

The Hongkong and Shanghai Banking Corporation Limited

New Zealand Banking Group

Disclosure Statement

31 December 2011

HSBC 

Disclosure Statement For the Year Ended 31 December 2011

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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 and controlled special purpose entities. The entities that have been considered for aggregation to form the Banking Group are detailed in the 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 subsidiary 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 can be found at HBAP’s website, www.hsbc.com.hk under About HSBC, Financial Information, Financial Reports.

Ranking of Local Creditors in a Winding-up

Under Section 265(1) (db) of the Companies Ordinance of the Hong Kong SAR 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 HKD100,000, to each depositor and that this Section has no geographic limitation. Save as aforesaid, the Directors believe that no other material legislative or regulatory restrictions exist which subordinate the claims of any class of the Banking Group’s unsecured creditors on the global 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 effect 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.

Auditors

New Zealand Banking Group

KPMG
KPMG Centre
18 Viaduct Harbour Avenue
Auckland
New Zealand

Overseas Banking Group

KPMG
8th Floor
Prince's Building
10 Chater Road
Hong Kong SAR

New Zealand Chief Executive Officer/Responsible Person

The New Zealand Chief Executive Officer, Noel Gerard McNamara, 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, Noel Gerard McNamara is a Responsible Person under the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order (No 4) 2011.

Noel Gerard McNamara

Chief Executive Officer New Zealand Branch. Joined the HSBC Group in 1995 and resides in New Zealand. He has a Post Graduate Diploma in International Management from the Institute of Management Adelaide 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
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

Dr William Fung Kwok Lun, SBS, OBE (Non-Executive Deputy Chairman)

BSE, Princeton University, 1970 and MBA, Harvard Graduate School of Business, 1972
Honorary Doctorate of Business Administration, Hong Kong University of Science & Technology, 1999
Executive Deputy Chairman, Li & Fung Limited

Laura Cha May Lung, GBS (Non-Executive Deputy Chairman)

B.A., 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)*

Peter Wong Tung Shun (Chief Executive)

Bachelor of Arts, Indiana University, 1974; Master of Business Administration, Indiana University, 1976
Master of Science, Indiana University, 1978

Executive Director, Hong Kong and Mainland China, The Hongkong and Shanghai Banking Corporation Limited

Dr Raymond Ch'ien Kuo Fung, GBS, CBE

B.A., Rockford College, 1973; Master of Arts and Doctor of Philosophy (Economics), University of Pennsylvania, 1976 and 1978

Non-Executive Chairman of MTR Corporation Limited

* **Naina Lal Kidwai**

Bachelor of Arts degree (Honours Course) in Economics, Delhi University, examined in 1977, certificate awarded 4 March 1978; Masters in Business Administration, Harvard University, 1982

Group General Manager and Country Head, HSBC India

Margaret Leung Ko May Yee

Bachelor of Social Sciences, University of Hong Kong, 1975

Vice-Chairman and Chief Executive, Hang Seng Bank Limited

Victor Li Tzar Kuoi

B.Sc. and M.Sc., Stanford University, 1986

Managing Director and Deputy Chairman, Cheung Kong (Holdings) Limited

Dr Lo Ka Shui, GBS

B.Sc. (Hons) Biophysics, McGill University, 1970; M.D. Cornell University, 1974; Residency, American Board of Internal Medicine, University of Michigan, 1976; and Fellowship, American Board of Cardiology, University of Michigan, 1979

Chairman and Managing Director, Great Eagle Holdings Limited

* **Zia Mody**

Master of Laws, Harvard University, 1979; Bachelor of Arts (Law), Cambridge University, 1978

Partner, AZB & Partners

Peter James Holland Riley

BA Hons in Geography from University College, Durham University; ACA (Qualified 1985), FCPA

Group Finance Director of Jardine Matheson Holdings Ltd.

Christopher Dale Pratt

M A Modern History, Oxford University, 1978

Chairman, John Swire & Sons (H.K.) Limited

* **Andreas Sohmen-Pao**

First Class Honors Degree in Oriental Studies, Oxford University, 1994; Master in Business Administration with distinction, Harvard University Graduate School of Business, 1997; Master of Arts, Oxford University, 2000

Chief Executive Officer, BW Maritime Pte Ltd

Thomas Brian Stevenson, SBS

Bachelor of Laws, Glasgow University, Scotland, 1965; Master of Laws, University of Hong Kong, 2001; Member, Institute of Chartered Accountants of Scotland, 1968; Fellow, Hong Kong Institute of Certified Public Accountants; and Member, Certified Public Accountants of Singapore.

Chartered Accountant

Paul Anthony Thurston

Bachelor of Arts, Economics and Business Studies, University of Sheffield, 1975; Associate Member, Chartered Institute of Bankers, 1979; and Fellow, Ifs School of Finance, 2009

Group Managing Director and Chief Executive, Retail Banking and Wealth Management, HSBC Holdings plc

General Disclosures *(continued)*

Board of Directors of HBAP *(continued)*

Dr Patrick Wang Shui Chung

B.Sc. and M.Sc., in Electrical Engineering, Purdue University, Indiana USA, 1972.

Honorary Doctorate of Engineering, Purdue University in Indiana, USA, 2004.

Chairman and Chief Executive Officer, Johnson Electric Holdings Limited

Dr Rosanna Wong Yick-Ming, 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

Marjorie Yang Mun Tak

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

Chairman, Esquel Holdings Inc.

Country of Residence

With the exception of those denoted with an *, all directors reside in Hong Kong. Zia Mody and Naina Lal Kidwai reside in India, and Andreas Sohmén-Pao resides in Singapore.

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

The composition of the Board of Directors has changed since 31 December 2010.

Mr David Wei Zhe resigned as a non-executive director of HBAP with effect from 22 February 2011. Mr Paul Anthony Thurston was appointed as a director of HBAP with effect from 27 April 2011. Mr Peter James Holland Riley was appointed as a non-executive director of HBAP with effect from 1 January 2012.

Directors' Policy on Conflicts of Interests

Regulation 99(h) of HBAP's Articles of Association states:

“The office of a director shall ipso facto be vacated if he or his firm or any partner therein or representative thereof acts (otherwise than with the consent of the Board) either directly or indirectly as a director, managing director, manager or partner of any corporation, company, partnership or body of persons other than a subsidiary of the Company (or of the holding company of the Company or any of its subsidiaries) carrying on business which competes with that carried on by the Company, such consent must be evidenced by writing signed by the Chairman pursuant to a resolution of the Board and may be at any time withdrawn by the Board without previous notice.”

Directors' Interests in Contracts

No contracts of significance to which HBAP, its ultimate holding company, its subsidiary companies or any fellow subsidiary company was a party to and in which a Director had a material interest existed at 31 December 2011 or at any time during the period.

General Disclosures *(continued)*

Audit Committee

The Banking Group does not have an Audit Committee. The Audit Committee of HBAP, comprising three 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 Thomas Brian Stevenson (Chairman of the Committee), Dr Patrick Wang Shui Chung and Dr Lo Ka Shui.

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.	Aa1 (stable outlook)	Not changed	-
Standard & Poor's Corporation	AA- (stable outlook)	AA (stable outlook)	29 November 2011
Fitch IBCA Inc.	AA (negative outlook)	AA (stable outlook)	2 March 2012

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 30 September 2011.

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 practices; 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.

Conditions of Registration *(continued)*

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.
5. That The Hongkong and Shanghai Banking Corporation Limited complies with the requirements imposed on it by the Hong Kong Monetary Authority.
6. That The Hongkong and Shanghai Banking Corporation Limited complies with the following minimum capital adequacy requirements, as administered by the Hong Kong Monetary Authority:
 - (a) tier one capital of The Hongkong and Shanghai Banking Corporation Limited is not less than 4 percent of risk weighted exposures; and
 - (b) capital of The Hongkong and Shanghai Banking Corporation Limited is not less than 8 percent of risk weighted exposures.
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.

In these conditions of registration, –

“banking group” means the New Zealand business of the registered bank and its subsidiaries as required to be reporting in group financial statements for the group’s New Zealand business under section 9(2) of the Financial Reporting Act 1993:

“business of the registered bank in New Zealand” means the New Zealand business of the registered bank as required to be reported in financial statements under section 8(2) of the Financial Reporting Act 1993:

“generally accepted accounting practice” has the same meaning as in section 2 of the Financial Reporting Act 1993:

“liabilities of the registered bank in New Zealand” means the liabilities of the registered bank as required to be reported in the financial statements under section 8(2) of the Financial Reporting Act 1993.

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

<i>Dollars in Thousands</i>	<i>Banking Group</i>					
	Audited					
	Year ended 31 December					
	2011	2010	2009	2008	2007	2006
Summary of Financial Results						
Interest income	201,411	214,285	266,178	492,489	509,987	493,922
Interest expense	(118,816)	(124,794)	(168,803)	(400,099)	(424,036)	(408,514)
Net interest income	82,595	89,491	97,375	92,390	85,951	85,408
Net trading income	14,929	12,459	13,896	12,730	10,223	6,951
Other net operating income	45,647	47,857	25,104	25,292	20,489	18,742
Operating income	143,171	149,807	136,375	130,412	116,663	111,101
Operating expenses	(63,726)	(57,496)	(57,287)	(65,782)	(63,203)	(69,570)
Operating profit before provisions and tax	79,445	92,311	79,088	64,630	53,460	41,531
Provisions for loan impairment	(24,522)	(11,111)	(6,488)	(6,496)	292	1,742
Operating profit before tax	54,923	81,200	72,600	58,134	53,752	43,273
Income tax expense	(15,526)	(25,011)	(21,869)	(18,357)	(17,825)	(14,572)
Profit after tax	39,397	56,189	50,731	39,777	35,927	28,701
Head Office Account brought forward	28,184	24,607	19,777	17,475	28,701	19,402
Retained profit repatriated	(52,189)	(52,612)	(45,901)	(37,475)	(47,153)	(19,402)
Head Office Account carried forward	15,392	28,184	24,607	19,777	17,475	28,701
Statement of Financial Position						
Individually impaired assets	75,325	71,781	43,900	33,066	14,867	11,295
Total assets	4,939,706	5,020,899	4,770,370	6,190,389	6,170,241	6,481,900
Liabilities	4,922,561	4,992,990	4,743,689	6,169,688	6,146,511	6,450,428
Equity	17,145	27,909	26,681	20,701	23,730	31,472
Total liabilities and equity	4,939,706	5,020,899	4,770,370	6,190,389	6,170,241	6,481,900

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

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2011

<i>Dollars in Thousands</i>	Note	<i>Banking Group and Branch</i>	
		Audited 12 months ended	
		31.12.11	31.12.10
Interest income	3	201,411	214,285
Interest expense	3	(118,816)	(124,794)
Net interest income		82,595	89,491
Net trading income	3	14,929	12,459
Other net operating income	3	45,647	47,857
Operating income		143,171	149,807
Operating expenses	4	(63,726)	(57,496)
Operating profit before provisions and tax		79,445	92,311
Provisions for loan impairment	15	(24,522)	(11,111)
Operating profit before tax		54,923	81,200
Income tax expense	6	(15,526)	(25,011)
Profit after tax		39,397	56,189
Other comprehensive income			
Cashflow hedges		2,786	(4,276)
Income tax expense on cashflow hedge		(1,124)	1,291
Available-for-sale financial assets		(17)	419
Income tax expense on available-for-sale financial assets		14	(120)
Other comprehensive income for the period		1,659	(2,686)
Total comprehensive income for the period		41,056	53,503

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 2011

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited	
	12 months ended	
	31.12.11	31.12.10
Head Office Account *		
At beginning of period	28,184	24,607
Repatriation to Head Office	(52,189)	(52,612)
Profit after tax	39,397	56,189
At end of period	15,392	28,184
Cashflow Hedging Reserve		
At beginning of period	(1,909)	1,076
Movement in the fair value of derivatives	3,003	(3,129)
Amortisation of previously terminated swaps to profit or loss	(217)	(1,147)
Tax on movements and transfers	(1,124)	1,291
At end of period	(247)	(1,909)
Available for Sale Reserve		
At beginning of period	36	(263)
Movement in the fair value of debt and equity securities	(57)	384
Tax on movements and transfers	14	(120)
Transfers to profit or loss on disposal of equity securities	40	35
At end of period	33	36
Other Reserve		
At beginning of period	1,598	1,261
Amortisation of share options granted	422	353
Movement in respect of share-based payment arrangements	(53)	(16)
At end of period	1,967	1,598
Equity at end of period	17,145	27,909
Represented by:		
Profit after tax	39,397	56,189
Other comprehensive income	1,659	(2,686)
Total comprehensive income for the period	41,056	53,503
Repatriation to Head Office	(52,189)	(52,612)
Movement in other reserve	369	337
Equity at beginning of period	27,909	26,681
	17,145	27,909

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

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

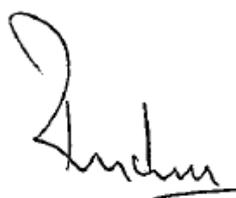
STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2011

		<i>Banking Group and Branch</i>	
		Audited	
<i>Dollars in Thousands</i>	Note	31.12.11	31.12.10
ASSETS			
Cash and demand balances with central banks		543,467	783,962
Advances to banks	8	14,337	1,235
Debt and equity securities	9	552,292	665,404
Derivative financial instruments	10	189,207	182,921
Advances to customers	11	3,431,183	3,126,984
Amounts due from related parties	21	153,681	212,951
Other assets	12	16,688	17,208
Current taxation		-	1,380
Deferred taxation	6	14,014	6,425
Intangible assets	13	22,539	20,173
Fixed assets	14	2,298	2,256
Total Assets		4,939,706	5,020,899
LIABILITIES			
Deposits by banks	16	153,240	164,321
Derivative financial instruments	17	186,451	215,519
Customer deposits	18	3,091,785	2,427,178
Debt securities	19	634,805	719,269
Amounts due to related parties	21	812,760	1,431,776
Other liabilities	20	34,920	34,927
Current taxation		8,600	-
Total Liabilities		4,922,561	4,992,990
Net Assets		17,145	27,909
EQUITY			
Head Office Account		15,392	28,184
Cashflow Hedging Reserve		(247)	(1,909)
Available for Sale Reserve		33	36
Other Reserve		1,967	1,598
Total Equity		17,145	27,909

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



Director: Peter T S Wong
Date: 29 March 2012



Director: Paul A Thurston
Date: 29 March 2012

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2011

	<i>Banking Group and Branch</i>	
	Audited	
	12 months ended	
<i>Dollars in Thousands</i>	31.12.11	31.12.10 (Restated)
<i>Cash flows from / (to) operating activities</i>		
Interest received	188,927	203,592
Fees and commissions	45,140	47,539
Realised trading gain / (loss)	(16,644)	15,715
Interest paid	(101,731)	(107,018)
Operating expenses	(56,875)	(53,262)
Taxation paid	(14,245)	(36,795)
Net cash flows from / (to) operating activities before changes in operating assets and liabilities	44,572	69,771
Changes in operating assets and liabilities arising from cash flow movements		
Cash was provided net from / applied net (to):		
Debt and equity securities purchased	127,498	(111,102)
Advances to customers	(270,289)	138,164
Amounts due from related parties	63,651	(45,101)
Other assets	2,292	(2,798)
Other liabilities	(3,205)	2,169
Debt securities issued (Certificates of deposit)	(298,547)	18,279
Debt securities issued (Medium term notes)	200,000	(97,100)
Deposits by banks	17,872	5,337
Customer deposits	275,676	(347,855)
Amounts due to related parties	(401,610)	351,788
Net change in operating assets and liabilities	(286,662)	(88,219)
Net cash flows from / (to) operating activities	(242,090)	(18,448)
<i>Cash flows from / (to) investing activities</i>		
Proceeds from sale of fixed assets	4	2
Acquisition of fixed assets	(950)	(1,031)
Acquisition of intangible assets	(3,513)	(850)
Net cash flows from / (to) investing activities	(4,459)	(1,879)
<i>Cash flows from / (to) financing activities</i>		
Repatriation to head office	(52,189)	(52,612)
Net cash flows from / (to) financing activities	(52,189)	(52,612)
Net increase / (decrease) in cash and cash equivalents	(298,738)	(72,939)
Effect of exchange rate fluctuations on cash held	(1,253)	24,169
Cash and cash equivalents at beginning of period	(669,389)	(620,619)
Cash and cash equivalents at end of period	(969,380)	(669,389)

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 2011

	<i>Banking Group and Branch</i>	
	Audited	
	12 months ended	
<i>Dollars in Thousands</i>	31.12.11	31.12.10 (Restated)
<i>Analysis of cash and cash equivalents</i>		
Cash and demand balances with central banks	543,467	783,962
Advances to banks – demand	14,337	1,235
Advances to customers – demand	156,888	95,588
Balance due from related parties – demand	16,871	12,432
Balance due to related parties – demand	(70,534)	(292,175)
Deposits by banks – demand	(119,383)	(148,336)
Deposits by customers - demand	(1,511,026)	(1,122,095)
	(969,380)	(669,389)
<i>Reconciliation of profit after tax to net cash flows from operating activities</i>		
Profit after tax	39,397	56,189
<i>Adjustments to reconcile profit after tax to net cash flow from operating activities:</i>		
Change in interest accruals and deferred income	4,156	2,484
Change in mark to market accruals	(32,120)	2,903
Depreciation	897	841
Amortisation of intangible asset	1,147	848
Amortisation of premium and discounts	445	4,599
Change in deferred income and accrued expense	4,378	2,193
Amortisation of share options granted	422	353
Impairment charge / (release) on loans and advances	24,522	11,111
(Gain) / loss on disposal of available-for-sale equity securities	40	35
(Gain) / loss on disposal of fixed assets	7	(1)
Current / deferred taxation	1,281	(11,784)
Adjust operating cash flows not included in profit after tax:		
Net change in operating assets and liabilities	(286,662)	(88,219)
Net cash flows from operating activities	(242,090)	(18,448)

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 New Zealand Banking Group (“Banking Group”). As the Branch and Banking Group’s financial performance and position are the same in all material aspects, a single set of Banking Group numbers are presented.

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 provides fund management services to customers and commenced trading operations in June 2008. HSBC Investments New Zealand Limited is wholly owned by HSBC Asia Pacific Holdings (UK) Limited which is wholly owned by HBAP.

HSBC Cash Fund

The HSBC Cash Fund is a unit trust set up in June 2008 following the introduction by the New Zealand Inland Revenue of the Portfolio Investment Entity (“PIE”) regime. The HSBC Cash Fund is managed by HSBC Investments New Zealand Limited with an independent trustee (New Zealand Guardian Trust) responsible for ensuring that the HSBC Cash Fund is administered in accordance with the trust deed. All funds received into the HSBC Cash Fund are placed with the Branch and are included in the Banking Group’s financial results as Customer Deposits.

HSBC Term Fund

The HSBC Term Fund is a unit trust, first set up in April 2009, following the introduction by the New Zealand Inland Revenue of the Portfolio Investment Entity (“PIE”) regime. The HSBC Term Fund is managed by HSBC Investments New Zealand Limited with an independent trustee (New Zealand Guardian Trust) responsible for ensuring that the HSBC Term Fund is administered in accordance with the trust deed. All funds received into the HSBC Term Fund are placed with the Branch and are included in the Banking Group’s financial results as Customer Deposits.

Non-Banking Group Entities

The following New Zealand incorporated entities do not form part of the Banking Group as defined in the Conditions of Registration. They are ultimately wholly owned by HSBC Holdings plc and HBAP is not their parent entity.

HSBC International Trustee (New Zealand) Limited and *HSBC International Trustee Limited, New Zealand Branch* provide trustee services to an international client base. HSBC International Trustee (New Zealand) Limited is a wholly owned subsidiary of Bermuda Asia Pacific Holdings Limited, incorporated in the Cook Islands. HSBC International Trustee Limited is a body corporate incorporated in British Virgin Islands.

Non-controlled Special Purpose Entities

The following New Zealand incorporated entities do not form part of the Banking Group as defined in the Conditions of Registration. The Banking Group does not control the Special Purpose Entities.

HSBC Global Unit Trusts

The HSBC Global Unit Trusts were set up in August 2009 to support the local launch of HSBC Group Investment Funds under the Portfolio Investment Entity (“PIE”) structure and branded locally as HSBC Investments New Zealand Limited Global Unit Trusts.

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

1. Statement of Accounting Policies *(continued)*

Non-controlled Special Purpose Entities *(continued)*

HSBC Global Unit Trusts (continued)

The HSBC Global Unit Trusts are managed by HSBC Investments New Zealand Limited with an independent trustee (New Zealand Guardian Trust) responsible for ensuring that the HSBC Global Unit Trusts are administered in accordance with the trust deed. Funds received into the HSBC Global Unit Trusts are primarily invested in shares of a sub-fund of HSBC Global Investment Funds, an investment company incorporated in the Grand Duchy of Luxembourg. HSBC Investment Funds (Luxembourg) S.A., the manager of the Sub-funds is part of HSBC Global Asset Management. There are currently four funds offered; HSBC China Fund, HSBC BRIC Fund, HSBC India Fund and HSBC Asia ex Japan Fund.

HSBC World Selection Funds

The HSBC World Selection Funds were established on 18 January 2010 to support the local launch of HSBC Portfolios under the Portfolio Investment Entity (“PIE”) structure.

The HSBC World Selection Funds are managed by HSBC Investments New Zealand Limited with an independent trustee (New Zealand Guardian Trust) responsible for ensuring that the HSBC World Selection Funds are administered in accordance with the trust deed. Funds received into the HSBC World Selection Funds are invested primarily in shares of a sub-fund of HSBC Portfolios, an investment company incorporated in the Grand Duchy of Luxembourg. HSBC Investment Funds (Luxembourg) S.A. is the manager of the HSBC Portfolios and HSBC Global Asset Management (UK) Limited is the investment adviser. Both the manager and investment adviser are part of HSBC Global Asset Management. There are currently three funds offered; HSBC World Selection – Foundation Fund, HSBC World Selection – Frontier Fund, and HSBC World Selection – Horizon Fund.

Basis of consolidation

Special purpose entities

The Banking Group has established the following special purpose entities (‘SPEs’): the HSBC Cash Fund, the HSBC Term Fund, the HSBC Global Unit Trusts and the HSBC World Selection Funds.

The Banking Group does not have any direct or indirect unit holding in these entities. An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Banking Group and the SPE’s risks and rewards, the Banking Group concludes that it controls the SPE. The SPEs controlled by the Banking Group are established under terms that impose strict limitations on the decision making powers of the SPEs’ management and operates in a predetermined way such that virtually all rights, obligations and aspects of their activities are controlled through these terms.

Transactions eliminated on consolidation

Intra-group balances are eliminated in preparing the Banking Group’s financial statements.

Basis of Reporting

These financial statements are prepared and presented in accordance with the Financial Reporting Act 1993, the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order (No 4) 2011, the Reserve Bank of New Zealand Act 1989, and all applicable financial reporting standards and other generally accepted accounting practices in New Zealand.

Measurement Base

These financial statements are based on the general principles of historical cost accounting, as modified by the revaluation of certain assets and liabilities. They are prepared on a going concern basis. All amounts are expressed in New Zealand currency, the presentation currency and functional currency, and all references to “\$” is to New Zealand dollars unless otherwise stated.

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

1. Statement of Accounting Policies *(continued)*

Particular Accounting Policies

These financial statements have been prepared in accordance with NZGAAP. They comply with New Zealand Equivalents to International Financial Reporting Standards (“NZ IFRS”), and other applicable Financial Reporting Standards, as appropriate for profit oriented entities.

The New Zealand Institute of Chartered Accountants has released the following standards and amendments which are not yet effective but will be relevant to the Banking Group. These standards and amendments have not been adopted early and are excluded from application to these financial statements.

- NZ IFRS 9 (2009) Financial instruments (approved November 2009) and NZ IFRS 9 (2010) Financial instruments (approved November 2010)

In November 2009 NZ IFRS 9 ‘Financial Instruments’ was issued. This standard introduces new requirements for the classification and measurement of financial assets. In November 2010 new requirements for the classification and measurement of financial liabilities were added. The standard is effective for annual accounting periods beginning on or after 1 January 2015 with early adoption permitted. NZ IFRS 9 is required to be applied retrospectively but prior periods need not be restated. The Banking Group will adopt the standard in line with HBAP’s adoption of IFRS 9. IFRS 9 is subject to EU endorsement, the timing of which is uncertain. Accordingly, management are unable to provide a date by which it plans to apply NZ IFRS 9.

IFRS 9 (2009) is the first phase and IFRS 9 (2010) is the second phase of the IASB’s planned phased replacement of IAS 39 with a less complex and improved standard for financial instruments. The next steps in the IASB’s project will address the impairment of financial assets measured at amortised cost and hedge accounting. The IASB did not finalise the replacements of IAS 39 by its stated target of June 2011, and the IASB and the US Financial Accounting Standards Board have agreed to extend the timetable beyond this date to permit further work and consultation with stakeholders, including reopening IFRS 9 to address practice and other issues. The impact of IFRS 9, and consequently NZ IFRS 9, may change as a consequence of further developments resulting from the IASB’s financial instruments project. As a result, it is impracticable to quantify the impact of NZ IFRS 9 as at the date of publication of these financial statements.

- NZ IFRS 10 Consolidated Financial Statements (approved June 2011)

The standard is effective for annual accounting periods beginning on or after 1 January 2013. The standard creates a single basis for consolidation of all entities. It includes a new definition of control. The standard, in conjunction with NZ IAS 27 Separate Financial Statements (revised 2011), supersedes NZ IAS 27 Consolidated and Separate Financial Statements (issued 2008). It is part of a package of five financial statements which also includes NZ IAS 27 Separate Financial Statements (revised 2011), NZ IFRS 11 Joint Arrangements, NZ IFRS 12 Disclosure of Interests in Other Entities, and NZ IAS 28 Investments in Associates and Joint Ventures (revised 2011). Early adoption is allowed provided all other standards in the package of five are also early adopted. The application of the standard is not expected to have an impact on the Banking Group’s financial results as the application of the new control definition results in the same consolidation outcome.

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

1. Statement of Accounting Policies *(continued)*

Particular Accounting Policies *(continued)*

- NZ IFRS 12 Disclosure of Interests in Other Entities (approved June 2011)

The standard is effective for annual accounting periods beginning on or after 1 January 2013. The standard applies to entities that have an interest in subsidiaries, joint arrangements, associates, or unconsolidated structured entities. The standard establishes disclosure objectives and minimum disclosures that are required to meet those objectives. The standard is not expected to have an impact on the Banking Group's financial results but it is likely to result in additional disclosures on unconsolidated structured entities.

- NZ IAS 27 Separate Financial Statements (approved June 2011)

The amendment is effective for annual accounting periods beginning on or after 1 January 2013. The amended standard in conjunction with NZ IFRS 10 Consolidated Financial Statements (issued June 2011) supersedes NZ IAS 27 Consolidated and Separate Financial Statements (issued 2008). The amended standard includes the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The application of the revised standard is not expected to have an impact on the Banking Group's financial results as the revision is only concerned with presentation.

- NZ IFRS 13 Fair Value Measurement (approved June 2011)

The standard is effective for annual reporting periods beginning on or after 1 January 2013. NZ IFRS 13 replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. It explains how to measure fair value when it is required or permitted by other IFRSs. It does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards. As a result, it is anticipated that the impact of NZ IFRS 13 will not be material to the financial statements.

- NZ IAS 1 Amendment to Presentation of Financial Statements: Presentation of items of other comprehensive income (approved August 2011)

This amendment is effective for annual accounting periods beginning on or after 1 July 2012. The amendment requires items included in other comprehensive income to be grouped into those that will and will not subsequently be reclassified to profit or loss. The application of the revised standard is not expected to have an impact on the Banking Group's financial results as the revision is only concerned with the presentation of the primary statements.

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

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

1. Statement of Accounting Policies *(continued)*

Changes in Accounting Policies

The following standards and amendments became effective at the beginning of the reporting period and have been applied in the preparation of these financial statements:

- NZ IFRS 7 Amendment to Financial instruments: Disclosures (approved July 2010)

This amendment is effective for annual accounting periods beginning on or after 1 January 2011. The amendment adds an explicit statement that qualitative disclosures should be made in the context of quantitative disclosures to better enable users to evaluate an entity's exposure to risks arising from financial instruments. The application of the revised standard has not had an impact on the Banking Group's financial results as the revision was only concerned with disclosure.

- NZ IAS 1 Amendment to Presentation of Financial Statements (approved July 2010)

This amendment is effective for annual accounting periods beginning on or after 1 January 2011. The amendments clarify that disaggregation of changes in each component of equity arising from transactions recognised in other comprehensive income are also required to be presented, but may be presented either in the statement of changes in equity or in the notes. The application of the revised standard has not had an impact on the Banking Group's financial results as the revision was only concerned with the presentation of the primary statements and notes.

The following amendment has been adopted early and has been applied to these financial statements:

- NZ IFRS 7 Amendment to Financial instruments: Appendix E (approved March 2011)

This amendment is effective for annual accounting periods beginning on or after 1 April 2011. The amendment reduces the scope of entities required to apply appendix E to specifically exclude registered banks. The application of the revised reporting requirements has resulted in the removal of disclosure of restructured assets from the asset quality note.

There have been no other changes to accounting policies. They are the same as those applied by the Banking Group in the General Disclosure Statement for the year ended 31 December 2010.

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 (No 4) 2011.

In the comparative period, the amortisation of premium and discounts of debt securities was presented in interest received and interest paid in the Statement of Cash Flows. For the current period ended 31 December 2011, it is presented as a non-cash item and reclassified as changes in operating assets and liabilities. The classification of amounts due to related parties and medium term notes has been changed from financing activities to operating activities in the Statement of Cash Flows, to more accurately reflect the nature of the transactions. Comparative figures have been restated accordingly and there was no impact on the net movement in cash and cash equivalents.

There have been no other material changes to the comparative figures.

Certain comparative balances have been reclassified to align with the presentation used in the current period. These reclassifications have no impact on the overall financial performance or financial position for the comparative period.

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

1. Statement of Accounting Policies *(continued)*

PRINCIPAL ACCOUNTING POLICIES

The preparation of financial information requires the use of estimates and assumptions about future conditions. Use of available information and application of judgement are inherent in the formation of estimates. Actual results in the future may differ from those reported. In this connection, management believes that the critical accounting policies where management judgement is necessarily applied are those in relation to provisions for impairment on loans and advances, impairment of goodwill and the valuation of financial instruments.

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.

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 recognized 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.

Accounting for Business Combinations

All business combinations are accounted for by applying the acquisition method.

When an entity becomes or ceases to be part of the Banking Group during the period the results of the entity are included in the results from the date that control or significant influence commenced or until the date that control or significant influence ceased. When an entity is acquired all identifiable assets and liabilities are recognised at their fair value at acquisition date. The fair value does not take into consideration any future intentions of the Banking Group. Where an entity that is part of the Banking Group is disposed of, the gain or loss recognised in profit or loss is calculated as the difference between the sale price and the carrying amount of the entity.

Advances to Banks, Customers & Related Parties

Advances to banks, customers, and related parties include loans and advances originated by the Banking Group, which are not intended to be sold in the short term and have not been classified either as held for trading or designated at fair value. Loans and advances are recognised when cash is advanced to borrowers. 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 losses.

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

1. Statement of Accounting Policies *(continued)*

Asset Impairment

Provisions for impaired financial assets are made when objective evidence of impairment exists and on a consistent basis. Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Banking Group on terms that the Banking Group would not otherwise consider, indication that the borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

Impairment provisions represent the quantification of incurred losses from homogeneous portfolios of assets and individually identified accounts. Impairment provisions are deducted from loans and advances in the Statement of Financial Position. There are two basic methods of calculating impairment losses, those calculated on individual loans and those losses assessed on a collective basis. Losses expected as a result of future events, no matter how likely, are not recognised.

Individually assessed accounts

Specific impairment provisions on individually assessed accounts are determined by an evaluation of the discounted future cash flows on a case-by-case basis. This procedure is applied to all accounts that are not subject to a portfolio-based approach. In estimating future cash flows on individually assessed accounts, the following factors are considered:

- The Banking Group's exposure to the customer (including contingent liabilities);
- The likely dividend available on liquidation or bankruptcy;
- The viability of the customer's business model and the capability of management to trade successfully out of financial difficulties and generate sufficient cash flow to service their debt obligations;
- The extent of other creditors' commitments ranking ahead of, or *pari passu* with, the Banking 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 amount and timing of expected receipts and recoveries;
- The realisable value of security (or other credit mitigants) and likelihood of successful repossession;
- The likely deduction of any costs involved in recovery of amounts outstanding; and
- The ability of the borrower to obtain the relevant foreign currency if loans are not in local currency.

Releases on individually calculated specific provisions are recognised whenever the Banking Group has reasonable evidence that the established estimate of loss has been reduced.

Impairment loss is calculated by comparing the present value of the expected future cash flows, discounted at the original effective interest rate of the loan, with its current carrying value and the amount of any loss is charged in profit or loss. The carrying amount of impaired loans is reduced through the use of a specific provision account.

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

1. Statement of Accounting Policies *(continued)*

Asset Impairment *(continued)*

Collectively assessed loans and advances

For the calculation of impairment on a portfolio basis, loans and advances are grouped on the basis of similar credit risk characteristics.

Future expected cash flows are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group, adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future expected cash flows reflect and are directionally consistent with changes in related observable data from period to period. The methodologies and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Write-offs of loans and advances

Loans and advances (and the related impairment provisions) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and when the proceeds from the realisation of security have been received.

Reversals of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed to the extent it is now excessive by reducing the provision account. The amount of any reversal is recognised in profit or loss.

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.

Renegotiated Loans

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Banking Group has made concessions that it would not otherwise consider. Once the loan is restructured, it remains in this category independent of satisfactory performance after restructuring. Renegotiated loans do not include loans which are past due or impaired.

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 they are extinguished, i.e. when the obligation is discharged or cancelled.

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

1. Statement of Accounting Policies *(continued)*

Debt & Equity Securities

Treasury bills, debt securities and equity shares intended to be held on a continuing basis are classified as available-for-sale securities and are measured at fair value. Available-for-sale securities are initially measured at fair value plus direct and incremental transaction costs on the trade date, the date on which the Banking Group commits to purchase or sell the asset. They are subsequently remeasured at fair value. Unless they are in a fair value hedge relationship, changes in fair value are recognised in equity, through other comprehensive income, until the securities are either sold or impaired. Where the debt securities are in a fair value hedge relationship, the revaluation gain or loss attributable to the hedged risk is recognised in profit or loss.

On the sale of available-for-sale securities, cumulative gains or losses held within equity are recognised through profit or loss in 'Other net operating income'. Interest income is recognised on such securities using the effective interest rate method, calculated over the asset's expected life. Where dated debt securities have been purchased at a premium or discount, these premiums and discounts are recognised as an adjustment to the effective interest rate.

An assessment is made at the end of each reporting period as to whether there is any objective evidence of impairment, being circumstances where an adverse impact on estimated future cash flows of the financial asset or group of assets can be reliably estimated.

Impairment losses recognised in profit or loss for an equity instrument shall not be reversed through profit or loss.

If an available-for-sale financial asset is determined to be impaired, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

Debt securities in issue are initially measured at fair value, which is the consideration received, 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 debt, unless the securities are designated at fair value.

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.

Derivative Financial Instruments

Derivatives are bilateral contracts or payment exchange agreements whose value derives from the value of an underlying asset, reference rate or index. Derivative financial instruments include foreign exchange and interest rate forwards, forward purchase and sale agreements, futures, options, interest rate and currency swaps.

Derivatives are initially recognised at fair value from the date a derivative contract is entered into and subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques. Changes in the fair value, together with related interest income and expense, are recognised immediately in profit or loss as 'Net trading income'

Valuation techniques include discounted cash flow models and option pricing models as appropriate. All derivatives are classified as assets when their fair value is positive and as liabilities when their fair value is negative.

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

1. Statement of Accounting Policies *(continued)*

Derivative Financial Instruments *(continued)*

In the normal course of business, the fair value of a derivative at initial recognition is considered to be the transaction price (i.e. the fair value of the consideration given or received). However, in certain circumstances the fair value of an instrument will be evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Banking Group recognises trading profits on inception of the derivative.

If observable market data is not available, the initial increase in fair value indicated by the valuation model, but based on unobservable inputs, is not recognised immediately in profit or loss but is recognised over the life of the transaction on an appropriate basis, or recognised in profit or loss when the inputs become observable, or when the transaction matures or is closed out.

Certain derivatives embedded in other financial instruments, such as the conversion option in a convertible bond, are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in profit or loss.

Derivative Financial Instruments – Hedge Accounting

The method of recognising the resulting fair value gain or loss depends on whether the derivative is held for trading, or designated as a hedging instrument, and if so, the nature of the item being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in profit or loss. Where derivatives are designated as hedges, the Banking Group classifies them as either:

- hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge); or
- hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (cash flow hedge).

It is the Banking Group's policy to document, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. Such policies also require documentation of the assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. Interest on designated qualifying hedges is included in "net interest income".

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 hedges are recorded in profit or loss, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If a hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment to the carrying amount of the hedged item is amortised to profit or loss based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item is derecognised, in which case, it is released to the profit or loss immediately.

If the hedged item is an available-for-sale asset, hedge accounting will discontinue prospectively and the effect of previous hedge accounting will not be reversed.

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

1. Statement of Accounting Policies *(continued)*

Derivative Financial Instruments – Hedge Accounting *(continued)*

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 equity and other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss.

Amounts accumulated in equity are recycled to profit or loss in the periods in which the hedged item will affect profit or loss (for example, when the forecast sale that is hedged takes place). However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a liability, the gains and losses previously recognised in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to profit or loss.

Derivatives that do not qualify for hedge accounting

Certain derivative instruments, used for risk management purposes, do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting, together with related interest income and expense, are recognised immediately in profit or loss as 'Other net operating income'.

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 (prospective effectiveness). Actual effectiveness (retrospective effectiveness) must also be demonstrated 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 its risk management strategy.

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.

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.

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

1. Statement of Accounting Policies *(continued)*

Employee Benefits

Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in profit or loss as incurred.

Equity compensation plans

Inducements awarded to an employee to join the Banking Group that are available to the employee immediately, with no vesting period attached to the award are expensed immediately. When an inducement is awarded to an employee on commencement of employment with the Banking Group, and the employee must complete a specified period of service before this vests, the expense is spread over the period to vesting.

Share options

The compensation expense to be spread over the vesting period is determined by reference to the fair value of the options on grant date, and the impact of any non-market vesting conditions such as option lapses. Guaranteed share options awarded in respect of service in the past, where an employee must complete a specified period of service until entitled to the award, are spread over the period of services rendered to the vesting date. Discretionary share options awarded in respect of service in the past are expensed over the vesting period which, in this case, is the period from the date the share option is announced until the award vests.

Other Reserve

The other reserve comprises the share-based payment reserve accounts. These accounts are used to record the corresponding amount relating to share options granted to employees of the Banking Group directly by HSBC Holdings plc.

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.

Fixed Assets

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 ruling 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 end of the reporting period. Any resulting exchange differences are included in profit or loss. 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.

Funds Management Activities

HSBC Investments New Zealand Limited acts as manager for the HSBC Cash Fund, the HSBC Term Fund, the HSBC Global Unit Trusts, and the HSBC World Selection Funds.

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, legal fees etc directly attributable to an acquisition are expensed.

Goodwill is stated at cost less any accumulated impairment losses.

Goodwill is assessed at each reporting date to determine whether there is an indication of impairment. If any such indication exists, goodwill is tested for impairment. Goodwill is tested for impairment at least annually by comparing the present value of the expected future cash flows from a business with the carrying value of its net assets, including attributable goodwill. Goodwill is allocated to cash-generating units for the purposes of impairment testing. Goodwill is tested for impairment at the lowest level at which it is monitored for internal management purposes. Any impairment loss in respect of goodwill would not be reversed.

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 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 – between 3 and 12 years
- Software – between 3 and 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 financial assets and financial liabilities that are not measured at fair value are recognised in profit or loss using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability or, where appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. Interest on impaired financial assets is recognised at the original effective interest rate of the financial asset applied to the impaired carrying amount.

Income – 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).

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)*

Sale & Repurchase Agreements

When securities are sold subject to a commitment to repurchase them at a predetermined price ('repos') they remain on the Statement of Financial Position and a liability is recorded in respect of the consideration received. The Banking Group does not purchase securities under commitment to sell ('reverse repos').

The difference between the sale and repurchase price is treated as interest and recognised over the life of the agreement.

The Banking Group does not engage in securities borrowing transactions. Securities lending transactions are generally entered into on a collateralised basis, with securities or cash received as collateral. The transfer of the securities to counterparties is not normally reflected on the Statement of Financial Position.

If cash collateral is received, a liability is recorded at the amount of cash collateral received.

Statement of Cash Flows

The Statement of Cash Flows has been prepared using the direct approach modified by the netting of certain items as disclosed below.

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. Certain cash flows have been netted in order to provide more meaningful disclosure.

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)*

1. Statement of Accounting Policies *(continued)*

Trustee Activities

HSBC International Trustee (New Zealand) Limited and HSBC International Trustee Limited, New Zealand Branch act as trustees for trusts. These trusts have not been included in the Banking Group financial statements as the Banking Group does not have direct or indirect benefit of the funds of these trusts. The trustee holds a right of indemnity against the assets of the applicable trusts for liabilities incurred in the capacity as trustee. As the assets are sufficient to cover liabilities, the liabilities are not included in the financial statements.

The HSBC Cash Fund, HSBC Term Fund, HSBC Global Unit Trusts, and HSBC World Selection Funds are managed by HSBC Investments New Zealand Limited with an independent trustee (New Zealand Guardian Trust) responsible for ensuring that the HSBC Cash Fund, HSBC Term Fund, HSBC Global Unit Trusts, and HSBC World Selection Funds are administered in accordance with the trust deed. The Directors of HSBC Investments New Zealand Limited meet regularly to ensure that managed fund activities are managed independently from other activities carried out by the Banking Group.

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 Committee ('RMC'), 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 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 that a customer or counterparty of the Banking Group will be unable or unwilling to meet a commitment that it has entered into with the Banking Group.

It arises from the lending, trade finance, treasury and other finance activities undertaken by the Banking Group. The Banking Group has policies and procedures for the control and monitoring of all such risks.

The HSBC Holdings plc Group Management Office (GMO) is responsible for the formulation of high level credit policies, the independent review of the Group's largest credit exposures, the control of the Group's cross-border exposures and portfolio management of risk concentrations. It also reviews the efficiency of Group companies' credit approval processes, a key element of which is the Group's universal facility grading system.

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

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.

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

2. Risk Management *(continued)*

Credit risk *(continued)*

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. At present the intention is not to exercise this right and as such, the balances have been disclosed gross.

Market risk

Market risk is the risk that movements in foreign exchange rates, interest rates, credit spreads or equity and commodity prices will result in profits or losses to the Banking Group. 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. Group Risk, an independent unit within GMO develops the Group's market 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.

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 over a specified time horizon and to a given level of confidence (for Group, 99%). VAR is calculated daily.

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 involves historical simulation calculations conducted under scenario models provided by Group Risk. Stress testing enables firms to gain useful insight into low probability possible losses in situations where normal market relationships breakdown. In such abnormal or crisis situations, vital model inputs swing to extreme values and losses can be much greater than is suggested by VAR models.

The Group carries out stress testing at a regional level in HBAP and at a global level in GMO using data from internal systems. Testing is performed using HBAP's RiskWatch system and is compiled using the selected scenarios into graphical form on a local level.

The scenarios considered, along with the realism of the currency and interest rate shifts suggested, are discussed and determined at regular meetings of the Stress Test Review Group which comprises senior members of Group staff. The Banking Group does not hold any significant open trading positions. Under current scenarios the potential adverse profit impact is less than USD 1.77 million (December 2010: USD 1.43 million).

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 (PVB), together with stress and sensitivity testing and concentration limits. These techniques quantify the impact on capital of defined market movements.

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

2. Risk Management *(continued)*

Market risk *(continued)*

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 27. A sensitivity analysis is not performed due to the Banking Group FX exposure being materially hedged.

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.

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

2. Risk Management *(continued)*

Interest rate risk *(continued)*

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 31.12.11	Audited 31.12.10
Equity Reserves	(14,838)	424
Profit and Loss	(1,476)	582

Liquidity and funding

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

The management of liquidity and funding is primarily undertaken locally in HBAP's operating entities in compliance with practices and limits set by HBAP ALCO. 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.

It is the responsibility of ALCO to ensure compliance with local regulatory requirements and limits set by HBAP ALCO. Liquidity is managed on a daily basis by local treasury functions.

HBAP's liquidity and funding management process includes:

- projecting cash flows under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet liquidity and advances to core 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 debt maturities;
- 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.

Primary sources of funding

Current accounts and savings deposits payable on demand or at short notice form a significant part of HBAP's funding, and HBAP places considerable importance on maintaining their stability. For deposits, stability depends upon preserving depositor confidence in HBAP's capital strength and liquidity, and on competitive and transparent pricing. HBAP also accesses professional markets in order to provide funding for non-banking subsidiaries that do not accept deposits, to maintain a presence in local money markets and to optimise the funding of asset maturities not naturally matched by core deposit funding. In aggregate, HBAP's banking entities are liquidity providers to the interbank market, placing significantly more funds with other banks than they themselves borrow.

A contractual maturity analysis of assets and liabilities for the Banking Group is disclosed in note 25.

Core deposits

HBAP's internal framework is based on a categorisation of customer deposits into core and non-cored based on the expectation of the behaviour of these deposits during a liquidity stress. This characterisation takes into account the inherent liquidity risk categorisation of the entity originating the deposit, the nature of the customer and the size and pricing of the deposit. Deposits deemed to be core are considered to be a long-term source of funding and are assumed to not be withdrawn in the liquidity stress used for principal liquidity risk metrics.

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

2. Risk Management *(continued)*

Liquidity and funding *(continued)*

The management of liquidity risk

HBAP uses a number of principal measures to manage liquidity risk, as described below.

Advances to core funding ratio

HBAP emphasises the importance of core customer deposits as a source of funds to finance lending to customers, and discourages reliance on short-term professional funding. This is achieved by placing limits on banking entities which restrict their ability to increase loans and advances to customers without corresponding growth in core customer deposits or long term debt funding. This measure is referred to as the 'advances to core funding'.

Advances to core funding ratio limits are set by the HBAP ALCO and monitored by HBAP Finance. The ratio describes current loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year. Loans and advances to customers which are part of reverse repurchase arrangements, and where HSBC receives securities which are deemed to be liquid, are excluded from the advances to core funding ratio.

The Branch's advances to core funding ratios as at the reporting date and during the reporting period were as follows:

	Unaudited 12 months 31.12.11	Unaudited 12 months 31.12.10
	%	%
End of period	114.0	119.0
Maximum for the period	119.0	156.0
Minimum for the period	110.0	114.0
Average for the period	113.5	134.0

Projected cash flow scenario analysis

HBAP uses a number of standard hypothetical projected cash flow scenarios designed to model both HBAP specific and market-wide liquidity crises in which the rate and timing of deposit withdrawals and drawdowns on committed lending facilities are varied, and the ability to access interbank funding and term debt markets and to generate funds from asset portfolios are restricted. HBAP applies conservative criteria to those securities that can be deemed 'liquid' and are therefore assumed to be a source of funding under stress scenarios. The scenarios are modelled by all HBAP banking entities and by HBAP Finance. The appropriateness of the assumptions under each scenario is regularly reviewed. In addition to HBAP's standard hypothetical projected cash flow scenarios, individual entities are required to design their own scenarios to reflect specific local market conditions, products and funding bases.

Limits for cumulative net cash flows under stress scenarios are set for each entity. Both ratio and cash flow limits reflect the local market place, the diversity of funding sources available and the concentration from large depositors. Compliance with entity level limits is monitored centrally.

As at 31 December 2011 the Branch has a committed loan facility from HBAP of USD 0.9 billion (December 2010: USD1.4 billion). Up to USD 0.3 billion is on call, up to USD 0.3 billion may be drawn with 7 days notice, with a further USD 0.3 billion drawn with 30 days notice. The committed loan facility amount may change from time to time depending on the local balance sheet structure.

Notes to and forming part of the Financial Statements *(continued)***2. Risk Management** *(continued)***Liquidity and funding** *(continued)***The management of liquidity risk** *(continued)***Stressed one month coverage ratio**

The stressed one month coverage ratios tabulated below are derived from these scenario analyses, and express the stressed cash inflows as a percentage of stressed cash outflows over a one month time horizon. The Branch is required to target a ratio of 100 per cent or greater.

	Unaudited 12 months 31.12.11	Unaudited 12 months 31.12.10
	%	%
End of period	132	122
Maximum for the period	150	151
Minimum for the period	109	122
Average for the period	125	133

Contingent liquidity risk

In the normal course of business, the Branch provides customers with committed facilities, and standby facilities to corporate customers. These facilities increase the funding requirements of the Branch when customers choose to raise drawdown levels over and above their normal utilisation rates. The liquidity risk consequences of increased levels of drawdown are analysed in the form of projected cash flows under different stress scenarios. The HBAP ALCO also sets limits for non-cancellable contingent funding commitments for the Branch after due consideration of the Branch's ability to fund them. The limits are split according to the borrower, the liquidity of the underlying assets and the size of the committed line.

The Branch's contractual exposures at 31 December monitored under the contingent liquidity risk limit structure were as follows:

	Unaudited 12 months 31.12.11	Unaudited 12 months 31.12.10
	NZDm	NZDm
Non cancellable undrawn commitment limits		
Five largest	493	420
Largest market sector	528	524

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

2. Risk Management *(continued)*

Operational risk

Operational risk is the risk of losses as a result of inadequate systems and controls, human error or management failure. Risks include natural disaster, systems failure, fraud and non-compliance with legislation and regulations.

Local management is responsible for establishing an effective and efficient operational control environment in accordance with Group standards so that the Group's assets are adequately protected, and whereby the operational risks have been identified and adequate risk management procedures maintained to control those risks. Risk management techniques include appropriate systems, staff, internal controls and business continuity planning.

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.

The 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 HSBC Holdings plc can be found at HBAP's website, www.hsbc.com.hk under About HSBC, Financial Information, Financial Reports, HSBC Holdings plc.

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

	<i>Banking Group and Branch</i>	
	Audited 12 months 31.12.11	Audited 12 months 31.12.10
<i>Dollars in Thousands</i>		
3. Operating income		
Interest income:		
Advances to banks	14,413	17,221
Debt securities	17,787	24,657
Advances to customers	167,725	170,173
Related parties – HBAP	1,149	1,679
Related parties – other	300	250
Other	37	305
	<u>201,411</u>	<u>214,285</u>
Interest expense:		
Deposits by banks	(2,771)	(2,824)
Customer deposits	(67,813)	(68,390)
Debt securities	(22,831)	(28,076)
Related parties – HBAP	(25,263)	(24,195)
Related parties – other	(114)	(1,127)
Other	(24)	(182)
	<u>(118,816)</u>	<u>(124,794)</u>
Other net operating income:		
Fee and commission income		
Lending and credit facility fees receivable	20,641	25,259
Custody and clearing fees receivable	2,459	2,001
Other fees and commissions receivable from:		
– Third parties	14,678	13,632
– Related parties-HBAP	207	337
– Related parties-other	11,188	12,379
	<u>49,173</u>	<u>53,608</u>
Fee and commission expense		
Brokerage expense	(1,190)	(1,078)
Other fees and commissions payable to:		
– Third parties	(255)	(265)
– Related parties-HBAP	(1,773)	(3,361)
– Related parties-other	(261)	(1,013)
	<u>(3,479)</u>	<u>(5,717)</u>
Other income		
Gain / (loss) on disposal of available-for-sale equity securities	(40)	(35)
Gain / (loss) on disposal of equipment, fixtures and fittings	(7)	1
	<u>(47)</u>	<u>(34)</u>
	<u>45,647</u>	<u>47,857</u>
Net trading income:		
Foreign exchange gains	12,248	8,499
Revaluation of derivatives	2,644	3,960
Loss on hedging instrument in fair value hedge	(864)	-
Gain on hedged item in fair value hedge	901	-
	<u>14,929</u>	<u>12,459</u>

Included within interest expense on debt securities is \$3.847 million (December 2010: \$6.468 million interest expense) of interest expense from derivatives held in a qualifying cashflow hedging relationship.

Included within interest income on debt securities is \$1.544 million (December 2010: \$8.304 million interest income) of interest income from derivatives held in a qualifying cashflow or fair value hedging relationship.

Included within interest income from advances to customers is \$2.417 million (December 2010: \$0.759 million) of interest income from impaired advances to customers.

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

	<i>Banking Group and Branch</i>	
	Audited 12 months 31.12.11	Audited 12 months 31.12.10
<i>Dollars in Thousands</i>		
4. Operating expenses		
Rental expense		
Premises	2,289	2,370
Equipment	352	312
	<u>2,641</u>	<u>2,682</u>
Depreciation and amortisation		
Leasehold improvements	573	484
Equipment, fixtures and fittings	324	357
Intangibles	1,147	848
	<u>2,044</u>	<u>1,689</u>
Auditors' remuneration		
Audit fees	482	389
Audit related fees	131	117
Tax services	21	39
	<u>634</u>	<u>545</u>
Staff costs		
Salaries & other staff expenses	26,503	24,291
Defined contribution pension costs	1,623	1,768
Share based payments	422	353
Leave provision movement	218	28
Other	520	772
	<u>29,286</u>	<u>27,212</u>
Other		
Related party management and technical fees – HBAP	16,659	12,970
Related party management and technical fees – other	3,260	2,498
Donations	369	109
Other operating expenses	12,346	10,641
Capitalisation of software development cost	(3,513)	(850)
	<u>29,121</u>	<u>25,368</u>
	<u>63,726</u>	<u>57,496</u>

The average number of persons employed by the Branch for the twelve months was 245 (December 2010: 231).

Audit related fees include fees charged for the reporting on custodial services, trust deed and prospectus, and the review of the June Disclosure Statement.

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

5. Segment reporting

Segment information is presented in respect of the Banking Group's business segments based on the Banking Group's management and internal reporting structure.

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. Geographical information on revenues from external customers is not available and the cost to develop it would be excessive.

Business Segments

The Banking Group comprises the following main business segments:

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

Reconciling items include income from the investment of interest free funding from HBAP provided to support thin capitalisation ratios and income from the investment of retained profits.

<i>Banking Group and Branch</i>						
Audited 12 months ended 31.12.11						
<i>Dollars in Thousands</i>	RBWM	CMB	GBM	Total Reportable Segments	Reconciling items	Consolidated
Operating income	29,887	81,097	24,135	135,119	8,052	143,171
Operating profit / (loss) before tax	5,580	30,506	11,540	47,626	7,297	54,923
Net Interest Income	26,907	39,009	8,864	74,780	7,815	82,595
Depreciation and amortisation	419	355	857	1,631	413	2,044
Other material non-cash items						
Impairment losses on financial assets	1,220	26,540	-	27,760	-	27,760
Impairment recoveries on financial assets	(1,907)	(1,331)	-	(3,238)	-	(3,238)
Total other material non-cash items	(687)	25,209	-	24,522	-	24,522

Notes to and forming part of the Financial Statements *(continued)***5. Segment reporting** *(continued)*

The following tables present the segment reporting for the comparative period.

<i>Banking Group and Branch</i>						
Audited 12 months ended 31.12.10						
<i>Dollars in Thousands</i>	RBWM	CMB	GBM	Total Reportable Segments	Reconciling items	Consolidated
Operating income	24,424	84,618	31,852	140,894	8,913	149,807
Operating profit / (loss) before tax	(1,144)	52,934	20,238	72,028	9,172	81,200
Net Interest Income	21,447	42,443	16,796	80,686	8,805	89,491
Depreciation and amortisation	616	250	823	1,689	-	1,689
Other material non-cash items						
Impairment losses on financial assets	3,501	10,754	-	14,255	-	14,255
Impairment recoveries on financial assets	(1,595)	(1,549)	-	(3,144)	-	(3,144)
Total other material non-cash items	1,906	9,205	-	11,111	-	11,111

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

	<i>Banking Group and Branch</i>	
	Audited 12 months 31.12.11	Audited 12 months 31.12.10
<i>Dollars in Thousands</i>		
6. Taxation		
Current tax expense		
Current tax expense	<u>23,905</u>	<u>27,138</u>
	23,905	27,138
Deferred tax expense		
Origination and reversal of temporary differences	(8,379)	(2,519)
Effect of change in tax rate*	-	392
	<u>(8,379)</u>	<u>(2,127)</u>
	15,526	25,011
Total income tax expense included in profit after tax	<u>15,526</u>	<u>25,011</u>
Reconciliation of effective tax rate		
Operating profit before tax	<u>54,923</u>	81,200
Income tax using the domestic corporation tax rate	28.0% <u>15,378</u>	30.0% 24,360
Non-deductible expenses	0.2% <u>143</u>	0.2% 176
Under / (over) provided in prior periods	0.0% <u>4</u>	0.1% 80
Effect of change in tax rate*	0.0% <u>-</u>	0.5% 392
Other permanent differences	0.0% <u>1</u>	0.0% 3
	28.2% <u>15,526</u>	30.8% <u>25,011</u>
Recognised deferred tax assets and liabilities		
<u>Assets</u>		
Accelerated capital allowances	2,665	2,116
Provision for loan impairment	12,026	5,652
Other provisions	863	734
Cash flow hedges	150	939
Income deferred for accounting purposes	<u>3,274</u>	<u>2,153</u>
	<u>18,978</u>	<u>11,594</u>
<u>Liabilities</u>		
Other intangible assets	(1,369)	(1,574)
Tax deductible premium	<u>(3,595)</u>	<u>(3,595)</u>
	<u>(4,964)</u>	<u>(5,169)</u>
Deferred tax asset / (liability)	<u>14,014</u>	<u>6,425</u>

* The corporate tax rate has been reduced from 30% to 28% effective from 1 January 2011 for the Banking Group, being the beginning of the tax year to which the new rate will apply.

With the exception of cash flow hedge temporary differences, all deferred tax on temporary differences is recognised in the profit or loss.

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

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10
7. Additional financial disclosures on the statement of financial position		
Total interest earning and discount bearing assets	4,688,752	4,788,809
Total interest and discount bearing liabilities	4,463,656	4,515,802
Total liabilities net of amounts due to related parties	4,074,840	3,502,806
<hr/>		
8. Advances to banks		
Able to be withdrawn without prior notice	<u>14,337</u>	<u>1,235</u>
	14,337	1,235
<hr/>		
9. Debt and equity securities		
Available-for-sale		
Debt securities	453,097	616,527
Treasury bills	99,143	48,722
Equity shares	<u>52</u>	<u>155</u>
	522,292	665,404

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

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10
10. Derivative financial instruments - assets		
Related party		
<i>Interest rate contracts</i>		
Trading derivatives	-	377
	-	377
<i>Exchange rate contracts</i>		
Trading derivatives	65,386	54,988
	65,386	54,988
Derivative financial instruments – related party	65,386	55,365
<i>Related party breakdown</i>		
HBAP	-	364
Others	65,386	55,001
	65,386	55,365
Others		
<i>Interest rate contracts</i>		
Cash flow hedging derivatives	1,441	734
Trading derivatives	29,377	22,999
Fair value hedging derivatives	61	-
	30,879	23,733
<i>Exchange rate contracts</i>		
Trading derivatives	92,942	103,823
	92,942	103,823
Derivative financial instruments – others	123,821	127,556
Total derivative financial instruments - assets	189,207	182,921

Cashflow hedges

Principal asset balances, on which the expected interest cash flows arise, are as follows:

<i>Dollars in Millions</i>	Audited 31.12.11	Audited 31.12.10
3 months	988	496

This table reflects the interest rate refixing profile of the underlying hedged items.

The gains and losses on ineffective portions of cash flow hedges are recognised immediately in profit or loss.

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

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10
11. Advances to customers		
Maturity analysis		
Demand	156,888	95,588
Other short term	881,918	928,576
Long term	2,392,377	2,102,820
	3,431,183	3,126,984
12. Other assets		
Prepayments and accrued income – third party	13,043	11,271
Acceptances and endorsements	2,416	5,453
Other	1,229	484
	16,688	17,208
13. Intangible assets		
<u>Goodwill</u>		
<i>Cost</i>		
Balance at the beginning of the period	15,744	15,744
Balance at the end of the period	15,744	15,744
<i>Impairment</i>		
Balance at the beginning of the period	(2,043)	(2,043)
Balance at the end of the period	(2,043)	(2,043)
<i>Carrying amounts</i>		
Balance at the beginning of the period	13,701	13,701
Balance at the end of the period	13,701	13,701
<u>Other Intangible Assets</u>		
Customer relationships purchased		
<i>Cost</i>		
Balance at the beginning of the period	9,143	9,143
Fully amortised balance written off	(345)	-
Balance at the end of the period	8,798	9,143
<i>Amortisation and impairment</i>		
Balance at the beginning of the period	(3,521)	(2,673)
Amortisation of customer relationships	(734)	(848)
Fully amortised balance written off	345	-
Balance at the end of the period	(3,910)	(3,521)
<i>Carrying amounts</i>		
Balance at the beginning of the period	5,622	6,470
Balance at the end of the period	4,888	5,622

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

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10

13. Intangible assets (continued)**Other Intangible Assets** (continued)**Internally generated computer software***Cost*

Balance at the beginning of the period	850	-
Internal development	3,513	850
Balance at the end of the period	4,363	850

Amortisation and impairment

Balance at the beginning of the period	-	-
Amortisation of Internally generated computer software	(413)	-
Balance at the end of the period	(413)	-

Carrying amounts

Balance at the beginning of the period	850	-
Balance at the end of the period	3,950	850

Total Intangible Assets	22,539	20,173
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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 Branch'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 2011 is \$12.840 million (December 2010: \$12.840 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 two year time frame, approved by HBAP senior management. Profit forecasts greater than two years are estimated by Branch management based on their assessment of sustainable growth. The discounted cash flow model has used a five year profit projection, a discount rate (pre tax) of 15.0% (December 2010: 15.3%), average annual growth rates for revenues and direct expenses (as detailed in the following table) based on December 2011 actual results, and a terminal value of \$69.7 million (December 2010: \$27.3 million).

Average annual growth rate projections as at 31 December 2011

	Years 1-2	Years 3-5	5 Year Average
Revenues	2.1%	3.8%	3.1%
Direct Expenses	0.3%	2.3%	1.5%

The net average annual growth rate for revenues and expenses for years 3 to 5 does not exceed the average growth in GDP for New Zealand over the last 10 years.

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

13. Intangible assets *(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 2010

	Years 1-2	Years 3-5	5 Year Average
Revenues	7.2%	3.0%	4.6%
Direct Expenses	2.8%	2.0%	2.3%

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 10.8% (December 2010: 11.0%) and an annual sustainable growth rate from January 2017 onwards of 2.2% (December 2010: 2.4%) 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 121% (December 2010: 82%), all other variables being equal, in order for the CGU's recoverable amount to be equal to its carrying value. As at 31 December 2011 the recoverable amount exceeds the carrying amount by \$50.5 million (December 2010: \$13.2 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 2011 is \$0.861 million (December 2010: \$0.861 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 two year time frame, approved by HBAP senior management. Profit forecasts greater than two years are estimated by Branch management based on their assessment of sustainable growth. The discounted cash flow model has used a five year profit projection, a discount rate (pre tax) of 15.0% (December 2010: 15.3%), annual growth rate for revenues and direct expenses (as detailed in the following table) based on December 2011 actual results, and a terminal value of \$17.2 million (December 2010: \$6.4 million).

Average annual growth rate projections as at 31 December 2011

	Years 1-2	Years 3-5	5 Year Average
Revenues	3.0%	3.0%	3.0%
Direct Expenses	2.0%	2.0%	2.0%

The net average annual growth rate for revenues and expenses for years 3 to 5 does not exceed the average growth in GDP for New Zealand over the last 10 years.

Notes to and forming part of the Financial Statements *(continued)***13. Intangible assets** *(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 2010

	Years 1-2	Years 3-5	5 Year Average
Revenues	0.0%	3.0%	1.7%
Direct Expenses	5.6%	3.0%	4.0%

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 10.8% (December 2010: 11.0%) and an annual sustainable growth rate from January 2017 onwards of 2.2% (December 2010: 2.4%) 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 105% (December 2010: 23%), all other variables being equal, in order for the CGU's recoverable amount to be equal to its carrying value. As at 31 December 2011 the recoverable amount exceeds the carrying amount by \$10.8 million (December 2010: \$0.9 million)

Other Intangible Assets

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

The internally generated computer software is amortised on a straight line basis over 5 years. The remaining unamortised periods at 31 December 2011 are between 4 years 5 months and 4 years 11 months.

These 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 2011 is 6 years 8 months (December 2010: 7 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)

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10
14. Fixed assets		
Leasehold improvements		
<i>Cost</i>		
At beginning of period	7,188	6,535
Additions	669	653
Disposals	(1,342)	-
At end of period	<u>6,515</u>	<u>7,188</u>
<i>Accumulated depreciation</i>		
At beginning of period	5,709	5,225
Depreciation charge	573	484
Disposals	(1,342)	-
At end of period	<u>4,940</u>	<u>5,709</u>
Closing net book value	<u>1,575</u>	<u>1,479</u>
Equipment, fixtures and fittings		
<i>Cost</i>		
At beginning of period	4,568	6,503
Additions	281	378
Disposals	(702)	(2,313)
At end of period	<u>4,147</u>	<u>4,568</u>
<i>Accumulated depreciation</i>		
At beginning of period	3,791	5,746
Depreciation charge	324	357
Disposals	(691)	(2,312)
At end of period	<u>3,424</u>	<u>3,791</u>
Closing net book value	<u>723</u>	<u>777</u>
Total net book value	<u>2,298</u>	<u>2,256</u>

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

	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10

Dollars in Thousands

15. Asset quality**Past due but not impaired**

Less than 30 days	58,218	56,409
At least 30 days but less than 60 days	3,088	5,246
At least 60 days but less than 90 days	1,539	735
At least 90 days or more	-	-
Carrying amount	62,845	62,390

In the current period there is only one class of impaired financial assets, being advances to customers.

Gross individually impaired assets

Balance at the beginning of the period	71,781	43,900
Exchange adjustment	(3)	(212)
Transfers from performing	13,055	40,157
Transfers to performing	(1,430)	(1,394)
Write-offs	(771)	(5,179)
Repayment	(7,307)	(5,491)
Balance at the end of the period	75,325	71,781

Specific provision for loan impairment

Balance at the beginning of the period	18,412	11,249
New and additional provisions charged to profit or loss	27,251	13,961
Provisions released during the period to profit or loss	(1,211)	(648)
Write-offs	(771)	(5,179)
Discount unwind ¹	(2,417)	(759)
Exchange adjustment	(3)	(212)
Balance at the end of the period	41,261	18,412

Collective provision for loan impairment

Balance at the beginning of the period	1,775	3,030
Additional provision charged to profit or loss	509	294
Provisions released during the period to profit or loss	(594)	(1,549)
Balance at the end of the period	1,690	1,775

Total provisions for loan impairment	42,951	20,187
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Profit or loss charge / (credit)

Specific provisions for impairment against advances	27,251	13,961
Collective provisions for impairment against advances	509	294
Total provisions for impairment against advances	27,760	14,255

Specific provisions released	(1,211)	(648)
Collective provisions released	(594)	(1,549)
Total provisions released no longer required	(1,805)	(2,197)

Net increase in provisions for impairment against advances	25,955	12,058
Recoveries of amounts written off in previous period	(1,433)	(947)
	24,522	11,111

¹ 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 real estate assets or other assets acquired through the enforcement of security or assets under administration.

The aggregate amount as at 31 December 2011 of any undrawn balances on lending commitments to counterparties for whom drawn balances fall within the above mentioned class of assets, before deducting allowances for credit impairment loss where applicable, is nil (December 2010: Nil).

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

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10
16. Deposits by banks		
Demand	119,383	148,336
Other short term	33,857	15,985
	<u>153,240</u>	<u>164,321</u>
17. Derivative financial instruments – liabilities		
Related party		
<i>Interest rate contracts</i>		
Trading derivatives	1,105	5,635
<i>Exchange rate contracts</i>		
Trading derivatives	33,856	52,773
Derivative financial instruments – related party	<u>34,961</u>	<u>58,408</u>
<i>Related party breakdown</i>		
HBAP	28,772	51,386
Others	6,189	7,022
	<u>34,961</u>	<u>58,408</u>
Others		
<i>Interest rate contracts</i>		
Cash flow hedging derivatives	2,317	4,466
Trading derivatives	27,946	17,405
Fair value hedging derivatives	1,065	-
	<u>31,328</u>	<u>21,871</u>
<i>Exchange rate contracts</i>		
Trading derivatives	120,162	135,240
Derivative financial instruments – others	<u>151,490</u>	<u>157,111</u>
Total derivative financial instruments – liabilities	<u>186,451</u>	<u>215,519</u>

Cash flow hedges

Principal liability balances, on which the expected interest cash flows arise, are as follows:

<i>Dollars in Millions</i>	Audited 31.12.11	Audited 31.12.10
3 months	430	407

This table reflects the interest rate fixing profile of the underlying hedged items.

The gains and losses on ineffective portions of cash flow hedges are recognised immediately in profit or loss.

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

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10

18. Customer deposits

Demand deposits	1,511,026	1,122,095
Savings and term deposits	1,580,759	1,305,083
	<u>3,091,785</u>	<u>2,427,178</u>

The total retail term deposits as at 31 December 2011 were \$1,543,784 thousand (December 2010: \$1,281,318 thousand).

\$6,308 thousand of the retail deposits are issued to unit holders of the HSBC Cash Fund (December 2010: \$5,965 thousand) and \$55,049 thousand of the retail deposits are issued to unit holders of the HSBC Term Fund (December 2010: \$37,647 thousand).

The total other money market deposits as at 31 December 2011 were \$255,990 thousand (December 2010: \$132,006 thousand).

19. Debt securities

Certificates of deposit issued	434,805	719,269
Medium term notes issued	200,000	-
	<u>634,805</u>	<u>719,269</u>

There are no debt securities on demand.

20. Other liabilities

Accruals and deferred income	27,636	24,491
Acceptances and endorsements	2,416	5,453
Other	4,868	4,983
	<u>34,920</u>	<u>34,927</u>

Accruals as at 31 December 2011 include \$6.9 million for employee entitlements (December 2010: \$6.9 million).

Notes to and forming part of the Financial Statements *(continued)***21. Related party transactions**

Related party transactions are unsecured and entered into in the normal course of business. During the period there have been dealings between the Branch, 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 financial statements of the Banking Group should be read in conjunction with the financial statements of HBAP for period ended 31 December 2011.

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10
Key management compensation		
(a) Salaries and other short-term benefits	3,152	3,413
(b) Post-employment benefits	184	186
	<u>3,336</u>	<u>3,599</u>

(c) Shares, options and other incentive plans

HSBC Holdings Savings-Related Share Option Plan (International)

Number of options granted	-	551
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The total fair value of the options granted converted into NZ dollars at grant date is nil (December 2010: NZD 2 thousand).

These options provide the right to acquire ordinary shares after a vesting period of 1, 3 or 5 years.

The fair value of each option granted under the HSBC Holdings Savings-Related Share Option Plan (International)

1 year	-	£1.40
3 years	-	£1.60
5 years	-	£1.75

Key management personnel represent the members of the New Zealand ALCO who are employees of the Registered Bank.

Interest Free Funding

The Branch has received an interest free loan from HBAP of \$194 million (December 2010: \$194 million) to support the thin capitalisation ratio imposed under New Zealand tax law.

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

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10
21. Related party transactions (continued)		
Amounts due from related parties		
On demand	16,871	12,432
Other short term	136,810	200,519
	153,681	212,951
The Hongkong and Shanghai Banking Corporation Limited (HBAP):		
Hong Kong Branch	135,391	197,966
Singapore Branch	5,028	690
Tokyo Branch	6,446	630
Other:		
HSBC Bank USA	1,442	1,401
HSBC Bank plc	573	3,474
HSBC Bank Canada	165	1,147
HSBC Bank Australia Limited	368	145
HBME United Arab Emirates	21	280
Other	4,247	7,218
	153,681	212,951
Amounts due to related parties		
On demand	264,332	485,973
Other short term	67,405	665,326
Long term	481,023	280,477
	812,760	1,431,776
The Hongkong and Shanghai Banking Corporation Limited (HBAP):		
Singapore Branch	17,596	17,275
Hong Kong Branch	661,568	1,056,754
Brunei Branch	147	700
Japan Branch	286	197
Bahamas Branch	80,031	80,030
Taiwan Branch	490	856
Australia Branch	343	200,281
Macau Branch	433	273
Philippines Branch	719	766
India Branch	40	145
Indonesia Branch	254	171
Korea Branch	97	189
Mauritius POB Branch	208	554
Sri Lanka Branch	233	208
Thailand Branch	176	17
Other:		
HSBC Bank Canada	-	383
HSBC France	11,522	5,692
HSBC Private Banking Holdings (Suisse) SA	1,557	1,826
HSBC Bank Australia Limited	528	831
HSBC Bank USA	7,522	20,251
HSBC Bank Plc UK Ops	5,020	1
HSBL Mauritius – PTL	129	6
HSBC Republic Bank (UK)	296	316
HSBC Trinkaus and Burkhardt	159	181
HSBC Bank Malaysia Berhad	2,005	1,035
Bank of Bermuda – Bermuda	754	27,290
HBME United Arab Emirates	581	-
HSBC Bank International Limited (Jersey)	193	13
HIB plc London Branch	14,537	7,706
Other	5,336	7,829
	812,760	1,431,776

Notes to and forming part of the Financial Statements (continued)**22. 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 best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used.

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. In inactive markets, obtaining assurance that the transaction price provides evidence of fair value or determining the adjustments to transaction prices that are necessary to measure the fair value of the instrument requires additional work during the valuation process.

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 and Branch</i> Audited				
<i>Dollars in Thousands</i>	31.12.11	31.12.11	31.12.11	31.12.11
	Level 1	Level 2	Level 3	TOTAL
ASSETS				
Debt and equity securities	136,815	415,445	32	552,292
Derivatives financial instruments	-	187,994	1,213	189,207
LIABILITIES				
Derivatives financial instruments	-	185,238	1,213	186,451

<i>Banking Group and Branch</i> Audited				
<i>Dollars in Thousands</i>	31.12.10	31.12.10	31.12.10	31.12.10
	Level 1	Level 2	Level 3	TOTAL
ASSETS				
Debt and equity securities	-	665,404	-	665,404
Derivatives financial instruments	-	182,921	-	182,921
LIABILITIES				
Derivatives financial instruments	-	215,519	-	215,519

There have been no significant transfers between levels 1 and 2 in the period to 31 December 2011 (2010: Nil).

Notes to and forming part of the Financial Statements *(continued)***22. Fair value of financial instruments** *(continued)***Reconciliation of fair value measurements in level 3 of the fair value hierarchy**

The following table provides a reconciliation of the movement between opening and closing balance of level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs.

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>		
	Audited		
	31.12.11		
	<u>Assets</u>	<u>Assets</u>	<u>Liabilities</u>
	<u>Available-</u>	<u>Derivatives</u>	<u>Derivatives</u>
	<u>For-sale</u>		
Balance at the beginning of the period	-	-	-
Total gains or losses recognised in profit or loss	-	1,213	1,213
Purchases	32	-	-
Balance at the end of the period	<u>32</u>	<u>1,213</u>	<u>1,213</u>

For the derivative assets and liabilities, gains and losses are presented in the Statement of Comprehensive Income under 'Net trading income'.

Sources of uncertainty for fair value measurement in level 3

For the available-for-sale equity securities, the unobservability of valuation of certain equity shares resulted in these assets being determined as level 3. There is no quoted market price in an active market.

For the derivative assets and liabilities, they are classified as level 3 as the foreign exchange volatilities are not observable.

Effects of changes in significant non-observable assumptions to reasonably possible alternatives

For the available-for-sale equity securities, given that their total carrying amount at December 2011 is \$32 thousand, the effect in equity arising from changes in significant non-observable assumptions is insignificant.

Since the level 3 derivative assets and liabilities are perfectly matched transactions, there is no significant exposure to the Banking Group and no impact on the profit or loss is expected. There will be no significant impact on the profit or loss arising from changes in significant non-observable assumptions.

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

22. 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, fair value is determined by using discounted cash flow methods using the interest rates applicable to financial instruments of similar maturity.

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.

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, 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 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.

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

The following table summarises the carrying values and fair values of financial assets and liabilities in the Banking Group.

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>			
	Audited	Audited	Audited	Audited
	31.12.11	31.12.11	31.12.10	31.12.10
	Carrying	Fair	Carrying	Fair
	Value	Value	Value	Value
ASSETS				
Advances to customers	3,431,183	3,439,742	3,126,984	3,133,348
Total financial assets not carried at fair value	3,431,183	3,439,742	3,126,984	3,133,348
Total financial assets whose carrying value approximates fair value	1,469,425	1,469,425	1,863,426	1,863,426
Total financial assets	4,900,608	4,909,167	4,990,410	4,996,774
Total non-financial assets	39,098		30,489	
Total assets	4,939,706		5,020,899	
LIABILITIES				
Customer deposits	3,091,785	3,094,057	2,427,178	2,429,182
Debt securities	634,805	631,370	719,269	719,269
Amounts due to related parties	812,760	812,726	1,431,776	1,436,432
Total financial liabilities not carried at fair value	4,539,350	4,538,153	4,578,223	4,584,883
Total financial liabilities whose carrying value approximates fair value	372,267	372,267	410,702	410,702
Total financial liabilities	4,911,617	4,910,420	4,988,925	4,995,585
Total non-financial liabilities	10,944		4,065	
Total liabilities	4,922,561		4,992,990	

Notes to and forming part of the Financial Statements (continued)**23. 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 and Branch</i>	
	Audited	Audited
	31.12.11	31.12.10
On-balance sheet credit exposures		
Cash and demand balances with central banks	543,467	783,962
Advances to banks	14,337	1,235
Debt and equity securities	552,292	665,404
Advances to customers	3,431,183	3,126,984
Amounts due from related parties	153,681	212,951
Other assets	16,441	16,953
	4,711,401	4,807,489
Off-balance sheet credit exposures and derivatives	1,902,195	1,819,947
Total credit exposures	6,613,596	6,627,436

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	1,097,787	1,124,100
Commercial and industrial	2,291,271	1,946,431
Commercial real estate and construction	720,956	750,118
Banks and financial institutions	1,680,940	2,078,591
Agriculture, forestry and mining	284,033	218,713
Other	538,609	509,483
	6,613,596	6,627,436

Concentrations of credit risk by geographical area

New Zealand	5,852,741	5,846,551
Hong Kong	158,994	226,253
Other Overseas	601,861	554,632
	6,613,596	6,627,436

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 period. These exposures do not include exposures to counterparties if they are booked outside of New Zealand.

Notes to and forming part of the Financial Statements (continued)**23. Concentrations of credit and funding risk** (continued)

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10
Concentrations of funding		
Concentrations of funding by product		
Deposits by banks	153,240	164,321
Customer deposits	3,091,785	2,427,178
Debt securities	634,805	719,269
Amounts due to related parties	812,760	1,431,776
	<u>4,692,590</u>	<u>4,742,544</u>
Concentrations of funding by industry		
Agriculture, forestry, fishing and mining	69,211	33,561
Manufacturing	140,908	149,728
Electricity, gas and water	529	528
Wholesale and retail trade	139,577	123,549
Accommodation and restaurants	11,819	13,782
Banking and finance	2,048,311	2,449,454
Property and business services	320,528	173,830
Local authorities	58,707	14,044
Individual	1,813,987	1,718,282
Other	89,013	65,786
	<u>4,692,590</u>	<u>4,742,544</u>
Concentrations of funding by geographical area		
New Zealand	2,602,466	2,310,918
Australia	49,163	248,318
China	295,136	284,454
Great Britain	142,069	131,617
Hong Kong	733,528	1,133,203
Malaysia	43,662	44,956
Singapore	73,107	50,407
Taiwan	65,396	65,867
Other Overseas	688,063	472,804
	<u>4,692,590</u>	<u>4,742,544</u>

Notes to and forming part of the Financial Statements (continued)**23. Concentrations of credit and funding risk** (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>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10
Carrying amount		
Advances to customers	<u>3,431,183</u>	<u>3,126,984</u>
	3,431,183	3,126,984
Individually Impaired		
Grade 6: Impaired	<u>75,325</u>	<u>71,781</u>
Gross amount	<u>75,325</u>	<u>71,781</u>
Allowance for impairment	<u>(41,261)</u>	<u>(18,412)</u>
Carrying amount	<u>34,064</u>	<u>53,369</u>
Collectively Impaired		
Allowance for impairment	<u>(1,690)</u>	<u>(1,775)</u>
Carrying amount	<u>(1,690)</u>	<u>(1,775)</u>
Past due but not impaired		
Grade 1-3: Low-fair risk	<u>54,335</u>	<u>52,188</u>
Grade 4-5: Watch List	<u>8,510</u>	<u>10,202</u>
Carrying amount	<u>62,845</u>	<u>62,390</u>
Past due comprises:		
0-30 days	<u>58,218</u>	<u>56,409</u>
30-90 days	<u>4,627</u>	<u>5,981</u>
90 days +	<u>-</u>	<u>-</u>
Carrying amount	<u>62,845</u>	<u>62,390</u>
Neither past due nor impaired		
Grade 1-3: Low-fair risk	<u>3,292,695</u>	<u>2,954,147</u>
Grade 4-5: Watch List	<u>43,269</u>	<u>58,853</u>
Carrying amount	<u>3,335,964</u>	<u>3,013,000</u>
Total carrying amount	<u><u>3,431,183</u></u>	<u><u>3,126,984</u></u>

Notes to and forming part of the Financial Statements *(continued)***23. 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 applies a loan to value ratio for customer advances of 80%, however this ratio may be varied according to other criteria such as customer income streams, mortgage protection insurance and relationship with HSBC. 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.

Collateral is generally not held over advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity.

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 period (December 2010: Nil).

Other financial assets neither past due nor impaired

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. The below schedule excludes accrued interest.

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>			
	TOTAL	Grade 1-2	Grade 3	Grade 4-5
31 December 2011 (Audited)				
Cash and demand balances with central banks	543,467	543,467	-	-
Advances to banks	14,337	13,936	401	-
Debt and equity securities	552,292	552,292	-	-
Derivative financial instruments	189,207	151,325	37,882	-
Amounts due from related parties	153,681	153,681	-	-
31 December 2010 (Audited)				
Cash and demand balances with central banks	783,962	783,962	-	-
Advances to banks	1,235	716	519	-
Debt and equity securities	665,404	665,404	-	-
Derivative financial instruments	182,921	144,821	38,064	36
Amounts due from related parties	212,951	212,951	-	-

Notes to and forming part of the Financial Statements (continued)**24. Interest rate risk – repricing schedule**

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

<i>Dollars in Millions</i>	<i>Banking Group and Branch</i>							<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 2011 (Audited)								
<i>Assets</i>								
Cash and demand balances with central banks	537	-	-	-	-	537	6	543
Advances to banks	14	-	-	-	-	14	-	14
Debt and equity securities	316	99	-	105	32	552	-	552
Derivative financial instruments	-	-	-	-	-	-	189	189
Advances to customers	2,289	948	71	82	42	3,432	-	3,432
Amounts due from related parties	144	4	6	-	-	154	-	154
Other assets	-	-	-	-	-	-	17	17
Deferred taxation	-	-	-	-	-	-	14	14
Intangible assets	-	-	-	-	-	-	23	23
Fixed assets	-	-	-	-	-	-	2	2
<i>Total assets</i>	3,300	1,051	77	187	74	4,689	251	4,940
<i>Liabilities</i>								
Deposits by banks	132	15	6	-	-	153	-	153
Derivative financial instruments	-	-	-	-	-	-	186	186
Customer deposits	2,488	405	126	25	29	3,073	19	3,092
Debt securities	583	52	-	-	-	635	-	635
Amounts due to related parties	523	-	80	-	-	603	210	813
Other liabilities	-	-	-	-	-	-	35	35
Current taxation	-	-	-	-	-	-	9	9
<i>Total liabilities</i>	3,726	472	212	25	29	4,464	459	4,923
Net balance of derivative financial instruments	20	(75)	200	(125)	(20)	-	-	-
31 December 2010 (Audited)								
<i>Assets</i>								
Cash and demand balances with central banks	783	-	-	-	-	783	1	784
Advances to banks	1	-	-	-	-	1	-	1
Debt and equity securities	538	73	54	-	-	665	-	665
Derivative financial instruments	-	-	-	-	-	-	183	183
Advances to customers	2,014	879	60	94	81	3,128	-	3,128
Amounts due from related parties	211	-	-	-	-	211	2	213
Other assets	-	-	-	-	-	-	18	18
Current taxation	-	-	-	-	-	-	1	1
Deferred taxation	-	-	-	-	-	-	6	6
Intangible assets	-	-	-	-	-	-	20	20
Fixed assets	-	-	-	-	-	-	2	2
<i>Total assets</i>	3,547	952	114	94	81	4,788	233	5,021
<i>Liabilities</i>								
Deposits by banks	158	5	1	-	-	164	-	164
Derivative financial instruments	-	-	-	-	-	-	216	216
Customer deposits	1,819	341	216	9	23	2,408	19	2,427
Debt securities	712	7	-	-	-	719	-	719
Amounts due to related parties	1,144	-	80	-	-	1,224	208	1,432
Other liabilities	-	-	-	-	-	-	35	35
<i>Total liabilities</i>	3,833	353	297	9	23	4,515	478	4,993
Net balance of derivative financial instruments	120	-	-	(90)	(30)	-	-	-

Notes to and forming part of the Financial Statements (continued)**25. 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, treasury bills, government and local government bonds, registered certificates of deposits issued by other banks, and overnight deposits held with related parties. The Banking Group holds the following liquid assets in order to manage its liquidity risk:

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10
Demand balances with the central bank	537,353	782,635
Available-for-sale debt securities and treasury bills	552,240	665,249
	<u>1,089,593</u>	<u>1,447,884</u>

Maturity Analysis

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 and Branch</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 2011 (Audited)								
<i>Assets</i>								
Cash and demand balances with central banks	543	-	-	-	-	-	-	543
Advances to banks	14	-	-	-	-	-	-	14
Debt and equity securities	-	200	100	99	153	-	-	552
Advances to customers	157	104	212	566	1,488	905	-	3,432
Amounts due from related parties	17	114	13	10	-	-	-	154
Other assets	2	15	-	-	-	-	-	17
Deferred taxation	-	-	-	-	-	-	14	14
Intangible assets	-	-	-	1	7	1	14	23
Fixed assets	-	-	-	-	-	-	2	2
<i>Total</i>	733	433	325	676	1,648	906	30	4,751
Derivative financial instruments – inflow	-	8	14	265	2,173	30	-	2,490
Derivative financial instruments – (outflow)	-	-	-	(251)	(2,025)	(25)	-	(2,301)
Derivative financial instruments - assets	-	8	14	14	148	5	-	189
<i>Liabilities</i>								
Deposits by banks	119	4	9	21	-	-	-	153
Customer deposits	1,511	369	625	512	55	20	-	3,092
Debt securities	-	-	383	52	200	-	-	635
Amounts due to related parties	264	18	50	-	481	-	-	813
Other liabilities	1	34	-	-	-	-	-	35
Current taxation	-	-	-	9	-	-	-	9
<i>Total</i>	1,895	425	1,067	594	736	20	-	4,737
Derivative financial instruments – (inflow)	-	-	-	(251)	(2,025)	(25)	-	(2,301)
Derivative financial instruments – outflow	-	9	11	265	2,173	29	-	2,487
Derivative financial instruments – liabilities	-	9	11	14	148	4	-	186
<i>Net assets</i>	(1,162)	7	(739)	82	912	887	30	17

Notes to and forming part of the Financial Statements (continued)**25. Liquidity risk management** (continued)**Maturity Analysis** (continued)

<i>Dollars in Millions</i>	Banking Group and Branch							<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 2010 (Audited)								
Assets								
Cash and demand balances with central banks	784	-	-	-	-	-	-	784
Advances to banks	1	-	-	-	-	-	-	1
Debt and equity securities	-	389	149	127	-	-	-	665
Advances to customers	96	88	207	634	1,176	927	-	3,128
Amounts due from related parties	12	184	17	-	-	-	-	213
Other assets	2	13	3	-	-	-	-	18
Current taxation	1	-	-	-	-	-	-	1
Deferred taxation	-	-	-	-	-	-	6	6
Intangible assets	-	-	-	-	4	2	14	20
Fixed assets	-	-	-	-	-	-	2	2
Total	896	674	376	761	1,180	929	22	4,838
Derivative financial instruments – inflow	-	14	36	395	702	3	-	1,150
Derivative financial instruments – (outflow)	-	-	-	(347)	(620)	-	-	(967)
Derivative financial instruments - assets	-	14	36	48	82	3	-	183
Liabilities								
Deposits by banks	148	5	5	6	-	-	-	164
Customer deposits	1,122	333	381	537	32	22	-	2,427
Debt securities	-	339	373	7	-	-	-	719
Amounts due to related parties	486	65	200	400	281	-	-	1,432
Other liabilities	1	32	2	-	-	-	-	35
Total	1,757	774	961	950	313	22	-	4,777
Derivative financial instruments – (inflow)	-	-	-	(347)	(620)	-	-	(967)
Derivative financial instruments – outflow	-	23	42	410	706	2	-	1,183
Derivative financial instruments – liabilities	-	23	42	63	86	2	-	216
Net assets	(861)	(109)	(591)	(204)	863	908	22	28

Notes to and forming part of the Financial Statements (continued)**25. 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 and Branch							<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 2011 (Audited)								
Financial Assets								
Cash and demand balances with central banks	543	-	-	-	-	-	-	543
Advances to banks	14	-	-	-	-	-	-	14
Debt and equity securities	-	200	101	108	161	-	-	570
Advances to customers	157	117	238	670	1,809	1,695	-	4,686
Amounts due from related parties	17	114	13	10	-	-	-	154
Other assets	2	15	-	-	-	-	-	17
Total non-derivative financial assets	733	446	352	788	1,970	1,695	-	5,984
Derivative financial instruments – inflow	-	9	17	274	2,179	30	-	2,509
Derivative financial instruments – (outflow)	-	-	(3)	(260)	(2,032)	(25)	-	(2,320)
Derivative financial instruments - assets	-	9	14	14	147	5	-	189
Financial Liabilities								
Deposits by banks	119	4	9	21	-	-	-	153
Customer deposits	1,511	369	632	534	66	21	-	3,133
Debt securities	-	1	386	58	226	-	-	671
Amounts due to related parties	264	19	53	11	491	-	-	838
Other liabilities	1	31	-	-	-	-	-	32
Total non-derivative financial liabilities	1,895	424	1,080	624	783	21	-	4,827
Derivative financial instruments – (inflow)	-	-	(1)	(253)	(2,026)	(25)	-	(2,305)
Derivative financial instruments – outflow	-	9	12	268	2,175	29	-	2,493
Derivative financial instruments – liabilities	-	9	11	15	149	4	-	188
<i>Net financial assets</i>	(1,162)	22	(725)	163	1,185	1,675	-	1,158
<i>Undrawn loan commitments</i>	602	-	818	-	-	-	-	1,420

Notes to and forming part of the Financial Statements *(continued)***25. Liquidity risk management** *(continued)***Maturity Analysis – undiscounted cashflows basis** *(continued)*

<i>Dollars in Millions</i>	Banking Group and Branch							<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 2010 (Audited)								
<i>Financial Assets</i>								
Cash and demand balances with central banks	784	-	-	-	-	-	-	784
Advances to banks	1	-	-	-	-	-	-	1
Debt and equity securities	-	390	149	130	-	-	-	669
Advances to customers	96	101	232	738	1,488	1,781	-	4,436
Amounts due from related parties	12	184	17	-	-	-	-	213
Other assets	2	13	3	-	-	-	-	18
Total non-derivative financial assets	895	688	401	868	1,488	1,781	-	6,121
Derivative financial instruments – inflow	-	15	37	398	702	3	-	1,155
Derivative financial instruments – (outflow)	-	(1)	(1)	(349)	(620)	-	-	(971)
Derivative financial instruments - assets	-	14	36	49	82	3	-	184
<i>Financial Liabilities</i>								
Deposits by banks	148	6	5	6	-	-	-	165
Customer deposits	1,122	334	386	560	42	24	-	2,468
Debt securities	-	339	375	7	-	-	-	721
Amounts due to related parties	486	67	205	411	298	-	-	1,467
Other liabilities	1	28	2	-	-	-	-	31
Total non-derivative financial liabilities	1,757	774	973	984	340	24	-	4,852
Derivative financial instruments – (inflow)	-	-	(1)	(350)	(623)	-	-	(974)
Derivative financial instruments – outflow	-	24	44	416	710	2	-	1,196
Derivative financial instruments – liabilities	-	24	43	66	87	2	-	222
<i>Net financial assets</i>	(862)	(96)	(579)	(133)	1,143	1,758	-	1,231
<i>Undrawn loan commitments</i>	522	-	858	-	-	-	-	1,380

Notes to and forming part of the Financial Statements *(continued)***26. Additional mortgage information****Residential mortgages by loan-to-valuation ratio**

	<i>Banking Group and Branch</i>			
	Principal Amount			Total \$m
	Does not exceed 80% \$m	Exceeds 80% and not 90% \$m	Exceeds 90% \$m	
31 December 2011 (Unaudited)				
Value of exposures on balance sheet	933.7	25.0	9.7	968.4
Value of exposures off balance sheet	35.7	0.1	0.0	35.8
Total value of exposures	969.4	25.1	9.7	1,004.2
31 December 2010 (Unaudited)				
Value of exposures on balance sheet	943.2	28.9	9.3	981.4
Value of exposures off balance sheet	33.3	1.0	0.3	34.6
Total value of exposures	976.5	29.9	9.6	1,016.0

27. 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 aggregated with the net expected future cash flows from off-balance sheet purchases and sales from foreign exchange transactions 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 and Branch</i>	
	Audited 31.12.11	Audited 31.12.10
Receivable / (payable)		
AUD	0.0	0.0
GBP	0.0	0.0
USD	0.2	(0.1)
Other	(0.4)	0.2
	(0.2)	0.1

Notes to and forming part of the Financial Statements *(continued)***28. 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 the Ninth Schedule to the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order (No 4) 2011.

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>	<i>Banking Group and Branch</i>	
	<i>Implied risk weighted Exposure</i>	<i>Notional capital charge</i>
<i>Exposure at 31 December 2011 (Unaudited)</i>		
Interest rate risk	36.8	2.9
Foreign currency risk	0.0	0.0
Equity risk	-	-
<i>Peak exposure period 1 July 2011 to 31 December 2011 (Unaudited)</i>		
Interest rate risk	49.1	3.9
Foreign currency risk	2.4	0.2
Equity risk	-	-

Notes to and forming part of the Financial Statements (continued)**29. 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 Executive Share Option Scheme
HSBC Holdings ordinary shares of US\$0.50

The HSBC Holdings Executive Share Option Scheme is a long-term incentive scheme available to certain HSBC employees with grants made each year in 1999 and 2000. The Scheme expired on 16 May 2000. No options have been granted under the Scheme following the adoption of the HSBC Holdings Group Share Option Plan since that date. Options were granted at market value and are normally exercisable between the third and tenth anniversaries of the date of the grant, subject to vesting conditions. The final exercisable date was 3 April 2010.

	Banking Group and Branch			
	Audited		Audited	
	31.12.11		31.12.10	
	<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	-	-	£6.50	5,106
Share options granted during the period	-	-	-	-
Share options forfeited during the period	-	-	-	-
Share options exercised during the period	-	-	£6.50	(3,040)
Share options expired during the period	-	-	£6.50	(2,066)
Share options outstanding at the end of the period		<u>-</u>		<u>-</u>
Share options exercisable at the end of the period		<u>-</u>		<u>-</u>

The weighted average share price on the dates on which options were exercised was £7.05 for December 2010.

Notes to and forming part of the Financial Statements (continued)**29. Share options** (continued)**b. HSBC Holdings Group Share Option Plan**
HSBC Holdings ordinary shares of US\$0.50

The HSBC Holdings Group Share Option Scheme is a long-term incentive scheme available to certain HSBC employees with grants usually made each year between 2001 and 2004. The Scheme expired on 26 May 2005. No options have been granted under the Plan since that date. Options were granted at market value and are normally exercisable between the third and tenth anniversaries of the date of the grant, subject to vesting conditions. The exercisable date may be advanced in certain circumstances e.g. retirement. The final exercisable dates are from April 2011 to April 2014.

	Banking Group and Branch			
	Audited 31.12.11		Audited 31.12.10	
	<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	£7.10	97,192	£7.11	103,504
Share options forfeited during the period		-	£7.26	(6,312)
Share options exercised during the period	£6.02	(2,582)		-
Share options expired during the period	£7.59	(15,950)		-
Share options outstanding at the end of the period	£7.04	78,660	£7.10	97,192
Share options exercisable at the end of the period	£7.04	78,660	£7.10	97,192

The weighted average share price on the date on which options were exercised was £6.65 for December 2011. (2010: Nil).

The options outstanding at 31 December 2011 have an exercise price in the range of £6.02 to £7.32 (December 2010: £6.02 to £7.60) and a weighted average remaining contractual life of 19 months (December 2010: 27 months).

Notes to and forming part of the Financial Statements (continued)**29. Share options** (continued)

c. **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 exercise price is at a 20% (2010: 20%) discount to the market value at the date of grant.

	Banking Group and Branch			
	Audited 31.12.11		Audited 31.12.10	
	<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	£3.87	144,514	£3.66	160,801
Share options granted during the period	£5.10	20,949	£5.46	25,952
Share options exercised during the period	£5.54	(6,860)	£3.75	(26,353)
Share options expired during the period	£5.50	(5,456)	£3.96	(536)
Share options cancelled during the period	£5.62	(9,299)	£4.23	(8,113)
Share options transferred in during the period		-	£3.31	2,174
Share options transferred out during the period		-	£4.49	(9,411)
Share options outstanding at the end of the period	£3.80	143,848	£3.87	144,514
Share options exercisable at the end of the period	£5.94	5,038	£6.18	321

The weighted average share price on the dates on which options were exercised was £5.89 for December 2011 (December 2010: £6.55).

The weighted average fair value of share options granted was £1.27 (December 2010: £1.53).

The options outstanding at 31 December 2011 have an exercise price in the range of £3.31 to £6.18 (December 2010: £3.31 to £6.69) and a weighted average remaining contractual life of 21 months (December 2010: 31 months).

Notes to and forming part of the Financial Statements (continued)**29. Share options** (continued)**d. HSBC Achievement Share Award Scheme**

Achievement shares were launched in 2005 and were utilised to promote widespread interest in HSBC shares amongst employees and are awarded to eligible employees after taking into account of the employee's performance in the prior year. High-performing and/or high-potential senior and middle managers are normally eligible to receive achievement shares as part of the annual pay review process. Shares are awarded without corporate performance conditions and are released to employees after three years provided the employees have remained employed by the group for this period.

Additional awards are made during the 3-year vesting period. At the end of three years, the original award together with the additional share awards will be released.

	Banking Group and Branch	
	Audited	Audited
	31.12.11	31.12.10
	<i>Number of</i>	<i>Number of</i>
	<i>shares</i>	<i>shares</i>
Shares at beginning of the period	6,785	11,497
Shares granted during the period	-	-
Shares forfeited during the period	-	-
Shares released during the period	(6,785)	(4,712)
Shares outstanding at the end of the period	<u>-</u>	<u>6,785</u>

There were no shares granted during 2011 (2010: Nil).

e. 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.

	Audited	Audited
	31.12.11	31.12.10
	<i>Number of</i>	<i>Number of</i>
	<i>shares</i>	<i>shares</i>
Shares at beginning of the period	22,891	-
New shares granted during the period	15,441	22,148
Additional shares arising from scrip dividends	1,467	743
Shares released during the period	(2,260)	-
Shares forfeited during the period	-	-
Share transferred in during the period	518	-
Share transferred out during the period	(3,798)	-
Shares outstanding at the end of the period	<u>34,259</u>	<u>22,891</u>

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

29. Share options *(continued)*

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 binomial lattice methodology that is based on the underlying assumptions of the Black-Scholes model. When modelling options/awards with vesting dependent on HSBC's Total Shareholder Return over a period, the performance targets are incorporated into the model using Monte Carlo simulation. Non-market conditions, such as HSBC meeting earnings per share targets, are not incorporated into the calculation of fair value at grant date but are reflected in the amount of compensation expense accrued over the vesting period.

The expected life of options depends on the behaviour of option holders, which is incorporated into the option model consistent with historic observable data. Prior to 2004, share options were valued using a simpler methodology also based on the Black-Scholes model.

The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used. The significant weighted average assumptions used to estimate the fair value of the options granted are as follows:

2011	<u>Savings related Share option</u>		
	1 year	3 year	5 year
Risk-free interest rate (%)	0.8	1.7	2.5
Expected life (years)	1	3	5
Expected volatility (%)	25	25	25

2010	<u>Savings related Share option</u>		
	1 year	3 year	5 year
Risk-free interest rate (%)	0.7	2.1	2.4
Expected life (years)	1	3	5
Expected volatility (%)	50	35	30

The risk-free interest rate was determined from the UK gilts zero-coupon yield curve. Expected volatility is estimated by considering historic average HSBC share price volatility and implied volatility for traded options over HSBC shares of similar maturity to those of the employee options. In addition, the expected US dollars denominated dividend growth was determined to be 4.5 per cent per annum in line with consensus analyst forecasts (December 2010: 4.5 per cent).

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

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

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10

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

Within one year	3,002	3,064
Between one year and two years	2,641	2,574
Between two years and five years	8,299	7,637
More than five years	640	3,211
	<u>14,582</u>	<u>16,486</u>

31. Contingent liabilities and other commitments**Contingent liabilities**

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	48,143	55,029
Transaction related contingent items	123,584	85,623
Trade related contingent items	121,282	115,866
Commitments, maturity one year or more	731,939	676,524
Commitments, maturity up to one year	688,040	703,984
	<u>1,712,988</u>	<u>1,637,026</u>

Capital commitments

Contracted expenditure	<u>-</u>	<u>75</u>
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The contracted expenditure in December 2010 was related to computers and leasehold improvements.

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

The financial statements of the Branch include income in respect of custodial services provided to customers by the Branch's nominee company, HSBC Nominees (New Zealand) Limited. As at 31 December 2011, securities held by the nominee company on behalf of the Branch's customers were excluded from the nominee company and the Branch's Statement of Financial Position. The value of securities held by the nominee company at 31 December 2011 was NZD38,333 million (December 2010: NZD32,595 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.

Notes to and forming part of the Financial Statements *(continued)***32. Custodial services, funds management and other fiduciary activities** *(continued)***Funds management**

The aggregate value of funds managed by the Banking Group at the end of the reporting period was:

<i>Dollars in Thousands</i>	<i>Banking Group and Branch</i>	
	Audited 31.12.11	Audited 31.12.10
Discretionary funds	65,980	48,169
Totals funds under management	65,980	48,169

Discretionary funds are represented by the HSBC Cash Fund, HSBC Term Fund, HSBC Global Unit Trusts, and HSBC World Selection Funds.

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

33. Marketing and distribution of insurance products

The Branch 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 Branch 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.

34. 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.

35. Subsequent event

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

Notes to and forming part of the Financial Statements *(continued)***36. Profitability, size and asset quality of HBAP Group**

<i>Dollars in HK\$ millions</i>	Unaudited 12 months ended 31.12.11
Profitability	
Net profit after tax	73,904
Net profit after tax over the previous year as a percentage of average total assets	1.4%
Size	
Total assets as at 31 December 2011	5,607,480
Percentage increase in total assets over the year ending on 31 December 2011	11.3%
Asset quality	
Individually impaired assets	13,851
Individual impairment provision against advances to customers	(6,894)
Collective impairment provision against advances to customers	(4,407)
Individually impaired assets / total assets	0.2%
Individual impairment provision / individually impaired assets	49.8%

37. Capital adequacy ratios

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 (IRBA) 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 securitisation exposures. For market risk, HBAP Group uses an internal models approach to calculate its general market risk, specific risk for the interest rate risk category and market risk relating to equity options. HBAP Group uses the standardised (market risk) approach for calculating other market risk positions 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 (commonly known as "Basel II") and are not publicly available. HBAP Group exceeds the minimum capital ratio requirements as specified by the HKMA as at 31 December 2011 and 31 December 2010.

HBAP Group reported the following capital adequacy ratios:

	Unaudited 31.12.11	Unaudited 31.12.10
Capital Ratios		
Core capital ratio	12.4%	11.7%
Capital adequacy ratio	14.6%	14.7%

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

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 (No 4) 2011;
- 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 2011.

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, Noel Gerard McNamara, and also in his capacity as Chief Executive Officer:



Noel Gerard McNamara
Chief Executive Officer
New Zealand Branch

29 March 2012

It is confirmed that the said powers of attorney appointing Noel Gerard McNamara are still in force and have not been revoked.



Independent auditor's report

To the Shareholder of The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch

Report on the Branch and Banking Group Disclosure Statement (excluding supplementary information relating to Credit and Market Risk Exposures and Capital Adequacy)

We have audited the accompanying Disclosure Statement and supplementary information (excluding the supplementary information relating to Credit and Market Risk Exposures and Capital Adequacy, disclosed in notes 26, 28 and 37) of The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch (the "Branch") and its related entities (the "Banking Group") on pages 11 to 79. The Disclosure Statement comprises the statement of financial position as at 31 December 2011, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information of the Branch and Banking Group. The supplementary information comprises the information that is required to be disclosed under the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order (No 4) 2011 (the "Order").

Directors' responsibility for the disclosure statement

The directors are responsible for the preparation of the Disclosure Statement, which includes financial statements prepared in accordance with Clause 25 of the Order and generally accepted accounting practice in New Zealand, and that gives a true and fair view of the matters to which it relates. The directors are also responsible for such internal controls as they determine are necessary to enable the preparation of the Disclosure Statement that is free from material misstatement whether due to fraud or error.

The directors are responsible for the preparation and fair presentation of supplementary information, in accordance with Schedules 2, 4, 7, 10, 11 and 13 of the Order.

Auditor's responsibility

Our responsibility is to express an opinion on the Disclosure Statement, including the supplementary information disclosed in accordance with Schedules 4, 7, 10, 11 and 13 of the Order (this excludes the supplementary information relating to Credit and Market Risk Exposures and Capital Adequacy disclosed in notes 26, 28 and 37, which are covered by our review opinion below). We conducted our audit in accordance with International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Disclosure Statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Disclosure Statement. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the Disclosure Statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the Branch and Banking Group's preparation of the Disclosure Statement that gives a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Branch and Banking Group's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the presentation of the Disclosure Statement.

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

Our firm has provided other services to the Branch and Banking Group in relation to taxation and general accounting services. Partners and employees of our firm may also deal with The Hongkong and Shanghai Banking Corporation Limited (the “Registered Bank”), the Branch and Banking Group on normal terms within the ordinary course of trading activities of the business of the Registered Bank, Branch and Banking Group. There are, however, certain restrictions on dealings which the partners and employees of our firm can have with the Registered Bank, Branch and Banking Group. These matters have not impaired our independence as auditors of the Branch and Banking Group. The firm has no other relationship with, or interest in, the Registered Bank, Branch and Banking Group.

Opinion on financial statements

In our opinion the financial statements of The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch and its related entities (the “Branch” and “Banking Group”) on pages 11 to 79 (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 9, 10, 11 and 13 of the Order):

- complies with generally accepted accounting practice in New Zealand; and
- gives a true and fair view of the financial position as at 31 December 2011 and of their financial performance and cash flows for the year ended on that date.

Opinion on supplementary information (excluding supplementary information relating to Credit and Market Risk Exposures and Capital Adequacy)

In our opinion, the supplementary information that is required to be disclosed in accordance with Schedules 4, 7, 10, 11 and 13 of the Order, and is included within notes 2, 7, 15, 23, 24, 25, 32, 33 and 36 of the Disclosure Statement:

- has been prepared, in all material respects, in accordance with the guidelines issued pursuant to section 78(3) of the Reserve Bank of New Zealand Act 1989 and any Conditions of Registration;
- is in accordance with the books and records of the Branch and Banking Group; and
- presents fairly, in all material respects, the matters to which it relates, in accordance with those Schedules.

Report on 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, as disclosed in notes 26, 28 and 37 of the Disclosure Statement for the year ended 31 December 2011.

Directors’ responsibility for the supplementary information relating to Credit and Market Risk Exposures and Capital Adequacy

The directors are responsible for the preparation of supplementary information relating to Credit and Market Risk Exposures and Capital Adequacy that is required to be disclosed under Schedule 9 of the Order and prepared in accordance with the Capital Adequacy Framework (Basel I Approach) (BS2) and Capital Adequacy Framework (Standardised Approach) (BS2A), and described in notes 26, 28 and 37 of the Disclosure Statement.

Auditor’s responsibility

Our responsibility is to express an opinion on the supplementary information relating to Credit and Market Risk Exposures and Capital Adequacy based on our review. We conducted our review in accordance with the Review Engagement Standards issued by the New Zealand Institute of Chartered Accountants. Those standards require that we comply with ethical requirements and plan and perform the



review to obtain limited assurance about whether the supplementary information is, in all material respects:

- prepared in accordance with Capital Adequacy Framework (Basel I Approach) (BS2) and Capital Adequacy Framework (Standardised Approach) (BS2A); and
- disclosed in accordance with Schedule 9 of the Order.

A review is limited primarily to enquiries of Branch and Banking Group personnel and analytical review procedures applied to the financial data, and thus provides less assurance than an audit. We have not performed an audit in respect of the Credit and Market Risk Exposures and Capital Adequacy disclosures, and accordingly, we do not express an audit opinion on these disclosures.

Opinion

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 26, 28 and 37 of the Disclosure Statement, is not prepared and disclosed, in all material respects, in accordance with:

- the Capital Adequacy Framework (Basel I Approach) (BS2) and Capital Adequacy Framework (Standardised Approach) (BS2A); and
- Schedule 9 of the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order (No 4) 2011.

Report on Other Legal and Regulatory Requirements (excluding Supplementary Information relating to Credit and Market Risk Exposures and Capital Adequacy)

In accordance with the requirements of sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993, and clauses 2(d) and 2(e) of Schedule 1 of the Order, we report that:

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

Auckland

29 March 2012

HSBC 