

## General Disclosure Statement For the Year Ended 31 December 2010

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## General Disclosures

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### Registered Bank

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The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch (“Branch”)  
1 Queen Street  
Auckland  
New Zealand

### Overseas Bank

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

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

### Ultimate Holding Company

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

### Access to parental disclosures

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The most recent publicly available financial statements disclosure made by the ultimate holding company in relation to capital adequacy requirement or risk management processes implemented by the ultimate holding company can be found at HSBC Holdings plc's website, [www.hsbc.com](http://www.hsbc.com).

### Ranking of Local Creditors in a Winding-up

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Under Section 265(1) (db) of the Companies Ordinance of the Hong Kong SAR which HBAP is subject to, in the event of a winding up of HBAP, there shall be paid in priority to all other unsecured debts the aggregate amount held on deposit, up to a maximum of HKD100,000, to each depositor and that this Section has no geographic limitation. Save as aforesaid, the Directors believe that no other material legislative or regulatory restrictions exist which subordinate the claims of any class of the Branch's unsecured creditors on the global assets of HBAP to those of any other class of unsecured creditors of HBAP, in a winding up of HBAP.

### Guarantee Arrangements for Overseas Bank

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No material obligations of the Overseas Bank are guaranteed as at the date of signing this General Disclosure Statement.

### Government Guarantee

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The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch (“the Registered Bank”) does not have a guarantee under the New Zealand retail deposit guarantee scheme as at the date of signing this General Disclosure Statement.

### Other Material Matters

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There are no material matters that, if disclosed, would adversely effect the decision of a person to subscribe for Debt Securities of which the Registered Bank is the issuer.

### Pending Proceedings and Arbitration

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

## General Disclosures *(continued)*

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### Auditors

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**Registered Bank**

KPMG  
KPMG Centre  
18 Viaduct Harbour Avenue  
Auckland  
New Zealand

**Overseas Bank**

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

### New Zealand Chief Executive Officer/Responsible Person

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The New Zealand Chief Executive Officer, David James Howard Griffiths, 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 General Disclosure Statement on the Directors' behalf. Accordingly, David James Howard Griffiths is a Responsible Person under the Registered Bank Disclosure Statement (Full & Half Year – Overseas Incorporated Registered Banks) Order 2008 (New Zealand).

**David James Howard Griffiths**

Chief Executive Officer New Zealand Branch. Joined the HSBC Group in 1976 and resides in New Zealand.

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

### Dealings with Responsible Person

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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

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The Directors of the Overseas Bank at the time this General Disclosure Statement was signed are:

**\* Stuart Thomson Gulliver** (Chairman)

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

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

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

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

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

**Peter Wong Tung Shun** (Chief Executive)

Bachelor of Arts, Indiana University, 1974; Master of Business Administration, Indiana University, 1976  
Master of Science, Indiana University, 1978  
Executive Director, Hong Kong and Mainland China, The Hongkong and Shanghai Banking Corporation Ltd

**Dr Raymond Ch'ien Kuo Fung**, GBS, CBE

B.A., Rockford College, 1973; Master of Arts and Doctor of Philosophy (Economics), University of Pennsylvania, 1976 and 1978  
Chairman, CDC Corporation and Chairman, China.com Inc.

## General Disclosures *(continued)*

### Board of Directors of HBAP *(continued)*

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**\* Naina Lal Kidwai**

Bachelor of Arts degree (Honours Course) in Economics, Delhi University, examined in 1977, certificate awarded 4 March 1978; Masters in Business Administration, Harvard University, 1982  
Group General Manager and Country Head, HSBC India

**Margaret Leung Ko May Yee**

Bachelor of Social Sciences, University of Hong Kong, 1975  
Vice-Chairman and Chief Executive, Hang Seng Bank Limited

**Victor Li Tzar Kuoi**

B.Sc. and M.Sc., Stanford University, 1986  
Managing Director and Deputy Chairman, Cheung Kong (Holdings) Limited

**Dr Lo Ka Shui, GBS**

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

**\* Zia Mody**

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

**Christopher Dale Pratt**

M A Modern History, Oxford University, 1978  
Chairman, John Swire & Sons (H.K.) Limited

**\*Andreas Sohmen-Pao**

First Class Honors Degree in Oriental Studies, Oxford University, 1994; Master in Business Administration with distinction, Harvard University Graduate School of Business, 1997; Master of Arts, Oxford University, 2000  
Chief Executive Officer, BW Maritime Pte Ltd

**Thomas Brian Stevenson, SBS**

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

**Dr Patrick Wang Shui Chung**

B.Sc. and M.Sc., in Electrical Engineering, Purdue University, Indiana USA, 1972.  
Honorary Doctorate of Engineering, Purdue University in Indiana, USA, 2004.  
Chairman and Chief Executive Officer, Johnson Electric Holdings Ltd

**Dr Rosanna Wong Yick-Ming, DBE**

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

**Marjorie Yang Mun Tak**

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

## **General Disclosures** *(continued)*

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### **Board of Directors of HBAP** *(continued)*

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#### **Country of Residence**

With the exception of those denoted with an \*, all directors reside in Hong Kong. Stuart Thomson Gulliver resides in the United Kingdom, Zia Mody and Naina Lal Kidwai reside in India, and Andreas Sohlen-Pao resides in Singapore.

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

### **Change in Board of Directors for HBAP**

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The composition of the Board of Directors has changed since the publication of the General Disclosure Statement for the year ended 31 December 2009.

Ms Naina Lal Kidwai was appointed as a non-executive director of HBAP with effective from 8 October 2010. Mr Stuart Thomson Gulliver was appointed as Chairman of HBAP with effect from 31 December 2010, succeeding Michael Francis Geoghegan who resigned as a director. Mr Alexander Andrew Flockhart resigned as a director of HBAP with effect from 31 December 2010. Mr Stephen Keith Green resigned as a director of HBAP with effect from 3 December 2010. Mr David Wei Zhe resigned as a non-executive director of HBAP with effect from 22 February 2011.

### **Directors' Policy on Conflicts of Interests**

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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**

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No contracts of significance to which HBAP, its ultimate holding company, its subsidiary companies or any fellow subsidiary company was a party to and in which a Director had a material interest existed at 31 December 2010 or at any time during the period.

### **Audit Committee**

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The Branch does not have an Audit Committee. The Audit Committee of HBAP, comprising three independent Directors, meets regularly with the Group's senior management and the external auditors to consider and review the Group's financial statements, the nature and scope of audit reviews and the effectiveness of the systems of internal control and compliance. The members of the Audit Committee are Thomas Brian Stevenson (Chairman of the Committee), Dr Patrick Wang Shui Chung and Dr Lo Ka Shui.

### **Supplemental Disclosure**

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Copies of the most recent publicly available financial statements which are included in the Financial Review, Directors' Report and Accounts of HBAP will be provided immediately at no charge at 1 Queen Street, Auckland and within five working days from our New Zealand branch network. No financial information, other than that included in the Financial Review, Directors' Report and Accounts of the HBAP Group, is publicly available for HBAP.

**General Disclosures** *(continued)***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:

|                               | <b>Current Rating</b> | <b>Previous credit rating<br/>(if changed in the previous two years)</b> |
|-------------------------------|-----------------------|--|
| Moody's Investor Service Inc. | Aa1 (stable outlook)  | n/a  |
| Standard & Poor's Corporation | *AA (stable outlook)  | n/a  |
| Fitch IBCA Inc.               | AA (stable outlook)   | n/a  |

\* Revised by Standard & Poor's Corporation on 20 August 2010 from a negative outlook to a stable outlook.

**Rating History of HBAP**

|                               | <b>Date of change</b> | <b>Previous credit rating</b> |
|-------------------------------|-----------------------|-------------------------------|
| Moody's Investor Service Inc. | December 2007         | Aa2                           |
| Standard & Poor's Corporation | July 2006             | AA-                           |
| Fitch IBCA Inc.               | June 2005             | AA                            |

**Rating scales are:**

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

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

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

## Conditions of Registration

### **The Hongkong and Shanghai Banking Corporation Limited New Zealand Branch Conditions of Registration as from 26 November 2007**

The registration of the New Zealand Branch of The Hongkong and Shanghai Banking Corporation Limited ('the Registered Bank') 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, where the term material is based on generally accepted accounting practice, as defined in the Financial Reporting Act 1993;
2. That the banking group's insurance business is not greater than 1% of its total consolidated assets. For the purposes of this condition:
  - (i) Insurance business means any business of the nature referred to in section 4 of the Insurance Companies (Ratings and Inspections) Act 1994 (including those to which the Act is disappplied by sections 4(1)(a) and (b) and 9 of that Act), or any business of the nature referred to in section 3(1) of the Life Insurance Act 1908;
  - (ii) In measuring the size of the banking group's insurance business:
    - (a) where insurance business is conducted by any entity whose business predominantly consists of insurance business, the size of that insurance business shall be:
      - the total consolidated assets of the group headed by that entity;
      - or if the entity is a subsidiary of another entity whose business predominantly consists of insurance business, the total consolidated assets of the group headed by the latter entity;
    - (b) otherwise, the size of each insurance business conducted by any entity within the banking group shall equal the total liabilities relating to that insurance business, plus the equity retained by the entity to meet the solvency or financial soundness needs of the insurance business;
    - (c) the amounts measured in relation to parts (a) and (b) shall be summed and compared to the total consolidated assets of the banking group. All amounts in parts (a) and (b) shall relate to on balance sheet items only, and shall be determined in accordance with generally accepted accounting practice, as defined in the Financial Reporting Act 1993;
    - (d) where products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets shall be considered part of the insurance business.
3. That the business of the Registered Bank does not constitute a predominant proportion of the business of The Hongkong and Shanghai Banking Corporation Limited.

## Conditions of Registration *(continued)*

4. That no appointment to the position of the New Zealand chief executive officer of the Registered Bank shall be made unless:
  - (i) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
  - (ii) the Reserve Bank has advised that it has no objection to that appointment.
5. That The Hongkong and Shanghai Banking Corporation Limited complies with the requirements imposed on it by the Hong Kong Monetary Authority.
6. That The Hongkong and Shanghai Banking Corporation Limited complies with the following minimum capital adequacy requirements, as required by the Banking Ordinance of Hong Kong:
  - Tier one capital of The Hongkong and Shanghai Banking Corporation Limited is not less than 4 percent of risk weighted exposures; and
  - Capital of The Hongkong and Shanghai Banking Corporation Limited is not less than 8 percent of risk weighted exposures.
7. That liabilities of the Registered Bank in New Zealand, net of amounts due to related parties (including amounts due to a subsidiary or affiliate of the registered bank), do not exceed NZ\$15 billion.

For the purposes of these conditions of registration, the term “Banking Group” means the New Zealand operations of The Hongkong and Shanghai Banking Corporation Limited and all New Zealand incorporated subsidiaries of The Hongkong and Shanghai Banking Corporation Limited.



## SUMMARY OF FINANCIAL STATEMENTS

### FIVE YEAR COMPARISON

|   | 2010<br>NZ IFRS  | Audited<br>Year ended 31 December |                 |                 |                 |                 |
|---|------------------|-----------------------------------|-----------------|-----------------|-----------------|-----------------|
|   |                  | 2009<br>NZ IFRS                   | 2008<br>NZ IFRS | 2007<br>NZ IFRS | 2006<br>NZ IFRS | 2005<br>NZ IFRS |
| <i>Dollars in Thousands</i>                       |                  |                                   |                 |                 |                 |                 |
| <b>Summary of Financial Results</b>               |                  |                                   |                 |                 |                 |                 |
| Interest income                                   | 214,285          | 266,178                           | 492,489         | 509,987         | 493,922         | 462,421         |
| Interest expense                                  | (124,794)        | (168,803)                         | (400,099)       | (424,036)       | (408,514)       | (358,159)       |
| <b>Net interest income</b>                        | <b>89,491</b>    | 97,375                            | 92,390          | 85,951          | 85,408          | 104,262         |
| Net trading income                                | 12,459           | 13,896                            | 12,730          | 10,223          | 6,951           | (20,498)        |
| Other net operating income                        | 47,857           | 25,104                            | 25,292          | 20,489          | 18,742          | 21,945          |
| <b>Operating income</b>                           | <b>149,807</b>   | 136,375                           | 130,412         | 116,663         | 111,101         | 105,709         |
| Operating expenses                                | (57,496)         | (57,287)                          | (65,782)        | (63,203)        | (69,570)        | (70,004)        |
| <b>Operating profit before provisions and tax</b> | <b>92,311</b>    | 79,088                            | 64,630          | 53,460          | 41,531          | 35,705          |
| Provisions for loan impairment                    | (11,111)         | (6,488)                           | (6,496)         | 292             | 1,742           | 337             |
| <b>Operating profit before tax</b>                | <b>81,200</b>    | 72,600                            | 58,134          | 53,752          | 43,273          | 36,042          |
| Income tax expense                                | (25,011)         | (21,869)                          | (18,357)        | (17,825)        | (14,572)        | (11,650)        |
| <b>Profit after tax</b>                           | <b>56,189</b>    | 50,731                            | 39,777          | 35,927          | 28,701          | 24,392          |
| Head Office Account brought forward               | 24,607           | 19,777                            | 17,475          | 28,701          | 19,402          | 12,091          |
| Prior period adjustment                           | -                | -                                 | -               | -               | -               | (5,215)         |
| Head Office Account brought forward, restated     | 24,607           | 19,777                            | 17,475          | 28,701          | 19,402          | 6,876           |
| NZ IFRS opening transition adjustments            | -                | -                                 | -               | -               | -               | (1,078)         |
| Retained profit repatriated                       | (52,612)         | (45,901)                          | (37,475)        | (47,153)        | (19,402)        | (10,788)        |
| <b>Head Office Account carried forward</b>        | <b>28,184</b>    | 24,607                            | 19,777          | 17,475          | 28,701          | 19,402          |
| <b>Statement of Financial Position</b>            |                  |                                   |                 |                 |                 |                 |
| Individually impaired assets                      | 71,781           | 43,900                            | 33,066          | 14,867          | 11,295          | 13,299          |
| Provisions  | (20,187)         | (14,279)                          | (13,775)        | (6,368)         | (6,611)         | (7,634)         |
| Net impaired assets                               | 51,594           | 29,621                            | 19,291          | 8,499           | 4,684           | 5,665           |
| <b>Total assets</b>                               | <b>5,020,899</b> | 4,770,370                         | 6,190,389       | 6,170,241       | 6,481,900       | 6,480,780       |
| Liabilities                                       | 4,992,990        | 4,743,689                         | 6,169,688       | 6,146,511       | 6,450,428       | 6,460,114       |
| Equity  | 27,909           | 26,681                            | 20,701          | 23,730          | 31,472          | 20,666          |
| <b>Total liabilities and equity</b>               | <b>5,020,899</b> | 4,770,370                         | 6,190,389       | 6,170,241       | 6,481,900       | 6,480,780       |

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

## STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2010

| <i>Dollars in Thousands</i>                       | Note | Audited<br>12 months<br>31.12.10 | Audited<br>12 months<br>31.12.09 |
|---|------|----------------------------------|----------------------------------|
| Interest income                                   | 3    | 214,285                          | 266,178                          |
| Interest expense                                  | 3    | (124,794)                        | (168,803)                        |
| <b>Net interest income</b>                        |      | <b>89,491</b>                    | <b>97,375</b>                    |
| Net trading income                                | 3    | 12,459                           | 13,896                           |
| Other net operating income                        | 3    | 47,857                           | 25,104                           |
| <b>Operating income</b>                           |      | <b>149,807</b>                   | <b>136,375</b>                   |
| Operating expenses                                | 4    | (57,496)                         | (57,287)                         |
| <b>Operating profit before provisions and tax</b> |      | <b>92,311</b>                    | <b>79,088</b>                    |
| Provisions for loan impairment                    | 13   | (11,111)                         | (6,488)                          |
| <b>Operating profit before tax</b>                |      | <b>81,200</b>                    | <b>72,600</b>                    |
| Income tax expense                                | 5    | (25,011)                         | (21,869)                         |
| <b>Profit after tax</b>                           |      | <b>56,189</b>                    | <b>50,731</b>                    |
| <b>Other comprehensive income</b>                 |      |                                  |                                  |
| Cashflow hedges                                   |      | (4,276)                          | 299                              |
| Available-for-sale financial assets               |      | 419                              | 629                              |
| Income tax expense on other comprehensive income  |      | 1,171                            | (316)                            |
| <b>Other comprehensive income for the period</b>  |      | <b>(2,686)</b>                   | <b>612</b>                       |
| <b>Total comprehensive income for the period</b>  |      | <b>53,503</b>                    | <b>51,343</b>                    |

*The notes on pages 15 – 68 form part of and should be read in conjunction with these financial statements.*

## STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2010

| <i>Dollars in Thousands</i>                                   | Note | Audited<br>12 months<br>31.12.10 | Audited<br>12 months<br>31.12.09 |
|---|------|----------------------------------|----------------------------------|
| <b>Head Office Account *</b>                                  |      |                                  |                                  |
| At beginning of period  |      | 24,607                           | 19,777                           |
| Repatriation to Head Office                                   |      | (52,612)                         | (45,901)                         |
| Profit after tax  |      | 56,189                           | 50,731                           |
| At end of period  |      | <u>28,184</u>                    | <u>24,607</u>                    |
| <b>Cashflow Hedging Reserve</b>                               |      |                                  |                                  |
| At beginning of period  |      | 1,076                            | 867                              |
| Movement in the fair value of derivatives                     |      | (3,129)                          | 2,091                            |
| Amortisation of previously terminated swaps to profit or loss |      | (1,147)                          | (1,792)                          |
| Tax on movements and transfers                                |      | 1,291                            | (90)                             |
| At end of period  |      | <u>(1,909)</u>                   | <u>1,076</u>                     |
| <b>Available for Sale Reserve</b>                             |      |                                  |                                  |
| At beginning of period  |      | (263)                            | (666)                            |
| Movement in the fair value of debt and equity securities      |      | 384                              | 1,615                            |
| Transfers to profit or loss on disposal of debt securities    | 3    | -                                | (837)                            |
| Tax on movements and transfers                                |      | (120)                            | (226)                            |
| Transfers to profit or loss on disposal of equity securities  | 3    | 35                               | (149)                            |
| At end of period  |      | <u>36</u>                        | <u>(263)</u>                     |
| <b>Other Reserve</b>  |      |                                  |                                  |
| At beginning of period  |      | 1,261                            | 723                              |
| Amortisation of share options granted                         |      | 353                              | 669                              |
| Movement in respect of share-based payment arrangements       |      | (16)                             | (131)                            |
| At end of period  |      | <u>1,598</u>                     | <u>1,261</u>                     |
| <b>Equity at end of period</b>                                |      | <u>27,909</u>                    | <u>26,681</u>                    |
| <b>Represented by:</b>  |      |                                  |                                  |
| Profit after tax  |      | 56,189                           | 50,731                           |
| Other comprehensive income                                    |      | (2,686)                          | 612                              |
| <b>Total comprehensive income for the period</b>              |      | <u>53,503</u>                    | <u>51,343</u>                    |
| Repatriation to Head Office                                   |      | (52,612)                         | (45,901)                         |
| Movement in other reserve                                     |      | 337                              | 538                              |
| Equity at beginning of period                                 |      | <u>26,681</u>                    | <u>20,701</u>                    |
|   |      | <u>27,909</u>                    | <u>26,681</u>                    |

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

*The notes on pages 15 – 68 form part of and should be read in conjunction with these financial statements. Refer to the accounting policies for a description of the nature and purpose of each reserve.*

## STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2010

| <i>Dollars in Thousands</i>                 | Note | Audited<br>31.12.10 | Audited<br>31.12.09 |
|---|------|---------------------|---------------------|
| <b>ASSETS</b>                               |      |                     |                     |
| Cash and demand balances with central banks |      | 783,962             | 546,403             |
| Advances to banks                           | 6    | 1,235               | 1,946               |
| Debt and equity securities                  | 7    | 665,404             | 538,965             |
| Derivative financial instruments            | 8    | 182,921             | 165,377             |
| Advances to customers                       | 9    | 3,126,984           | 3,307,337           |
| Amounts due from related parties            | 19   | 212,951             | 169,268             |
| Other assets                                | 10   | 17,208              | 15,410              |
| Current taxation                            |      | 1,380               | -                   |
| Deferred taxation                           | 5    | 6,425               | 3,426               |
| Intangible assets                           | 11   | 20,173              | 20,171              |
| Fixed assets                                | 12   | 2,256               | 2,067               |
| <b>Total Assets</b>                         |      | <b>5,020,899</b>    | <b>4,770,370</b>    |
| <b>LIABILITIES</b>                          |      |                     |                     |
| Deposits by banks                           | 14   | 164,321             | 62,496              |
| Derivative financial instruments            | 15   | 215,519             | 166,627             |
| Customer deposits                           | 16   | 2,427,178           | 2,850,555           |
| Debt securities                             | 17   | 719,269             | 778,538             |
| Amounts due to related parties              | 19   | 1,431,776           | 841,835             |
| Other liabilities                           | 18   | 34,927              | 35,062              |
| Current taxation                            |      | -                   | 8,576               |
| <b>Total Liabilities</b>                    |      | <b>4,992,990</b>    | <b>4,743,689</b>    |
| <b>Net Assets</b>                           |      | <b>27,909</b>       | <b>26,681</b>       |
| <b>EQUITY</b>                               |      |                     |                     |
| Head Office Account                         |      | 28,184              | 24,607              |
| Cashflow Hedging Reserve                    |      | (1,909)             | 1,076               |
| Available for Sale Reserve                  |      | 36                  | (263)               |
| Other Reserve                               |      | 1,598               | 1,261               |
| <b>Total Equity</b>                         |      | <b>27,909</b>       | <b>26,681</b>       |

The notes on pages 15 – 68 form part of and should be read in conjunction with these financial statements.



Director: Peter T S Wong  
Date: 28 March 2011



Director: Margaret M Y Leung  
Date: 28 March 2011

## STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2010

| <i>Dollars in Thousands</i>  | <b>Audited<br/>12 months<br/>31.12.10</b> | Audited<br>12 months<br>31.12.09 |
|--|---|----------------------------------|
| <b><i>Cash flows from / (to) operating activities</i></b>  |   |                                  |
| Interest received  | <b>218,545</b>                            | 277,732                          |
| Fees and commissions   | <b>47,539</b>                             | 23,820                           |
| Realised trading gain / (loss)   | <b>15,715</b>                             | (45,444)                         |
| Interest paid  | <b>(126,570)</b>                          | (181,112)                        |
| Operating expenses   | <b>(53,262)</b>                           | (59,096)                         |
| Taxation paid  | <b>(36,795)</b>                           | (21,001)                         |
| Net cash flows from / (to) operating activities before changes in operating assets and liabilities | <b>65,172</b>                             | (5,101)                          |
| Changes in operating assets and liabilities arising from cash flow movements                       |   |                                  |
| Cash was provided net from/applied net (to):   |   |                                  |
| Debt securities purchased  | <b>(126,055)</b>                          | 274,534                          |
| Advances to customers  | <b>138,164</b>                            | 742,821                          |
| Advances to banks  | -   | 40,000                           |
| Amounts due from related parties   | <b>(45,101)</b>                           | 168,329                          |
| Other assets   | <b>(2,798)</b>                            | 4,250                            |
| Other liabilities  | <b>2,169</b>                              | (6,469)                          |
| Debt securities issued   | <b>37,831</b>                             | (699,158)                        |
| Deposits by banks  | <b>5,337</b>                              | (11,362)                         |
| Customer deposits  | <b>(347,855)</b>                          | (247,156)                        |
| Net change in operating assets and liabilities   | <b>(338,308)</b>                          | 265,789                          |
| Net cash flows from operating activities   | <b>(273,136)</b>                          | 260,688                          |
| <b><i>Cash flows from / (to) investing activities</i></b>  |   |                                  |
| Proceeds from sale of fixed assets   | <b>2</b>                                  | 4                                |
| Purchase of fixed assets   | <b>(1,031)</b>                            | (581)                            |
| Purchase of intangible assets  | <b>(850)</b>                              | -                                |
| Net cash flows from / (to) investing activities  | <b>(1,879)</b>                            | (577)                            |
| <b><i>Cash flows from / (to) financing activities</i></b>  |   |                                  |
| Debt securities issued   | <b>(97,100)</b>                           | (103,100)                        |
| Amounts due to related parties   | <b>351,788</b>                            | (130,563)                        |
| Repatriation to head office  | <b>(52,612)</b>                           | (45,901)                         |
| Net cash flows from / (to) financing activities  | <b>202,076</b>                            | (279,564)                        |
| Net increase / (decrease) in cash and cash equivalents   | <b>(72,939)</b>                           | (19,453)                         |
| Effect of exchange rate fluctuations on cash held  | <b>24,169</b>                             | 60,147                           |
| Cash and cash equivalents at beginning of period   | <b>(620,619)</b>                          | (661,313)                        |
| Cash and cash equivalents at end of period   | <b>(669,389)</b>                          | (620,619)                        |

*The notes on pages 15 – 68 form part of and should be read in conjunction with these financial statements.*

## STATEMENT OF CASH FLOWS *(continued)*

### FOR THE YEAR ENDED 31 DECEMBER 2010

|  | Audited<br>12 months<br>31.12.10 | Audited<br>12 months<br>31.12.09 |
|--|----------------------------------|----------------------------------|
| <i>Dollars in Thousands</i>  |                                  |                                  |
| <i>Analysis of cash and cash equivalents</i>   |                                  |                                  |
| Cash and demand balances with central banks  | 783,962                          | 546,403                          |
| Advances to banks – demand   | 1,235                            | 1,946                            |
| Advances to customers – demand   | 95,588                           | 123,423                          |
| Balance due from related parties – demand  | 12,432                           | 13,833                           |
| Balance due to related parties – demand  | (292,175)                        | (56,759)                         |
| Deposits by banks – demand   | (148,336)                        | (51,848)                         |
| Deposits by customers - demand   | (1,122,095)                      | (1,197,617)                      |
|  | <u>(669,389)</u>                 | <u>(620,619)</u>                 |
| <i>Reconciliation of operating profit to net cash flows from operating activities</i>        |                                  |                                  |
| Profit after tax   | 56,189                           | 50,731                           |
| <i>Adjustments to reconcile profit after tax to net cash flow from operating activities:</i> |                                  |                                  |
| Change in interest accruals and deferred income  | 2,484                            | (755)                            |
| Change in mark to market accruals  | 2,903                            | (59,648)                         |
| Depreciation   | 841                              | 1,035                            |
| Amortisation of intangible asset   | 848                              | 848                              |
| Change in deferred income and accrued expense  | 2,193                            | (4,397)                          |
| Amortisation of share options granted  | 353                              | 669                              |
| Impairment charge / (release) on loans and advances  | 11,111                           | 6,488                            |
| (Gain) / loss on disposal of debt securities   | -                                | (837)                            |
| (Gain) / loss on disposal of available-for-sale equity securities                            | 35                               | (149)                            |
| (Gain) / loss on vesting of Achievement Shares   | -                                | 10                               |
| (Gain) / loss on disposal of fixed assets  | (1)                              | 36                               |
| Current / deferred taxation  | (11,784)                         | 868                              |
| Adjust operating cash flows not included in profit after tax:                                |                                  |                                  |
| Net change in operating assets and liabilities   | <u>(338,308)</u>                 | <u>265,789</u>                   |
| Net cash flows from operating activities   | <u>(273,136)</u>                 | <u>260,688</u>                   |

*The notes on pages 15 – 68 form part of and should be read in conjunction with these financial statements.*

## Notes to and forming part of the Financial Statements

### 1. Statement of Accounting Policies

#### GENERAL ACCOUNTING POLICIES

##### Reporting Entity

These financial statements are for the New Zealand operations of The Hongkong and Shanghai Banking Corporation Limited (“HBAP”) and all New Zealand incorporated subsidiaries of HBAP and controlled special purpose entities, which together represent the “Banking Group”.

The following entities have been considered for aggregation to form the Banking Group:

##### *The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch (“Branch”)*

##### *HSBC Nominees (New Zealand) Limited*

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

Due to the immaterial nature of the investments and results of both HSBC Nominees (New Zealand) Limited and HSBC Investments New Zealand Limited for the year ended 31 December 2010, management has decided to exclude both subsidiaries from the financial statements of the Banking Group. The companies are both incorporated in New Zealand.

##### *HSBC Cash Fund*

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

##### *HSBC Term Fund*

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

##### Non-Banking Group Entities

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

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

##### Non-controlled Special Purpose Entities

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

##### *HSBC Global Unit Trusts*

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

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

### 1. Statement of Accounting Policies *(continued)*

#### Non-controlled Special Purpose Entities *(continued)*

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

#### *HSBC World Selection Funds*

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

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

#### Basis of consolidation

As the Branch and Banking Group’s financial performance and position are the same in all material respects, a single set of Banking Group numbers is presented.

#### *Special purpose entities*

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

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

#### *Transaction eliminated on consolidation*

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

#### Basis of Reporting

These financial statements are prepared and presented in accordance with the Financial Reporting Act 1993, the Registered Bank Disclosure Statement (Full & Half Year – Overseas Incorporated Registered Banks) Order 2008, the Reserve Bank of New Zealand Act 1989, and all applicable financial reporting standards and other generally accepted accounting practices in New Zealand.

#### Measurement Base

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



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

### 1. Statement of Accounting Policies *(continued)*

#### Particular Accounting Policies

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

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

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

In November 2009 NZ IFRS 9 ‘Financial Instruments’ was issued. This standard introduces new requirements for the classification and measurement of financial assets. In November 2010 new requirements for the classification and measurement of financial liabilities were added. The standard is effective for annual accounting periods beginning on or after 1 January 2013 with early adoption permitted. NZ IFRS 9 is required to be applied retrospectively. If the standard is adopted prior to 1 January 2012, an entity will be exempt from the requirement to restate prior period comparative information. The Banking Group will adopt the standard in line with HBAP’s adoption of IFRS 9. IFRS 9 is subject to EU endorsement, the timing of which is uncertain. Accordingly, management are unable to provide a date by which it plans to apply NZ IFRS 9.

The main changes to the requirements of NZ IAS 39 are summarised below.

- All financial assets that are currently in the scope of NZ IAS 39 will be classified as either amortised cost or fair value. The available-for-sale and held-to-maturity categories will no longer exist.
- Classification is based on an entity’s business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. Reclassifications between the two categories are prohibited unless there is a change in the entity’s business model.
- A financial asset is measured at amortised cost if two criteria are met: i) the objective of the business model is to hold the financial asset for the collection of the contractual cash flows; and ii) the contractual cash flows of the instrument are solely payments of principal and interest on the principal outstanding. All other financial assets are measured at fair value. Movements in the fair value of financial assets classified at fair value are recognised in profit or loss, except for equity investments where an entity takes the option to designate an equity instrument that is not held for trading at fair value through other comprehensive income. If this option is taken, all subsequent changes in fair value are recognised in other comprehensive income with no recycling of gains or losses to the profit or loss statement. Dividend income would continue to be recognised in the profit or loss statement.
- An entity is only permitted to designate a financial asset otherwise meeting the amortised cost criteria at fair value through the profit and loss if doing so significantly reduces or eliminates an accounting mismatch. This designation is made on initial recognition and is irrevocable.
- Financial instruments which contain embedded derivatives are to be classified in their entirety either at fair value or amortised cost depending on whether the contracts as a whole meet the relevant criteria under NZ IFRS 9.
- Most of NZ IAS 39’s requirements for financial liabilities are retained, including amortised cost accounting for most financial liabilities. However, fair value changes attributable to changes in own credit risk for financial liabilities designated under the fair value option other than loan commitments and financial guarantee contracts are to be presented in the statement of other comprehensive income unless the treatment would create or enlarge an accounting mismatch in profit or loss. These amounts are not subsequently reclassified to the profit or loss statement but may be transferred within equity.

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

### 1. Statement of Accounting Policies *(continued)*

#### Particular Accounting Policies *(continued)*

- NZ IFRS 9 Financial instruments: Recognition (approved November 2010) *(continued)*

IFRS 9 (2009) is the first phase and IFRS 9 (2010) is the second phase of the IASB's planned phased replacement of IAS 39 with a less complex and improved standard for financial instruments. The next steps in the IASB's project will address the impairment of financial assets measured at amortised cost and hedge accounting. The IASB has indicated that it aims to finalise the replacement of IAS 39 by June 2011. In addition, the IASB is working with the US Financial Accounting Standards Board to reduce inconsistencies between US GAAP and IFRS in accounting for financial instruments. The impact of IFRS 9, and consequently NZ IFRS 9, may change as a consequence of further developments resulting from the IASB's financial instruments project. As a result, it is impracticable to quantify the impact of NZ IFRS 9 as at the date of publication of these financial statements.

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

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

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

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

#### Comparative Figures

There have been no changes to comparative figures.

#### Changes in Accounting Policies

The accounting policy for goodwill arising from acquisitions has changed due to the adoption of NZ IFRS 3 (2008). Acquisition-related costs, other than those associated with the issue of debt or equity securities, incurred in connection with a business combination are expensed as incurred. Prior to 2010 these acquisition-related costs were capitalised. The change in accounting policy is applied prospectively and has had no impact on the Banking Group's financial results.

There have been no other changes to accounting policies. They are the same as those applied by the Banking Group in the General Disclosure Statement for the year ended 31 December 2009.

#### PRINCIPAL ACCOUNTING POLICIES

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

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

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

### 1. Statement of Accounting Policies *(continued)*

#### Acceptances & Endorsements *(continued)*

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

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

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

#### Accounting for Business Combinations

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

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

#### Advances to Banks, Customers & Related Parties

Advances to banks, customers, and related parties include loans and advances originated by the Branch, which are not intended to be sold in the short term and have not been classified either as held for trading or designated at fair value. Loans and advances are recognised when cash is advanced to borrowers. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment losses.

#### Asset Impairment

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

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

#### *Individually assessed accounts*

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

- The Branch's exposure to the customer (including contingent liabilities);
- The likely dividend available on liquidation or bankruptcy;
- The viability of the customer's business model and the capability of management to trade successfully out of financial difficulties and generate sufficient cash flow to service their debt obligations;

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

### 1. Statement of Accounting Policies *(continued)*

#### Asset Impairment *(continued)*

- The extent of other creditors' commitments ranking ahead of, or *pari passu* with, the Branch and the likelihood of other creditors continuing to support the company;
- The complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- The amount and timing of expected receipts and recoveries;
- The realisable value of security (or other credit mitigants) and likelihood of successful repossession;
- The likely deduction of any costs involved in recovery of amounts outstanding; and
- The ability of the borrower to obtain the relevant foreign currency if loans are not in local currency.

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

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

#### *Collectively assessed loans and advances*

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

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

#### *Write-offs of loans and advances*

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

#### *Reversals of impairment*

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

#### *Past due assets/90 days past due assets*

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

#### *Restructured Loans*

Restructured assets include facilities for which the original terms have been changed to grant the counterparty a concession that would not otherwise have been available, due to the counterparty's difficulties in complying with the original terms. The revised terms of the facility are not comparable with the terms of new facilities with comparable risk. The yield on the asset following the restructuring is equal to, or greater than, the average cost of funds, or a loss is not otherwise expected to be incurred.

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

### 1. Statement of Accounting Policies *(continued)*

#### Asset Impairment *(continued)*

##### *Renegotiated Loans*

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

#### Assets & Liabilities – Derecognition

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

#### Debt & Equity Securities

Treasury bills, debt securities and equity shares intended to be held on a continuing basis are classified as available-for-sale securities and are measured at fair value. Available-for-sale securities are initially measured at fair value plus direct and incremental transaction costs on the trade date, the date on which the Banking Group commits to purchase or sell the asset. They are subsequently remeasured at fair value. Changes in fair value are recognised in equity, through other comprehensive income, until the securities are either sold or impaired.

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

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

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

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

Debt securities in issue are initially measured at fair value, which is the consideration received, net of directly attributable transaction costs incurred. Subsequent measurement is at amortised cost, using the effective interest rate method to amortise the difference between proceeds net of directly attributable transaction costs and the redemption amount over the expected life of the debt, unless the securities are designated at fair value.

#### Deposits by Banks, Customers & Related Parties

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

#### Derivative Financial Instruments

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

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

### 1. Statement of Accounting Policies *(continued)*

#### Derivative Financial Instruments *(continued)*

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

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

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

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

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

#### Derivative Financial Instruments – Hedge Accounting

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

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

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

##### *Fair value hedge*

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

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

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest rate method is used shall be amortised to profit or loss over the period to maturity. The adjustment to the carrying amount of a hedged available-for-sale equity security remains in equity until the disposal of the equity security.

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

### 1. Statement of Accounting Policies *(continued)*

#### Derivative Financial Instruments – Hedge Accounting *(continued)*

##### *Fair value hedge (continued)*

In the past, the New Zealand operations had Fair value hedge transactions; however there was none as of the date of these financial statements.

##### *Cash flow hedge*

Cash flow hedges in place mainly represent hedges via interest rate swaps of interest rate risk associated with certificates of deposit and medium term notes issued. Cash flow hedges may also be used to manage the interest rate risk associated with assets such as certificates of deposit purchased.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity and other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss.

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

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

##### *Derivatives that do not qualify for hedge accounting*

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

##### *Hedge effectiveness testing*

To qualify for hedge accounting, NZ IAS 39 requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness). Actual effectiveness (retrospective effectiveness) must also be demonstrated on an on-going basis.

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

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

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

#### Employee Benefits

##### *Defined contribution plans*

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

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

### 1. Statement of Accounting Policies *(continued)*

#### Employee Benefits *(continued)*

##### *Equity compensation plans*

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

##### *Share options*

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

##### *Other Reserve*

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

#### Financial Instruments Designated as at Fair Value Through Profit or Loss

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

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

The Branch designates certain financial instruments as at fair value through profit or loss to remove or reduce accounting mismatches in measurement or recognition.

In 2009 the Branch used the fair value designation for certain fixed rate debt security issues whose rate profile had been changed to floating through interest rate swaps derivatives (measured at fair value) as part of a documented interest rate management strategy. The liabilities designated as at fair value through profit and loss were based on the accounting mismatch.

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

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

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



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

### 1. Statement of Accounting Policies *(continued)*

#### Financial Instruments – Right to Offset

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

#### Fixed Assets

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

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

#### Foreign Currencies

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the end of the reporting period. Any resulting exchange differences are included in profit or loss. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined.

#### Funds Management Activities

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

#### Intangible Assets

##### Goodwill

Goodwill represents the difference between the cost of an acquisition and the fair value of the net identifiable assets acquired. Acquisition expenses such as professional fees, legal fees etc directly attributable to an acquisition are expensed.

Goodwill is stated at cost less any accumulated impairment losses.

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

##### Other Intangible Assets

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

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

Customer relationships – between 3 and 12 years

Software – between 3 and 5 years.

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

### 1. Statement of Accounting Policies *(continued)*

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#### Intangible Assets *(continued)*

##### Other Intangible Assets *(continued)*

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

#### Interest Income & Expense

Interest income and expense for financial assets and financial liabilities that are not measured at fair value are recognised in profit or loss using the effective interest rates of the financial assets or financial liabilities to which they relate.

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

#### Income – Net Fees

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

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

#### Leases

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

#### Sale & Repurchase Agreements

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

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

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

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

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

### 1. Statement of Accounting Policies *(continued)*

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#### Statement of Cash Flows

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

Cash and cash equivalents reflect the balance of cash and liquid assets used in the day-to-day cash management of the Branch, which are unconditionally convertible into cash within no more than two working days. Certain cash flows have been netted in order to provide more meaningful disclosure.

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value.

#### Taxation

Income tax on the profit or loss for the period comprises current tax and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised directly in 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.

#### Trustee Activities

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

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

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

### 2. Risk Management

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#### POLICIES

The Branch 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 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. 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 Branch will be unable or unwilling to meet a commitment that it has entered into with the Branch.

It arises from the lending, trade finance, treasury and other finance activities undertaken by the Branch. The Branch 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 Branch, local management is responsible for the quality of its credit portfolios. The Branch 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 Branch remains responsible for its own credit exposures. In addition to the portfolio management undertaken at Group level, the Branch manages its own risk concentrations on a market sector, geographical and product basis.

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

Special attention is paid to the management of problem loans.

The Branch does have legal right of off-set in some instances. At present the intention is not to exercise this right and as such, the balances have been disclosed gross.

#### Market risk

Market risk is the risk that movements in foreign exchange rates, interest rates, credit spreads or equity and commodity prices will result in profits or losses to the 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 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.

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

### 2. Risk Management *(continued)*

#### Market risk *(continued)*

The management of market risk is principally undertaken in Global Markets using risk limits approved by the 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 Branch 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 the local 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.

#### 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; and
- VAR is calculated on the basis of exposures outstanding at close of business and therefore does not necessarily reflect intra-day exposures.

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 HSBC Group staff.

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

### 2. Risk Management *(continued)*

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#### Market risk *(continued)*

#### Stress Testing *(continued)*

The Branch does not hold any significant open trading positions. Under current scenarios the potential adverse profit impact is less than USD 1.43 million (December 2009: USD 0.27 million).

#### Trading

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

In addition, at both portfolio and position levels, market risk in trading portfolios is monitored and controlled using a complementary set of techniques such as VAR and present value of a basis point (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 the local 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. Local ALCOs regularly monitor all such behavioural assumptions and interest rate risk positions to ensure they comply with interest rate risk limits established by senior management.

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 Branch'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 the HBAP Executive Committee. The Branch manages these exposures on a daily basis.

Foreign currency risk exposure is disclosed in note 26. A sensitivity analysis is not performed due to the Branch FX exposure being materially hedged.

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

### 2. Risk Management *(continued)*

#### Interest rate risk

The Branch'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 the Branch's 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 Branch also seeks to enhance net interest income, subject to risk limits approved by the 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<br>31.12.10 | Audited<br>31.12.09 |
|-----------------|---------------------|---------------------|
| Equity Reserves | 424                 | 13,759              |
| Profit and Loss | 582                 | 3,245               |

#### Liquidity and funding

Liquidity risk is the risk that HBAP 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 HBAP'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, HBAP 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 HBAP to respond quickly and smoothly to unforeseen liquidity requirements.

HBAP 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.

HBAP 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. HBAP also seeks to continuously evolve and strengthen its liquidity and funding risk management framework. As part of this on-going process, HBAP has refined the way in which it characterises core deposits. The characterisation takes into account the activities and operating environment of the HBAP entity originating the deposit, the nature of the customer and the size and pricing of the deposit. This exercise has resulted in a revised internal calculation of advances to core funding ratios (discussed more fully below), and comparatives have been restated accordingly.

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

### 2. Risk Management *(continued)*

#### Liquidity and funding *(continued)*

HBAP employs a number of measures to monitor liquidity risk. The emphasis on the ratio of net liquid assets to customer deposits, as reported in the General Disclosure Statement for the year ended 31 December 2009, has been reduced and a 'stressed one month coverage' ratio, an extension of HBAP's projected cash flow scenario analysis, is now used by HBAP ALCO as a simple and more useful metric to express liquidity risk.

#### Policies and procedures

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

It is the responsibility of the local 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 and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet liquidity 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 Branch is disclosed in note 24.

#### The management of liquidity risk

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

#### **Advances to core funding ratio**

HBAP emphasises the importance of core customer deposits as a source of funds to finance lending to customers, and discourages reliance on short-term professional funding. This is achieved by placing limits on banking entities which restrict their ability to increase loans and advances to customers without corresponding growth in core customer deposits or long term debt funding. This measure is referred to as the 'advances to core funding' ratio (previously referred to in the General Disclosure Statement for the year ended 31 December 2009 as the 'advances to deposits' ratio).



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

### 2. Risk Management *(continued)*

#### Liquidity and funding *(continued)*

##### **Advances to core funding ratio *(continued)***

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:

|                        | <b>Unaudited<br/>12 months<br/>31.12.10</b> | Unaudited<br>12 months<br>31.12.09 |
|------------------------|---|------------------------------------|
|                        | %   | %                                  |
| End of period          | <b>119.0</b>                                | 151.0                              |
| Maximum for the period | <b>156.0</b>                                | 172.4                              |
| Minimum for the period | <b>114.0</b>                                | 148.5                              |
| Average for the period | <b>134.0</b>                                | 161.3                              |

##### **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.

As at 31 December 2010 the Branch has a committed loan facility from HBAP of USD1.4 billion (December 2009: USD0.9 billion). Up to USD 0.5 billion is on call, up to USD 0.5 billion may be drawn with 7 days notice, with a further USD 0.4 billion drawn with 30 days notice. The facility increase from USD 0.9 billion to USD 1.4 billion represented existing funding from HBAP under money market lines which was previously un-committed. The committed loan facility amount may change from time to time depending on the local balance sheet structure.

##### **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. HBAP sites are required to target a ratio of 100 per cent or greater.

|                        | <b>Unaudited<br/>12 months<br/>31.12.10</b> | Unaudited<br>12 months<br>31.12.09 |
|------------------------|---|------------------------------------|
|                        | %   | %                                  |
| End of period          | <b>122</b>                                  | 125                                |
| Maximum for the period | <b>151</b>                                  | 168                                |
| Minimum for the period | <b>122</b>                                  | 125                                |
| Average for the period | <b>133</b>                                  | 144                                |

**Notes to and forming part of the Financial Statements** *(continued)***2. Risk Management** *(continued)***Contingent liquidity risk**

In the normal course of business, HBAP entities provide customers with committed facilities, and standby facilities to corporate customers. These facilities increase the funding requirements of HBAP 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 by HBAP entity after due consideration of each entity'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. In times of market stress, HBAP may choose to provide non-contractual liquidity support to certain HBAP-sponsored vehicles or HBAP promoted products. This support would only be provided after careful consideration of the potential funding requirement and the impact on the entity's overall liquidity.

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

|  | <b>Unaudited<br/>12 months<br/>31.12.10</b> | Unaudited<br>12 months<br>31.12.09 |
|--|---|------------------------------------|
|  | <b>NZDm</b>                                 | NZDm                               |
| <b>Non cancellable<br/>undrawn commitment<br/>limits</b> |   |                                    |
| Five largest   | <b>420</b>                                  | 301                                |
| Largest market sector                                    | <b>524</b>                                  | 467                                |

**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 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 Branch.

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

|   | <b>Audited<br/>12 months<br/>31.12.10</b> | Audited<br>12 months<br>31.12.09 |
|---|---|----------------------------------|
| <i>Dollars in Thousands</i>                                       |   |                                  |
| <b>3. Operating income</b>  |   |                                  |
| <b>Interest income:</b>   |   |                                  |
| Advances to banks   | 17,221                                    | 15,241                           |
| Debt securities   | 24,657                                    | 37,504                           |
| Advances to customers   | 170,173                                   | 210,184                          |
| Related parties – HBAP  | 1,679                                     | 2,957                            |
| Related parties – other   | 250                                       | 291                              |
| Other   | 305                                       | 1                                |
|   | <u>214,285</u>                            | <u>266,178</u>                   |
| <b>Interest expense:</b>  |   |                                  |
| Deposits by banks   | (2,824)                                   | (849)                            |
| Customer deposits   | (68,390)                                  | (89,320)                         |
| Debt securities   | (28,076)                                  | (56,998)                         |
| Debt securities – designated at fair value                        | -   | (2,256)                          |
| Related parties – HBAP  | (24,195)                                  | (19,281)                         |
| Related parties – other   | (1,127)                                   | (99)                             |
| Other   | (182)                                     | -                                |
|   | <u>(124,794)</u>                          | <u>(168,803)</u>                 |
| <b>Other net operating income:</b>                                |   |                                  |
| <b>Fee and commission income</b>                                  |   |                                  |
| Lending and credit facility fees receivable                       | 25,259                                    | 18,693                           |
| Custody and clearing fees receivable                              | 2,001                                     | 1,799                            |
| Other fees and commissions receivable – third parties             | 13,632                                    | 12,975                           |
| Other fees and commissions receivable – related parties-HBAP      | 12,114                                    | 415                              |
| Other fees and commissions receivable – related parties-other     | 602                                       | 725                              |
|   | <u>53,608</u>                             | <u>34,607</u>                    |
| <b>Fee and commission expense</b>                                 |   |                                  |
| Brokerage expense   | (1,078)                                   | (581)                            |
| Other fees and commissions payable – third parties                | (265)                                     | (485)                            |
| Other fees and commissions payable – related parties-HBAP         | (3,361)                                   | (8,516)                          |
| Other fees and commissions payable – related parties-other        | (1,013)                                   | (861)                            |
|   | <u>(5,717)</u>                            | <u>(10,443)</u>                  |
| <b>Other income</b>   |   |                                  |
| Gain on disposal of available-for-sale debt securities            | -   | 837                              |
| Gain / (loss) on disposal of available-for-sale equity securities | (35)                                      | 149                              |
| Gain / (loss) on vesting of Achievement Shares                    | -   | (10)                             |
| Gain / (loss) on disposal of equipment, fixtures and fittings     | 1   | (36)                             |
|   | <u>(34)</u>                               | <u>940</u>                       |
|   | <u>47,857</u>                             | <u>25,104</u>                    |
| <b>Net trading income</b>   |   |                                  |
| Foreign exchange gains  | 8,499                                     | 9,484                            |
| Revaluation of derivatives  | 3,960                                     | 4,308                            |
| Revaluation of financial liabilities designated at fair value     | -   | 104                              |
|   | <u>12,459</u>                             | <u>13,896</u>                    |

Included within interest expense on debt securities is \$6.468 million (December 2009: \$10.495 million interest expense) of interest expense from derivatives held in a qualifying cashflow hedging relationship.

Included within interest income on debt securities is \$8.304 million (December 2009: \$10.972 million interest income) of interest income from derivatives held in a qualifying cashflow hedging relationship.

The only other components of interest income and expense reported above that relate to financial assets or liabilities carried at fair value through profit or loss is the expense on debt securities designated at fair value.

Included within interest income from advances to customers is \$0.759 million (December 2009: Nil) of interest income from impaired advances to customers.

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

| <i>Dollars in Thousands</i>                         | <b>Audited<br/>12 months<br/>31.12.10</b> | Audited<br>12 months<br>31.12.09 |
|---|---|----------------------------------|
| <b>4. Operating expenses</b>                        |   |                                  |
| <b>Rental expense</b>                               |   |                                  |
| Premises  | 2,370                                     | 2,653                            |
| Equipment   | 312                                       | 299                              |
|   | <u>2,682</u>                              | <u>2,952</u>                     |
| <b>Depreciation and amortisation</b>                |   |                                  |
| Leasehold improvements                              | 484                                       | 512                              |
| Equipment, fixtures and fittings                    | 357                                       | 523                              |
| Intangibles   | 848                                       | 848                              |
|   | <u>1,689</u>                              | <u>1,883</u>                     |
| <b>Auditors' remuneration</b>                       |   |                                  |
| Audit fees  | 389                                       | 416                              |
| Audit related fees                                  | 117                                       | 112                              |
| Tax services  | 39  | 26                               |
|   | <u>545</u>                                | <u>554</u>                       |
| <b>Staff costs</b>                                  |   |                                  |
| Salaries & other staff expenses                     | 24,291                                    | 24,513                           |
| Defined contribution pension costs                  | 1,768                                     | 1,903                            |
| Share based payments                                | 353                                       | 669                              |
| Leave provision movement                            | 28  | 18                               |
| Other   | 772                                       | 769                              |
|   | <u>27,212</u>                             | <u>27,872</u>                    |
| <b>Other</b>  |   |                                  |
| Related party management and technical fees – HBAP  | 12,970                                    | 10,985                           |
| Related party management and technical fees – other | 2,498                                     | 2,905                            |
| Donations   | 109                                       | 16                               |
| Other operating expenses                            | 9,791                                     | 10,120                           |
|   | <u>25,368</u>                             | <u>24,026</u>                    |
|   | <u>57,496</u>                             | <u>57,287</u>                    |

The average number of persons employed by the Branch for the twelve months was 231 (December 2009: 239).

Audit related fees include fees charged for the reporting on custodial services and the review of the June General Disclosure Statement.

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

|  | <b>Audited<br/>12 months<br/>31.12.10</b> | <b>Audited<br/>12 months<br/>31.12.09</b> |
|--|---|---|
| <i>Dollars in Thousands</i>                                  |   |   |
| <b>5. Taxation</b>   |   |   |
| <b>Current tax expense</b>                                   |   |   |
| Current tax expense  | <u>27,138</u>                             | <u>23,124</u>                             |
|  | <u>27,138</u>                             | <u>23,124</u>                             |
| <b>Deferred tax expense</b>                                  |   |   |
| Origination and reversal of temporary differences            | (2,519)                                   | (1,255)                                   |
| Effect of change in tax rate                                 | <u>392</u>                                | <u>-</u>                                  |
|  | <u>(2,127)</u>                            | <u>(1,255)</u>                            |
| <b>Total income tax expense included in profit after tax</b> | <u>25,011</u>                             | <u>21,869</u>                             |
| <b>Reconciliation of effective tax rate</b>                  |   |   |
| Operating profit before tax                                  | <u>81,200</u>                             | <u>72,600</u>                             |
| Income tax using the domestic corporation tax rate           | 30% <u>24,360</u>                         | 30% <u>21,780</u>                         |
| Non-deductible expenses                                      | 0.2% <u>176</u>                           | 0.2% <u>174</u>                           |
| Under / (over) provided in prior periods                     | 0.1% <u>80</u>                            | (0.1%) <u>(87)</u>                        |
| Effect of change in tax rate                                 | 0.5% <u>392</u>                           | 0.0% <u>-</u>                             |
| Other permanent differences                                  | 0.0% <u>3</u>                             | 0.0% <u>2</u>                             |
|  | <u>30.8%</u> <u>25,011</u>                | <u>30.1%</u> <u>21,869</u>                |
| <b>Recognised deferred tax assets and liabilities</b>        |   |   |
| <u>Assets</u>  |   |   |
| Accelerated capital allowances                               | <u>2,116</u>                              | <u>2,831</u>                              |
| Provision for loan impairment                                | <u>5,652</u>                              | <u>4,284</u>                              |
| Other provisions   | <u>734</u>                                | <u>692</u>                                |
| Cash flow hedges   | <u>939</u>                                | <u>67</u>                                 |
| Income deferred for accounting purposes                      | <u>2,153</u>                              | <u>1,311</u>                              |
|  | <u>11,594</u>                             | <u>9,185</u>                              |
| <u>Liabilities</u>   |   |   |
| Other intangible assets                                      | <u>(1,574)</u>                            | <u>(1,907)</u>                            |
| Tax deductible premium                                       | <u>(3,595)</u>                            | <u>(3,852)</u>                            |
|  | <u>(5,169)</u>                            | <u>(5,759)</u>                            |
| <b>Deferred tax asset / (liability)</b>                      | <u>6,425</u>                              | <u>3,426</u>                              |

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

| <i>Dollars in Thousands</i>                            | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 |
|--|-----------------------------|---------------------|
| <b>6. Advances to banks</b>                            |                             |                     |
| Able to be withdrawn without prior notice              | <u>1,235</u>                | <u>1,946</u>        |
|  | <b>1,235</b>                | <b>1,946</b>        |
| <b>7. Debt and equity securities</b>                   |                             |                     |
| <b>Available-for-sale</b>                              |                             |                     |
| Debt securities  | <b>616,527</b>              | 538,748             |
| Treasury bills   | <b>48,722</b>               | -                   |
| Equity shares  | <b>155</b>                  | 217                 |
|  | <u><b>665,404</b></u>       | <u>538,965</u>      |
| <b>8. Derivative financial instruments - assets</b>    |                             |                     |
| <b>Related party</b>                                   |                             |                     |
| <i>Interest rate contracts</i>                         |                             |                     |
| Cash flow hedging derivatives                          | -                           | 985                 |
| Trading derivatives                                    | <u>377</u>                  | <u>1,293</u>        |
|  | <b>377</b>                  | <b>2,278</b>        |
| <i>Exchange rate contracts</i>                         |                             |                     |
| Trading derivatives                                    | <u>54,988</u>               | <u>46,502</u>       |
|  | <b>54,988</b>               | <b>46,502</b>       |
| Derivative financial instruments – related party       | <u><b>55,365</b></u>        | <u>48,780</u>       |
| <i>Related party breakdown</i>                         |                             |                     |
| HBAP   | <b>364</b>                  | 2,278               |
| Others   | <u><b>55,001</b></u>        | <u>46,502</u>       |
|  | <b>55,365</b>               | <b>48,780</b>       |
| <b>Others</b>  |                             |                     |
| <i>Interest rate contracts</i>                         |                             |                     |
| Cash flow hedging derivatives                          | <b>734</b>                  | 3,976               |
| Trading derivatives                                    | <u><b>22,999</b></u>        | <u>19,045</u>       |
|  | <b>23,733</b>               | <b>23,021</b>       |
| <i>Exchange rate contracts</i>                         |                             |                     |
| Trading derivatives                                    | <u><b>103,823</b></u>       | <u>93,576</u>       |
|  | <b>103,823</b>              | <b>93,576</b>       |
| Derivative financial instruments – others              | <u><b>127,556</b></u>       | <u>116,597</u>      |
| <b>Total derivative financial instruments - assets</b> | <u><b>182,921</b></u>       | <u>165,377</u>      |

**Cash flow hedges**

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

| <i>Dollars in Millions</i> | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 |
|----------------------------|-----------------------------|---------------------|
| 3 months                   | <b>496</b>                  | 537                 |

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

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

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

| <i>Dollars in Thousands</i>                  | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 |
|--|-----------------------------|---------------------|
| <b>9. Advances to customers</b>              |                             |                     |
| <b>Maturity analysis</b>                     |                             |                     |
| Demand                                       | 95,588                      | 123,423             |
| Other short term                             | 928,576                     | 1,261,021           |
| Long term                                    | 2,102,820                   | 1,922,893           |
|  | <u>3,126,984</u>            | <u>3,307,337</u>    |
| <b>10. Other assets</b>                      |                             |                     |
| Prepayments and accrued income – third party | 11,271                      | 11,737              |
| Acceptances and endorsements                 | 5,453                       | 3,139               |
| Other  | 484                         | 534                 |
|  | <u>17,208</u>               | <u>15,410</u>       |
| <b>11. Intangible assets</b>                 |                             |                     |
| <b><u>Goodwill</u></b>                       |                             |                     |
| <i>Cost</i>                                  |                             |                     |
| Balance at the beginning of the period       | 15,744                      | 15,744              |
| Balance at the end of the period             | <u>15,744</u>               | <u>15,744</u>       |
| <i>Impairment</i>                            |                             |                     |
| Balance at the beginning of the period       | (2,043)                     | (2,043)             |
| Balance at the end of the period             | <u>(2,043)</u>              | <u>(2,043)</u>      |
| <i>Carrying amounts</i>                      |                             |                     |
| Balance at the beginning of the period       | 13,701                      | 13,701              |
| Balance at the end of the period             | <u>13,701</u>               | <u>13,701</u>       |
| <b><u>Other Intangible Assets</u></b>        |                             |                     |
| <b>Customer relationships purchased</b>      |                             |                     |
| <i>Cost</i>                                  |                             |                     |
| Balance at the beginning of the period       | 9,143                       | 9,143               |
| Balance at the end of the period             | <u>9,143</u>                | <u>9,143</u>        |
| <i>Amortisation and impairment</i>           |                             |                     |
| Balance at the beginning of the period       | (2,673)                     | (1,825)             |
| Amortisation of customer relationships       | (848)                       | (848)               |
| Balance at the end of the period             | <u>(3,521)</u>              | <u>(2,673)</u>      |
| <i>Carrying amounts</i>                      |                             |                     |
| Balance at the beginning of the period       | 6,470                       | 7,318               |
| Balance at the end of the period             | <u>5,622</u>                | <u>6,470</u>        |

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

| <i>Dollars in Thousands</i>                       | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 |
|---|-----------------------------|---------------------|
| <b>11. Intangible assets</b> (continued)          |                             |                     |
| <b><u>Other Intangible Assets</u></b> (continued) |                             |                     |
| <b>Internally generated computer software</b>     |                             |                     |
| <i>Cost</i>                                       |                             |                     |
| Balance at the beginning of the period            | -                           | -                   |
| Internal development                              | <b>850</b>                  | -                   |
| Balance at the end of the period                  | <b>850</b>                  | -                   |
| <i>Carrying amounts</i>                           |                             |                     |
| Balance at the beginning of the period            | -                           | -                   |
| Balance at the end of the period                  | <b>850</b>                  | -                   |
| <b>Total Intangible Assets</b>                    | <b>20,173</b>               | 20,171              |

**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 2010 is \$12.840 million (December 2009: \$12.840 million).

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

The recoverable amount of the CGU is determined based on value-in-use calculations. These calculations use discounted cash flow projections based on profit forecasts approved by management as part of the rolling operating plan process. The rolling operating plan covers a detailed two year time frame, approved by HBAP senior management. Profit forecasts greater than two years are estimated by Branch management based on their assessment of sustainable growth. The discounted cash flow model has used a five year profit projection, a discount rate (pre tax) of 15.3% (December 2009: 14.6%), average annual growth rates for revenues and direct expenses (as detailed in the following table) based on December 2010 actual results, and a terminal value of \$27.3 million (December 2009: \$36.6 million).

**Average annual growth rate projections as at 30 December 2010**

|                        | Years 1-2   | Years 3-5   | 5 Year<br>Average |
|------------------------|-------------|-------------|-------------------|
| <b>Revenues</b>        | <b>7.2%</b> | <b>3.0%</b> | <b>4.6%</b>       |
| <b>Direct Expenses</b> | <b>2.8%</b> | <b>2.0%</b> | <b>2.3%</b>       |

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

**Average annual growth rate projections as at 30 December 2009**

|                 | Years 1-2 | Years 3-5 | 5 Year<br>Average |
|-----------------|-----------|-----------|-------------------|
| Revenues        | 10.8%     | 7.0%      | 8.3%              |
| Direct Expenses | 1.0%      | 2.0%      | 1.6%              |



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

### 11. Intangible assets *(continued)*

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

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 11.0% (December 2009: 10.2%) and an annual sustainable growth rate from July 2015 onwards of 2.4% (December 2009: 3.1%) 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 82% (December 2009: 50%), all other variables being equal, in order for the CGU's recoverable amount to be equal to its carrying value. As at 31 December 2010 the recoverable amount exceeds the carrying amount by \$13.2 million (December 2009: \$11.2 million).

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

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

This goodwill relates entirely to the Branch's custody and clearing business, being the cash-generating unit (CGU) as defined in NZ IAS 36. The carrying value that relates to this CGU at 31 December 2010 is \$0.861 million (December 2009: \$0.861 million).

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

The recoverable amount of the CGU is determined based on value-in-use calculations. These calculations use discounted cash flow projections based on profit forecasts approved by management as part of the rolling operating plan process. The rolling operating plan covers a detailed two year time frame, approved by HBAP senior management. Profit forecasts greater than two years are estimated by Branch management based on their assessment of sustainable growth. The discounted cash flow model has used a five year profit projection, a discount rate (pre tax) of 15.3% (December 2009: 14.6%), annual growth rate for revenues and direct expenses (as detailed in the following table) based on December 2010 actual results, and a terminal value of \$6.4 million (December 2009: \$7.2 million).

#### Average annual growth rate projections as at 30 December 2010

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

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

#### Average annual growth rate projections as at 30 December 2009

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

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

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 11.0% (December 2009: 10.2%) and an annual sustainable growth rate from July 2015 onwards of 2.4% (December 2009: 3.1%) 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 23% (December 2009: 21%), all other variables being equal, in order for the CGU's recoverable amount to be equal to its carrying value. As at 31 December 2010 the recoverable amount exceeds the carrying amount by \$0.9 million (December 2009: \$0.9 million)

**Other Intangible Assets**

Other intangible assets primarily represent internally generated software and customer relationships arising from the Branch's acquisition of Westpac Banking Corporation's New Zealand custody and clearing business. These customer relationships have a carrying amount at 31 December 2010 of \$5.622 million (December 2009: \$6.470 million) and 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 2010 is 7 years 8 months (December 2009: 8 years 8 months). The intangible asset is assessed quarterly for indications of impairment.

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

| <i>Dollars in Thousands</i>             | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 |
|---|-----------------------------|---------------------|
| <b>12. Fixed assets</b>                 |                             |                     |
| <b>Leasehold improvements</b>           |                             |                     |
| <i>Cost</i>                             |                             |                     |
| At beginning of period                  | 6,535                       | 7,314               |
| Additions                               | 653                         | 72                  |
| Disposals                               | -                           | (851)               |
| At end of period                        | <u>7,188</u>                | <u>6,535</u>        |
| <i>Accumulated depreciation</i>         |                             |                     |
| At beginning of period                  | 5,225                       | 5,530               |
| Depreciation charge                     | 484                         | 512                 |
| Disposals                               | -                           | (817)               |
| At end of period                        | <u>5,709</u>                | <u>5,225</u>        |
| Closing net book value                  | <u>1,479</u>                | <u>1,310</u>        |
| <b>Equipment, fixtures and fittings</b> |                             |                     |
| <i>Cost</i>                             |                             |                     |
| At beginning of period                  | 6,503                       | 6,892               |
| Additions                               | 378                         | 509                 |
| Disposals                               | (2,313)                     | (898)               |
| At end of period                        | <u>4,568</u>                | <u>6,503</u>        |
| <i>Accumulated depreciation</i>         |                             |                     |
| At beginning of period                  | 5,746                       | 6,115               |
| Depreciation charge                     | 357                         | 523                 |
| Disposals                               | (2,312)                     | (892)               |
| At end of period                        | <u>3,791</u>                | <u>5,746</u>        |
| Closing net book value                  | <u>777</u>                  | <u>757</u>          |
| <b>Total net book value</b>             | <u>2,256</u>                | <u>2,067</u>        |

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

|  | Audited<br>31.12.10 | Audited<br>31.12.09 |
|--|---------------------|---------------------|
| <i>Dollars in Thousands</i>  |                     |                     |
| <b>13. Asset quality</b>   |                     |                     |
| In the current and comparative period there is only one class of impaired financial assets, being loans and advances to customers. |                     |                     |
| <b>Gross individually impaired assets</b>  |                     |                     |
| Balance at the beginning of the period   | 43,900              | 33,066              |
| Exchange adjustment  | (212)               | (908)               |
| Transfers from performing  | 40,157              | 35,770              |
| Transfers to performing  | (1,394)             | (1,423)             |
| Write-offs   | (5,179)             | (5,142)             |
| Repayment  | (5,491)             | (17,463)            |
| Balance at the end of the period   | <u>71,781</u>       | <u>43,900</u>       |
| <b>Interest foregone for the period on the above impaired assets</b>   | <u>5,100</u>        | <u>2,628</u>        |
| <b>Gross advances past due 90 days or more</b>   |                     |                     |
| Balance at the beginning of the period   | 47                  | 8                   |
| Transfers in   | 9,782               | 19,781              |
| Transfers out to performing  | (92)                | (19,742)            |
| Transfer to non-performing   | (9,737)             | -                   |
| Balance at the end of the period   | <u>-</u>            | <u>47</u>           |
| <b>Specific provisions for loan impairment</b>   |                     |                     |
| Balance at the beginning of the period   | 11,249              | 11,531              |
| New and additional provisions charged to profit or loss  | 13,961              | 9,152               |
| Provisions released during the period to profit or loss  | (648)               | (3,384)             |
| Write-offs   | (5,179)             | (5,142)             |
| Discount unwind <sup>1</sup>   | (759)               | -                   |
| Exchange adjustment  | (212)               | (908)               |
| Balance at the end of the period   | <u>18,412</u>       | <u>11,249</u>       |
| <b>Collective provision for loan impairment</b>  |                     |                     |
| Balance at the beginning of the period   | 3,030               | 2,244               |
| Additional provision charged to profit or loss   | 294                 | 936                 |
| Provisions released during the period to profit or loss  | (1,549)             | (150)               |
| Balance at the end of the period   | <u>1,775</u>        | <u>3,030</u>        |
| <b>Total provisions for loan impairment</b>  | <u>20,187</u>       | <u>14,279</u>       |
| <b>Profit or loss charge / (credit)</b>  |                     |                     |
| Provisions for impairment against advances   | 14,255              | 10,088              |
| Provisions release no longer required  | (2,197)             | (3,534)             |
|  | <u>12,058</u>       | <u>6,554</u>        |
| Recoveries of amounts written off in previous period   | (947)               | (66)                |
|  | <u>11,111</u>       | <u>6,488</u>        |

<sup>1</sup> 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, real estate assets, other assets acquired through the enforcement of security or assets under administration.

The aggregate amount as at 31 December 2010 of any undrawn balances on lending commitments to counterparties for whom drawn balances fall within the above mentioned class of assets, before deducting allowances for credit impairment loss where applicable, is Nil (December 2009: Nil).

Interest foregone on impaired assets is calculated based on the original effective rate before the asset became impaired.

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

| <i>Dollars in Thousands</i>  | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 |
|------------------------------|-----------------------------|---------------------|
| <b>14. Deposits by banks</b> |                             |                     |
| Demand                       | <b>148,336</b>              | 51,848              |
| Other short term             | <b>15,985</b>               | 10,648              |
|                              | <b><u>164,321</u></b>       | <u>62,496</u>       |

**15. Derivative financial instruments – liabilities****Related party***Interest rate contracts*

Trading derivatives

**5,635**      2,090*Exchange rate contracts*

Trading derivatives

**52,773**      34,644

Derivative financial instruments – related party

**58,408**      36,734*Related party breakdown*

HBAP

**51,386**      16,650

Others

**7,022**      20,084**58,408**      36,734**Others***Interest rate contracts*

Cash flow hedging derivatives

**4,466**      6,553

Trading derivatives

**17,405**      18,161**21,871**      24,714*Exchange rate contracts*

Trading derivatives

**135,240**      105,179

Derivative financial instruments – others

**157,111**      129,893**Total derivative financial instruments – liabilities****215,519**      166,627**Cash flow hedges**

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

| <i>Dollars in Millions</i> | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 |
|----------------------------|-----------------------------|---------------------|
| 3 months                   | <b>407</b>                  | 446                 |
| 6 months                   | -                           | 108                 |

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

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

**16. Customer deposits***Dollars in thousands*

Demand deposits

**1,122,095**      1,197,617

Savings and Term deposits

**1,305,083**      1,652,938**2,427,178**      2,850,555

The total retail term deposits as at 31 December 2010 were \$1,281,318 thousand (December 2009: \$1,519,698 thousand). \$5,965 thousand of the retail deposits are issued to unit holders of the HSBC Cash Fund (December 2009: \$17,524 thousand) and \$37,647 thousand of the retail deposits are issued to unit holders of the HSBC Term Fund (December 2009: \$45,767 thousand).

The total other money market deposits as at 31 December 2010 were \$132,006 thousand (December 2009: \$278,975 thousand).

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

| <i>Dollars in Thousands</i>    | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 |
|--------------------------------|-----------------------------|---------------------|
| <b>17. Debt securities</b>     |                             |                     |
| Certificates of deposit issued | 719,269                     | 681,438             |
| Medium term notes issued       | -                           | 97,100              |
|                                | <u>719,269</u>              | <u>778,538</u>      |

There are no debt securities on demand.

**18. Other liabilities**

|                              |               |               |
|------------------------------|---------------|---------------|
| Accruals and deferred income | 24,491        | 26,811        |
| Acceptances and endorsements | 5,453         | 3,139         |
| Other                        | 4,983         | 5,112         |
|                              | <u>34,927</u> | <u>35,062</u> |

Accruals as at 31 December 2010 include \$6.9 million for employee entitlements (December 2009: \$6.5 million).

**19. Related party transactions**

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

The financial statements of the Branch should be read in conjunction with the financial statements of HBAP for period ended 31 December 2010.

**Key management compensation**

|  |              |              |
|--|--------------|--------------|
| (a) Salaries and other short-term benefits | 3,413        | 3,101        |
| (b) Post-employment benefits               | 186          | 268          |
|  | <u>3,599</u> | <u>3,369</u> |

(c) Shares, options and other incentive plans

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

|                           |     |        |
|---------------------------|-----|--------|
| Number of options granted | 551 | 20,925 |
|---------------------------|-----|--------|

The total fair value of the options granted converted into NZ dollars at grant date is NZD 2 thousand. (December 2009: NZD 73 thousand).

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

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

|         |       |       |
|---------|-------|-------|
| 1 year  | £1.40 | £1.48 |
| 3 years | £1.60 | £1.42 |
| 5 years | £1.75 | £1.33 |

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

**Interest Free Funding**

The HSBC NZ Branch has received an interest free loan from HBAP of \$194 million (December 2009: \$194 million) to support the thin capitalisation ratios imposed under New Zealand tax law.

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

|  | Audited<br>31.12.10 | Audited<br>31.12.09 |
|--|---------------------|---------------------|
| <i>Dollars in Thousands</i>  |                     |                     |
| <b>19. Related party transactions</b> <i>(continued)</i>             |                     |                     |
| <b>Amounts due from related parties</b>                              |                     |                     |
| On demand  | 12,432              | 13,833              |
| Other short term   | 200,519             | 155,435             |
|  | <u>212,951</u>      | <u>169,268</u>      |
| <b>The Hongkong and Shanghai Banking Corporation Limited (HBAP):</b> |                     |                     |
| Hong Kong Branch   | 197,966             | 156,554             |
| Singapore Branch   | 690                 | 270                 |
| Tokyo Branch   | 630                 | 4,999               |
| <b>Other:</b>  |                     |                     |
| HSBC Bank USA  | 1,401               | 3,238               |
| HSBC Bank plc  | 3,474               | 982                 |
| HSBC Bank Canada   | 1,147               | 25                  |
| HSBC Bank Australia Limited  | 145                 | 2,057               |
| HBME United Arab Emirates  | 280                 | 87                  |
| Other  | 7,218               | 1,056               |
|  | <u>212,951</u>      | <u>169,268</u>      |
| <b>Amounts due to related parties</b>                                |                     |                     |
| On demand  | 485,973             | 250,557             |
| Other short term   | 665,326             | 591,278             |
| Long term  | 280,477             | -                   |
|  | <u>1,431,776</u>    | <u>841,835</u>      |
| <b>The Hongkong and Shanghai Banking Corporation Limited (HBAP):</b> |                     |                     |
| Singapore Branch   | 17,275              | 5,200               |
| Hong Kong Branch   | 1,056,754           | 762,631             |
| Brunei Branch  | 700                 | 21,116              |
| Japan Branch   | 197                 | 257                 |
| Bahamas Branch   | 80,030              | 8                   |
| Taiwan Branch  | 856                 | 1,165               |
| Australia Branch   | 200,281             | 123                 |
| Macau Branch   | 273                 | 90                  |
| Philippines Branch   | 766                 | 4,316               |
| India Branch   | 145                 | 26                  |
| Indonesia Branch   | 171                 | 235                 |
| Korea Branch   | 189                 | 189                 |
| Mauritius POB Branch   | 554                 | 337                 |
| Sri Lanka Branch   | 208                 | 157                 |
| Thailand Branch  | 17                  | 18                  |
| <b>Other:</b>  |                     |                     |
| HSBC Bank Canada   | 383                 | 3,017               |
| HSBC France  | 5,692               | 2,445               |
| HSBC Private Banking Holdings (Suisse) SA                            | 1,826               | 4,039               |
| HSBC Bank Australia Limited  | 831                 | 711                 |
| HSBC Bank USA  | 20,251              | 24,678              |
| HSBC Bank Plc UK Ops   | 1                   | 4,510               |
| HSBL Mauritius – PTL   | 6                   | 106                 |
| HSBC Republic Bank (UK)  | 316                 | 910                 |
| HSBC Trinkaus and Burkhardt  | 181                 | 150                 |
| HSBC Bank Malaysia Berhad  | 1,035               | 668                 |
| Bank of Bermuda – Bermuda  | 27,290              | 429                 |
| HBME United Arab Emirates  | -                   | 470                 |
| HSBC Bank International Limited (Jersey)                             | 13                  | 289                 |
| Other  | 15,535              | 3,545               |
|  | <u>1,431,776</u>    | <u>841,835</u>      |

**Notes to and forming part of the Financial Statements** *(continued)***20. Segment Reporting**

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

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

The Banking Group operates primarily in New Zealand. Geographical information on revenues from external customers is not available and the cost to develop it would be excessive.

**Business Segments**

The Banking Group comprises the following main business segments:

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

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

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



**Notes to and forming part of the Financial Statements** *(continued)***20. Segment Reporting** *(continued)*

| <i>Dollars in Thousands</i>                | Audited 12 months ended 31.12.09 |            |          |                           |                   |              |
|--|----------------------------------|------------|----------|---------------------------|-------------------|--------------|
|  | PFS                              | CMB        | GBM      | Total Reportable Segments | Reconciling items | Consolidated |
| Operating income                           | 21,863                           | 73,802     | 32,682   | 128,347                   | 8,028             | 136,375      |
| Operating profit / (loss) before tax       | (9,719)                          | 52,671     | 21,461   | 64,413                    | 8,187             | 72,600       |
| Net Interest Income                        | 17,226                           | 51,252     | 20,850   | 89,328                    | 8,047             | 97,375       |
| Depreciation and amortisation              | 754                              | 288        | 841      | 1,883                     | -                 | 1,883        |
| <b>Other material non-cash items</b>       |                                  |            |          |                           |                   |              |
| Impairment losses on financial assets      | 7,056                            | 3,032      | -        | 10,088                    | -                 | 10,088       |
| Impairment recoveries on financial assets  | (672)                            | (2,928)    | -        | (3,600)                   | -                 | (3,600)      |
| <b>Total other material non-cash items</b> | <b>6,384</b>                     | <b>104</b> | <b>-</b> | <b>6,488</b>              | <b>-</b>          | <b>6,488</b> |

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

### 21. Fair Value of Financial Instruments

#### Determination of fair value of financial instruments carried at fair value

Fair values are determined according to the following hierarchy:

##### *Level 1 – quoted market price*

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

##### *Level 2 – valuation technique using observable inputs*

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

##### *Level 3- valuation technique with significant unobservable inputs*

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

The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used.

The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid / offer spreads. In inactive markets, obtaining assurance that the transaction price provides evidence of fair value or determining the adjustments to transaction prices that are necessary to measure the fair value of the instrument requires additional work during the valuation process.

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

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

There have been no significant transfers between levels 1 and 2 in the period to 31 December 2010 (2009: Nil).

**Notes to and forming part of the Financial Statements** *(continued)***21. Fair Value of Financial Instruments** *(continued)*

|                                   | Audited<br>31.12.09 | Audited<br>31.12.09 | Audited<br>31.12.09 | Audited<br>31.12.09 |
|-----------------------------------|---------------------|---------------------|---------------------|---------------------|
| <i>Dollars in Thousands</i>       | Level 1             | Level 2             | Level 3             | TOTAL               |
| <b>ASSETS</b>                     |                     |                     |                     |                     |
| Debt and equity securities        | -                   | 538,965             | -                   | 538,965             |
| Derivatives financial instruments | -                   | 165,377             | -                   | 165,377             |
| <b>LIABILITIES</b>                |                     |                     |                     |                     |
| Derivatives financial instruments | -                   | 166,627             | -                   | 166,627             |

**Methodologies**

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

*Cash and demand balances with central banks*

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

*Debt securities issued*

Fair value for certificates of deposit and medium term notes issued with maturities less than six months is approximated to be the carrying value. For certificates of deposit and medium term notes issued with a maturity greater than six months, fair value is determined by using discounted cash flow methods using the interest rates applicable to financial instruments of similar maturity.

*Debt securities*

For available-for-sale securities that are quoted in active markets, fair values are determined by reference to the current quoted bid/offer price.

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

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

*Deposits, other accounts and amounts due to related parties*

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

*Derivative financial instruments*

The fair values of exchange rate and interest rate contracts were obtained from quoted market prices or discounted cash flow models.

*Other assets and other liabilities*

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

**Notes to and forming part of the Financial Statements** (continued)**21. Fair Value of Financial Instruments** (continued)

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

| <i>Dollars in Thousands</i>  | <b>Audited<br/>31.12.10</b> | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 | Audited<br>31.12.09 |
|--|-----------------------------|-----------------------------|---------------------|---------------------|
|  | <b>Carrying<br/>Value</b>   | <b>Fair<br/>Value</b>       | Carrying<br>Value   | Fair<br>Value       |
| <b>ASSETS</b>  |                             |                             |                     |                     |
| Advances to customers  | <b>3,126,984</b>            | <b>3,133,348</b>            | 3,307,337           | 3,309,879           |
| Total financial assets not carried at fair value                         | <b>3,126,984</b>            | <b>3,133,348</b>            | 3,307,337           | 3,309,879           |
| Total financial assets whose carrying value approximates fair value      | <b>1,863,426</b>            | <b>1,863,426</b>            | 1,437,369           | 1,437,369           |
| <b>Total financial assets</b>  | <b>4,990,410</b>            | <b>4,996,774</b>            | 4,744,706           | 4,747,248           |
| Total non-financial assets   | <b>30,489</b>               |                             | 25,664              |                     |
| <b>Total assets</b>  | <b>5,020,899</b>            |                             | 4,770,370           |                     |
| <b>LIABILITIES</b>   |                             |                             |                     |                     |
| Customer deposits  | <b>2,427,178</b>            | <b>2,429,182</b>            | 2,850,555           | 2,851,297           |
| Debt securities  | <b>719,269</b>              | <b>719,269</b>              | 778,538             | 778,376             |
| Amounts due to related parties   | <b>1,431,776</b>            | <b>1,436,432</b>            | 841,835             | 843,266             |
| Total financial liabilities not carried at fair value                    | <b>4,578,223</b>            | <b>4,584,883</b>            | 4,470,928           | 4,472,939           |
| Total financial liabilities whose carrying value approximates fair value | <b>410,702</b>              | <b>410,702</b>              | 264,185             | 264,185             |
| <b>Total financial liabilities</b>                                       | <b>4,988,925</b>            | <b>4,995,585</b>            | 4,735,113           | 4,737,124           |
| Total non-financial liabilities  | <b>4,065</b>                |                             | 8,576               |                     |
| <b>Total liabilities</b>   | <b>4,992,990</b>            |                             | 4,743,689           |                     |

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

### 22. Risk weighted exposures

Risk weighted exposures are derived in accordance with the Reserve Bank of New Zealand's Capital Adequacy Framework as required by the Registered Bank Disclosure Statement (Full & Half Year Overseas Incorporated Banks) Order 2008.

Contingent liabilities and commitments are credit-related instruments which include letters of credit, guarantees and commitments to extend credit. The contract amount represents the amount at risk should the contract be fully drawn upon and the client default. The credit equivalent amounts are determined in accordance with the original exposure method under the Reserve Bank of New Zealand's risk weighted capital adequacy guidelines.

Off - balance sheet financial instruments arise from futures, forward, swap and option transactions undertaken by the Branch in the foreign exchange and interest rate markets. Contractual amounts of these instruments indicate the volume of transactions outstanding at the end of the reporting period; they do not represent amounts at risk.

#### *Total risk weighted exposure – 31 December 2010 (Audited)*

##### *On-balance sheet*

|  | <i>Principal<br/>Amount</i> | <i>Risk Weight</i> | <i>Risk<br/>Weighted<br/>Exposure</i> |
|--|-----------------------------|--------------------|---------------------------------------|
|  | \$m                         | %                  | \$m                                   |
| Cash and short-term claims on government | 870.7                       | 0.0                | -                                     |
| Claims on banks                          | 1,022.8                     | 20.0               | 204.6                                 |
| Residential mortgages                    | 981.4                       | 50.0               | 490.7                                 |
| Other assets                             | 1,963.1                     | 100.0              | 1,963.1                               |
| Non-risk weighted assets                 | 182.9                       | -                  | -                                     |
|  | <u>5,020.9</u>              |                    | <u>2,658.4</u>                        |

##### *Off-balance sheet*

|  | <i>Contract<br/>amount</i> | <i>Credit<br/>equivalent<br/>amount</i> | <i>Average<br/>Counterparty<br/>Risk weight</i> | <i>Risk<br/>Weighted<br/>Exposure</i> |
|--|----------------------------|---|---|---------------------------------------|
|  | \$m                        | \$m                                     | %   | \$m                                   |
| Direct credit substitutes              | 55.0                       | 55.0                                    | 40.9  | 22.5                                  |
| Transaction related contingent items   | 85.6                       | 42.8                                    | 93.5  | 40.0                                  |
| Trade related contingent items         | 115.9                      | 23.2                                    | 30.6  | 7.1                                   |
| Commitments, maturity one year or more | 676.5                      | 338.3                                   | 92.9  | 314.3                                 |
| Commitments, maturity up to one year   | 704.0                      | -                                       | -   | -                                     |
| Market related contracts               |                            |   |   |                                       |
| Exchange rate contracts:               |                            |   |   |                                       |
| Forwards                               |                            |   |   |                                       |
| - Trading                              | 4,643.3                    | 135.2                                   | 32.8  | 44.3                                  |
| Currency Options                       |                            |   |   |                                       |
| - Trading                              | 2,551.1                    | 121.1                                   | 33.8  | 40.9                                  |
| Cross Currency Swaps                   |                            |   |   |                                       |
| - Trading                              | 933.9                      | 116.9                                   | 35.1  | 41.0                                  |
| Interest rate contracts:               |                            |   |   |                                       |
| Swaps                                  |                            |   |   |                                       |
| - Trading                              | 2,160.2                    | 87.8                                    | 29.6  | 26.0                                  |
| - Other than trading                   | 414.0                      | 7.6                                     | 19.7  | 1.5                                   |
| Forwards interest rate agreement       |                            |   |   |                                       |
| - Trading                              | -                          | -                                       | -   | -                                     |
| Interest rate options                  |                            |   |   |                                       |
| - Trading                              | 193.0                      | 6.1                                     | 23.0  | 1.4                                   |
| Total off-balance sheet exposures      | <u>12,532.5</u>            | <u>934.0</u>                            |   | <u>539.0</u>                          |
| Total risk weighted exposures          |                            |   |   | <u>3,197.4</u>                        |

#### **Residential mortgages by loan-to-valuation ratio as at 31 December 2010**

|                       | <b>Principal Amount</b> |
|-----------------------|-------------------------|
|                       | \$m                     |
| LVR Range             |                         |
| 0%-80%                | 943.2                   |
| 81%-90%               | 28.9                    |
| Over 90%              | 9.3                     |
| Residential mortgages | <u>981.4</u>            |

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

### 22. Risk weighted exposures (continued)

#### Total risk weighted exposure – 31 December 2009 (Audited)

##### On-balance sheet

|  | <i>Principal<br/>Amount</i> | <i>Risk Weight</i> | <i>Risk<br/>Weighted<br/>Exposure</i> |
|--|-----------------------------|--------------------|---------------------------------------|
|  | \$m                         | %                  | \$m                                   |
| Cash and short-term claims on government | 583.4                       | 0.0                | -                                     |
| Claims on banks                          | 871.4                       | 20.0               | 174.3                                 |
| Residential mortgages                    | 957.7                       | 50.0               | 478.9                                 |
| Other assets                             | 2,192.5                     | 100.0              | 2,192.5                               |
| Non-risk weighted assets                 | 165.4                       | -                  | -                                     |
|  | <u>4,770.4</u>              |                    | <u>2,845.7</u>                        |

##### Off-balance sheet

|  | <i>Contract<br/>amount</i> | <i>Credit<br/>equivalent<br/>amount</i> | <i>Average<br/>Counterparty<br/>Risk weight</i> | <i>Risk<br/>Weighted<br/>Exposure</i> |
|--|----------------------------|---|---|---------------------------------------|
|  | \$m                        | \$m                                     | %   | \$m                                   |
| Direct credit substitutes              | 32.6                       | 32.6                                    | 51.5  | 16.8                                  |
| Transaction related contingent items   | 71.5                       | 35.8                                    | 91.9  | 32.9                                  |
| Trade related contingent items         | 78.9                       | 15.8                                    | 34.2  | 5.4                                   |
| Commitments, maturity one year or more | 778.3                      | 389.2                                   | 100.0   | 389.2                                 |
| Commitments, maturity up to one year   | 898.7                      | -                                       | -   | -                                     |
| Market related contracts               |                            |   |   |                                       |
| Exchange rate contracts:               |                            |   |   |                                       |
| Forwards                               |                            |   |   |                                       |
| - Trading                              | 3,430.6                    | 98.8                                    | 32.2  | 31.8                                  |
| Currency Options                       |                            |   |   |                                       |
| - Trading                              | 3,230.5                    | 141.7                                   | 34.9  | 49.5                                  |
| Cross Currency Swaps                   |                            |   |   |                                       |
| - Trading                              | 617.0                      | 110.1                                   | 36.2  | 39.9                                  |
| Interest rate contracts:               |                            |   |   |                                       |
| Swaps                                  |                            |   |   |                                       |
| - Trading                              | 2,153.2                    | 81.2                                    | 29.2  | 23.7                                  |
| - Other than trading                   | 457.0                      | 11.4                                    | 20.2  | 2.3                                   |
| Forwards interest rate agreement       |                            |   |   |                                       |
| - Trading                              | -                          | -                                       | -   | -                                     |
| Interest rate options                  |                            |   |   |                                       |
| - Trading                              | 416.0                      | 11.2                                    | 29.5  | 3.3                                   |
| Total off-balance sheet exposures      | <u>12,164.3</u>            | <u>927.8</u>                            |   | <u>594.8</u>                          |
| Total risk weighted exposures          |                            |   |   | <u>3,440.5</u>                        |

#### Residential mortgages by loan-to-valuation ratio as at 31 December 2009

| LVR Range             | Principal Amount |
|-----------------------|------------------|
|                       | \$m              |
| 0%-80%                | 900.0            |
| 81%-90%               | 46.4             |
| Over 90%              | 11.3             |
| Residential mortgages | <u>957.7</u>     |

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

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

| <i>Dollars in Thousands</i>                               | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 |
|---|-----------------------------|---------------------|
| <b>On-balance sheet credit exposures</b>                  |                             |                     |
| Cash and demand balances with central banks               | <b>783,962</b>              | 546,403             |
| Advances to banks   | <b>1,235</b>                | 1,946               |
| Debt and equity securities                                | <b>665,404</b>              | 538,965             |
| Advances to customers                                     | <b>3,126,984</b>            | 3,307,337           |
| Amounts due from related parties                          | <b>212,951</b>              | 169,268             |
| Other assets  | <b>16,953</b>               | 15,410              |
|   | <b>4,807,489</b>            | 4,579,329           |
| <b>Off-balance sheet credit exposures and derivatives</b> |                             |                     |
|   | <b>1,819,947</b>            | 2,025,408           |
| Total credit exposures                                    | <b>6,627,436</b>            | 6,604,737           |

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                              | <b>1,124,100</b> | 1,109,330 |
| Commercial and industrial               | <b>1,946,431</b> | 2,022,556 |
| Commercial real estate and construction | <b>750,118</b>   | 819,954   |
| Banks and financial institutions        | <b>2,078,591</b> | 1,928,485 |
| Agriculture – Forestry and mining       | <b>218,713</b>   | 266,663   |
| Other                                   | <b>509,483</b>   | 457,749   |
|   | <b>6,627,436</b> | 6,604,737 |

**Concentrations of credit risk by geographical area**

|                |                  |           |
|----------------|------------------|-----------|
| New Zealand    | <b>5,846,551</b> | 5,630,962 |
| Hong Kong      | <b>226,253</b>   | 193,869   |
| Other Overseas | <b>554,632</b>   | 779,906   |
|                | <b>6,627,436</b> | 6,604,737 |

**Concentration of Credit Exposures to Individual Counterparties**

The Registered Bank in New Zealand has no credit exposures including exposures to any OECD Government, equal to or in excess of 10% of the Overseas Bank's equity, during the current reporting period and the previous corresponding period. These exposures do not include exposures to counterparties if they are booked outside of New Zealand.

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

| <i>Dollars in Thousands</i>                           | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 |
|---|-----------------------------|---------------------|
| <b>Concentrations of funding</b>                      |                             |                     |
| <b>Concentrations of funding by product</b>           |                             |                     |
| Deposits by banks                                     | 164,321                     | 62,496              |
| Customer deposits                                     | 2,427,178                   | 2,850,555           |
| Debt securities                                       | 719,269                     | 778,538             |
| Amounts due to related parties                        | 1,431,776                   | 841,835             |
|   | <u>4,742,544</u>            | <u>4,533,424</u>    |
| <b>Concentrations of funding by industry</b>          |                             |                     |
| Agriculture, forestry, fishing and mining             | 33,561                      | 27,473              |
| Manufacturing   | 149,728                     | 230,829             |
| Electricity, gas and water                            | 528                         | 21,512              |
| Wholesale and retail trade                            | 123,549                     | 127,928             |
| Accommodation and restaurants                         | 13,782                      | 6,221               |
| Banking and finance                                   | 2,449,454                   | 1,846,869           |
| Property and business services                        | 173,830                     | 204,433             |
| Local authorities                                     | 14,044                      | 8,646               |
| Individual  | 1,718,282                   | 2,001,400           |
| Other   | 65,786                      | 58,113              |
|   | <u>4,742,544</u>            | <u>4,533,424</u>    |
| <b>Concentrations of funding by geographical area</b> |                             |                     |
| New Zealand   | 2,310,918                   | 2,460,197           |
| Australia   | 248,318                     | 50,673              |
| China   | 284,454                     | 372,100             |
| Great Britain   | 131,617                     | 123,899             |
| Hong Kong   | 1,133,203                   | 1,063,563           |
| Malaysia  | 44,956                      | 32,804              |
| Singapore   | 50,407                      | 37,185              |
| Taiwan  | 65,867                      | 86,363              |
| Other Overseas  | 472,804                     | 306,640             |
|   | <u>4,742,544</u>            | <u>4,533,424</u>    |



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

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

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

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

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

Grades 6 and 7 relate to impaired loans and advances.

Restructured assets include facilities for which the original terms have been changed to grant the counterparty a concession that would not otherwise have been available, due to the counterparty's difficulties in complying with the original terms. The revised terms of the facility are not comparable with the terms of new facilities with comparable risk. The yield on the asset following the restructuring is equal to, or greater than, the average cost of funds, or a loss is not otherwise expected to be incurred.

|   | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09     |
|---|-----------------------------|-------------------------|
| <i>Dollars in Thousands</i>               |                             |                         |
| <b>Carrying amount</b>                    |                             |                         |
| Advances to customers                     | <u>3,126,984</u>            | <u>3,307,337</u>        |
|   | <b>3,126,984</b>            | <b>3,307,337</b>        |
| <b>Individually Impaired</b>              |                             |                         |
| Grade 6: Impaired                         | <u>71,781</u>               | 43,900                  |
| Gross amount                              | <u>71,781</u>               | 43,900                  |
| Allowance for impairment                  | <u>(18,412)</u>             | (11,249)                |
| Carrying amount                           | <u>53,369</u>               | 32,651                  |
| <b>Collectively Impaired</b>              |                             |                         |
| Allowance for impairment                  | <u>(1,775)</u>              | (3,030)                 |
| Carrying amount                           | <u>(1,775)</u>              | (3,030)                 |
| <b>Past due but not impaired</b>          |                             |                         |
| Grade 1-3: Low-fair risk                  | <u>52,188</u>               | 56,675                  |
| Grade 4-5: Watch List                     | <u>10,202</u>               | 20,464                  |
| Carrying amount                           | <u>62,390</u>               | 77,139                  |
| Past due comprises:                       |                             |                         |
| 0-30 days                                 | <u>56,409</u>               | 66,109                  |
| 30-90 days                                | <u>5,981</u>                | 10,983                  |
| 90 days +                                 | <u>-</u>                    | 47                      |
| Carrying amount                           | <u>62,390</u>               | 77,139                  |
| <b>Neither past due nor impaired</b>      |                             |                         |
| Grade 1-3: Low-fair risk                  | <u>2,954,147</u>            | 3,025,594               |
| Grade 4-5: Watch List                     | <u>58,853</u>               | 174,983                 |
| Carrying amount                           | <u>3,013,000</u>            | 3,200,577               |
| Includes accounts with renegotiated terms | <u>5,340</u>                | 49,727                  |
| <b>Total carrying amount</b>              | <u><b>3,126,984</b></u>     | <u><b>3,307,337</b></u> |

**Notes to and forming part of the Financial Statements** *(continued)***23. Concentration of Credit and Funding Risk** *(continued)*

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

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

There are no other assets, including Cash and demand balances with central banks, Advances to banks, Debt securities, Derivative financial instruments, and Amounts due from related parties which are considered past due, impaired or restructured at the end of the reporting period (December 2009: Nil).

**Other financial assets neither past due nor impaired**

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

| <i>Dollars in Thousands</i>                 | <b>TOTAL</b>   | <b>Grade 1-2</b> | <b>Grade 3</b> | <b>Grade 4-5</b> |
|---|----------------|------------------|----------------|------------------|
| <b>31 December 2010 (Audited)</b>           |                |                  |                |                  |
| Cash and demand balances with central banks | <b>783,962</b> | <b>783,962</b>   | -              | -                |
| Advances to banks                           | <b>1,235</b>   | <b>716</b>       | <b>519</b>     | -                |
| Debt and equity securities                  | <b>665,404</b> | <b>665,404</b>   | -              | -                |
| Derivative financial instruments            | <b>182,921</b> | <b>144,821</b>   | <b>38,064</b>  | <b>36</b>        |
| Amounts due from related parties            | <b>212,951</b> | <b>212,951</b>   | -              | -                |
| <b>31 December 2009 (Audited)</b>           |                |                  |                |                  |
| Cash and demand balances with central banks | 546,403        | 546,403          | -              | -                |
| Advances to banks                           | 1,946          | 1,745            | 201            | -                |
| Debt and equity securities                  | 538,965        | 538,965          | -              | -                |
| Derivative financial instruments            | 165,377        | 128,851          | 30,024         | 6,502            |
| Amounts due from related parties            | 169,268        | 169,268          | -              | -                |

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

### 24. Liquidity risk – Maturity Schedule

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

| <i>Dollars in Millions</i>                     | <i>On Demand</i> | <i>0-6 mth</i> | <i>6-12 mth</i> | <i>1-2 yrs</i> | <i>2-4 yrs</i> | <i>Over 4 yrs</i> | <i>No specific maturity</i> | <i>Total</i> |
|--|------------------|----------------|-----------------|----------------|----------------|-------------------|-----------------------------|--------------|
| <b>31 December 2010 (Audited)</b>              |                  |                |                 |                |                |                   |                             |              |
| <i>Assets</i>                                  |                  |                |                 |                |                |                   |                             |              |
| Cash and demand balances with central banks    | 784              | -              | -               | -              | -              | -                 | -                           | 784          |
| Advances to banks                              | 1                | -              | -               | -              | -              | -                 | -                           | 1            |
| Debt and equity securities                     | -                | 611            | 54              | -              | -              | -                 | -                           | 665          |
| Advances to customers                          | 96               | 385            | 544             | 539            | 552            | 1,012             | -                           | 3,128        |
| Amounts due from related parties               | 12               | 201            | -               | -              | -              | -                 | -                           | 213          |
| Other assets                                   | 2                | 16             | -               | -              | -              | -                 | -                           | 18           |
| Current taxation                               | 1                | -              | -               | -              | -              | -                 | -                           | 1            |
| Deferred taxation                              | -                | -              | -               | -              | -              | -                 | 6                           | 6            |
| Intangible assets                              | -                | -              | -               | 1              | 2              | 3                 | 14                          | 20           |
| Fixed assets                                   | -                | -              | -               | -              | -              | -                 | 2                           | 2            |
| <b>Total</b>                                   | <b>896</b>       | <b>1,213</b>   | <b>598</b>      | <b>540</b>     | <b>554</b>     | <b>1,015</b>      | <b>22</b>                   | <b>4,838</b> |
| Derivative financial instruments – inflow      | -                | 418            | 27              | 6              | 693            | 6                 | -                           | 1,150        |
| Derivative financial instruments – (outflow)   | -                | (347)          | -               | -              | (620)          | -                 | -                           | (967)        |
| Derivative financial instruments - assets      | -                | 71             | 27              | 6              | 73             | 6                 | -                           | 183          |
| <i>Liabilities</i>                             |                  |                |                 |                |                |                   |                             |              |
| Deposits by banks                              | 148              | 15             | 1               | -              | -              | -                 | -                           | 164          |
| Customer deposits                              | 1,122            | 1,035          | 216             | 9              | 11             | 34                | -                           | 2,427        |
| Debt securities                                | -                | 719            | -               | -              | -              | -                 | -                           | 719          |
| Amounts due to related parties                 | 486              | 565            | 100             | -              | 281            | -                 | -                           | 1,432        |
| Other liabilities                              | 1                | 34             | -               | -              | -              | -                 | -                           | 35           |
| <b>Total</b>                                   | <b>1,757</b>     | <b>2,368</b>   | <b>317</b>      | <b>9</b>       | <b>292</b>     | <b>34</b>         | <b>-</b>                    | <b>4,777</b> |
| Derivative financial instruments – (inflow)    | -                | 347            | -               | -              | 620            | -                 | -                           | 967          |
| Derivative financial instruments – outflow     | -                | (247)          | 28              | 9              | (547)          | 6                 | -                           | (751)        |
| Derivative financial instruments – liabilities | -                | 100            | 28              | 9              | 73             | 6                 | -                           | 216          |
| <b>Net assets</b>                              | <b>(861)</b>     | <b>(1,184)</b> | <b>280</b>      | <b>528</b>     | <b>262</b>     | <b>981</b>        | <b>22</b>                   | <b>28</b>    |
| <b>31 December 2009 (Audited)</b>              |                  |                |                 |                |                |                   |                             |              |
| <i>Assets</i>                                  |                  |                |                 |                |                |                   |                             |              |
| Cash and demand balances with central banks    | 546              | -              | -               | -              | -              | -                 | -                           | 546          |
| Advances to banks                              | 2                | -              | -               | -              | -              | -                 | -                           | 2            |
| Debt and equity securities                     | -                | 489            | 50              | -              | -              | -                 | -                           | 539          |
| Advances to customers                          | 123              | 553            | 708             | 430            | 560            | 933               | -                           | 3,307        |
| Amounts due from related parties               | 14               | 155            | -               | -              | -              | -                 | -                           | 169          |
| Other assets                                   | -                | 16             | -               | -              | -              | -                 | -                           | 16           |
| Deferred taxation                              | -                | -              | -               | -              | -              | -                 | 4                           | 4            |
| Intangible assets                              | -                | -              | -               | 1              | 2              | 3                 | 14                          | 20           |
| Fixed assets                                   | -                | -              | -               | -              | -              | -                 | 2                           | 2            |
| <b>Total</b>                                   | <b>685</b>       | <b>1,213</b>   | <b>758</b>      | <b>431</b>     | <b>562</b>     | <b>936</b>        | <b>20</b>                   | <b>4,605</b> |
| Derivative financial instruments – inflow      | -                | 54             | 38              | 18             | 707            | 2                 | -                           | 819          |
| Derivative financial instruments – (outflow)   | -                | -              | -               | -              | (654)          | -                 | -                           | (654)        |
| Derivative financial instruments - assets      | -                | 54             | 38              | 18             | 53             | 2                 | -                           | 165          |
| <i>Liabilities</i>                             |                  |                |                 |                |                |                   |                             |              |
| Deposits by banks                              | 52               | 10             | -               | -              | -              | -                 | -                           | 62           |
| Customer deposits                              | 1,198            | 1,504          | 87              | 32             | 3              | 27                | -                           | 2,851        |
| Debt securities                                | -                | 681            | 97              | -              | -              | -                 | -                           | 778          |
| Amounts due to related parties                 | 251              | 266            | 325             | -              | -              | -                 | -                           | 842          |
| Other liabilities                              | 1                | 34             | -               | -              | -              | -                 | -                           | 335          |
| Current taxation                               | -                | 9              | -               | -              | -              | -                 | -                           | 9            |
| <b>Total</b>                                   | <b>1,502</b>     | <b>2,504</b>   | <b>509</b>      | <b>32</b>      | <b>3</b>       | <b>27</b>         | <b>-</b>                    | <b>4,577</b> |
| Derivative financial instruments – (inflow)    | -                | -              | -               | -              | (654)          | -                 | -                           | (654)        |
| Derivative financial instruments – outflow     | -                | 57             | 33              | 20             | 709            | 2                 | -                           | 821          |
| Derivative financial instruments – liabilities | -                | 57             | 33              | 20             | 55             | 2                 | -                           | 167          |
| <b>Net assets</b>                              | <b>(817)</b>     | <b>(1,294)</b> | <b>254</b>      | <b>397</b>     | <b>557</b>     | <b>909</b>        | <b>20</b>                   | <b>26</b>    |

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

### 25. Interest Rate Risk – Repricing Schedule

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

| <i>Dollars in Millions</i>                      | <i>0-6<br/>mth</i> | <i>6-12<br/>mth</i> | <i>1-2<br/>yrs</i> | <i>2-4<br/>yrs</i> | <i>4-6<br/>yrs</i> | <i>6+<br/>yrs</i> | <i>Total<br/>interest<br/>bearing</i> | <i>Non<br/>interest<br/>bearing</i> | <i>Total</i> |
|---|--------------------|---------------------|--------------------|--------------------|--------------------|-------------------|---------------------------------------|-------------------------------------|--------------|
| <b>31 December 2010 (Audited)</b>               |                    |                     |                    |                    |                    |                   |                                       |                                     |              |
| <i>Assets</i>                                   |                    |                     |                    |                    |                    |                   |                                       |                                     |              |
| Cash and demand balances with central banks     | 783                | -                   | -                  | -                  | -                  | -                 | 783                                   | 1                                   | 784          |
| Advances to banks                               | 1                  | -                   | -                  | -                  | -                  | -                 | 1                                     | -                                   | 1            |
| Debt and equity securities                      | 611                | 54                  | -                  | -                  | -                  | -                 | 665                                   | -                                   | 665          |
| Derivative financial instruments                | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 183                                 | 183          |
| Advances to customers                           | 2,893              | 60                  | 94                 | 80                 | 1                  | -                 | 3,128                                 | -                                   | 3,128        |
| Amounts due from related parties                | 211                | -                   | -                  | -                  | -                  | -                 | 211                                   | 2                                   | 213          |
| Other assets                                    | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 18                                  | 18           |
| Current taxation                                | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 1                                   | 1            |
| Deferred taxation                               | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 6                                   | 6            |
| Intangible assets                               | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 20                                  | 20           |
| Fixed assets                                    | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 2                                   | 2            |
| <b>Total assets</b>                             | <b>4,499</b>       | <b>114</b>          | <b>94</b>          | <b>80</b>          | <b>1</b>           | <b>-</b>          | <b>4,788</b>                          | <b>233</b>                          | <b>5,021</b> |
| <i>Liabilities</i>                              |                    |                     |                    |                    |                    |                   |                                       |                                     |              |
| Deposits by banks                               | 163                | 1                   | -                  | -                  | -                  | -                 | 164                                   | -                                   | 164          |
| Derivative financial instruments                | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 216                                 | 216          |
| Customer deposits                               | 2,141              | 216                 | 9                  | 10                 | 32                 | -                 | 2,408                                 | 19                                  | 2,427        |
| Debt securities                                 | 719                | -                   | -                  | -                  | -                  | -                 | 719                                   | -                                   | 719          |
| Amounts due to related parties                  | 1,144              | 80                  | -                  | -                  | -                  | -                 | 1,224                                 | 208                                 | 1,432        |
| Other liabilities                               | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 35                                  | 35           |
| <b>Total liabilities</b>                        | <b>4,167</b>       | <b>297</b>          | <b>9</b>           | <b>10</b>          | <b>32</b>          | <b>-</b>          | <b>4,515</b>                          | <b>478</b>                          | <b>4,993</b> |
| Net balance of derivative financial instruments | 120                | -                   | (90)               | (30)               | -                  | -                 | -                                     | -                                   | -            |
| <b>31 December 2009 (Audited)</b>               |                    |                     |                    |                    |                    |                   |                                       |                                     |              |
| <i>Assets</i>                                   |                    |                     |                    |                    |                    |                   |                                       |                                     |              |
| Cash and demand balances with central banks     | 546                | -                   | -                  | -                  | -                  | -                 | 546                                   | -                                   | 546          |
| Advances to banks                               | 2                  | -                   | -                  | -                  | -                  | -                 | 2                                     | -                                   | 2            |
| Debt and equity securities                      | 489                | 50                  | -                  | -                  | -                  | -                 | 539                                   | -                                   | 539          |
| Derivative financial instruments                | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 165                                 | 165          |
| Advances to customers                           | 3,066              | 69                  | 95                 | 74                 | 3                  | -                 | 3,307                                 | -                                   | 3,307        |
| Amounts due from related parties                | 168                | -                   | -                  | -                  | -                  | -                 | 188                                   | 1                                   | 169          |
| Other assets                                    | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 16                                  | 16           |
| Deferred taxation                               | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 4                                   | 4            |
| Intangible assets                               | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 20                                  | 20           |
| Fixed assets                                    | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 2                                   | 2            |
| <b>Total assets</b>                             | <b>4,271</b>       | <b>119</b>          | <b>95</b>          | <b>74</b>          | <b>3</b>           | <b>-</b>          | <b>4,562</b>                          | <b>208</b>                          | <b>4,770</b> |
| <i>Liabilities</i>                              |                    |                     |                    |                    |                    |                   |                                       |                                     |              |
| Deposits by banks                               | 62                 | -                   | -                  | -                  | -                  | -                 | 62                                    | -                                   | 62           |
| Derivative financial instruments                | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 167                                 | 167          |
| Customer deposits                               | 2,679              | 88                  | 32                 | 3                  | 4                  | 21                | 2,827                                 | 24                                  | 2,851        |
| Debt securities                                 | 779                | -                   | -                  | -                  | -                  | -                 | 779                                   | -                                   | 779          |
| Amounts due to related parties                  | 312                | 325                 | -                  | -                  | -                  | -                 | 637                                   | 205                                 | 842          |
| Other liabilities                               | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 35                                  | 35           |
| Current taxation                                | -                  | -                   | -                  | -                  | -                  | -                 | -                                     | 8                                   | 8            |
| <b>Total liabilities</b>                        | <b>3,832</b>       | <b>413</b>          | <b>32</b>          | <b>3</b>           | <b>4</b>           | <b>21</b>         | <b>4,305</b>                          | <b>439</b>                          | <b>4,744</b> |
| Net balance of derivative financial instruments | 149                | -                   | (44)               | (105)              | -                  | -                 | -                                     | -                                   | -            |

**Notes to and forming part of the Financial Statements** (continued)**26. Foreign Currency Risk Exposure**

The net open position in each foreign currency, detailed in the table below, represents the on-balance sheet assets and liabilities in that foreign currency aggregated with the net expected future cash flows from off-balance sheet purchases and sales from foreign exchange transactions in that foreign currency. The amounts are stated in New Zealand dollar equivalents translated using the spot exchange rates as at the end of the reported period.

| <i>Dollars in Millions</i>    | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 |
|-------------------------------|-----------------------------|---------------------|
| <b>Receivable / (payable)</b> |                             |                     |
| AUD                           | <b>0.0</b>                  | (0.0)               |
| GBP                           | <b>0.0</b>                  | 0.0                 |
| USD                           | <b>(0.1)</b>                | (0.2)               |
| Other                         | <b>0.2</b>                  | 0.2                 |
|                               | <b>0.1</b>                  | 0.0                 |

**27. Market Risk Exposures**

Aggregate market risk exposures are derived in accordance with the Capital Adequacy Framework (Standardised Approach) (BS2A) as stated in clauses 3, 4 and 5 of the Fifth Schedule to the Registered Bank Disclosure Statement (Full & Half Year - Overseas Incorporated Registered Banks) Order 2008.

| <i>Dollars in Millions</i>                                     | <i>Implied risk<br/>weighted</i> | <i>Notional<br/>capital</i> | <i>% of HBAP's<br/>equity</i> |
|--|----------------------------------|-----------------------------|-------------------------------|
| <i>Exposure at 31 December 2010</i>                            |                                  |                             |                               |
| Interest rate risk   | <b>46.0</b>                      | <b>3.7</b>                  | <b>0.01%</b>                  |
| Currency risk  | -                                | -                           | -                             |
| Equity risk  | -                                | -                           | -                             |
| <i>Peak exposure period 1 October 2010 to 31 December 2010</i> |                                  |                             |                               |
| Interest rate risk   | <b>58.4</b>                      | <b>4.7</b>                  | <b>0.01%</b>                  |
| Currency risk  | <b>1.5</b>                       | <b>0.1</b>                  | -                             |
| Equity risk  | -                                | -                           | -                             |
| <i>Exposure at 31 December 2009</i>                            |                                  |                             |                               |
| Interest rate risk   | 34.6                             | 2.8                         | 0.01%                         |
| Currency risk  | -                                | -                           | -                             |
| Equity risk  | -                                | -                           | -                             |
| <i>Peak exposure period 1 October 2009 to 31 December 2009</i> |                                  |                             |                               |
| Interest rate risk   | 61.8                             | 4.9                         | 0.01%                         |
| Currency risk  | 2.3                              | 0.2                         | -                             |
| Equity risk  | -                                | -                           | -                             |

The peak exposure and period end exposures has been calculated based on the Overseas Bank's Group equity as at 31 December 2010 and 31 December 2009 respectively.

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

### 28. Share options

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

#### a. *HSBC Holdings Executive Share Option Scheme* *HSBC Holdings ordinary shares of US\$0.50*

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

|  | Audited<br>31.12.10                      |                      | Audited<br>31.12.09                      |                      |
|--|--|----------------------|--|----------------------|
|  | Weighted<br>average<br>exercise<br>price | Number<br>of options | Weighted<br>average<br>exercise<br>price | Number<br>of options |
| Share options at beginning of the period           | £6.50                                    | 5,106                | £7.46                                    | 4,950                |
| Share options granted during the period            | -  | -                    | -  | -                    |
| Share options forfeited during the period          | -  | -                    | -  | -                    |
| Share options exercised during the period          | £6.50                                    | (3,040)              | £6.50                                    | (574)                |
| Share options expired during the period            | £6.50                                    | (2,066)              | -  | -                    |
| Adjustment for rights issue                        | -  | -                    | £6.50                                    | 730                  |
| Share options outstanding at the end of the period | -  | -                    | £6.50                                    | 5,106                |
| Share options exercisable at the end of the period | -  | -                    | £6.50                                    | 5,106                |

The weighted average share price on the dates on which options were exercised was £7.05 for December 2010 (December 2009: £7.35).

The options outstanding at 31 December 2009 had an exercise price of £6.50 and a weighted average remaining contractual life of 3 months.

**Notes to and forming part of the Financial Statements** *(continued)***28. Share options** *(continued)***b. HSBC Holdings Group Share Option Plan**  
**HSBC Holdings ordinary shares of US\$0.50**

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

|  | <b>Audited</b><br><b>31.12.10</b>                  |                              | Audited<br>31.12.09                                |                              |
|--|--|------------------------------|--|------------------------------|
|  | <i>Weighted<br/>average<br/>exercise<br/>price</i> | <i>Number of<br/>options</i> | <i>Weighted<br/>average<br/>exercise<br/>price</i> | <i>Number<br/>of options</i> |
| Share options at beginning of the period           | <b>£7.11</b>                                       | <b>103,504</b>               | £8.16  | 90,200                       |
| Share options forfeited during the period          | <b>£7.26</b>                                       | <b>(6,312)</b>               |  | -                            |
| Adjustment for rights issue                        |  | -                            | £7.11  | 13,304                       |
| Share options outstanding at the end of the period | <b>£7.10</b>                                       | <b>97,192</b>                | £7.11  | 103,504                      |
| Share options exercisable at the end of the period | <b>£7.10</b>                                       | <b>97,192</b>                | £7.11  | 103,504                      |

No options expired or were exercised during 2010 (2009: Nil).

The options outstanding at 31 December 2010 have an exercise price in the range of £6.02 to £7.60 (December 2009: £6.02 to £7.60) and a weighted average remaining contractual life of 27 months (December 2009: 39 months).

**Notes to and forming part of the Financial Statements** (continued)**28. Share options** (continued)

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

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

The exercise price is at a 20% (2009: 20%) discount to the market value at the date of grant.

|   | Audited<br>31.12.10                      |                      | Audited<br>31.12.09                      |                      |
|---|--|----------------------|--|----------------------|
|   | Weighted<br>average<br>exercise<br>price | Number<br>of options | Weighted<br>average<br>exercise<br>price | Number<br>of options |
| Share options at beginning of the period              | £3.66                                    | 160,801              | £7.01                                    | 69,058               |
| Share options granted during the period               | £5.46                                    | 25,952               | £3.31                                    | 145,468              |
| Share options forfeited during the period             |  | -                    |  | -                    |
| Share options exercised during the period             | £3.75                                    | (26,353)             | £5.68                                    | (5,416)              |
| Share options expired during the period               | £3.96                                    | (536)                | £6.30                                    | (5,940)              |
| Share options cancelled during the period             | £4.23                                    | (8,113)              | £5.99                                    | (46,482)             |
| Share options transferred in during<br>the period     | £3.31                                    | 2,174                |  | -                    |
| Share options transferred out during<br>the period    | £4.49                                    | (9,411)              | £4.45                                    | (3,588)              |
| Adjustment for rights issue                           |  | -                    | £6.16                                    | 7,701                |
| Share options outstanding at the end of<br>the period | £3.87                                    | <u>144,514</u>       | £3.66                                    | <u>160,801</u>       |
| Share options exercisable at the end of<br>the period | £6.18                                    | <u>321</u>           | £6.69                                    | <u>797</u>           |

The weighted average share price on the dates on which options were exercised was £6.55 for December 2010 (December 2009: £6.76).

The weighted average fair value of share options granted was £1.53 (December 2009: £1.41).

The options outstanding at 31 December 2010 have an exercise price in the range of £3.31 to £6.69 (December 2009: £3.31 to £6.69) and a weighted average remaining contractual life of 31 months (December 2009: 36 months).



**Notes to and forming part of the Financial Statements** *(continued)***28. Share options** *(continued)***d. HSBC Achievement Share Award Scheme**

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

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

|   | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09         |
|---|-----------------------------|-----------------------------|
|   | <i>Number of<br/>shares</i> | <i>Number of<br/>shares</i> |
| Shares at beginning of the period           | <b>11,497</b>               | 10,534                      |
| Shares granted during the period            | -                           | -                           |
| Shares forfeited during the period          | -                           | -                           |
| Shares released during the period           | <b>(4,712)</b>              | (515)                       |
| Adjustment for rights issue                 | -                           | 1,478                       |
| Shares outstanding at the end of the period | <b><u>6,785</u></b>         | <u>11,497</u>               |

There were no shares granted during 2010 (2009: Nil).

**e. HSBC Restricted Share Award Scheme**

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

22,148 share awards were made to four employees during first half of 2010 on 1 March 2010. The monetary value of these awards was £151 thousand, where the market value per share was £6.82. As at 31 December 2010, the restricted share awards held including the additional shares arising from scrip dividends for 2010 awards was 22,891.

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

### 28. Share options *(continued)*

#### Calculation of fair values

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

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

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

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

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

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

| 2009                        | <u>Savings related Share option</u> |        |        |
|-----------------------------|-------------------------------------|--------|--------|
|                             | 1 year                              | 3 year | 5 year |
| Risk-free interest rate (%) | 0.7                                 | 2.1    | 2.4    |
| Expected life (years)       | 1                                   | 3      | 5      |
| Expected volatility (%)     | 50                                  | 35     | 30     |

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

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

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

|   | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 |
|---|-----------------------------|---------------------|
| <i>Dollars in Thousands</i>   |                             |                     |
| <b>29. Lease commitments</b>  |                             |                     |
| <b>Future rentals in respect of operating leases are:</b>                       |                             |                     |
| Within one year   | <b>3,064</b>                | 3,025               |
| Between one year and two years  | <b>2,574</b>                | 1,046               |
| Between two years and five years  | <b>7,637</b>                | 1,441               |
| More than five years  | <b>3,211</b>                | 817                 |
|   | <b><u>16,486</u></b>        | <u>6,329</u>        |
| <b>30. Capital commitments</b>  |                             |                     |
| Contracted expenditure  | <b><u>75</u></b>            | <u>-</u>            |
| This contracted expenditure is related to computers and leasehold improvements. |                             |                     |
| <b>31. Total Liabilities Net of Amounts<br/>Due to Related Parties</b>          | <b><u>3,502,806</u></b>     | <u>3,865,120</u>    |

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

The financial statements of the Branch include income in respect of custodial services provided to customers by the Branch's nominee company, HSBC Nominees (New Zealand) Limited. As at 31 December 2010, securities held by the nominee company on behalf of the Branch's customers were excluded from the nominee company and the Branch's Statement of Financial Position. The value of securities held by the nominee company at 31 December 2010 was NZD32,595 million (December 2009: NZD23,103 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.

**Funds management**

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

|                               | <b>Audited<br/>31.12.10</b> | Audited<br>31.12.09 |
|-------------------------------|-----------------------------|---------------------|
| <i>Dollars in Thousands</i>   |                             |                     |
| Discretionary funds           | <b><u>48,169</u></b>        | <u>64,873</u>       |
| Totals funds under management | <b><u>48,169</u></b>        | <u>64,873</u>       |

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

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

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

### 33. Marketing and distribution of insurance products

The Branch markets and distributes both life and general insurance products. The life and general insurance products are underwritten by external third party insurance companies. Disclosure statements are made in all marketing material that the products are underwritten by those companies and the Branch does not guarantee the obligations of, or any products issued by, those companies.

### 34. Insurance and non-financial activities

The Overseas Bank does not conduct any insurance business or non-financial activities in New Zealand outside the Banking Group. The Banking Group does not conduct any insurance business.

### 35. Capital Adequacy Ratios

HBAP is subject to the capital requirements as specified by the Hong Kong Monetary Authority (HKMA). From 1 January 2009, the Group migrated to the advanced internal ratings-based approach (IRBA) to calculate its credit risk for the majority of its non-securitisation exposures. The Group continued to use the internal ratings-based (securitisation) approach to determine credit risk for its securitisation exposures. For market risk, the Group used an internal models approach to calculate its general market risk and market risk relating to equity options. From 30 March 2009, the Group adopted an internal models approach to calculate its market risk in respect of specific risk for the interest rate risk category. The Group continued to use the standardised (market risk) approach for calculating other market risk positions and the standardised (operational risk) approach to calculate its operational risk.

The capital requirements of HKMA are at least equal to those specified under the Basel framework and are not publicly available. HBAP meets, and exceeds, the minimum capital ratio requirements as specified by the HKMA as at 31 December 2010 and 31 December 2009.

HBAP reported the following capital adequacy ratios:

|                               | Unaudited<br>31.12.10 | Unaudited<br>31.12.09 |
|-------------------------------|-----------------------|-----------------------|
| <b>Basel II IRBA Approach</b> |                       |                       |
| Core capital ratio            | 11.7%                 | 12.2%                 |
| Capital adequacy ratio        | 14.7%                 | 16.1%                 |

The ratios given for HBAP are for the consolidated HBAP Group, including HBAP and its subsidiary and associated companies. The capital ratios for unconsolidated HBAP are not publicly available.

### 36. Subsequent Event

#### *Christchurch Earthquake, 22 February 2011*

The Branch has a Business Continuity Management plan which has seen customer support maintained throughout the crisis despite the Christchurch Central Business District office being temporarily inaccessible. As at the date of signing of this General Disclosure Statement the Branch does not expect any material impact on financial performance.

## Directors' Statement

Each Director believes, after due enquiry by them, that:

- The Disclosure Statement contains all the information that is required by the Registered Bank Disclosure Statement (Full & Half Year - Overseas Incorporated Registered Banks) Order 2008;
- The Disclosure Statement is not false or misleading;

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

each Director believes, after due enquiry by them, that:

- the Registered Bank had systems in place to monitor and control adequately the Banking Group's material risks, 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 the Conditions of Registration imposed on it pursuant to Section 74 of the Reserve Bank of New Zealand Act 1989;

over the year ended 31 December 2010.

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, David Griffiths, and also in his capacity as Chief Executive Officer:



**David James Howard Griffiths**  
*Chief Executive Officer*  
*New Zealand Branch*

28 March 2011

It is confirmed that the said powers of attorney appointing David J H Griffiths are still in force and have not been revoked.



# Independent Auditor's Report

## **To the Shareholder of The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch**

### **Report on the Registered Bank and Banking Group financial statements**

We have audited the accompanying financial statements and supplementary information (excluding the supplementary information relating to capital adequacy disclosed in note 35) of The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch (the “Registered Bank” and “Banking Group”) on pages 10 to 68. The financial statements comprise the statement of financial position of the Registered Bank and Banking Group as at 31 December 2010, the statement of comprehensive income, changes in equity and cash flows of the Registered Bank and Banking Group for the year then ended, and a summary of significant accounting policies and other explanatory information. The supplementary information comprises the information that is required to be disclosed under the Registered Bank Disclosure Statement (Full and Half Year – Overseas Incorporated Registered Banks) Order 2008, as amended (the “Order”).

### ***Directors' responsibility for the Registered Bank and Banking Group financial statements***

The directors are responsible for the preparation of Registered Bank and Banking Group financial statements in accordance with Clause 22 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 they determine is necessary to enable the preparation of Registered Bank and Banking Group financial statements that are free from material misstatement whether due to fraud or error.

The directors are responsible for the preparation and fair presentation of supplementary information, in accordance with Schedules 3 to 8, and which is prepared in accordance with the guidelines (if any) issued pursuant to Section 78(3) of the Reserve Bank of New Zealand Act 1983 and any conditions of registration.

The directors are also responsible for the preparation of supplementary information relating to credit and market risk exposures and capital adequacy, in accordance with Schedule 5, and which is prepared in accordance with Capital Adequacy Framework (Basel I Approach) (BS2) and Capital Adequacy Framework (Standardised Approach) (BS2A).

### ***Auditor's responsibility***

Our responsibility is to express an opinion on these Registered Bank and Banking Group financial statements and supplementary information, including the supplementary information relating to credit and market risk exposures and capital adequacy presented in notes 22, 27 and 35, based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Registered Bank and Banking Group financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Registered Bank and Banking Group financial statements. The procedures selected depend on the

auditor's 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 auditor considers internal controls relevant to the Registered Bank and Banking Group's preparation of the 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 Registered Bank and Banking Group's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the presentation of the financial statements.

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

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

### ***Opinion***

In our opinion the financial statements of The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch ("the Registered Bank and Banking Group") on pages 10 to 68 (excluding the supplementary information relating to capital adequacy disclosed in note 35):

- comply with generally accepted accounting practice in New Zealand; and
- give a true and fair view of the financial position of the Registered Bank and Banking Group as at 31 December 2010 and of the financial performance and cash flows of the Registered Bank and Banking Group for the year ended on that date.

### **Report on other legal and regulatory requirements**

In our opinion:

- the supplementary information that is required to be disclosed in accordance with Schedules 3 to 8 of the Order has been prepared, in all material respects, in accordance with the guidelines issued pursuant to section 78(3) of the Reserve Bank of New Zealand Act 1989 and any conditions of registration;
- the supplementary information that is required to be disclosed under Schedules 4 and 6 to 8 and Clauses 19 and 20 of Schedule 3 (as applicable) of the Order fairly states, in all material respects, the matters to which it relates in accordance with those schedules; and
- the supplementary information relating to credit and market risk exposures and capital adequacy that is required to be disclosed under Schedule 5, and is included within notes 22, 27 and 35 of the financial statements, has been prepared, in all material respects, in accordance with Capital Adequacy Framework (Basel I Approach) (BS2) and Capital Adequacy Framework (Standardised Approach) (BS2A) and disclosed in accordance with Schedule 5.



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

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

A handwritten signature in black ink, appearing to read 'KPMG'.

28 March 2011  
Auckland