The Hongkong and Shanghai Banking Corporation Limited

New Zealand Banking Group

Disclosure Statement

31 December 2015

Disclosure Statement
For the Year Ended 31 December 2015

Contents	**Page**

General Disclosures

Registered Bank

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

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

New Zealand Branch

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

New Zealand Head Office:
1 Queen Street
Auckland
New Zealand

New Zealand Banking Group

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

Overseas Banking Group

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

Ultimate Holding Company

The ultimate holding company of HBAP is:
HSBC Holdings plc
8 Canada Square
London E14 5HQ
United Kingdom

Access to parental disclosures

The most recent publicly available financial statements of HBAP Group and HSBC Holdings plc ("Group") can be found at HSBC Holdings plc's website, www.hsbc.com/investor-relations/financial-and-regulatory-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 HKD 500,000, to each depositor on deposits placed in Hong Kong, regardless of the geographic location of the depositors. No other material legislative or regulatory restrictions in Hong Kong SAR exist which would subordinate the claims of any class of New Zealand branch unsecured creditors on the assets of HBAP to those of any other class of unsecured creditors of HBAP, in a winding up of HBAP.

Guarantee Arrangements

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

Government Guarantee

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

General Disclosures *(continued)*

Other Material Matters

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

Pending Proceedings and Arbitration

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

Auditor

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

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

New Zealand Chief Executive Officer/Responsible Person

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

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

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

Dealings with Responsible Person

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

Board of Directors of HBAP

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

Stuart Thomson Gulliver (Chairman)
Masters Degree in Jurisprudence, Worcester College, Oxford University, 1980
Executive Director and Group Chief Executive, HSBC Holdings plc

Peter Wong Tung Shun (Deputy Chairman and Chief Executive)
Bachelor of Arts, Indiana University, 1974; Master of Business Administration, Indiana University, 1976
Master of Science, Indiana University, 1978

[#] **Laura Cha May Lung**, GBS (Deputy Chairman)
Bachelor of Arts, University of Wisconsin-Madison, 1972; Juris Doctor, University of Santa Clara Law School, 1982; and admitted to practice in the State of California and in Federal Courts, 1983
Company Director

General Disclosures *(continued)*

Board of Directors of HBAP (*continued*)

* **Zia Mody** (Deputy Chairman)
Master of Laws, Harvard University, 1979; Bachelor of Arts (Law), Cambridge University, 1978
Partner, AZB & Partners

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

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

Dr Raymond Ch'ien Kuo Fung, GBS, CBE
Bachelor of Arts, Rockford College, 1973; Master of Arts and Doctor of Philosophy (Economics), University of Pennsylvania, 1976 and 1978
Independent Non-executive Chairman, Hang Seng Bank Limited

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

Rose Lee Wai Mun
Bachelor of Business Administration, University of Hawaii, 1977
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 of Cheung Kong Property Holdings Limited, and
Group Co-Managing Director and Deputy Chairman of CK Hutchison Holdings Limited

Peter James Holland Riley
Bachelor of Arts Hons in Geography from University College, Durham University, 1982; ACA, The Institute of Chartered Accountants in England and Wales (Qualified 1985); and
FCPA, The Hong Kong Society of Accountants, 2003
Group Finance Director, Jardine Matheson Holdings Limited

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

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, GBS
B.Sc. in Mathematics, Massachusetts Institute of Technology, 1974; and Master of Business Administration, Harvard Business School, 1976
Chairman, Esquel Holdings Inc.

General Disclosures *(continued)*

Board of Directors of HBAP (*continued*)

* **Tan Sri Dr Francis Yeoh Sock Ping**, CBE
Bachelor of Science (Hons.) in Civil Engineering, University of Kingston, UK, 1978; Honorary Doctorate of Engineering from University of Kingston, 2004
Managing Director, YTL Corporation Berhad

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

independent non-executive Director
^ non-executive Director

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

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

Change in Board of Directors for HBAP

Kevin Anthony Westley retired as an independent non-executive Director of HBAP on 12 May 2015.
Naina Lal Kidwai resigned as an executive Director of HBAP on 31 October 2015.

The composition of the Board of Directors has seen no other change since 31 December 2014.

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

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

On 25 March 2015, HBAP's fellow subsidiary, HSBC Bank plc ("HBEU") acted as mandated lead arranger, original bank and facility agent in providing Hutchison 3G UK Investments Limited ("H3G UK") with a 24 month GBP6bn bridge loan. HBEU subsequently reduced its commitment by syndicating the facility to 14 other banks in July 2015. H3G UK was, at the time of the transaction, an indirect wholly-owned subsidiary of Hutchison Whampoa Limited, which is currently wholly-owned by CK Hutchison Holdings Limited, an associated body corporate of Mr Victor Li, a non-executive Director of the Bank.

General Disclosures *(continued)*

Audit Committee

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

Credit Rating

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

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

Rating scales are:

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

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

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

Conditions of Registration

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

These conditions of registration apply on and after 1 November 2015.

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

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

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

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

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

   (a) if the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the group headed by the entity; and

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

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

   (a) all amounts must relate to on balance sheet items only, and must comply with generally accepted accounting practice; and

   (b) if products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets must be considered part of the insurance business.

   For the purposes of this condition of registration, –

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

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

3. That the business of the registered bank in New Zealand does not constitute a predominant proportion of the total business of the registered bank.

4. That no appointment to the position of the New Zealand chief executive officer of the registered bank shall be made unless:

   (i) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and

   (ii) the Reserve Bank has advised that it has no objection to that appointment.

Conditions of Registration *(continued)*

5. That The Hongkong and Shanghai Banking Corporation Limited complies with the requirements imposed on it by the Hong Kong Monetary Authority.

6. That, with reference to the following table, each capital adequacy ratio of The Hongkong and Shanghai Banking Corporation Limited must be equal to or greater than the applicable minimum requirement.

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

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

(a) must be calculated as a percentage of the registered bank's risk weighted assets; and
(b) are otherwise as administered by the Hong Kong Monetary Authority.

7. That liabilities of the registered bank in New Zealand, net of amounts due to related parties (including amounts due to a subsidiary or affiliate of the registered bank), do not exceed NZ$15 billion.

8. That, for a loan-to-valuation measurement period, the total of the business of the registered bank in New Zealand's qualifying new mortgage lending amount in respect of APIL with a loan-to-valuation ratio of more than 70%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of APIL arising in the loan-to-valuation measurement period.

9. That, for a loan-to-valuation measurement period, the total of the business of the registered bank in New Zealand's qualifying new mortgage lending amount in respect of ANPIL with a loan-to-valuation ratio of more than 80%, must not exceed 10% of the total of the qualifying new mortgage lending amount in respect of ANPIL arising in the loan-to-valuation measurement period..

10. That, for a loan-to-valuation measurement period, the total of the business of the registered bank in New Zealand's qualifying new mortgage lending amount in respect of non-Auckland loans with a loan-to-valuation ratio of more than 80%, must not exceed 15% of the total of the qualifying new mortgage lending amount in respect of non-Auckland loans arising in the loan to valuation measurement period.

11. That the business of the registered bank in New Zealand must not make a residential mortgage loan unless the terms and conditions of the loan contract or the terms and conditions for an associated mortgage require that a borrower obtain the registered bank's agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.

Conditions of Registration *(continued)*

In these conditions of registration, –

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

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

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

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

In conditions of registration 8 to 11,—

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

“loan-to-valuation measurement period” means a period of six calendar months ending on the last day of the sixth calendar month, the first of which ends on the last day of April 2016.

Changes to Conditions of Registration since the 30 September 2015 Disclosure Statement

The Conditions of Registration were amended on 1 November 2015. Conditions 8 to 11 were amended to introduce loan-to-value ratio requirements specific to geographic and loan purpose characteristics.

CONTENTS

HISTORICAL SUMMARY OF FINANCIAL STATEMENTS

FIVE YEAR COMPARISON

	Banking Group				
	Audited Year ended 31 December				
Dollars in Thousands	**2015**	2014	2013	2012	2011
Summary of Financial Results					
Interest income	**230,879**	206,493	188,494	203,549	201,411
Interest expense	**(135,843)**	(116,554)	(109,506)	(115,302)	(118,816)
Net interest income	**95,036**	89,939	78,988	88,247	82,595
Net trading income	**14,704**	8,650	17,912	9,140	14,929
Other net operating income	**36,632**	34,725	39,239	35,419	45,647
Operating income	**146,372**	133,314	136,139	132,806	143,171
Operating expenses	**(63,841)**	(58,926)	(58,483)	(58,628)	(63,726)
Operating profit before provisions and tax	**82,531**	74,388	77,656	74,178	79,445
Loan impairment (charges) / releases	**35,140**	18,046	(42,690)	(17,596)	(24,522)
Operating profit before tax	**117,671**	92,434	34,966	56,582	54,923
Income tax expense	**(33,032)**	(25,978)	(9,899)	(15,983)	(15,526)
Profit after tax	**84,639**	66,456	25,067	40,599	39,397
Head Office Account brought forward	**41,739**	(3,691)	13,503	15,392	28,184
Retained profit repatriated	**(72,585)**	(21,026)	(42,261)	(42,488)	(52,189)
Head Office Account carried forward	**53,793**	41,739	(3,691)	13,503	15,392
Statement of Financial Position					
Total assets	**5,591,088**	5,308,720	5,155,681	5,045,975	4,939,706
of which: Individually impaired assets	**3,503**	121,913	141,964	65,217	75,325
Total Liabilities	**5,536,733**	5,264,771	5,155,380	5,030,627	4,922,561
Total Equity	**54,355**	43,949	301	15,348	17,145
Head Office Account	**53,793**	41,739	(3,691)	13,503	15,392

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

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2015

		Banking Group	
		12 months ended	
Dollars in Thousands	Note	**31.12.15**	31.12.14
Interest income	3	**230,879**	206,493
Interest expense	3	**(135,843)**	(116,554)
Net interest income		**95,036**	89,939
Net trading income	3	**14,704**	8,650
Other net operating income	3	**36,632**	34,725
Operating income		**146,372**	133,314
Operating expenses	4	**(63,841)**	(58,926)
Operating profit before provisions and tax		**82,531**	74,388
Loan impairment (charges) / releases	5	**35,140**	18,046
Operating profit before tax		**117,671**	92,434
Income tax expense	7	**(33,032)**	(25,978)
Profit after tax		**84,639**	66,456
Other comprehensive income / (expense)			
Items that may be reclassified subsequently to profit or loss:			
Gains / (losses) on cashflow hedges		**(2,357)**	(3,090)
Income taxes on cashflow hedges		**659**	866
Gains / (losses) on available-for-sale financial assets		**51**	614
Income taxes on available-for-sale financial assets		**(15)**	(171)
Other comprehensive income / (expense) for the year		**(1,662)**	(1,781)
Total comprehensive income for the year		**82,977**	64,675

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 2015

	Banking Group	
	12 months ended	
Dollars in Thousands	**31.12.15**	31.12.14
Head Office Account *		
At beginning of the year	**41,739**	(3,691)
Repatriation to Head Office	**(72,585)**	(21,026)
Profit after tax	**84,639**	66,456
At end of the year	**53,793**	41,739
Cashflow Hedging Reserve		
At beginning of the year	**103**	2,327
Fair value changes taken to equity	**(3,137)**	(3,232)
Transferred to the income statement	**780**	142
Tax on movements and transfers	**659**	866
At end of the year	**(1,595)**	103
Available-for-Sale Reserve		
At beginning of the period	**485**	42
Fair value changes taken to equity	**4,160**	2,987
Transferred to the income statement	**(4,109)**	(2,373)
Tax on movements and transfers	**(15)**	(171)
At end of the year	**521**	485
Share-based Payment Reserve		
At beginning of the year	**1,622**	1,623
Transferred to the income statement	**243**	228
Movement in share-based payment arrangements	**(229)**	(229)
At end of the year	**1,636**	1,622
Equity at end of the year	**54,355**	43,949
Represented by:		
Profit after tax	**84,639**	66,456
Other comprehensive income	**(1,662)**	(1,781)
Total comprehensive income for the year	**82,977**	64,675
Repatriation to Head Office	**(72,585)**	(21,026)
Movement in share-based payment reserve	**14**	(1)
Equity at beginning of the year	**43,949**	301
	54,355	43,949

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

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

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2015

		Banking Group	
Dollars in Thousands	Note	**31.12.15**	31.12.14
ASSETS			
Cash and demand balances with central banks		**345,799**	411,548
Advances to banks		**7,601**	14,871
Debt and equity securities	9	**447,445**	494,580
Derivative financial instruments	10	**313,918**	196,182
Advances to customers	11	**3,585,997**	3,774,940
Amounts due from related parties	18	**854,687**	367,519
Other assets	12	**18,288**	22,921
Fixed assets		**997**	972
Deferred tax asset	7	**-**	7,086
Goodwill and intangible assets	13	**16,356**	18,101
Total Assets		**5,591,088**	5,308,720
LIABILITIES			
Deposits by banks		**185,925**	182,194
Derivative financial instruments	10	**314,362**	186,914
Customer deposits	15	**3,252,094**	3,180,934
Debt securities	16	**843,716**	739,746
Amounts due to related parties	18	**896,759**	925,126
Other liabilities	17	**36,430**	42,710
Current tax liabilities		**6,871**	7,147
Deferred tax liability	7	**576**	-
Total Liabilities		**5,536,733**	5,264,771
Net Assets		**54,355**	43,949
EQUITY			
Head Office Account		**53,793**	41,739
Cashflow Hedging Reserve		**(1,595)**	103
Available-for-Sale Reserve		**521**	485
Share-based Payment Reserve		**1,636**	1,622
Total Equity		**54,355**	43,949

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

Director: Peter T S Wong
Date: 18 March 2016

Director: Stuart T Gulliver
Date: 18 March 2016

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2015

	Banking Group	
	12 months ended	
Dollars in Thousands	**31.12.15**	31.12.14
Cash flows from / (to) operating activities		
Interest received	**233,150**	194,476
Fees and commissions	**32,836**	36,184
Realised trading gain	**20,144**	20,216
Interest paid	**(125,255)**	(102,664)
Operating expenses	**(60,776)**	(55,744)
Taxation paid	**(25,003)**	(15,500)
Net cash flows from operating activities before changes in operating assets and liabilities	**75,096**	76,968
Changes in operating assets and liabilities arising from cash flow movements		
Cash was provided net from / applied net (to):		
Advances to customers	**228,946**	(378,091)
Amounts due from related parties	**(487,168)**	(58,661)
Other assets	**(1,185)**	1,267
Other liabilities	**326**	2,849
Debt securities issued / (repaid)	**89,785**	(63,771)
Deposits by banks	**4,332**	23,807
Customer deposits	**71,160**	44,984
Amounts due to related parties	**(28,357)**	113,292
Net change in operating assets and liabilities	**(122,161)**	(314,324)
Net cash flows from / (to) operating activities	**(47,065)**	(237,356)
Cash flows from / (to) investing activities		
Debt securities purchased	**(792,697)**	(664,616)
Debt securities matured	**842,676**	571,354
Acquisition of fixed assets	**(698)**	(217)
Net cash flows to investing activities	**49,281**	(93,479)
Cash flows to financing activities		
Repatriation to head office	**(72,585)**	(21,026)
Net cash flows to financing activities	**(72,585)**	(21,026)
Net increase / (decrease) in cash and cash equivalents	**(70,369)**	(351,861)
Effect of exchange rate fluctuations on cash held	**(2,049)**	(894)
Cash and cash equivalents at beginning of year	**425,367**	778,122
Cash and cash equivalents at end of year	**352,949**	425,367

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 2015

	Banking Group	
	12 months ended	
Dollars in Thousands	**31.12.15**	31.12.14
Analysis of cash and cash equivalents		
Cash and demand balances with central banks	**345,799**	411,548
Items in the course of collection from other banks[1]	**11**	7
Advances to banks – demand	**7,590**	14,864
Less: items in the course of transmission to other banks[1]	**(451)**	(1,052)
	352,949	425,367

[1] *Items in the course of collection from / to other banks are presented on the balance sheet within Advances to banks and Deposits by banks respectively.*

Reconciliation of profit after tax to net cash flows from operating activities		
Profit after tax	**84,639**	66,456
Adjustments to reconcile profit after tax to net cash flow from operating activities:		
Change in interest accruals	**(409)**	(2,921)
Change in mark to market accruals	**5,296**	11,156
Depreciation	**462**	562
Amortisation of intangible asset	**1,745**	1,746
Amortisation of premium and discounts	**15,501**	12,289
Change in deferred income and accrued expense	**(3,201)**	646
Amortisation of share options granted	**196**	228
(Release) / impairment charge on loans and advances	**(35,140)**	(18,046)
Discount unwinding on impaired loans and advances	**(2,233)**	(5,626)
(Gain) / loss on disposal of fixed assets	**210**	-
Change in current and deferred taxation	**8,030**	10,478
Adjust operating cash flows not included in profit after tax:		
Net change in operating assets and liabilities	**(122,161)**	(314,324)
Net cash flows from operating activities	**(47,065)**	(237,356)

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

The Banking Group has amended the items included as cash and cash equivalents for disclosure purposes in the current year. Comparative data has been restated on the same basis. As a result the cash and cash equivalents total balance as at 31 December 2013 has been restated to $778,122,000 from ($980,300,000), and 31 December 2014 has been restated to $425,367,000 from ($1,453,665,000).

The following cash flows have been adjusted in the comparative period as a result of the restatement of cash and cash equivalents: Changes in operating assets and liabilities arising from cash flow movements, effect of exchange rate fluctuations on cash held, and realised trading gain / (loss).

There has been no change to the statement of comprehensive income or the statement of financial position.

Notes to and forming part of the Financial Statements

1. Statement of Accounting Policies

GENERAL ACCOUNTING POLICIES

Reporting Entity

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

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

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

The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch

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

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

Non-controlled Structured Entities

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

The Banking Group enters into transactions with unconsolidated structured entities in the normal course of business to facilitate customer transactions and for specific investment opportunities to earn income in the form of interest and fees. The Banking Group's arrangements that involve structured entities are authorised centrally prior to being established to ensure appropriate purpose and governance. The Banking Group has interests in an unconsolidated securitisation vehicle providing funding through the subscription of notes issued by the structured entity. The primary source of debt service and security is derived from the underlying assets of the structured entity. All lending is subject to the Banking Group's credit approval process. The total assets of the unconsolidated structured entity at reporting date was $401m (December 2014: $287m). The total assets and commitments of the Banking Group in the unconsolidated structured entity at reporting date was $58m and $9m respectively (December 2014: $57m and $10m). This reflects the maximum exposure to loss in relation to those interests regardless of the probability of the loss being incurred. This is stated gross of the effects of any collateral arrangements entered into to mitigate the Banking Groups exposure to loss. On balance sheet amounts are included in 'advances to customers'. The Banking Group has no provisions for amounts held in structured entities, nor does the Banking Group provide or anticipate providing in the future any non-contractual financial support.

Basis of Reporting

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

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

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

1. Statement of Accounting Policies *(continued)*

Measurement Base

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

Particular Accounting Policies

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

- NZ IFRS 9 (2014) Financial Instruments

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

  Classification and measurement

  The classification and measurement of financial assets will depend on the Banking Group's business model for their management and their contractual cash flow characteristics and result in financial assets being classified and measured at amortised cost, fair value through other comprehensive income ('FVOCI') or fair value through profit or loss. In many instances, the classification and measurement outcomes will be similar to NZ IAS 39, although some differences will arise. For example, since NZ IFRS 9 does not apply embedded derivative accounting to financial assets and equity securities will be measured at fair value through profit or loss or, in limited circumstances, at fair value through OCI. The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in population of financial assets measured at amortised cost or fair value compared with NZ IAS 39. The classification of financial liabilities is essentially unchanged, except that, for certain liabilities measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in OCI.

  Impairment

  The impairment requirements apply to financial assets measured at amortised cost, FVOCI, lease receivables, certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of commitments and guarantees) is required for expected credit losses ('ECL') resulting from default events that are possible within the next 12 months ('12 month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL').

  The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the probability of default occurring over the remaining life of the financial instrument, rather than by considering an increase in ECL.

  The assessment of credit risk, as well as the estimation of ECL, are required to be unbiased, probability-weighted and should incorporate all available information which is relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under NZ IAS 39 and the resulting impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of impairment

1. Statement of Accounting Policies *(continued)*

allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with NZ IAS 39.

Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks. The standard does not explicitly address macro hedge accounting strategies, which are being considered in a separate project. To remove the risk of any conflict between existing macro hedge accounting practice and the new general hedge accounting requirements, NZ IFRS 9 includes an accounting policy choice that allows entities to continue to apply NZ IAS 39 hedge accounting.

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. Hedge accounting is generally applied prospectively from the date of initial recognition.

The mandatory application date for the standard as a whole is 1 January 2018, but it is possible to apply the revised presentation for certain liabilities measured at fair value from an earlier date. The Banking Group intends to adopt NZ IFRS 9 in line with HBAP's adoption of HKFRS 9.

The Banking Group is currently assessing the impact NZ IFRS 9 will have on the financial statements through a group wide project managed by the ultimate parent, but due to the complexity of the classification and measurement, impairment, and hedge accounting requirements and their inter-relationships, it is not possible to quantify the potential effect at this stage.

- NZ IFRS 15 Revenue from contracts with Customers

  In July 2014, the XRB issued NZ IFRS 15 'Revenue from Contracts with Customers'. The original effective date of NZ IFRS 15 has been delayed by one year and the standard is now effective for annual periods beginning on or after 1 January 2018 with early application permitted. NZ IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied. The standard should be applied retrospectively, with certain practical expedients available. The Banking Group is currently assessing the impact of this standard but it is not practicable to quantify the effect as at the date of the publication of these financial statements.

- NZ IFRS 16 Leases

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

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

Changes in Accounting Policies

There were no new standards, interpretations or amendments to standards applied during the year ended 31 December 2015 which had a significant effect on the Banking Group Financial Statements.

Accounting policies have not changed and are the same as those applied by the Banking Group in the Disclosure Statement for the year ended 31 December 2014.

1. Statement of Accounting Policies *(continued)*

Comparative Figures

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

The application of the Banking Group's cash and cash equivalents policy was reviewed during the year and cash and equivalents were restated to better align with the accounting policy. The details are disclosed in the Statement of Cash Flows. There have been no other material changes to the comparative figures.

Critical Accounting Estimates in Applying Accounting Policies

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

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

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

Loan impairment

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

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

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

Valuation of financial instruments

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

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

1. Statement of Accounting Policies *(continued)*

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

Valuation of financial instruments *(continued)*

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

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

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

Goodwill impairment

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

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

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

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

1. Statement of Accounting Policies *(continued)*

PRINCIPAL ACCOUNTING POLICIES

Acceptances & Endorsements

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

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

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

Advances to Banks, Customers and Related Parties

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

Asset Impairment – Advances to Banks and Customers

Losses for impaired loans are promptly recognised when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances that are calculated on individual loans and on groups of loans assessed collectively are recorded as charges to the income statement and are recorded against the carrying amount of impaired loans on the balance sheet. Losses which may arise from future events are not recognised.

Individually assessed accounts

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

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

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

- known cash flow difficulties experienced by the borrower;
- contractual payments of either principal or interest being past due for more than 90 days;
- the probability that the borrower will enter bankruptcy or other financial realisation;
- a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in the forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and
- there has been deterioration in the financial condition or outlook of the borrower such that its ability to repay is considered doubtful

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

1. Statement of Accounting Policies *(continued)*

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

Individually assessed accounts *(continued)*

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

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

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

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at the loan's original effective interest rate, or an approximation thereof, and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require.

Collectively assessed loans and advances

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

Incurred but not yet identified impairment

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

The collective impairment allowance is determined after taking into account:

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

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

1. Statement of Accounting Policies *(continued)*

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

Collectively assessed loans and advances *(continued)*

Incurred but not yet identified impairment (continued)

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

Homogeneous groups of loans and advances

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

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

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

Write-offs of loans and advances

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

Reversals of impairment

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

Past due assets/90 days past due assets

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

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

1. Statement of Accounting Policies *(continued)*

Assets & Liabilities – Derecognition

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

Debt & Equity Securities

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

Available-for-sale securities

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

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

Available-for-sale financial assets are assessed at each balance sheet date for objective evidence of impairment. If such evidence exists as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event'), and that loss event has an impact which can be reliably measured on the estimated future cash flows of the financial asset, an impairment loss is recognised.

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

In assessing objective evidence of impairment at the reporting date, the Banking Group considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows.

Financial difficulties of the issuer, as well as other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment.

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

Deposits by Banks, Customers & Related Parties

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

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

1. Statement of Accounting Policies *(continued)*

Derivative Financial Instruments

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

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

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

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

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

Hedge accounting

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

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

Fair value hedge

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

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

Cash flow hedge

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

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

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

1. Statement of Accounting Policies *(continued)*

Derivative Financial Instruments *(continued)*

Cash flow hedge *(continued)*

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

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

Hedge effectiveness testing

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

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

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

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

Derivatives that do not qualify for hedge accounting

Non-qualifying hedges are economic hedges entered into, for which hedge accounting was not applied.

Employee Benefits

Defined contribution plans

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

Share-based payments

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

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

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

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

1. Statement of Accounting Policies *(continued)*

Employee Benefits *(continued)*

Share-based payments (continued)

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

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

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

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

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

Financial Instruments Designated as at Fair Value Through Profit or Loss

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

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

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

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

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

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

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

1. Statement of Accounting Policies *(continued)*

Financial Instruments – Right to Offset

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

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

Funds Management Activities

HSBC Investments New Zealand Limited previously acted as manager for the HSBC Cash Fund, the HSBC Term Fund, the HSBC Global Unit Trusts, and the HSBC World Selection Funds (collectively referred to as the “Unit Trusts”). The Unit Trusts have now closed.

Intangible Assets

Goodwill

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

Goodwill is stated at cost less any accumulated impairment losses.

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

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

1. Statement of Accounting Policies *(continued)*

Intangible Assets *(continued)*

Other Intangible Assets

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

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

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

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

Interest Income & Expense

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

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

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

Net Fees

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

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

Net trading income

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

Leases

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

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

1. Statement of Accounting Policies *(continued)*

Provisions

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

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security and contingent liabilities related to legal proceedings or regulatory matters, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the Banking Group; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

Statement of Cash Flows

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

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

Taxation

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

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

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

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

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

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

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

2. Risk Management

POLICIES

The Banking Group operates risk management policies in accordance with HBAP policies and procedures established by HSBC Holdings plc ("Group"). Systems and procedures are in place to identify, control and report on major risks including credit, market, liquidity and operational risk (including accounting, tax, legal, compliance, information, physical security and fraud risk). Exposure to these risks is monitored by the Banking Group's Risk Management 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.

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.

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

2. Risk Management *(continued)*

Credit risk *(continued)*

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

Market risk

Market risk is the risk that movements in 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 immaterial. This is consistent with the comparable period.

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

2. Risk Management *(continued)*

Market risk *(continued)*

Trading

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

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

Non-trading

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

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

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

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

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

Currency risk

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

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

2. Risk Management *(continued)*

Interest rate risk

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

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

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

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

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

USD PVBP	**Audited 31.12.15**	Audited 31.12.14
Equity Reserves	**17,232**	33,163
Profit and Loss	**(3,374)**	(5,371)

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.

2. Risk Management *(continued)*

Liquidity and funding *(continued)*

Policies and procedures

Management of liquidity and funding is primarily undertaken locally in HBAP's operating entities in compliance with 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 22.

Core deposits

HBAP's internal framework is based on a categorisation of customer deposits into core and non-core 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)*

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 31.12.15	Unaudited 12 months 31.12.14
	%	%
End of period	**109**	107
Maximum for the period	**111**	109
Minimum for the period	**104**	100
Average for the period	**108**	103

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 2015 the Banking Group has a committed loan facility from HBAP of USD 0.83 billion (December 2014: USD 0.83 billion). Up to USD 0.25 billion is on call, up to USD 0.35 billion was able to be drawn with 7 days notice, with a further USD 0.23 billion drawn with 30 days notice. The facility commitment expired on 31 December 2015 and will not be renewed following changes to the Banking Group's liquidity and funding framework.

2. Risk Management *(continued)*

Liquidity and funding *(continued)*

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 31.12.15	Unaudited 12 months 31.12.14
	%	%
End of period	**136**	119
Maximum for the period	**150**	125
Minimum for the period	**107**	109
Average for the period	**128**	118

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 31.12.15	Unaudited 31.12.14
	NZDm	NZDm
Non cancellable undrawn commitment limits		
Five largest	**648**	575
Largest market sector	**748**	618

Forward-looking framework *(Unaudited)*

From 1 January 2016, the Banking Group will implement a new liquidity and funding risk management framework. Our new internal framework uses the Liquidity Coverage Ratio ("LCR") and Net Stable Funding Ratio ("NSFR") regulatory framework as a foundation.

The key aspects of our new liquidity and funding risk management framework are:

- Standalone management of liquidity and funding by operating entity;
- Operating entity classification by Inherent Liquidity Risk ("ILR") categorisation;
- Minimum operating entity LCR requirement dependent on ILR categorisation (EU LCR Delegated Regulation basis, being the implementation of the Basel III framework within Europe and therefore applicable to the HSBC Group);
- Minimum operating entity NSFR requirement dependent on ILR categorisation (Based on the final regulations published by the Basel Committee on Banking Supervision in October 2014, pending finalisation of the regulation within Europe that will be applicable to the HSBC Group);

The decision to create an internal framework based around the regulatory framework was driven by the need to ensure that the regulatory and our internal frameworks are directionally aligned.

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 or internal audit function.

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

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

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

The most recent publicly available disclosures on risk management processes and capital adequacy requirements of HSBC Holdings plc can be found at HBAP's website, www.hsbc.com.hk under About HSBC, Investor Relations.

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

	Banking Group	
Dollars in Thousands	**12 months 31.12.15**	12 months 31.12.14
3. Operating income		
Interest income:		
Advances to banks	**19,771**	18,144
Debt securities	**15,947**	16,529
Advances to customers	**193,601**	170,615
Related parties – HBAP	**1,258**	815
Related parties – other	**186**	333
Other	**116**	57
	230,879	206,493
Interest expense:		
Deposits by banks	**(5,941)**	(4,946)
Customer deposits	**(68,477)**	(63,215)
Debt securities	**(32,684)**	(28,633)
Related parties – HBAP	**(28,300)**	(19,421)
Related parties – other	**(358)**	(339)
Other	**(83)**	-
	(135,843)	(116,554)
Other net operating income:		
Fee and commission income		
Lending and credit facility fees	**22,548**	18,471
Custody and clearing fees	**4,844**	4,098
Other fees and commissions from:		
– Third parties	**15,909**	15,579
– Related parties - HBAP	**320**	157
– Related parties - other	**618**	949
	44,239	39,254
Fee and commission expense		
Brokerage expense	**(1,856)**	(1,653)
Other fees and commissions to:		
– Third parties	**(1,420)**	(384)
– Related parties - HBAP	**(3,768)**	(2,385)
– Related parties - other	**(352)**	(107)
	(7,396)	(4,529)
Other income		
Gain / (loss) on disposal of equipment, fixtures and fittings	**(211)**	-
	(211)	-
	36,632	34,725
Net trading income:		
Foreign exchange gains	**11,098**	11,535
Gains / (losses) on revaluation of derivatives	**4,114**	148
Credit valuation adjustments on derivatives	**(1,344)**	(19)
Debit valuation adjustments on derivatives	**644**	(3,025)
Loss on hedging instrument in fair value hedge	**(3,917)**	(2,362)
Gain on hedged item in fair value hedge	**4,109**	2,373
	14,704	8,650

Total interest income for financial assets that are not held at fair value through profit or loss is $228.78 million (2014: $205.98 million).

Total interest expense for financial liabilities that are not held at fair value through profit or loss is $135.08 million (2014: $116.40 million)

Included within interest income from advances to customers is $4.96 million (December 2014: $5.63 million) of interest income from impaired advances to customers.

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

	Banking Group	
Dollars in Thousands	**12 months 31.12.15**	12 months 31.12.14
4. Operating expenses		
Rental expense		
Premises	**2,243**	2,651
Equipment	**169**	194
	2,412	2,845
Depreciation and amortisation		
Leasehold improvements	**173**	315
Equipment, fixtures and fittings	**289**	247
Intangibles	**1,745**	1,746
	2,207	2,308
Auditors' remuneration		
Fees paid to principal auditor		
Audit and review of financial statements - PricewaterhouseCoopers	**411**	-
Audit and review of financial statements - KPMG	**-**	524
Taxation services - PricewaterhouseCoopers	**19**	-
Taxation services - KPMG	**-**	4
Other services – PricewaterhouseCoopers[1]	**72**	-
Other services – KPMG[2]	**-**	135
Total fees paid to principal auditor	**502**	663
Staff costs		
Salaries & other staff expenses	**26,866**	25,204
Defined contribution pension costs	**1,947**	2,098
Share based payments	**587**	228
Other	**1,436**	1,047
	30,836	28,577
Other		
Related party management and technical fees – HBAP	**15,728**	14,154
Related party management and technical fees – other	**2,231**	1,630
Donations	**170**	135
Other operating expenses	**9,755**	8,614
	27,884	24,533
	63,841	58,926

The average number of persons employed by the Banking Group for the twelve months was 229 (December 2014: 225).

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

[2] *Other services performed by KPMG in 2014 include fees charged for the reporting on custodial services and trust deed and regulatory compliance assurance services.*

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

	Banking Group	
Dollars in Thousands	**31.12.15**	31.12.14
5. Loan impairment charges		
Individually assessed impairment (charges) / releases		
New charges	**(782)**	(506)
Releases	**17,932**	14,471
Recoveries	**15,736**	924
	32,886	14,889
Collectively assessed impairment (charge) / release	**2,254**	3,157
	35,140	18,046

6. Segment reporting

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

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

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

Business Segments

The Banking Group comprises the following main business segments:

- *Retail Banking and Wealth Management ("RBWM")*
  Includes loans, deposits and other transactions with retail customers.

- *Commercial Banking ("CMB")*
  Manages the relationships with corporate customers providing loans, deposits and other transactions including trade finance and payment cash management.

- *Global Banking and Markets ("GBM")*
  Manages the relationships with institutional customers and undertakes the Banking Group's treasury and investment banking operations.

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

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

6. Segment reporting *(continued)*

The following tables present the segment reporting.

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

	Banking Group 12 months ended 31.12.14					
Dollars in Thousands	**RBWM**	**CMB**	**GBM**	**Total Reportable Segments**	**Reconciling items**	**Consolidated**
Net interest income	31,362	42,065	9,684	83,111	6,828	89,939
Net trading income	1,770	3,123	3,755	8,648	2	8,650
Other net operating income	502	29,773	4,445	34,720	5	34,725
Operating income	33,634	74,961	17,884	126,479	6,835	133,314
Operating expenses	(21,475)	(27,217)	(10,152)	(58,844)	(82)	(58,926)
Loan impairment (charges) / release	525	17,521	-	18,046	-	18,046
Operating profit before tax	12,684	65,265	7,732	85,681	6,753	92,434
Advances to customers	1,084,066	2,690,874	-	3,774,940	-	3,774,940
Customer deposits	2,014,213	1,100,533	66,188	3,180,934	-	3,180,934

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

Dollars in Thousands		*Banking Group* 12 months 31.12.15		12 months 31.12.14
7. Taxation				
Current tax expense				
Current tax expense		**24,711**		23,069
		24,711		23,069
Deferred tax expense				
Origination and reversal of temporary differences		**8,321**		2,909
		8,321		2,909
Total income tax expense included in profit after tax		**33,032**		25,978
Reconciliation of effective tax rate				
Operating profit before tax		**117,671**		92,434
Income tax using the domestic corporation tax rate (28%)	*28.0%*	**32,948**	*28.0%*	25,882
Non-deductible expenses	*0.1%*	**84**	*0.1%*	75
Under / (over) provided in prior periods	*0.0%*	**-**	*0.0%*	21
Other permanent differences	*0.0 %*	**-**	*0.0%*	-
	28.1%	**33,032**	*28.1%*	25,978

Dollars in Thousands — *Banking Group*

Recognised deferred tax assets and liabilities

	Balance at 1 January	Credit / (charge) to income statement	Charges to Reserves	Balance at 31 December
2015				
Accelerated capital allowances	**480**	**204**	**-**	**684**
Provision for loan impairment	**7,267**	**(6,191)**	**-**	**1,076**
Other provisions	**771**	**129**	**-**	**900**
Cash flow hedges	**(40)**	**-**	**659**	**619**
Income deferred for accounting purposes	**2,956**	**(2,669)**	**-**	**287**
Other intangible assets	**(753)**	**206**	**-**	**(547)**
Tax deductible premium	**(3,595)**	**-**	**-**	**(3,595)**
Net deferred tax asset / (liability)	**7,086**	**(8,321)**	**659**	**(576)**
2014				
Accelerated capital allowances	428	52	-	480
Provision for loan impairment	13,638	(6,371)	-	7,267
Other provisions	(140)	911	-	771
Cash flow hedges	(905)	-	865	(40)
Income deferred for accounting purposes	662	2,294	-	2,956
Other intangible assets	(958)	205	-	(753)
Tax deductible premium	(3,595)	-	-	(3,595)
Net deferred tax asset / (liability)	9,130	(2,909)	865	7,086

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

	Banking Group	
Dollars in Thousands	**31.12.15**	31.12.14
8. Additional financial disclosures on the statement of financial position		
Total interest earning and discount bearing assets	**5,237,245**	5,059,148
Total interest and discount bearing liabilities	**4,947,793**	4,798,172
Total liabilities net of amounts due to related parties	**4,430,444**	4,225,221
Advances to banks pledged as collateral for liabilities in respect of credit support annex obligation to derivative counterparties	**-**	-
9. Debt and equity securities		
Available-for-sale		
Debt securities	**447,423**	491,603
Treasury bills	**-**	2,955
Equity shares	**22**	22
	447,445	494,580

10. Derivative financial instruments

	Banking Group					
Dollars in Thousands	**31.12.15**			31.12.14		
	Contract amount	Assets	Liabilities	Contract amount	Assets	Liabilities
Related Party						
Trading derivatives						
Exchange rate contracts[1]	**14,816,198**	**99,101**	**185,059**	10,015,597	77,269	100,367
Interest rate contracts	**1,719,511**	**6,712**	**24,471**	1,343,749	3,188	14,057
Total derivatives with related parties		**105,813**	**209,530**		80,457	114,424
Related party breakdown						
HBAP Group		**99,764**	**208,904**		78,536	113,206
HSBC Bank plc		**5,735**	**403**		1,355	712
Others		**314**	**223**		566	506
		105,813	**209,530**		80,457	114,424
Others						
Trading derivatives						
Exchange rate contracts[1]	**5,073,799**	**183,809**	**91,795**	3,864,700	99,685	67,921
Interest rate contracts	**1,689,511**	**23,478**	**5,649**	1,313,749	13,522	2,540
		207,287	**97,444**		113,207	70,461
Hedging derivatives						
Cash flow hedging derivatives	**702,500**	**818**	**3,382**	437,500	1,491	1,296
Fair value hedging derivatives	**198,700**	**-**	**4,006**	308,700	1,027	733
		818	**7,388**		2,518	2,029
Total derivatives with other parties		**208,105**	**104,832**		115,725	72,490
Total derivative financial instruments		**313,918**	**314,362**		196,182	186,914

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

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

10. Derivative financial instruments *(continued)*

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

Dollars in Millions	*Banking Group*		
	3 months or less	More than 3 months but less than 1 year	5 years or less, but more than one year
Net cash inflows /(outflows) exposure			
Assets	**235**	**235**	**50**
Liabilities	**(448)**	**(275)**	**(225)**
At 31 December 2015	**(213)**	**(40)**	**(175)**
Net cash inflows /(outflows) exposure			
Assets	10	10	10
Liabilities	(328)	(303)	(283)
At 31 December 2014	(318)	(293)	(273)

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

Dollars in Thousands	*Banking Group* **31.12.15**	31.12.14
11. Advances to customers		
Overdrafts	**136,564**	109,789
Mortgages	**1,166,623**	1,040,636
Term lending	**2,158,963**	2,457,797
Non-eligible bills	**113,192**	162,072
Money market loans	**14,500**	30,600
Total gross advances to customers	**3,589,842**	3,800,894
Provisions for loan impairment	**(3,845)**	(25,954)
Total net advances to customers	**3,585,997**	3,774,940
12. Other assets		
Accrued interest receivable – third party	**13,625**	19,366
Acceptances and endorsements	**3,624**	2,065
Other	**1,039**	1,490
	18,288	22,921

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

Dollars in Thousands — ***Banking Group***

13. Goodwill and intangible assets

2015	Goodwill	Customer relationships purchased	Software	Total
Cost				
At 1 January	**15,744**	**8,798**	**5,060**	**29,602**
At 31 December	**15,744**	**8,798**	**5,060**	**29,602**
Accumulated depreciation and impairment				
At 1 January	**(2,043)**	**(6,112)**	**(3,346)**	**(11,501)**
Amortisation charge for the year	**-**	**(733)**	**(1,012)**	**(1,745)**
At 31 December	**(2,043)**	**(6,845)**	**(4,358)**	**(13,246)**
Net carrying value	**13,701**	**1,953**	**702**	**16,356**
2014				
Cost				
At 1 January	15,744	8,798	5,060	29,602
At 31 December	15,744	8,798	5,060	29,602
Accumulated depreciation and impairment				
At 1 January	(2,043)	(5,378)	(2,334)	(9,755)
Amortisation charge for the year	-	(734)	(1,012)	(1,746)
At 31 December	(2,043)	(6,112)	(3,346)	(11,501)
Net carrying value	13,701	2,686	1,714	18,101

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 2015 is $12.840 million (December 2014: $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 9.7% (December 2014: 14.9%), average annual growth rates for revenues and direct expenses (as detailed in the following table) supported by December 2015 actual results, and a terminal value of $249.1 million (December 2014: $157.3 million). In 2015, the methodology used to determine discount rates was refined to more accurately reflect capital requirements appropriate to the business segment in which the CGU operates.

13. Goodwill and intangible assets *(continued)*

Goodwill *(continued)*

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

Average annual growth rate projections as at 31 December 2015

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

The net average annual growth rate for revenues and expenses for years 3 to 5 is supported by the actual December 2015 results and is consistent with December 2014 forecasted growth. This shows stable cash flow projections. Average annual growth beyond 5 years does not exceed the average growth in GDP for New Zealand over the last 10 years.

Average annual growth rate projections as at 31 December 2014

	Years 1-2	Years 3-5	5 Year Average
Revenues	5.8%	3.0%	4.1%
Direct Expenses	(1.8)%	2.0%	0.4%

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

The most significant variable underlying the valuation is the terminal value. Terminal value is calculated using a stable growth model. The key variables used to calculate terminal value are the post tax discount rate of 7.0% (December 2014: 10.7%) and an annual sustainable growth rate from January 2020 onwards of 2.0% (December 2014 1.9%) 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 119% (December 2014: 138%), all other variables being equal, in order for the CGU's recoverable amount to be equal to its carrying value. As at 31 December 2015 the recoverable amount exceeds the carrying amount by $207.7 million (December 2014: $130.5 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 2015 is $0.861 million (December 2014: $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 13.8% (December 2014: 14.9%), annual growth rate for revenues and direct expenses (as detailed in the following table) supported by December 2015 actual results, and a terminal value of $42.9 million (December 2014: $23.9 million). In 2015, the methodology used to determine discount rates was refined to more accurately reflect capital requirements appropriate to the business segment in which the CGU operates.

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

13. Goodwill and intangible assets *(continued)*

Goodwill *(continued)*

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

Average annual growth rate projections as at 31 December 2015

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

The net average annual growth rate for revenues and expenses for years 3 to 5 is supported by the actual December 2015 results and is consistent with December 2014 forecasted growth. This shows stable cash flow projections. Average annual growth beyond 5 years does not exceed the average growth in GDP for New Zealand over the last 10 years.

Average annual growth rate projections as at 31 December 2014

	Years 1-2	Years 3-5	5 Year Average
Revenues	1.9%	3.0%	2.5%
Direct Expenses	10.7%	2.0%	5.2%

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 9.9% (December 2014: 10.7%) and an annual sustainable growth rate from January 2019 onwards of 2.0% (December 2014: 1.9%) 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 128% (December 2014: 131%), all other variables being equal, in order for the CGU's recoverable amount to be equal to its carrying value. As at 31 December 2015 the recoverable amount exceeds the carrying amount by $33.5 million (December 2014: $18.8 million)

Other Intangible Assets

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

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

Customer relationships are amortised on a straight-line basis over 12 years based on a statistical analysis of expected customer life. The remaining unamortised period at 31 December 2015 is 2 years 8 months (December 2014: 3 years 8 months).

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

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

	Banking Group	
Dollars in Thousands	**31.12.15**	31.12.14
14. Asset quality of advances to customers		
Past due but not impaired		
Less than 30 days	**61,127**	90,758
At least 30 days but less than 60 days	**704**	2,166
At least 60 days but less than 90 days	**3,274**	113
At least 90 days	**-**	-
Carrying amount	**65,105**	93,037

In the current and prior year, there was only one class of impaired financial assets, being advances to customers.

Gross individually impaired assets [1]		
Balance at the beginning of the year	**121,913**	141,964
Transfers from performing	**2,110**	2,497
Transfers to performing	**(21,686)**	(117)
Write-offs	**(441)**	(6)
Repayment	**(98,393)**	(22,425)
Balance at the end of the year	**3,503**	121,913
Individual provision for loan impairment		
Balance at the beginning of the year	**20,720**	40,317
New and additional provisions charged to profit or loss	**782**	506
Provisions released during the year to profit or loss	**(17,932)**	(14,471)
Write-offs	**(472)**	(6)
Discount unwind [2]	**(2,233)**	(5,626)
Balance at the end of the year	**865**	20,720
Collective provision for loan impairment		
Balance at the beginning of the year	**5,234**	8,391
Charges / (releases) during the year to profit or loss	**(2,254)**	(3,157)
Balance at the end of the year	**2,980**	5,234
Total provisions for loan impairment	**3,845**	25,954

[1] Gross individually impaired assets is the pre-allowance balance of individually impaired assets. The actual impairment is reflected within the individual provision for loan impairment as doubtful debts of the gross individually impaired assets.
[2] The impairment loss on an impaired asset is calculated as the difference between the asset's carrying amount and the estimated future cash flows discounted to its present value using the original effective interest rate for the asset. This discount unwinds as interest income over the period the asset is held.

There are no restructured assets, assets acquired through the enforcement of security or assets under administration as at 31 December 2015 (31 December 2104: nil). The aggregate amount as at 31 December 2015 of any undrawn balances on lending commitments to counterparties for whom drawn balances are classified as individually impaired, before deducting allowances for credit impairment loss where applicable, is $10 thousand (December 2014: $21.2 million).

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

	Banking Group	
Dollars in Thousands	**31.12.15**	31.12.14

15. Customer deposits

Current accounts	**2,034,091**	1,855,438
Savings and deposit accounts	**1,206,649**	1,265,336
Other deposit accounts	**11,354**	60,160
Total customer deposits at amortised cost	**3,252,094**	3,180,934

The total retail term deposits as at 31 December 2015 were $1,200,941 thousand (December 2014: $1,249,730 thousand).

The total other money market deposits as at 31 December 2015 were $11,354 thousand (December 2014: $60,082 thousand).

16. Debt securities

Certificates of deposit issued	**443,716**	339,746
Medium term notes issued	**400,000**	400,000
	843,716	739,746

There are no debt securities on demand.

17. Other liabilities

Accrued interest payable	**18,549**	21,065
Accruals and deferred income	**7,560**	11,832
Acceptances and endorsements	**3,624**	2,065
Other	**6,697**	7,748
	36,430	42,710

Accruals as at 31 December 2015 include $6.1 million for employee entitlements (December 2014: $6.2 million).

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

18. Related party transactions

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

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

The financial statements of the Banking Group should be read in conjunction with the financial statements of HBAP for the year ended 31 December 2015.

	Banking Group	
Dollars in Thousands	**31.12.15**	31.12.14
Key management compensation		
(a) Salaries and other short-term benefits	**4,024**	3,835
(b) Post-employment benefits	**183**	172
(c) Share-based payments expenses recognised	**136**	181
	4,343	4,188
Advances to key management		
(d) Advances to key management personnel	**2,783**	3,058

(e) Shares, options and other incentive plans

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

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

(ii) HSBC Restricted Share Award Scheme		
Number of options awarded	**5,016**	15,621

The total fair value of the options awarded under the restricted share award scheme is $61 thousand when converted into NZ dollars at grant date (December 2014: $190 thousand).

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

The fair value of the share option granted under the HSBC Restricted Share Award Scheme is £5.83 (December 2014: £6.16).

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

Interest Free Funding
The Banking Group has received an interest free loan from HBAP of $194 million (December 2014: $194 million) to support the thin capitalisation ratio imposed under New Zealand tax law. This loan has no repayment terms.

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

	Banking Group	
Dollars in Thousands	**31.12.15**	31.12.14
18. Related party transactions *(continued)*		
Amounts due from related parties		
On demand	**21,094**	10,965
Other short term	**833,593**	356,554
	854,687	367,519
The Hongkong and Shanghai Banking Corporation Limited (HBAP):		
Hong Kong Branch	**816,881**	354,527
Singapore Branch	**21,036**	3,429
Sri Lanka Branch	**3,736**	3,306
Tokyo Branch	**6,892**	381
Other	**182**	138
Other:		
HSBC Bank plc	**2,732**	4,117
HUSI Non-Insurance North America	**1,453**	873
HSBC Bank (China) Company	**1,669**	6
Other	**106**	742
	854,687	367,519
Amounts due to related parties		
On demand	**246,079**	262,531
Other short term	**149,543**	451,192
Long term	**501,137**	211,403
	896,759	925,126
The Hongkong and Shanghai Banking Corporation Limited (HBAP):		
Hong Kong Branch	**844,485**	850,249
Singapore Branch	**3,754**	13,306
Philippines Branch	**1,525**	1,753
Other	**2,784**	2,843
Other:		
HSBC Bank USA	**11,573**	11,189
HSBC Bank Plc UK Ops	**9,045**	27,717
HSBC Bank Canada	**7,129**	2,173
HSBC Bank Bermuda – Bermuda	**1,657**	4,010
Other	**14,807**	11,886
	896,759	925,126

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

19. Fair value of financial instruments

Determination of fair value of financial instruments carried at fair value

Fair values are determined according to the following hierarchy:

Level 1 – quoted market price
Financial instruments with quoted prices for identical instruments in active markets.

Level 2 –valuation technique using observable inputs
Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

Level 3- valuation technique with significant unobservable inputs
Financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

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

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

		Banking Group 31.12.14		
Dollars in Thousands	Level 1	Level 2	Level 3	TOTAL
ASSETS				
Debt and equity securities	356,621	137,937	22	494,580
Derivatives financial instruments	-	196,182	-	196,182
LIABILITIES				
Derivatives financial instruments	-	186,914	-	186,914

There have been no transfers between levels 1 and 2 in the year to 31 December 2015 (December 2014: Nil).

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

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

Methodologies

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

Cash and demand balances with central banks
For cash and short - term funds the carrying amount is equivalent to the fair value.

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

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

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

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

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

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

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

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

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

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

			Banking Group		
			31.12.14		
	Fair Value				Carrying value
Dollars in Thousands	Level 1	Level 2	Level 3	Total	
ASSETS					
Advances to customers	-	-	3,782,726	3,782,726	3,774,940
LIABILITIES					
Customer deposits	-	3,182,901	-	3,182,901	3,180,934
Debt securities	-	739,735	-	739,735	739,746
Amounts due to related parties	-	925,438	-	925,438	925,126

Refer page 56 for the methodologies and assumptions used when determining fair value for the above financial assets and financial liabilities.

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

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

20. Concentrations of credit and funding risk

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

	Banking Group	
Dollars in Thousands	**31.12.15**	31.12.14
On-balance sheet credit exposures		
Cash and demand balances with central banks	**345,799**	411,548
Advances to banks	**7,601**	14,871
Debt and equity securities	**447,445**	494,580
Derivative financial instruments	**313,918**	196,182
Advances to customers	**3,585,997**	3,774,940
Amounts due from related parties	**854,687**	367,519
Other assets	**18,018**	22,674
	5,573,465	5,282,314
Off-balance sheet credit exposures	**2,336,105**	2,134,468
Total credit exposures	**7,909,570**	7,416,782

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	**1,438,695**	1,254,185
Commercial and industrial	**2,419,875**	2,337,304
Commercial real estate and construction	**824,235**	744,757
Banks and financial institutions	**2,257,200**	1,887,117
Agriculture, forestry and mining	**122,339**	305,858
Transport	**101,052**	129,339
Energy	**89,833**	82,392
Government	**78,314**	100,533
Other	**578,027**	575,297
	7,909,570	7,416,782

Concentrations of credit risk by geographical area		
New Zealand	**6,288,566**	6,322,171
Hong Kong	**920,913**	424,858
Australia	**229,298**	212,105
China	**108,887**	114,818
Great Britain	**90,224**	78,281
United States	**89,045**	80,202
Other Overseas	**182,637**	184,347
	7,909,570	7,416,782

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

20. Concentrations of credit and funding risk *(continued)*

Concentration of Credit Exposures to Individual counterparties

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

	Banking Group	
Dollars in Thousands	**31.12.15**	31.12.14
Concentrations of funding		
Concentrations of funding by product		
Deposits by banks	**185,925**	182,194
Customer deposits	**3,252,094**	3,180,934
Debt securities	**843,716**	739,746
Amounts due to related parties	**896,759**	925,126
	5,178,494	5,028,000
Concentrations of funding by industry		
Agriculture, forestry and mining	**50,196**	70,037
Manufacturing	**268,181**	296,575
Wholesale and retail trade	**154,336**	139,219
Accommodation and restaurants	**46,650**	35,648
Banking and finance	**2,414,074**	2,159,864
Property and business services	**237,191**	201,627
Local authorities	**6,543**	13,193
Individual	**1,823,967**	1,911,748
Other	**177,356**	200,089
	5,178,494	5,028,000
Concentrations of funding by geographical area		
New Zealand	**2,354,655**	2,648,783
China	**364,842**	366,532
Great Britain	**484,862**	171,884
Hong Kong	**1,213,690**	1,153,718
Japan	**129,196**	133,358
Singapore	**60,810**	59,963
Taiwan	**60,721**	56,597
United States	**166,052**	144,449
Other Overseas	**343,666**	292,716
	5,178,494	5,028,000

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

20. 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.

	Banking Group	
Dollars in Thousands	**31.12.15**	31.12.14
Carrying amount		
Advances to customers	**3,585,997**	3,774,940
Individually Impaired		
Grade 6: Impaired	**3,503**	121,913
Gross amount	**3,503**	121,913
Allowance for impairment	**(865)**	(20,720)
Carrying amount	**2,638**	101,193
Collectively Impaired		
Allowance for impairment	**(2,980)**	(5,234)
Carrying amount	**(2,980)**	(5,234)
Past due but not impaired		
Grade 1-3: Low-fair risk	**60,210**	86,846
Grade 4-5: Watch List	**4,895**	6,191
Carrying amount	**65,105**	93,037
Past due comprises:		
0-30 days	**61,127**	90,758
30-90 days	**3,978**	2,279
90 days +	**-**	-
Carrying amount	**65,105**	93,037
Neither past due nor impaired		
Grade 1-3: Low-fair risk	**3,298,256**	3,442,909
Grade 4-5: Watch List	**222,978**	143,035
Carrying amount	**3,521,234**	3,585,944
Total carrying amount	**3,585,997**	3,774,940

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

20. Concentration of credit and funding risk *(continued)*

The Banking Group holds collateral against advances to customers in the form of mortgage interest over property, other registered securities over assets, and guarantees. The Banking Group generally 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, regulatory requirements, mortgage protection insurance and relationship with the Group. Estimates of fair value are based on the value of the collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired.

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

	Banking Group	
Percentage of total gross loans and advances to customers	**31.12.15**	31.12.14
Fully collateralised	**46%**	49%
Partially collateralised	**13%**	14%
Not collateralised	**41%**	37%

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

Other financial assets neither past due nor impaired

There are no other assets, including Cash and demand balances with central banks, Advances to banks, Debt securities, Derivative financial instruments, and Amounts due from related parties which are considered past due, or impaired at the end of the reporting year (December 2014: Nil).

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

	Banking Group			
Dollars in Thousands	**TOTAL**	**Grade 1-2**	**Grade 3**	**Grade 4-5**
31 December 2015				
Cash and demand balances with central banks	**345,799**	**345,799**	**-**	**-**
Advances to banks	**7,601**	**7,601**	**-**	**-**
Debt and equity securities	**447,445**	**447,445**	**-**	**-**
Derivative financial instruments	**313,918**	**297,219**	**15,432**	**1,267**
Amounts due from related parties	**854,687**	**854,687**	**-**	**-**
31 December 2014				
Cash and demand balances with central banks	411,548	411,548	-	-
Advances to banks	14,871	14,820	51	-
Debt and equity securities	494,580	494,580	-	-
Derivative financial instruments	196,182	184,104	10,165	1,913
Amounts due from related parties	367,519	367,519	-	-

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

21. Interest rate risk – repricing schedule

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

	Banking Group							
Dollars in Millions	*Up to 3 months*	*Over 3 months and up to 6 months*	*Over 6 months and up to 1 year*	*Over 1 year and up to 2 years*	*Over 2 years*	*Total interest bearing*	*Non interest bearing*	*Total*
31 December 2015								
Financial Assets								
Cash and demand balances with central banks	**346**	**-**	**-**	**-**	**-**	**346**	**-**	**346**
Advances to banks	**8**	**-**	**-**	**-**	**-**	**8**	**-**	**8**
Debt and equity securities	**127**	**-**	**33**	**220**	**67**	**447**	**-**	**447**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**-**	**314**	**314**
Advances to customers	**2,585**	**257**	**236**	**242**	**266**	**3,586**	**-**	**3,586**
Amounts due from related parties	**851**	**-**	**-**	**-**	**-**	**851**	**4**	**855**
Other assets	**-**	**-**	**-**	**-**	**-**	**-**	**18**	**18**
Total financial assets	**3,917**	**257**	**269**	**462**	**333**	**5,238**	**336**	**5,574**
Financial Liabilities								
Deposits by banks	**186**	**-**	**-**	**-**	**-**	**186**	**-**	**186**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**-**	**314**	**314**
Customer deposits	**2,641**	**352**	**156**	**54**	**28**	**3,231**	**21**	**3,252**
Debt securities	**394**	**250**	**-**	**-**	**200**	**844**	**-**	**844**
Amounts due to related parties	**676**	**-**	**11**	**-**	**-**	**687**	**210**	**897**
Other liabilities	**-**	**-**	**-**	**-**	**-**	**-**	**36**	**36**
Total financial liabilities	**3,897**	**602**	**167**	**54**	**228**	**4,948**	**581**	**5,529**
Off-balance sheet financial instruments								
Net notional interest rate contracts	**157**	**(173)**	**115**	**(142)**	**(7)**	**(50)**	**-**	**(50)**
31 December 2014								
Financial Assets								
Cash and demand balances with central banks	411	-	-	-	-	411	-	411
Advances to banks	15	-	-	-	-	15	-	15
Debt and equity securities	122	128	5	30	210	495	-	495
Derivative financial instruments	-	-	-	-	-	-	196	196
Advances to customers	2,825	165	140	396	249	3,775	-	3,775
Amounts due from related parties	363	-	-	-	-	363	4	367
Other assets	-	-	-	-	-	-	23	23
Total financial assets	3,736	293	145	426	459	5,059	223	5,282
Financial Liabilities								
Deposits by banks	182	-	-	-	-	182	-	182
Derivative financial instruments	-	-	-	-	-	-	187	187
Customer deposits	2,538	359	179	54	30	3,160	21	3,181
Debt securities	662	78	-	-	-	740	-	740
Amounts due to related parties	705	-	-	-	11	716	209	925
Other liabilities	-	-	-	-	-	-	43	43
Total financial liabilities	4,087	437	179	54	41	4,798	460	5,258
Off-balance sheet financial instruments								
Net notional interest rate contracts	626	(135)	-	(258)	(233)	-	-	-

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

22. Liquidity risk management

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

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

	Banking Group	
Dollars in Thousands	**31.12.15**	31.12.14
Demand balances with the central bank	**345,644**	411,148
Available-for-sale debt securities and treasury bills	**447,423**	494,558
	793,067	905,706

Maturity Analysis – discounted maturities

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

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

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

22. Liquidity risk management *(continued)*

Maturity Analysis *(continued)*

	Banking Group							
Dollars in Millions	*On Demand*	*0-1 month*	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*	*No specific maturity*	*Total*
31 December 2014								
Assets								
Cash and demand balances with central banks	412	-	-	-	-	-	-	412
Advances to banks	15	-	-	-	-	-	-	15
Debt and equity securities	-	100	22	132	239	2	-	495
Advances to customers	255	115	196	777	1,468	964	-	3,775
Amounts due from related parties	11	356	-	-	-	-	-	367
Other assets	-	22	1	-	-	-	-	23
Deferred taxation	-	-	-	-	-	-	7	7
Intangible assets	-	-	-	-	-	-	18	18
Fixed assets	-	-	-	-	-	-	1	1
Total	693	593	219	909	1,707	966	26	5,113
Derivative financial instruments – inflow	-	24	233	628	1,289	1,738	-	3,912
Derivative financial instruments – (outflow)	-	-	(207)	(600)	(1,228)	(1,681)	-	(3,716)
Derivative financial instruments - assets	-	24	26	28	61	57	-	196
Liabilities								
Deposits by banks	182	-	-	-				182
Customer deposits	1,895	328	333	525	97	3	-	3,181
Debt securities	-	100	162	78	400	-	-	740
Amounts due to related parties	262	184	268	-	211	-	-	925
Other liabilities	-	29	13	-	1	-	-	43
Current taxation	-	-	7	-	-	-	-	7
Total	2,339	641	783	603	709	3	-	5,078
Derivative financial instruments – (inflow)	-	-	(207)	(600)	(1,228)	(1,679)	-	(3,714)
Derivative financial instruments – outflow	-	24	231	624	1,287	1,735	-	3,901
Derivative financial instruments – liabilities	-	24	24	24	59	56	-	187
Net assets	(1,646)	(48)	(562)	310	1,000	964	26	44

22. Liquidity risk management *(continued)*

Maturity Analysis – undiscounted cashflows basis

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

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

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

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

22. Liquidity risk management *(continued)*

Maturity Analysis – undiscounted cashflows basis *(continued)*

	Banking Group							
Dollars in Millions	*On Demand*	*0-1 month*	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*	*No specific maturity*	*Total*
31 December 2014								
Financial Assets								
Cash and demand balances with central banks	412	-	-	-	-	-	-	412
Advances to banks	15	-	-	-	-	-	-	15
Debt and equity securities	-	100	27	145	265	2	-	539
Advances to customers	255	131	225	898	1,804	1,754	-	5,067
Amounts due from related parties	11	356	-	-	-	-	-	367
Other assets	-	22	1	-	-	-	-	23
Total non-derivative financial assets	693	609	253	1,043	2,069	1,756	-	6,423
Derivative financial instruments – held for trading purposes	194	-	-	-	-	-	-	194
Derivative financial instruments – held for hedging purposes (net settled) Inflow / (outflow)	-	-	-	-	-	-	-	-
Total undiscounted financial assets	887	609	253	1,043	2,069	1,756	-	6,617
Financial Liabilities								
Deposits by banks	182	-	-	-	-	-	-	182
Customer deposits	1,895	332	339	544	110	3	-	3,223
Debt securities	-	102	166	93	432	-	-	793
Amounts due to related parties	262	185	269	6	218	-	-	940
Other liabilities	-	29	13	-	1	-	-	43
Total non-derivative financial liabilities	2,339	648	787	643	761	3	-	5,181
Derivative financial instruments – held for trading purposes	185	-	-	-	-	-	-	185
Derivative financial instruments – held for hedging purposes (net settled) (Inflow) / outflow	-	-	-	(1)	-	-	-	(1)
Total undiscounted financial liabilities	2,524	648	787	642	761	3	-	5,365
Undrawn loan commitments	591	-	1,151	-	-	-	-	1,742

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

23. Offsetting financial asset and financial liabilities

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously ("the offset criteria"). The Banking Group has no financial instruments that meet the offset criteria at 31 December 2015 (2014: nil).

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

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

		Amounts subject to enforceable netting arrangements but not offset in the balance sheet		
Dollars in Millions	Gross amounts presented in the balance sheet	Related financial instruments	Cash collateral received	Net amount
31 December 2015				
Derivative financial assets	**314**	**(26)**	**(25)**	**263**
Financial assets	**314**	**(26)**	**(25)**	**263**
Deposits by banks	**186**	**-**	**(25)**	**161**
Derivative financial liabilities	**314**	**(26)**	**-**	**288**
Financial liabilities	**500**	**(26)**	**(25)**	**449**
31 December 2014				
Derivative financial assets	196	(17)	(23)	156
Financial assets	196	(17)	(23)	156
Deposits by banks	182	-	(23)	159
Derivative financial liabilities	187	(17)	-	170
Financial liabilities	369	(17)	(23)	329

24. Foreign currency risk exposure

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

	Banking Group	
Dollars in Millions	**Audited 31.12.15**	Audited 31.12.14
Receivable / (payable)		
AUD	**0.1**	0.0
GBP	**(0.1)**	0.0
USD	**(0.1)**	0.1
Other	**0.1**	0.1
	-	0.2

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

25. Additional mortgage information

Residential mortgages by loan-to-valuation ratio

	Banking Group			
	Principal Amount			
Loan to value ratio range	**Does not exceed 80% $m**	**Exceeds 80% and not 90% $m**	**Exceeds 90% $m**	**Total $m**
31 December 2015 (Unaudited)				
Value of exposures on balance sheet	**1,153.9**	**10.6**	**2.1**	**1,166.6**
Value of exposures off balance sheet	**23.4**	**-**	**-**	**23.4**
Total value of exposures	**1,177.3**	**10.6**	**2.1**	**1,190.0**
31 December 2014 (Unaudited)				
Value of exposures on balance sheet	1,023.8	14.4	2.4	1,040.6
Value of exposures off balance sheet	24.5	-	0.1	24.6
Total value of exposures	1,048.3	14.4	2.5	1,065.2

26. Market risk exposures

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

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

	Banking Group	
Dollars in Millions	*Implied risk weighted Exposure*	*Notional capital charge*
Exposure at 31 December 2015 (Unaudited)		
Interest rate risk	**86.38**	**6.91**
Foreign currency risk	**0.25**	**0.02**
Equity risk	**-**	**-**
Peak exposure period 1 July 2015 to 31 December 2015 (Unaudited)		
Interest rate risk	**121.25**	**9.70**
Foreign currency risk	**0.38**	**0.03**
Equity risk	**-**	**-**

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

27. Share options

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

a. *HSBC Holdings Group 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			
	31.12.15		31.12.14	
	Weighted average exercise price	*Number of options*	*Weighted average exercise price*	*Number of options*
Share options at beginning of the period		-	£7.22	39,023
Share options forfeited during the period		-		-
Share options exercised during the period		-		-
Share options expired during the period		-	£7.22	(39,023)
Share options outstanding at the end of the period		-		-
Share options exercisable at the end of the period		-		-

No options outstanding since 31 December 2014.

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

27. Share options *(continued)*

b. *HSBC Holdings Savings-Related Share Option Plan (International)*
HSBC Holdings ordinary shares of US$0.50

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

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

	Banking Group			
	31.12.15		31.12.14	
	Weighted average exercise price	*Number of options*	*Weighted average exercise price*	*Number of options*
Share options at beginning of the period	£4.32	**30,349**	£4.13	54,571
Share options granted during the period		**-**		-
Share options exercised during the period	£4.11	**(23,467)**	£3.73	(14,989)
Share options expired during the period	£4.96	**(870)**	£5.19	(2,123)
Share options cancelled during the period	£4.46	**(752)**	£4.60	(2,581)
Share options forfeited during the period		**-**		-
Share options transferred in during the period	£4.31	**6,112**		-
Share options transferred out during the period		**-**	£3.31	(4,529)
Share options outstanding at the end of the period	£4.69	**11,372**	£4.32	30,349
Share options exercisable at the end of the period	£4.46	**4,722**	£3.54	5,209

The weighted average share price on the dates on which options were exercised was £4.89 for December 2015 (December 2014: £6.38).

The options outstanding at 31 December 2015 have an exercise price in the range of £4.46 to £5.47 (December 2014: £3.31 to £5.10) and a weighted average remaining contractual life of 11 months (December 2014: 12 months).

27. Share options *(continued)*

c. ***HSBC Restricted Share Award Scheme***

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

	31.12.15 ***Number of shares***	31.12.14 *Number of shares*
Shares at beginning of the period	**37,489**	48,004
New shares granted during the period	**32,848**	22,648
Additional shares arising from scrip dividends	**3,083**	2,662
Shares released during the period	**(30,285)**	(34,218)
Shares forfeited during the period	**-**	-
Shares transferred in during the period	**1,928**	1,176
Shares transferred out during the period	**(850)**	(2,783)
Shares outstanding at the end of the period	**44,213**	37,489

The fair value of the share option granted under the HSBC Restricted Share Award Scheme is £5.83 (December 2014: £6.16).

Calculation of fair values

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

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

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

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

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

	Banking Group	
Dollars in Thousands	**31.12.15**	31.12.14

28. Lease commitments

Future rentals in respect of operating leases are:		
Within one year	**2,908**	3,174
Between one year and two years	**748**	3,006
Between two years and five years	**391**	760
	4,047	6,940

29. Contingent liabilities and other commitments

Contingent liabilities and commitments

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

Direct credit substitutes	**60,454**	55,509
Transaction related contingent items	**274,588**	191,202
Trade related contingent items	**109,684**	145,726
Commitments, maturity one year or more	**1,144,938**	1,039,495
Commitments, maturity up to one year	**746,441**	702,536
	2,336,105	2,134,468

Capital commitments		
Contracted expenditure	**-**	-

30. Custodial services, funds management and other fiduciary activities

Custodial services

The financial statements of the Banking Group include income in respect of custodial services provided to customers. It is the Branch who contracts with the customers. The securities are held in the name of the Branch's nominee company, HSBC Nominees (New Zealand) Limited. As at 31 December 2015, securities held by the nominee company on behalf of the Branch's customers were excluded from the nominee company and the Banking Group's Statement of Financial Position. The value of securities held by the nominee company at 31 December 2015 was $65,385 million (2014: $61,540 million).

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

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

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

31. Marketing and distribution of insurance products

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

32. Insurance and non-financial activities

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

33. Subsequent events

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

These financial statements were authorised for issue by the directors of The Hongkong and Shanghai Banking Corporation Limited on 18 March 2016.

34. Capital adequacy ratios of HBAP Group

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

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

The capital requirements of HKMA are at least equal to those specified under the Basel framework (“Basel III”). HBAP Group exceeds the minimum capital ratio requirements as specified by the HKMA as at 31 December 2015 and 31 December 2014.

The capital adequacy disclosure made by the HBAP Group can be found in the Annual Report and Accounts at this website, http://www.hsbc.com/investor-relations/financial-and-regulatory-reports.

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

	Unaudited 31.12.15	Unaudited 31.12.14
Basel III Capital Ratios		
Common Equity Tier 1 (“CET1”) capital	**15.6%**	14.4%
Tier 1 capital	**16.6%**	14.4%
Total capital	**18.6%**	15.7%

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

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

35. Profitability, size and asset quality of HBAP Group

Dollars in HK$ millions	**Unaudited [1] 12 months ended 31.12.15**	Audited 12 months ended 31.12.14
Profitability		
Net profit after tax	**99,983**	92,177
Net profit after tax over the previous 12 month period, as a percentage of average total assets	**1.4%**	1.4%
Size		
Total assets	**6,953,683**	6,876,746
Percentage increase in total assets over the previous 12 months period	**1.1%**	6.8%
Asset quality		
Individually impaired assets	**15,323** [2]	14,515
Individual impairment provision against advances to customers	**(7,040)**	(6,299)
Collective impairment provision against advances to customers	**(4,489)**	(4,221)
Individually impaired assets / total assets	**0.2%** [2]	0.2%
Individual impairment provision / individually impaired assets	**45.9%** [2]	43.4%

1 At the date of signing this Disclosure Statement, the audited accounts of HBAP Group as at 31 December 2015 were not publicly available.

2 At the date of signing this Disclosure Statement, the amount of HBAP Group individually impaired assets as at 31 December 2015 was not publicly available. This disclosure uses the most recent publicly available information, as such the individually impaired assets balance is reported as at 30 June 2015.

Directors' and New Zealand Chief Executive Officer's Statements

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

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

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

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

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

over the year ended 31 December 2015.

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

Christopher David Gosse Russell
Chief Executive Officer
New Zealand Branch

18 March 2016

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

Independent Auditors' Report

To the Directors of The Hongkong and Shanghai Banking Corporation Limited

Report on the Financial Statements (excluding the Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy)

We have audited the Disclosure Statement of The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch (the 'Branch') on pages 12 to 74 which consists of the financial statements required by Clause 25 of the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended) (the 'Order') and the supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 25, 26 and 34) required by Schedules 4, 7, 10, 11 and 13 of the Order. The financial statements comprise the statement of financial position as at 31 December 2015, the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended, and the notes to the financial statements that include a summary of significant accounting policies and other explanatory information for the aggregated results of The Hongkong and Shanghai Banking Corporation Limited, New Zealand Banking Group (the 'Banking Group'). The Banking Group comprises the New Zealand operations of The Hongkong and Shanghai Banking Corporation Limited.

Directors' Responsibility for the Financial Statements (excluding the Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy)

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

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

Auditors' Responsibility (excluding the Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy)

Our responsibility is to express an opinion on the financial statements and the supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy) disclosed in accordance with Clause 25 and Schedules 4, 7, 10, 11 and 13 of the Order based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand) and International Standards on Auditing. These standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider the internal controls relevant to the Branch's preparation of financial statements that give 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'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 overall presentation of the financial statements.

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

We are independent of the Banking Group. We carry out other assignments on behalf of the Banking Group in the area of taxation, immigration advisory services and review of regulatory policies. In addition, certain partners and employees of our firm may deal with the Banking Group on normal terms within the ordinary course of trading activities of the Banking Group. These matters have not impaired our independence as auditors of the Banking Group. We have no other interests in the Banking Group.

Opinion

In our opinion, the financial statements on pages 12 to 74 (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 9, 10, 11 and 13 of the Order and included within Notes 2, 8, 14, 20, 21, 22, 25, 26, 30, 31, 32, 34 and 35):

(i) comply with generally accepted accounting practice in New Zealand;

(ii) comply with International Financial Reporting Standards; and

(iii) give a true and fair view of the financial position of the Banking Group as at 31 December 2015, and its financial performance and cash flows for the year then ended.

In our opinion, the supplementary information disclosed in accordance with Schedules 4, 7, 10, 11 and 13 of the Order and included within Notes 2, 8, 14, 20, 21, 22, 30, 31, 32, and 35:

(i) has been prepared, in all material respects, in accordance with the guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act 1989 or any conditions of registration;

(ii) is in accordance with the books and records of the Banking Group; and

(iii) fairly states, in all material respects, the matters to which it relates in accordance with those Schedules.

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

We also report in accordance with Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the financial statements (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 25, 26 and 34) for the year ended 31 December 2015:

(i) we have obtained all the information and explanations that we have required; and

(ii) in our opinion, proper accounting records have been kept by the Banking Group as far as appears from an examination of those records.

Report on the Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy

We have reviewed the supplementary information relating to credit and market risk exposures and capital adequacy required by Schedule 9 of the Order as disclosed in Notes 25, 26 and 34 of the financial statements of the Banking Group for the year ended 31 December 2015.

Directors' Responsibility for the Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy

The Directors are responsible on behalf of The Hongkong and Shanghai Banking Corporation Limited for the preparation and fair presentation of the supplementary information relating to credit and market risk exposures and capital adequacy that is prepared in accordance with Capital Adequacy Framework (Standardised Approach) (BS2A) and is disclosed in accordance with Schedule 9 of the Order.

Auditors' Responsibility for the Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy

Our responsibility is to express a conclusion on the supplementary information relating to credit and market risk exposures and capital adequacy, disclosed in Notes 25, 26 and 34, based on our review.

We conducted our review in accordance with the New Zealand Standard on Review Engagements 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity* (NZ SRE 2410). NZ SRE 2410 requires us to conclude whether anything has come to our attention that causes us to believe that the supplementary information relating to credit and market risk exposures and capital adequacy, disclosed in Notes 25, 26 and 34, is not, in all material respects:

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

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

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

As the auditors of the Banking Group, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 25, 26 and 34, as required by Schedule 9 of the Order, is not in all material respects:

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

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

Restriction on Distribution or Use

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

PricewaterhouseCoopers

Chartered Accountants
18 March 2016

Auckland

HSBC