8.16
Foreign currency risk	0.25	0.02
Equity risk	-	-
Peak exposure period 1 July 2016 to 31 December 2016 (Unaudited)		
Interest rate risk	117.13	9.37
Foreign currency risk	0.63	0.05
Equity risk	-	-

Notes to and forming part of the Financial Statements *(continued)***27. Share options**

The Branch participated in the following share compensation plans operated by the Group for the acquisition of HSBC Holdings plc shares. The options were granted at nil consideration. No options have been granted to substantial shareholders, suppliers of goods and services, or in excess of the individual limit of each share plan. In April 2009, HSBC Holdings plc raised £12.5 billion (US\$17.8 billion), net of expenses, by the way of a fully underwritten rights issue, offering its shareholders 5 new ordinary shares for every 12 ordinary shares at a price of 254 pence per new ordinary share. The Remuneration Committee agreed to make adjustments to all unexercised share options and share awards under HSBC's various share plans and share schemes as a consequence of the rights issue.

a. HSBC Holdings Group International Employee Share Purchase Plan

The HSBC Holdings Group International Employee Share Purchase Plan ('Share Match') invites eligible employees to enter into savings contracts with funds used to acquire shares. The Scheme commenced on 1 September 2015. Eligible employees use saved funds to acquire shares each quarter. Employees are awarded matching shares proportional to their purchased shares. Matching awards vest subject to continued employment and the retention of the purchased shares for a maximum of two years and nine months.

	31.12.16
	<i>Number of shares</i>
Shares at beginning of the period	-
New shares granted during the period	3,757
Additional shares arising from scrip dividends	452
Shares released during the period	-
Shares forfeited during the period	(47)
Shares transferred in during the period	11,271
Shares transferred out during the period	-
Shares outstanding at the end of the period	<u>15,433</u>

Notes to and forming part of the Financial Statements *(continued)***27. Share options** *(continued)***b. HSBC Holdings Savings-Related Share Option Plan (International)**
HSBC Holdings ordinary shares of US\$0.50

The HSBC Holdings Savings-Related Share Option Plan invites eligible employees to enter into savings contracts to save with the option to use the savings to acquire shares. Options have a vesting period of either 1, 3 or 5 years. The options are exercisable within 3 months following the first anniversary of the commencement of a 1 year savings contract or within 6 months following either the third or the fifth anniversary of the commencement of the 3 year or 5 year savings contract depending on conditions set at the date of grant. There is generally one grant each year (in April or May). The first grant was in 1999.

The subscription to this share option plan had been closed in 2013 and therefore no share option was granted in 2016 (2015: Nil).

	Banking Group			
	31.12.16		31.12.15	
	<i>Weighted average exercise price</i>	<i>Number of options</i>	<i>Weighted average exercise price</i>	<i>Number of options</i>
Share options at beginning of the period	£4.69	11,372	£4.32	30,349
Share options granted during the period	-	-	-	-
Share options exercised during the period	£4.46	(4,678)	£4.11	(23,467)
Share options expired during the period	£4.46	(44)	£4.96	(870)
Share options cancelled during the period	£4.37	(1,334)	£4.46	(752)
Share options forfeited during the period	-	-	-	-
Share options transferred in during the period	£4.05	1,334	£4.31	6,112
Share options transferred out during the period	£5.19	(346)	-	-
Share options outstanding at the end of the period	£4.84	6,304	£4.69	11,372
Share options exercisable at the end of the period	£5.34	1,553	£4.46	4,722

The weighted average share price on the dates on which options were exercised was £4.46 in the year ending 31 December 2016. (December 2015: £4.89).

The options outstanding at 31 December 2016 have an exercise price in the range of £4.46 to £5.47 (December 2015: £4.46 to £5.47) and a weighted average remaining contractual life of 11 months (December 2015: 11 months).

Notes to and forming part of the Financial Statements *(continued)***27. Share options** *(continued)***c. HSBC Restricted Share Award Scheme**

Awards of Restricted Shares may be made to other senior executives. These awards are typically made to certain employees as part of the Group's bonus deferral policy. Awards of Restricted Shares define the number of shares to which the employee will become entitled, generally between one and three years from the date of the award, and normally subject to the individual remaining in employment.

	31.12.16	31.12.15
	<i>Number of</i>	<i>Number of</i>
	<i>shares</i>	<i>shares</i>
Shares at beginning of the period	44,213	37,489
New shares granted during the period	14,532	32,848
Additional shares arising from scrip dividends	3,128	3,083
Shares released during the period	(18,580)	(30,285)
Shares forfeited during the period	(975)	-
Shares transferred in during the period	15,986	1,928
Shares transferred out during the period	(23,717)	(850)
Shares outstanding at the end of the period	<u>34,587</u>	<u>44,213</u>

The fair value of the share option granted under the HSBC Restricted Share Award Scheme is £4.60 (December 2015: £5.83).

Calculation of fair values

The fair value of services received in return for share options granted are measured by referring to the fair value of share options granted.

Fair values of share options/awards, measured at the date of grant of the option/award, are calculated using a Black-Scholes model.

The fair value of share option/award is based on the share price at the date of the grant. The fair value of share option/award is inherently subjective and uncertain due to the assumptions made and the limitations of the model used.

The fair value of the shares awarded under the HSBC Restricted Share Award Scheme is the market value of the shares at the date of award.

	<i>Banking Group</i>	
<i>Dollars in Thousands</i>	31.12.16	31.12.15

28. Lease commitments**Future rentals in respect of operating leases are:**

Within one year	2,741	2,908
Between one year and two years	2,370	748
Between two years and five years	6,313	391
Over five years	17,133	-
	<u>28,557</u>	<u>4,047</u>

Notes to and forming part of the Financial Statements *(continued)*

	<i>Banking Group</i>	
<i>Dollars in Thousands</i>	31.12.16	31.12.15

29. Contingent liabilities and other commitments**Contingent liabilities and commitments**

Contingent liabilities and commitments are credit-related instruments which include letters of credit, guarantees and commitments to extend credit. The amounts below represent the amount at risk should contracts be fully drawn upon and clients default.

Direct credit substitutes	56,550	60,454
Transaction related contingent items	288,453	274,588
Trade related contingent items	303,619	109,684
Commitments, maturity one year or more	1,136,423	1,144,938
Commitments, maturity up to one year	664,970	746,441
	<u>2,450,015</u>	<u>2,336,105</u>
Capital commitments		
Contracted expenditure	<u>-</u>	<u>-</u>

30. Custodial services, funds management and other fiduciary activities**Custodial services**

The financial statements of the Banking Group include income in respect of custodial services provided to customers. It is the Branch who contracts with the customers. The securities are held in the name of the Branch's nominee company, HSBC Nominees (New Zealand) Limited. As at 31 December 2016, securities held by the nominee company on behalf of the Branch's customers were excluded from the nominee company and the Banking Group's Statement of Financial Position. The value of securities held by the nominee company at 31 December 2016 was \$66,745 million (2015: \$65,385 million).

HSBC Nominees (New Zealand) Limited is subject to the standard risks incurred by custodial operations. HSBC Holdings plc holds Banker's Blanket Bond insurance that provides cover for it, and its subsidiary companies in respect of loss of cash and other assets (incurred accidentally or by reason of fraud). Such Banker's Blanket Bond insurance is maintained with limits of cover which vary from time to time but which are considered prudent and in accordance with international levels and insurance market capacity. In addition, securities custody operations are specifically covered by a wrap-around Papers of Value Cover.

The Banking Group has established governance and legal structures to ensure that difficulties arising from custodial activities would not impact adversely on the Banking Group. The legal structures are detailed within the Statement of Accounting Policies and as noted above.

31. Structured entities and marketing and distribution of insurance products*Structured entities*

The Banking Group enters into transactions with unconsolidated structured entities in the normal course of business to facilitate customer transactions and for specific investment opportunities to earn income in the form of interest and fees. The Banking Group's arrangements that involve structured entities are authorised centrally prior to being established to ensure appropriate purpose and governance. The Banking Group has interests in an unconsolidated securitisation vehicle providing funding through the subscription of notes issued by the structured entity. The primary source of debt service and security is derived from the underlying assets of the structured entity. All lending is subject to the Banking Group's credit approval process. The total assets of the unconsolidated structured entity at reporting date was \$391million (December 2015: \$401million). The total assets and commitments of the Banking Group in the unconsolidated structured entity at reporting date was \$57million and \$10million respectively (December 2015: \$58million and \$9million). This reflects the maximum exposure to loss in relation to those interests regardless of the probability of the loss being incurred. This is stated gross of the effects of any collateral arrangements entered into to mitigate the Banking Groups exposure to loss. On balance sheet amounts are included in 'advances to customers'.

Notes to and forming part of the Financial Statements *(continued)*

31. Structured entities and marketing and distribution of insurance products *(continued)*

Structured entities (continued)

The Banking Group has no provisions for amounts held in structured entities, nor does the Banking Group provide or anticipate providing in the future any non-contractual financial support.

Insurance products

The Banking Group markets and distributes both life and general insurance products. The life and general insurance products are underwritten by external third party insurance companies. Disclosure statements are made in all marketing material that the products are underwritten by those companies and the Banking Group does not guarantee the obligations of, or any products issued by, those companies. Such arrangements have been put in place to ensure that difficulties arising from these activities would not impact adversely on the Banking Group.

32. Insurance and non-financial activities

The Banking Group does not conduct any insurance business or non-financial activities in New Zealand. HBAP does not carry on any insurance business or non-financial activities in New Zealand that is outside its banking group.

33. Subsequent events

There were no events subsequent to the balance sheet date which would materially affect the financial statements.

34. Capital adequacy ratios of HBAP Group

HBAP Group is subject to the capital requirements as specified by the Hong Kong Monetary Authority (HKMA).

HBAP Group uses the advanced internal ratings-based approach to calculate its credit risk for the majority of its non-securitisation exposures and the internal ratings-based (securitisation) approach to determine credit risk for its banking book securitisation exposures. For market risk, HBAP Group uses an internal models approach to calculate its general market risk for the risk categories of interest rate exposures, foreign exchange (including gold) exposures and equity exposures. HBAP Group also uses an internal models approach to calculate its market risk in respect of specific risk for interest rate exposures and equity exposures. HBAP Group uses the standardised (market risk) approach for calculating other market risk positions as well as trading book securitisation exposures, and the standardised (operational risk) approach to calculate its operational risk.

The capital requirements of HKMA are at least equal to those specified under the Basel framework ("Basel III"). HBAP Group exceeds the minimum capital ratio requirements as specified by the HKMA as at 31 December 2016 and 31 December 2015.

The capital adequacy disclosure made by the HBAP Group can be found in the Annual Report and Accounts at this website, <http://www.hsbc.com/investor-relations/subsidiary-company-reporting>.

HBAP Group reported the following capital adequacy ratios under Basel III, which were the most recent publicly available information:

	Unaudited 31.12.16	Unaudited 31.12.15
Basel III Capital Ratios		
Common Equity Tier 1 ("CET1") capital	16.0%	15.6%
Tier 1 capital	17.2%	16.6%
Total capital	19.0%	18.6%

The capital ratios for HBAP, as a stand-alone entity, are not publicly available.

Notes to and forming part of the Financial Statements *(continued)***35. Profitability, size and asset quality of HBAP Group**

<i>Dollars in HK\$ millions</i>	Audited 12 months ended 31.12.16	Unaudited 6 months ended 30.06.2016	Audited 12 months ended 31.12.15
Profitability			
Net profit after tax	84,795	43,245	99,983
Net profit after tax over the previous 12 month period, as a percentage of average total assets	1.2% ¹	1.1% ¹	1.4% ¹
Size			
Total assets	7,548,952	7,404,171	6,953,683
Percentage increase in total assets over the previous 12 months period	8.6%	3.3%	1.1%
Asset quality			
Individually impaired assets	17,539	19,781	16,786
Individual impairment provision against advances to customers	(8,059)	(7,862)	(7,040)
Collective impairment provision against advances to customers	(4,633)	(4,868)	(4,489)
Individually impaired assets / total assets	0.2%	0.3%	0.2%
Individual impairment provision / individually impaired assets	44.8%	39.7%	41.9%

¹ Average total assets for HBAP Group is not publicly available. This calculation uses a two-point average of total assets as at the end of the reported period and the comparative period ended 12 months earlier.

Directors' and New Zealand Chief Executive Officer's Statements

Each Director and the New Zealand Chief Executive Officer believes, after due enquiry by them, that:

- The Disclosure Statement contains all the information that is required by the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended);
- The Disclosure Statement is not false or misleading;

as at the date on which the Disclosure Statement is signed; and

each Director and the New Zealand Chief Executive Officer believes, after due enquiry by them, that:

- the Branch had systems in place to monitor and control adequately the material risks of the Banking Group including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk and other business risks, and that those systems were being properly applied; and
- the Registered Bank has complied with all Conditions of Registration that applied;

over the year ended 31 December 2016.

This Disclosure Statement has been signed for and on behalf of the Directors of The Hongkong and Shanghai Banking Corporation Limited (as listed on pages 3 to 5) by their attorney, Christopher David Gosse Russell, and also in his capacity as Chief Executive Officer:



Christopher David Gosse Russell
Chief Executive Officer
New Zealand Branch

27 March 2017

It is confirmed that the said powers of attorney appointing Christopher David Gosse Russell are still in force and have not been revoked.



Independent auditor's report

To the Directors of The Hongkong and Shanghai Banking Corporation Limited

This report is for the aggregated New Zealand operations of The Hongkong and Shanghai Banking Corporation Limited ('Banking Group').

This report includes:

- our audit opinion on the financial statements prepared in accordance with Clause 25 of the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended) (the 'Order'), New Zealand Equivalents to International Financial Reporting Standards ('NZ IFRS') and International Financial Reporting Standards ('IFRS');
- our audit opinion on the supplementary information (excluding supplementary information relating to credit and market risk exposures and capital adequacy) prepared in accordance with Schedules 4, 7, 10, 11 and 13 of the Order;
- our audit opinion on other legal and regulatory requirements in accordance with Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order; and
- our review conclusion on the supplementary information relating to credit and market risk exposures and capital adequacy prepared in accordance with Schedule 9 of the Order.

Report on the audit of the financial statements and supplementary information (excluding supplementary information relating to credit and market risk exposures and capital adequacy)

We have audited the Banking Group's financial statements required by Clause 25 of the Order and the supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 25, 26 and 34) required by Schedules 4, 7, 10, 11 and 13 of the Order.

The Banking Group's financial statements and the supplementary information comprise:

- the statement of financial position as at 31 December 2016;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended;
- the notes to the financial statements, which include significant accounting policies; and
- the supplementary information required by the Order (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 25, 26 and 34).

Our opinion

In our opinion:

- The Banking Group's financial statements (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 9, 10, 11 and 13 of the Order and included within Notes 2, 8, 14, 20, 21, 22, 25, 26, 30, 31, 32, 34 and 35):



- (i) comply with generally accepted accounting practice in New Zealand;
 - (ii) comply with International Financial Reporting Standards; and
 - (iii) give a true and fair view of the financial position of the Banking Group as at 31 December 2016, and its financial performance and cash flows for the year then ended.
- The supplementary information disclosed in accordance with Schedules 4, 7, 10, 11 and 13 of the Order and included within Notes 2, 8, 14, 20, 21, 22, 30, 31, 32 and 35:
 - (i) has been prepared, in all material respects, in accordance with the guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act 1989 or any conditions of registration;
 - (ii) is in accordance with the books and records of the Banking Group; and
 - (iii) fairly states, in all material respects, the matters to which it relates in accordance with those Schedules.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs NZ) and International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements and supplementary information* section of our report.

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

Information other than the financial statements, supplementary information and auditor's report

The Directors of The Hongkong and Shanghai Banking Corporation Limited (the 'Directors') are responsible for the other information in the Disclosure Statement. The other information comprises the information required to be included in the Disclosure Statement in accordance with Schedule 2 of the Order and is included on pages 2 to 11. Our opinion on the financial statements and supplementary information does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements and supplementary information, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the aggregated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the financial statements and supplementary information

The Directors are responsible, on behalf of The Hongkong and Shanghai Banking Corporation Limited, for the preparation and fair presentation of the financial statements prepared in accordance with Clause 25 of the Order, NZ IFRS and IFRS and that give a true and fair view of the matters to which they relate. The Directors are also responsible for such internal controls as the Directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.



In addition, the Directors are responsible for the preparation and fair presentation of supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 10, 11 and 13 of the Order.

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

Auditor's responsibilities for the audit of the financial statements and supplementary information

Our objectives are to obtain reasonable assurance about whether the financial statements and the supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 25, 26 and 34) disclosed in accordance with Clause 25 and Schedules 4, 7, 10, 11 and 13 of the Order, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs NZ and ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these aggregated financial statements.

A further description of our responsibilities for the audit of the financial statements is located at the External Reporting Board's website at:

https://xrb.govt.nz/Site/Auditing_Assurance_Standards/Current_Standards/Page5.aspx

This description forms part of our auditor's report.

Report on other legal and regulatory requirements (excluding supplementary information relating to credit and market risk exposures and capital adequacy)

We also report in accordance with the requirements of Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the financial statements and supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 25, 26 and 34) for the year ended 31 December 2016:

- (i) we have obtained all the information and explanations that we have required; and
- (ii) in our opinion, proper accounting records have been kept by the Banking Group as far as appears from an examination of those records.

Report on the review of the supplementary information relating to credit and market risk exposures and capital adequacy

We have reviewed the supplementary information relating to credit and market risk exposures and capital adequacy required by Schedule 9 of the Order as disclosed in Notes 25, 26 and 34 of the financial statements of the Banking Group for the year ended 31 December 2016.

Our conclusion

Based on our review, nothing has come to our attention that causes us to believe that the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 25, 26 and 34, is not in all material respects:

- (i) prepared in accordance with Capital Adequacy Framework (Standardised Approach) (BS2A); and



- (ii) disclosed in accordance with Schedule 9 of the Order.

This conclusion is to be read in the context of what we say in the remainder of this report.

Basis for our conclusion

We conducted our review in accordance with the New Zealand Standard on Review Engagements 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity* (NZ SRE 2410). Our responsibilities under this standard is further described in the *Auditor's responsibilities for the review of the supplementary information relating to credit and market risk exposures and capital adequacy* section of our report.

Responsibilities of the Directors for the supplementary information relating to credit and market risk exposures and capital adequacy

The Directors are responsible, on behalf of The Hongkong and Shanghai Banking Corporation Limited, for the preparation and fair presentation of the supplementary information relating to credit and market risk exposures and capital adequacy in accordance with the Capital Adequacy Framework (Standardised Approach) (BS2A) and is disclosed in accordance with Schedule 9 of the Order. The Directors are also responsible for such internal controls as the Directors determine are necessary to enable the preparation of the supplementary information relating to credit and market risk exposures and capital adequacy that is free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for the review of the supplementary information relating to credit and market risk exposures and capital adequacy

Our responsibility is to express a conclusion, whether, based on our review, the supplementary information relating to credit and market risk exposures and capital adequacy, disclosed in Notes 25, 26 and 34, is not, in all material respects:

- (i) prepared in accordance with Capital Adequacy Framework (Standardised Approach) (BS2A); and
- (ii) disclosed in accordance with Schedule 9 of the Order.

A review of the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 25, 26 and 34 in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with ISAs NZ and ISAs. Accordingly we do not express an audit opinion on the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 25, 26 and 34.

Auditor independence

We are independent of the Banking Group in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* (PES 1) issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements.



Our firm carries out other services for the Banking Group in the areas of taxation and immigration advisory services. In addition, certain partners and employees of our firm may deal with the Banking Group on normal terms within the ordinary course of trading activities of the Banking Group. These matters have not impaired our independence as auditor of the Banking Group.

Who we report to

This report is made solely to the Directors', as a body. Our work has been undertaken so that we might state those matters which we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than The Hongkong and Shanghai Banking Corporation Limited and the Directors' as a body, for our work, for this report or for the opinions and conclusion we have formed.

The engagement partner on the engagement resulting in this independent auditor's report is Sam Shuttleworth.

For and on behalf of:

A handwritten signature in black ink that reads 'PricewaterhouseCoopers'. The signature is written in a cursive, flowing style.

Chartered Accountants
27 March 2017

Auckland

