The Hongkong and Shanghai Banking Corporation Limited

New Zealand Banking Group

Disclosure Statement

31 December 2019

Disclosure Statement
For the Year Ended 31 December 2019

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General Disclosures

Registered Bank

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

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

New Zealand Branch

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

New Zealand Head Office:
1 Queen Street
Auckland
New Zealand

New Zealand Banking Group

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

Overseas Banking Group

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

Ultimate Holding Company

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

Access to parental disclosures

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

Ranking of Local Creditors in a Winding-up

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

Guarantee Arrangements

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

General Disclosures *(continued)*

Other Material Matters

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

Pending Proceedings and Arbitration

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

Auditor

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

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

New Zealand Chief Executive Officer /Responsible Person

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

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

Communications addressed to the responsible person may be sent to:
c/o The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch
PO Box 5947
Victoria Street West
Auckland 1142
New Zealand

Dealings with Responsible Person

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

General Disclosures *(continued)*

Board of Directors of HBAP

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

Laura May Lung Cha, GBM (Chairman)
Bachelor of Arts, University of Wisconsin-Madison; Juris Doctor, University of Santa Clara Law School; and admitted to practice in the State of California and in Federal Courts
Company Director

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

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

* **Graham John Bradley**
Bachelor of Arts and Bachelor of Laws (Hons I), Sydney University; and Master of Laws, Harvard University
Company Director

Louisa Wai Wan Cheang
Bachelor of Social Sciences, The University of Hong Kong
Vice-Chairman and Chief Executive, Hang Seng Bank Limited

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

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

Yiu Kwan Choi
Higher Certificate in Accountancy, The Hong Kong Polytechnic University
Fellow Member of The Hong Kong Institute of Bankers
Company Director

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

* **Jennifer Xinzhe Li**
Bachelor of Arts, Tsinghua University, Beijing, China; and Master of Business Administration, University of British Columbia, Vancouver, Canada
General Managing Partner, Changcheng Investment Partners

^ **Victor Tzar Kuoi Li**
Bachelor of Science degree in Civil Engineering and Master of Science degree in Civil Engineering, Stanford University; and Honorary Degree, Doctor of Laws, honoris causa (LL.D.), University of Western Ontario
Chairman and Managing Director of CK Asset Holdings Limited; and
Chairman and Group Co-managing Director of CK Hutchison Holdings Limited

General Disclosures *(continued)*

Board of Directors of HBAP (*continued*)

* **Bin Hwee Quek (née Chua)**, PBM, BBM, JP
Bachelor of Accountancy (Hons), The University of Singapore; and Chartered Accountant, Institute of Singapore Chartered Accountants
Company Director

Kevin Anthony Westley, BBS
Bachelor of Arts (Hons), University of London (LSE); and Fellow, Institute of Chartered Accountants in England and Wales
Company Director

* **Tan Sri (Sir) Francis Sock Ping Yeoh**, KBE, CBE
Bachelor of Science (Hons) in Civil Engineering and Honorary Doctorate of Engineering, University of Kingston
Executive Chairman, YTL Corporation Berhad

independent non-executive Director
^ non-executive Director

Country of Residence

With the exception of those denoted with an *, all directors reside in Hong Kong. Zia Mody resides in India, Graham John Bradley resides in Australia, Tan Sri (Sir) Francis Sock Ping Yeoh resides in Malaysia, Jennifer Xinzhe Li resides in China, and Bin Hwee Quek (née Chua) 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

Marjorie Mun Tak Yang retired as an independent non-executive director on 4 April 2019.

John Michael Flint stepped down as a non-executive Director and the Chairman of the Board with effect from 5 August 2019.

Laura May Lung Cha, an existing independent non-executive Director and a former Deputy Chairman, was appointed as Chairman of the Board with effect from 6 December 2019.

There have been no other changes in the composition of the Board of Directors of HBAP since 31 December 2018.

Directors' Policy on Conflicts of Interests

The Board has a conflicts of interest policy. It sets out HBAP's policy on the notification, review or approval process of Directors' conflicts or potential conflicts of interest and the Board's approach to dealing with any non-compliance with the policy. Directors are required to notify all external directorships and appointments, and any other conflict or potential conflicts of interest. The notified matter will be referred to the Board for its noting or consideration in accordance with the conflicts of interest policy. In addition, under Division 5 of Part 11 of the Companies Ordinance (Cap. 622) of the Laws of Hong Kong, Directors who are interested either directly or indirectly in a transaction, arrangement or contract, or a proposed transaction, arrangement or contract that is significant to HBAP's business shall, if such Director's interest is material, declare the nature and extent of their interest as soon as reasonably practicable.

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

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

General Disclosures *(continued)*

Audit Committee

The Banking Group does not have an Audit Committee. The Audit Committee of HBAP has non-executive responsibility for oversight of and advice to the Board on matters relating to financial reporting and internal financial controls. The current members of the Committee, all being independent non-executive Directors, are Kevin Westley (Chairman of the Committee), Graham Bradley, Yiu Kwan Choi, Irene Lee and Jennifer Li. The Committee met four times in 2019.

The Audit Committee monitors the integrity of HBAP's Consolidated Financial Statements and disclosures relating to financial performance, the effectiveness of the internal audit function and the external audit process, and the effectiveness of internal financial control systems. The Committee reviews the adequacy of resources and expertise as well as succession planning for the finance function. It reviews, and considers changes to, the Bank's accounting policies. The Committee advises the Board on the appointment, re-appointment, or removal of the external auditor and reviews and monitors the external auditor's independence and objectivity. The Committee reviews matters escalated for its attention by subsidiaries' audit committees and reviews minutes of meetings of the Asset, Liability and Capital Management Committee.

Credit Rating

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

	Current Rating	Previous Rating (if changed in the previous two years)	Date of Change
Moody's Investor Service Inc.	Aa3 (negative outlook)	Aa3 (stable outlook)	17 December 2019
Standard & Poor's Corporation	AA- (stable outlook)	Not changed	-
Fitch IBCA Inc.	AA- (stable outlook)	Not changed	-

Rating scales are:

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

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

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

Conditions of Registration

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

These conditions of registration apply on and after 1 January 2019.

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

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

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

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

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

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

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

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

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

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

   For the purposes of this condition of registration, –

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

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

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

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

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

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

Conditions of Registration *(continued)*

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

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

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

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

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

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

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

9. That, for a loan-to-valuation measurement period, the total of the business of the registered bank in New Zealand's qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans with a loan-to-valuation ratio of more than 80%, must not exceed 20% of the total of the qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

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

Conditions of Registration *(continued)*

In these conditions of registration, –

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

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

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

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

In conditions of registration 8 to 10,—

"loan-to-valuation ratio", "non property-investment residential mortgage loans", “property-investment residential mortgage loans", "qualifying new mortgage lending amount in respect of property-investment residential mortgage loans", "qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans", and "residential mortgage loan" have the same meaning as in the Reserve Bank of New Zealand document entitled "Framework for Restrictions on High-LVR Residential Mortgage Lending" (BS19) dated January 2019, and where the version of the Reserve Bank of New Zealand document "Capital Adequacy Framework (Standardised Approach)" (BS2A) referred to in BS19 for the purpose of defining these terms is that dated November 2015.

“loan-to-valuation measurement period” means a period of six calendar months ending on the last day of the sixth calendar month, the first of which ends on the last day of June 2019.

Changes to Conditions of Registration since the 30 June 2019 Disclosure Statement

There were no changes in the conditions of registration between 30 June 2019 and 31 December 2019.

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HISTORICAL SUMMARY OF FINANCIAL STATEMENTS

FIVE YEAR COMPARISON

	Banking Group				
	Audited Year ended 31 December				
Dollars in Thousands	**2019**	2018	2017	2016	2015
Summary of Financial Results					
Interest income	**176,484**	188,819	167,356	174,238	230,879
Interest expense	**(96,884)**	(104,098)	(79,554)	(93,279)	(135,843)
Net interest income	**79,600**	84,721	87,802	80,959	95,036
Net trading income	**8,732**	11,085	6,868	8,552	14,704
Other net operating income	**36,850**	37,905	35,453	34,654	36,632
Net operating income before credit impairment charges	**125,182**	133,711	130,123	124,165	146,372
Loan impairment (charges) / releases	**-**	-	(3,288)	1,429	35,140
Change in expected credit loss and other credit impairment charges	**2,494**	3,844	-	-	-
Net operating income	**127,676**	137,555	126,835	125,594	181,512
Operating expenses	**(71,672)**	(66,001)	(61,331)	(61,205)	(63,841)
Operating profit before tax	**56,004**	71,554	65,504	64,389	117,671
Income tax expense	**(15,840)**	(20,132)	(18,394)	(18,081)	(33,032)
Profit after tax	**40,164**	51,422	47,110	46,308	84,639
Retained profit repatriated	**(42,133)**	(46,584)	(47,174)	(77,290)	(72,585)
Balance Sheet					
Total assets	**6,641,631**	6,029,755	6,404,765	5,086,021	5,591,088
of which: Individually impaired assets[1]	**2,657**	2,613	9,384	2,833	3,503
Total Liabilities	**6,617,609**	6,003,914	6,379,409	5,060,948	5,536,733
Head Office Account	**21,130**	23,099	22,747	22,811	53,793
Total Equity	**24,022**	25,841	25,356	25,073	54,355

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

1. Balances reported for 2018 and subsequent years are calculated under NZ IFRS 9, all prior year balances are calculated under NZ IAS 39 and are not directly comparable. The balance reported for 2018 has been restated to show individually assessed impaired assets following clarified guidance from the Reserve Bank of New Zealand.

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2019

		Banking Group	
		12 months ended	
Dollars in Thousands	Note	**31.12.19**	31.12.18
Interest income	3	**176,484**	188,819
Interest expense	3	**(96,884)**	(104,098)
Net interest income		**79,600**	84,721
Net trading income	3	**8,732**	11,085
Other net operating income	3	**36,850**	37,905
Net operating income before credit impairment charges		**125,182**	133,711
Change in expected credit loss	10	**2,494**	3,844
Net operating income		**127,676**	137,555
Operating expenses	4	**(71,672)**	(66,001)
Operating profit before tax		**56,004**	71,554
Income tax expense	19	**(15,840)**	(20,132)
Profit after tax attributable to owners of the Banking Group		**40,164**	51,422
Other comprehensive income / (expense)			
Items that may be reclassified subsequently to profit or loss:			
Financial assets at fair value through other comprehensive income:			
Fair value gains / (losses) other comprehensive income		**204**	42
Income taxes		**(56)**	(11)
Total comprehensive income for the year attributable to owners of the Banking Group		**40,312**	51,453

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

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2019

		Banking Group	
		12 months ended	
Dollars in Thousands	Note	**31.12.19**	31.12.18
Head Office Account *			
At beginning of the year		**23,099**	22,747
Changes in initial application of NZ IFRS 9		**-**	(4,486)
Restated balance at beginning of the year		**23,099**	18,261
Repatriation to Head Office		**(42,133)**	(46,584)
Profit after tax		**40,164**	51,422
At end of the year		**21,130**	23,099
Financial assets at Fair Value through Other Comprehensive Income Reserve			
At beginning of the year		**1,086**	-
Changes in initial application of NZ IFRS 9		**-**	1,055
Restated balance at beginning of the year		**1,086**	1,055
Fair value changes taken to equity		**(151)**	18
Transferred to the profit or loss		**355**	24
Tax on movements and transfers		**(56)**	(11)
At end of the year		**1,234**	1,086
Share-based Payment Reserve			
At beginning of the year		**1,656**	1,559
Transferred to the profit or loss		**225**	106
Movement in share-based payment arrangements		**(223)**	(9)
At end of the year		**1,658**	1,656
Equity at end of the year		**24,022**	25,841

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

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

BALANCE SHEET
AS AT 31 DECEMBER 2019

		Banking Group	
Dollars in Thousands	Note	**31.12.19**	31.12.18
ASSETS			
Cash and demand balances with central banks		**675,760**	529,852
Advances to banks		**10,702**	6,704
Financial investments		**541,559**	421,975
Derivative financial instruments	22	**83,323**	49,986
Advances to customers	6	**4,657,004**	4,124,212
Amounts due from related parties	21	**632,251**	855,678
Other assets	16	**21,723**	24,415
Property, plant and equipment		**2,778**	1,248
Deferred tax asset	19	**674**	1,180
Goodwill and intangible assets	20	**15,857**	14,505
Total Assets		**6,641,631**	6,029,755
LIABILITIES			
Deposits by banks		**347,859**	228,503
Derivative financial instruments	22	**85,453**	51,135
Customer deposits	13	**3,538,301**	3,058,901
Debt securities	14	**924,917**	689,748
Amounts due to related parties	21	**1,676,580**	1,921,719
Other liabilities	17	**43,528**	48,602
Current tax liabilities		**971**	5,306
Total Liabilities		**6,617,609**	6,003,914
Net Assets		**24,022**	25,841
EQUITY			
Head Office account		**21,130**	23,099
Other reserves		**1,234**	1,086
Share-based payment reserve	29	**1,658**	1,656
Total Equity		**24,022**	25,841

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

Christopher David Gosse Russell
3rd April 2020
For and on behalf of the Directors of The Hongkong and Shanghai Banking Corporation Limited by their attorney.

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

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2019

	Banking Group	
	12 months ended	
Dollars in Thousands	**31.12.19**	31.12.18
Cash flows from / (to) operating activities		
Interest received	**175,610**	193,426
Fees and commissions	**36,322**	36,035
Realised trading gains	**10,646**	14,614
Interest paid	**(89,956)**	(96,912)
Operating expenses	**(84,466)**	(58,307)
Taxation paid	**(19,726)**	(18,366)
Net cash flows from operating activities before changes in operating assets and liabilities	**28,430**	70,490
Changes in operating assets and liabilities arising from cash flow movements		
Cash was provided net from / applied net (to):		
Advances to customers	**(529,777)**	319,971
Amounts due from related parties	**223,656**	11,206
Other assets	**3,914**	(923)
Other liabilities	**(5,462)**	496
Debt securities issued / (repaid)	**234,592**	298,283
Deposits by banks	**119,684**	(46,954)
Customer deposits	**479,191**	(95,418)
Amounts due to related parties	**(235,544)**	(566,889)
Net change in operating assets and liabilities	**290,254**	(80,228)
Net cash flows (to) / from operating activities	**318,684**	(9,738)
Cash flows (to) / from investing activities		
Financial investments purchased	**(276,500)**	(232,004)
Financial investments sold	**-**	5,066
Financial investments matured	**242,000**	43,500
Acquisition of property, plant and equipment	**(284)**	(372)
Acquisition of intangible assets	**(1,714)**	(821)
Net cash flows (to) / from investing activities	**(36,498)**	(184,631)
Cash flows to financing activities		
Repatriation to head office	**(42,133)**	(46,584)
Principal payments on lease liabilities	**(1,764)**	-
Net cash flows (to) / from financing activities	**(43,897)**	(46,584)
Net (decrease) / increase in cash and cash equivalents	**238,289**	(240,953)
Effect of exchange rate fluctuations on cash held	**(71)**	62
Cash and cash equivalents at beginning of year	**536,083**	776,974
Cash and cash equivalents at end of year	**774,301**	536,083

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

STATEMENT OF CASH FLOWS *(continued)*
FOR THE YEAR ENDED 31 DECEMBER 2019

	Banking Group	
	12 months ended	
Dollars in Thousands	**31.12.19**	31.12.18
Analysis of cash and cash equivalents		
Cash and demand balances with central banks	**675,760**	529,852
Items in the course of collection from other banks[1]	**5,684**	48
Advances to banks – demand	**5,018**	6,656
Treasury Bills with initial maturity less than 3 months[2]	**87,983**	-
Less: items in the course of transmission to other banks[1]	**(144)**	(473)
	774,301	536,083

[1] Items in the course of collection from / transmission to other banks are presented on the balance sheet within Advances to banks and Deposits by banks respectively.
[2] Treasury Bills are presented on the Balance Sheet within Financial Investments

	Banking Group	
Reconciliation of profit after tax to net cash flows from operating activities		
Profit after tax	**40,164**	51,422
Adjustments to reconcile profit after tax to net cash flow from operating activities:		
Change in interest accruals	**3,585**	4,251
Change in fair value of derivatives	**1,412**	2,595
Depreciation of property, plant and equipment	**2,245**	523
Amortisation of intangible asset	**362**	560
Amortisation of premium and discounts	**2,469**	7,542
Change in deferred income and accrued expense	**(15,422)**	5,237
Change in expected credit loss	**(2,499)**	(3,406)
Change in current and deferred taxation	**(3,886)**	1,766
Adjust operating cash flows not included in profit after tax:		
Net change in operating assets and liabilities	**290,254**	(80,228)
Net cash flows (to) / from operating activities	**318,684**	(9,738)

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

Notes to and forming part of the Financial Statements

1. Statement of significant accounting policies

GENERAL ACCOUNTING POLICIES

Reporting entity

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

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

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

The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch

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

Basis of reporting

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

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

Measurement base

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

Comparative figures

These financial statements include comparative information as required by NZ IAS 1 and the Order.

Other than as disclosed in Note 8, there have been no material changes to comparative figures. Comparative information has been restated where appropriate to conform to changes in presentation in the current year and to enhance comparability.

Authorisation of financial statements

These financial statements were authorised for issue on 3rd April 2020 by Christopher David Gosse Russell on behalf of the directors of The Hongkong and Shanghai Banking Corporation Limited.

Future accounting developments

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

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

1. Statement of significant accounting policies *(continued)*

Changes in accounting policies

Implementation of NZ IFRS 16 Leases

The Banking Group has adopted the requirements of New Zealand Equivalent to International Financial Reporting Standard 16 Leases (NZ IFRS 16) from 1 January 2019. The Banking Group recognised lease liabilities in relation to leases which had previously been classified as 'operating leases' in accordance with New Zealand Equivalent to International Accounting Standard 17 Leases (NZ IAS 17). These liabilities were measured at the present value of the remaining lease payments, discounted at the lessee's incremental borrowing rate as at 1 January 2019. The associated right of use (ROU) assets were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments or provisions for onerous leases recognised on balance sheet at 31 December 2018. In addition, the following practical expedients permitted by the standard were applied:

- Reliance was placed on previous assessments on whether leases were onerous;
- Operating leases with a remaining lease term of less than 12 months as at 1 January 2019 were treated as short-term leases; and
- Initial direct costs were not included in the measurement of ROU assets for leases previously accounted for as operating leases.

The differences between NZ IAS 17 and NZ IFRS 16 are summarised in the table below:

NZ IAS 17	NZ IFRS 16
Leases were classified as either finance or operating leases. Payments made under operating leases were charged to profit or loss on a straight-line basis over the period of the lease.	Leases are recognised as a ROU asset and a corresponding liability at the date at which the leased asset is made available for use. Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease term so as to produce a constant period rate of interest on the remaining balance of the liability. The ROU asset is depreciated over the shorter of the ROU asset's useful economic life and the lease term on a straight-line basis. In determining lease term, the Banking Group considers all facts and circumstances that create an economic incentive to exercise an extension option or not exercise a termination option over the planning horizon of five years. In general, it is not expected that the discount rate implicit in the lease is available so the lessee's incremental borrowing rate is used. This is the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of a similar value in a similar economic environment with similar terms and conditions. The rates are determined by adjusting swap rates with funding spreads and cross currency basis where appropriate.

The Banking Group adopted the requirements of NZ IFRS 16 using the modified retrospective approach, with the cumulative effect of initially applying the standard recognised as an adjustment to the opening balance of retained earnings at 1 January 2019. Comparatives were not restated. In relation to the operating lease that were under NZ IAS 17 'Leases', the adoption of the standard increased assets by $3.6 million reported under 'Property, plant and equipment' and increased financial liabilities by the same amount reported under 'Other liabilities' with no effect on net assets or retained earnings.

Future operating lease commitments of $21.6 million disclosed in the 31 December 2018 financial statements are not included in the ROU asset or lease liability on adoption of NZ IFRS 16 as this lease is not yet available for use.

Interest rate benchmark reform: Amendments to IFRS 9 and IAS 39 'Financial Instruments'

Amendments to NZ IFRS 9 and NZ IAS 39 issued in November 2019 modify specific hedge accounting requirements so that entities apply those hedge accounting requirements assuming that the interest rate benchmark on which the hedged cash flows and cash flows of the hedging instrument are based is not altered as a result of interest rate benchmark reform. These amendments apply from 1 January 2020 with early adoption permitted. The Banking Group has early adopted the amendments that apply to NZ IAS 39 from 1 January 2019.

The Banking Group does not enter into cash flow hedges and this change has had no material effect on the Banking Group's financial statements.

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

1. Statement of significant accounting policies *(continued)*

PRINCIPAL ACCOUNTING POLICIES AND CRITICAL ACCOUNTING JUDGEMENTS

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

The results of the Banking Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of the aggregated financial statements.

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

Interest income and expense

Interest income and expense for all financial instruments, excluding those classified as held for trading or designated at fair value are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method. Interest income on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Non-interest income and expenses

The Banking Group generates fee income from services provided at a fixed price over time, such as account services, or when delivering a specific transaction at a point in time such as broking services and import/export services. Fees are generated at a fixed price. Fee income is generally earned from short term contracts with payment terms that do not include a significant financing component.

The Banking Group acts as principal in the majority of contracts with customers, with the exception of broking services. For most brokerage trades the Banking Group acts as agent in the transaction and recognises broking income net of fees payable to other parties in the arrangement.

The Banking Group recognises fees earned on transaction-based arrangements at a point in time when it has fully provided the service to the customer. Where the contract requires services to be provided over time, income is recognised on a systematic basis over the life of the agreement. Where the Banking Group offers a package of services that contain multiple non-distinct performance obligations, such as those in account service packages, the promised services are treated as a single performance obligation.

Employee benefits

Short-term benefits

Short-term benefits for services received from employees are recognised as an expense during the accounting period in which employee service is rendered. Any difference between the expense recognised and cash payments made is recognised as a liability or prepayment as appropriate. The expense recognised should be undiscounted.

Defined contribution plans

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

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

1. Statement of significant accounting policies *(continued)*

Employee benefits *(continued)*

Share-based payments

The Banking Group enters into equity-settled share-based payment arrangements with its employees as compensation for services provided by employees. Equity-settled share-based payment arrangements entitle employees to receive equity instruments of HSBC Holdings plc. The cost of equity-settled share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted and recognised as an expense on a straight-line basis over the vesting period. The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately.

HSBC Holdings plc is the grantor of its equity instruments for all share awards across the Group and recharges the Banking Group the market value on vesting date. The Banking Group uses the share-based payment reserve to record the corresponding amount relating to shares granted to employees of the Banking Group and represents an effective capital contribution or payment.

Fair value is determined by using market prices or appropriate valuation models, taking into account the terms and conditions upon which the equity instruments were granted. Vesting conditions are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy service conditions.

Financial instruments measured at amortised cost

Financial assets that are held to collect the contractual cash flows and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest, such as most loans and advances, are initially measured at fair value and subsequently measured at amortised cost less allowances for credit losses. Most financial liabilities are initially measured at fair value and subsequently measured at amortised cost. The carrying value of these financial instruments at initial recognition includes any directly attributable transactions costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some leveraged finance and syndicated lending activities, the difference is deferred and recognised over the life of the loan through the recognition of interest income, unless the loan becomes impaired.

Financial assets measured at fair value through other comprehensive income ('FVOCI')

Financial assets held for a business model that is achieved by both collecting contractual cash flows and selling financial assets and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest are measured at FVOCI. These comprise the Banking Groups debt securities held for liquidity management purposes. They are recognised on the trade date when the Banking Group enters into contractual arrangements to purchase and are normally derecognised when they are either sold or redeemed. They are subsequently remeasured at fair value and changes therein (except for those relating to impairment, interest income and foreign currency exchange gains and losses) are recognised in other comprehensive income until the assets are sold. Upon disposal, the cumulative gains or losses in other comprehensive income are recognised in the profit or loss as 'Other net operating income'. Financial assets measured at FVOCI are included in the impairment calculations and impairment is recognised in the profit or loss.

Critical accounting judgement

Valuation of financial instruments

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

1. Statement of significant accounting policies *(continued)*

Financial assets measured at fair value through other comprehensive income ('FVOCI') (continued)

Critical accounting judgement *(continued)*

Valuation of financial instruments *(continued)*

which they would be willing to sell. Valuation techniques may incorporate assumptions about factors that other market participants would use in their valuations, including:

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

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

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

Equity securities measured at fair value with fair value movements presented in OCI

The equity securities for which fair value movements are shown in other comprehensive income ('OCI') are business facilitation and other similar investments where the Banking Group holds the investments other than to generate a capital return. Gains or losses on the derecognition of these equity securities are not transferred to profit or loss. Dividend income is recognised in profit or loss.

1. Statement of significant accounting policies *(continued)*

Derivative financial instruments

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, bonds, interest rates, foreign exchange, credit spreads, commodities and equity or other indices. Derivatives are recognised initially, and are subsequently remeasured, at fair value, with changes in fair value recorded in the income statement. Fair values of derivatives are obtained either from quoted market prices or by using valuation techniques. Gains and losses from changes in the fair value of derivatives, including the contractual interest, that do not qualify for hedge accounting are reported in 'Net trading income'.

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

Financial instruments – Right to offset

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

Impairment of amortised cost and FVOCI financial assets

Expected credit losses ('ECL') are recognised for advances to banks and customers, other financial assets held at amortised cost, debt instruments measured at fair value through other comprehensive income, and certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is required for ECL resulting from default events that are possible within the next 12 months (or less, where the remaining life is less than 12 months) ('12-month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment are considered to be in default or otherwise credit-impaired are in 'stage 3'. Purchased or originated credit-impaired financial assets (POCI) are treated differently as set out below.

Credit-impaired (stage 3)

The Banking Group determines that a financial instrument is credit-impaired and in stage 3 by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are past due for more than 90 days;
- there are other indications that the borrower is unlikely to pay such as that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; or
- the loan is otherwise considered to be in default.

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due, even where regulatory rules permit a longer period. Therefore the definitions of credit-impaired and default are aligned as far as possible so that stage 3 represents all loans which are considered defaulted or otherwise credit impaired. Interest income is recognised by applying the effective interest rate to the amortised cost amount, i.e. gross carrying amount less ECL allowance.

Write-off

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

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

1. Statement of significant accounting policies *(continued)*

Impairment of amortised cost and FVOCI financial assets *(continued)*

Renegotiation

Loans are identified as renegotiated and classified as credit-impaired when we modify the contractual payment terms due to significant credit distress of the borrower. Renegotiated loans remain classified as credit-impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows and retain the designation of renegotiated until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement is made on substantially different terms or if the terms of an existing agreement are modified such that the renegotiated loan is a substantially different financial instrument. Any new loans that arise following derecognition events in these circumstances are considered to be POCI and will continue to be disclosed as renegotiated loans.

Other than originated credit-impaired loans, all other modified loans could be transferred out of stage 3 if they no longer exhibit any evidence of being credit-impaired and, in the case of renegotiated loans, there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, over the minimum observation period, and there are no other indicators of impairment. These loans could be transferred to stage 1 or 2 based on the mechanism as described below by comparing the risk of a default occurring at the reporting date (based on the modified contractual terms) and the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms). Any amount written off as a result of the modification of contractual terms would not be reversed.

Loan modifications that are not credit-impaired

Loan modifications that are not identified as renegotiated are considered to be commercial restructuring. Where a commercial restructuring results in a modification (whether legalised through an amendment to the existing terms or the issuance of a new loan contract) such that the Banking Group's rights to the cash flows under the original contract have expired, the old loan is derecognised and the new loan is recognised at fair value. The rights to cash flows are generally considered to have expired if the commercial restructure is at market rates and no payment-related concession has been provided.

Significant increase in credit risk (stage 2)

An assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. The assessment explicitly or implicitly compares the risk of default occurring at the reporting date compared to that at initial recognition, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. The assessment is unbiased, probability-weighted, and to the extent relevant, uses forward-looking information consistent with that used in the measurement of ECL. The analysis of credit risk is multifactor. The determination of whether a specific factor is relevant and its weight compared with other factors depends on the type of product, the characteristics of the financial instrument and the borrower, and the geographical region. Therefore, it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk and these criteria will differ for different types of lending, particularly between retail and wholesale. However, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when past due. In addition, wholesale loans that are individually assessed, typically corporate and commercial customers, and included on a watch or worry list are included in stage 2.

For wholesale portfolios, the quantitative comparison assesses default risk using a lifetime probability of default which encompasses a wide range of information including the obligor's customer risk rating, macroeconomic condition forecasts and credit transition probabilities. Significant increase in credit risk is measured by comparing the average probability of default ('PD') for the remaining term estimated at origination with the equivalent estimation at reporting date (or where the origination PD has doubled in the case of origination credit risk rating ('CRR') is less than 'satisfactory'). The significance of changes in PD was informed by expert credit risk judgement, referenced to historical credit migrations and to relative changes in external market rates.

For loans originated prior to the implementation of NZ IFRS 9, the origination PD does not include adjustments to reflect expectations of future macroeconomic conditions since these are not available without the use of hindsight. In the absence of this data, origination PD must be approximated assuming through-the-cycle ('TTC') PDs and TTC migration probabilities, consistent with the instrument's underlying modelling approach and the CRR at origination.

1. Statement of significant accounting policies *(continued)*

Impairment of amortised cost and FVOCI financial assets *(continued)*

Significant increase in credit risk (stage 2) *(continued)*

For certain portfolios of debt securities where external market ratings are available and credit ratings are not used in credit risk management, the debt securities will be in stage 2 if their credit risk increases to the extent they are no longer considered investment grade. Investment grade is where the financial instrument has a low risk of incurring losses, the structure has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil their contractual cash flow obligations.

For retail portfolios, default risk is assessed using a reporting date 12-month PD derived from credit rating model which incorporate all available information about the customer. This PD is adjusted for the effect of macroeconomic forecasts for periods longer than 12 months and is considered to be a reasonable approximation of a lifetime PD measure. Retail exposures are first segmented into homogeneous portfolios, generally by product. Within each portfolio, the stage 2 accounts are defined as accounts where there has been any delinquency pre-90 days past due. The expert credit risk judgement is that no prior increase in credit risk is significant. This portfolio-specific threshold identifies loans with a PD higher than would be expected from loans that are performing as originally expected and higher than that which would have been acceptable at origination. It therefore approximates a comparison of origination to reporting date PDs.

Unimpaired and without significant increase in credit risk - (stage 1)

ECL resulting from default events that are possible within the next 12 months ('12-month ECL') are recognised for financial instruments that remain in stage 1.

Purchased or originated credit-impaired ('POCI')

Financial assets that are purchased or originated at a deep discount that reflects the incurred credit losses are considered to be POCI. This population includes the recognition of a new financial instrument following a renegotiation where concessions have been granted for economic or contractual reasons relating to the borrower's financial difficulty that otherwise would not have been considered. The amount of change-in-lifetime ECL is recognised in profit or loss until the POCI is derecognised, even if the lifetime ECL are less than the amount of ECL included in the estimated cash flows on initial recognition. The Banking Group does not have any POCI financial assets.

Movement between stages

Financial assets can be transferred between the different categories (other than POCI) depending on their relative increase in credit risk since initial recognition. Financial instruments are transferred out of stage 2 if their credit risk is no longer considered to be significantly increased since initial recognition based on the assessments described above. Except for renegotiated loans, financial instruments are transferred out of stage 3 when they no longer exhibit any evidence of credit impairment as described above. Renegotiated loans that are not POCI will continue to be in stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, observed over a minimum one-year period and there are no other indicators of impairment. For loans that are assessed for impairment on a portfolio basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

Measurement of ECL

The assessment of credit risk, and the estimation of ECL, are unbiased and probability-weighted, and incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money.

In general, the Banking Group calculates ECL using three main components, a probability of default ('PD'), a loss given default ('LGD') and the exposure at default ('EAD').

The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated using the lifetime PD instead. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument respectively.

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

1. Statement of significant accounting policies *(continued)*

Impairment of amortised cost and FVOCI financial assets *(continued)*

Measurement of ECL *(continued)*

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of committed facilities. The LGD represents expected losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realised and the time value of money.

The Banking Group leverages the Basel II IRB framework issued by the Basel Committee on Banking Supervision where possible, with recalibration to meet the differing NZ IFRS 9 requirements as follows:

Model	Basel II IRB framework	NZ IFRS 9
PD	• Through the cycle (represents long-run average PD throughout a full economic cycle) • The definition of default includes a backstop of 90+ days past due	• Point in time (based on current conditions, adjusted to take into account estimates of future conditions that will impact PD) • Default backstop of 90+ days past due for all portfolios
EAD	• Cannot be lower than current balance	• Amortisation captured for term products
LGD	• Downturn LGD (consistent losses expected to be suffered during a severe but plausible economic downturn) • Regulatory floors may apply to mitigate risk of underestimating downturn LGD due to lack of historical data • Discounted using cost of capital • All collection costs included	• Expected LGD (based on estimate of loss given default including the expected impact of future economic conditions such as changes in value of collateral) • No floors • Discounted using the original effective interest rate of the loan • Only costs associated with obtaining/selling collateral included
Other		• Discounted back from point of default to balance sheet date

While 12-month PDs are recalibrated from Basel models where possible, the lifetime PDs are determined by projecting the 12-month PD using a term structure. For the wholesale methodology, the lifetime PD also takes into account credit migration, i.e. a customer migrating through the CRR bands over its life.

The ECL for wholesale stage 3 is determined on an individual basis using a discounted cash flow methodology. The expected future cash flows are based on the credit risk officer's estimates as at the reporting date, reflecting reasonable and supportable assumptions and projections of future recoveries and expected future receipts of interest. Collateral is taken into account if it is likely that the recovery of the outstanding amount will include realisation of collateral based on its estimated fair value of collateral at the time of expected realisation, less costs for obtaining and selling the collateral. The cash flows are discounted at a reasonable approximation of the original effective interest rate. For significant cases, cash flows under three different scenarios are probability-weighted by reference to the three economic scenarios applied more generally and the judgement of the credit risk officer in relation to the likelihood of the workout strategy succeeding or receivership being required. For less significant cases, the effect of different economic scenarios and work-out strategies is approximated and applied as an adjustment to the most likely outcome.

Period over which ECL is measured

Expected credit loss is measured from the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the Banking Group is exposed to credit risk. For wholesale overdrafts, credit risk management actions are taken no less frequently than on an annual basis and therefore this period is to the expected date of the next substantive credit review. The date of the substantive credit review also represents the initial recognition of the new facility. However, where the financial instrument includes both a drawn and undrawn commitment and the contractual ability to demand repayment and cancel the undrawn commitment does not serve to limit the Banking Group's exposure to credit risk to the contractual notice period, the contractual period does not determine the maximum period considered. Instead, ECL is measured over the period the Banking Group remains exposed to credit risk that is not mitigated by credit risk management actions. This applies to retail overdrafts where the period is the average time taken for stage 2 exposures to default or close as performing accounts, determined on a portfolio basis and ranging from between two and six years. In addition, for these facilities it is not possible to identify the ECL on the loan commitment component separately from the financial asset component. As a result, the total ECL is recognised in the loss allowance for the financial asset unless the total ECL exceeds the gross carrying amount of the financial asset, in which case the ECL is recognised within other liabilities.

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

1. Statement of significant accounting policies *(continued)*

Impairment of amortised cost and FVOCI financial assets *(continued)*

Forward-looking economic inputs

The Banking Group will in general apply multiple forward-looking global economic scenarios determined by Group with reference to external forecast distributors representative of our view of forecast economic conditions. This approach is considered sufficient to calculate unbiased expected loss in most economic environments. They represent a 'most likely outcome' (the Central scenario) and two, less likely, 'Outer' scenarios on either side of the Central, referred to as an Upside and a Downside scenario respectively. The Central scenario is used by the annual operating planning process and, with regulatory modifications, will also be used in enterprise-wide stress tests. The Upside and Downside are constructed following a standard process supported by a scenario narrative reflecting the Group's current top and emerging risks. The relationship between the Outer scenarios and Central scenario will generally be fixed with the Central scenario being assigned a weighting of 80% and the Upside and Downside scenarios 10% each, with the difference between the Central and Outer scenarios in terms of economic severity being informed by the spread of external forecast distributions among professional industry forecasts. The Outer scenarios are economically plausible, internally consistent states of the world and will not necessarily be as severe as scenarios used in stress testing. The period of forecast is five years, after which the forecasts will revert to a view based on average past experience. The central forecast and spread between the Central and Outer scenarios is grounded on expected gross domestic product. The economic factors include, but are not limited to, gross domestic product, consumption, exports and house prices.

In general, the consequences of the assessment of credit risk and the resulting ECL outputs will be probability-weighted using the standard probability weights. This probability weighting may be applied directly or the effect of the probability weighting determined on a periodic basis, at least annually, and then applied as an adjustment to the outcomes resulting from the central economic forecast. The central economic forecast is updated quarterly.

The Banking Group recognises that the Consensus Economic Scenario approach using three scenarios will be insufficient in certain economic environments. Additional analysis may be requested at management's discretion, including the production of extra scenarios. If conditions warrant, this could result in a management overlay for economic uncertainty which is included in the ECL estimates.

Critical accounting judgements

Impairment of amortised cost and FVOCI financial assets

The application of NZ IFRS 9 creates critical accounting estimates and judgements related to impairment of financial assets. In determining expected credit loss ("ECL"), management is required to exercise judgement in defining what is considered to be a significant increase in credit risk and in making assumptions and estimates to incorporate relevant information about past events, current conditions and forecasts of economic conditions.

Judgement has been applied in determining the lifetime and point of initial recognition of revolving facilities. The PD, LGD and EAD models which support these determinations are reviewed regularly in light of differences between loss estimates and actual loss experience, but given that NZ IFRS 9 requirements adopted in 2018, there have been limited opportunities to make these comparisons. Therefore, the underlying models and their calibration, including how they react to forward-looking economic conditions remain subject to review and refinement.

Measurement uncertainty and sensitivity of ECL estimates

Expected credit loss impairment allowances recognised in the financial statements reflect the effect of a range of possible economic outcomes, calculated on a probability-weighted basis, based on the economic scenarios described below. The recognition and measurement of ECL involves the use of significant judgement and estimation. It is necessary to formulate multiple forward-looking economic forecasts and incorporate them into the ECL estimates. The Banking Group uses the Group's standard framework to form economic scenarios to reflect assumptions about future economic conditions, supplemented with the use of management judgement, which may result in using alternative or additional economic scenarios and/or management adjustments.

Methodology
The Banking Group has adopted the use of multiple scenarios, representative of our view of forecast economic conditions, sufficient to calculate unbiased expected loss in most economic environments.

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

1. Statement of significant accounting policies *(continued)*

Impairment of amortised cost and FVOCI financial assets *(continued)*

Critical accounting judgements *(continued)*

Measurement uncertainty and sensitivity of ECL estimates *(continued)*

The Banking Group relies on an average of external forecasts and their distributions to create three scenarios that represent a 'most likely outcome', the Central scenario, and two less likely outcomes, referred to as the Upside and Downside scenarios. Each outer scenario is consistent with a probability of 10%, while the Central scenario is assigned the remaining 80%, according to the decision of the Banking Group's Impairment Committee. This weighting scheme is deemed appropriate for the unbiased estimation of ECL in most circumstances. These three scenarios are referred to as the 'consensus economic scenarios'. Additional scenarios would be used to specifically address the forward looking risks that management consider are not adequately captured by the consensus.

Economic assumptions in the Central consensus economic scenario are set using consensus forecasts which represent the average of forecasts of external economists. Reliance on external forecasts helps ensure that the Central scenario is unbiased and maximises the use of independent information. The Upside and Downside scenarios are selected with reference to externally available forecast distributions and are designed to be cyclical. The Upside and Downside scenarios are generated once a year, reviewed at each reporting date to ensure that they are an appropriate reflection of managements view and updated if economic conditions change significantly. The Central scenario is generated every quarter.

Description of economic scenarios
The following table describes key macroeconomic variables and the probabilities assigned in the scenarios:

Average 5yr forecast 2020-2024	**Central**	**Upside**	**Downside**
GDP growth %[1]	2.6	3.3	1.9
Private consumption growth %	2.3	3.0	1.6
House price growth %	2.4	3.7	1.1
Exports of goods and services growth %	3.7	4.3	2.9
Probability weight %	80	10	10

[1] Comparative central GDP growth rate for the 2019 -2023 period was 2.7%.

Economic scenarios sensitivity analysis of ECL estimates
The ECL outcome is sensitive to judgement and estimations made with regards to the formulation and incorporation of multiple forward-looking economic conditions described above. As a result, management assessed and considered the sensitivity of the ECL outcome against the forward-looking economic conditions as part of the ECL governance process by recalculating the ECL under each scenario described above for selected portfolios, applying a 100% weighting to each scenario in turn. The weighting is reflected in both the determination of significant increase in credit risk as well as the measurement of the resulting ECL.

The impact on ECL of exposures moving from stage 1 (12-month provisioning) to a lifetime provisioning stage (and vice versa) as well as changes in ECL for existing stages 1 and 2 loans as a result of changes in forecasts of future economic conditions is captured in sensitivity analysis by recalculating the ECL for stages 1 and 2, reflecting changes in the population of loans in each stage, and their PD and the LGD factors. Stage 3 ECL would only be sensitive to changes in forecasts of future economic conditions if the LGD of the particular portfolio were sensitive to such changes.

The economic scenarios are generated to capture HSBC's view of a range of possible forecast economic conditions that is sufficient for the calculation of unbiased and probability-weighted ECL. Therefore, the ECL calculated for each of the scenarios represent a range of possible outcomes that have been evaluated to estimate ECL. As a result, the ECL calculated for the Upside and Downside scenarios should not be taken to represent the upper and lower limits of possible actual ECL outcomes.

Sensitivity: Total ECL ($000)	**Central**	**Upside**	**Downside**	**Reported**
31 December 2019	4,862	4,287	5,852	4,904
31 December 2018	7,322	6,542	8,578	7,370

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

1. Statement of significant accounting policies *(continued)*

Property, plant and equipment

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

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

Foreign currencies

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the balance sheet date. Any resulting exchange differences are included in the 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. Any foreign exchange component of a gain or loss on a non-monetary item is recognised either in other comprehensive income or in the profit or loss depending on where the gain or loss on the underlying non-monetary item is recognised.

Intangible assets

Goodwill

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

Goodwill is stated at cost less any accumulated impairment losses.

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

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

1. Statement of significant accounting policies *(continued)*

Intangible assets *(continued)*

Goodwill (continued)

Critical accounting judgement

Goodwill impairment

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

- the future cash flows of the CGUs are sensitive to the cash flows projected for the periods for which detailed forecasts are available and to assumptions regarding the long-term pattern of sustainable cash flows thereafter. Forecasts are compared with actual performance and verifiable economic data, but they reflect management's view of future business prospects at the time of the assessment; and

- the rates used to discount future expected cash flows can have a significant effect on their valuation and are based on the costs of capital assigned to individual CGUs. These variables are subject to fluctuations in external market rates and economic conditions beyond management's control, are subject to uncertainty and require the exercise of significant judgement.

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

Other intangible assets

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

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

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

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

Provisions, contingent liabilities and guarantees

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

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security and contingent liabilities related to legal proceedings or regulatory matters are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received or the present value of the fee receivable.

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

1. Statement of significant accounting policies *(continued)*

Statement of cash flows

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

Cash and cash equivalents reflect the balance of cash and liquid assets used in the day-to-day cash management of the Banking Group, which are unconditionally convertible into cash within no more than two working days. For the purpose of the statement of cash flows, 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 the income statement except to the extent that it relates to items recognised in other comprehensive income or equity, in which case it is recognised in the same statement as the related item appears.

Current tax is the tax expected to be payable on the taxable profit for the year and on any adjustment to tax payable in respect of previous years. The group provides for potential current tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet, and the amounts attributed to such assets and liabilities for tax purposes. 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.

Current and deferred tax are calculated based on tax rates and laws enacted, or substantively enacted, by the balance sheet date.

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.

2. Risk management

RISK APPETITE

We have maintained a conservative approach to risk throughout our history. This is central to our business and strategy. We recognise that the primary role of risk management is to protect our customers, colleagues, shareholders and the communities that we serve while enabling sustainable growth.

We have long recognised the importance of a strong risk culture, which refers to our shared attitudes, values and norms that shape behaviours related to risk awareness, risk taking and risk management. All employees are responsible for the management of risk, with the ultimate accountability residing with the Board.

RISK MANAGEMENT POLICIES

We use an enterprise-wide risk management framework across the organisation and across all risk types, underpinned by our risk culture. This outlines the key principles, policies and practices that we employ in managing material risks, both financial and non-financial.

The framework fosters continuous monitoring, promotes risk awareness and encourages sound operational and strategic decision making. It also ensures a consistent approach to identifying, assessing, managing and reporting the risks we accept and incur in our activities.

Our risk culture
Our risk culture is reinforced by our values. It is instrumental in aligning the behaviours of individuals with our attitude to assuming and managing risk, which helps to ensure that our risk profile remains in line with our risk appetite. The fostering of a strong risk culture is a key responsibility of our senior executives.

We use clear and consistent employee communications on risk to convey strategic messages and set the tone from senior management and the Board. We also deploy mandatory training on risk and compliance topics to embed skills and understanding in order to strengthen our risk culture and reinforce the attitude to risk in the behaviour expected of employees, as described in our risk policies.

Our responsibilities
All our people are responsible for identifying and managing risk within the scope of their role as part of the three lines of defence model.

To create a robust control environment to manage risks, we use an activity-based three lines of defence model. This model delineates management accountabilities and responsibilities for risk management and the control environment.

The model underpins our approach to risk management by clarifying responsibility and encouraging collaboration, as well as enabling efficient coordination of risk and control activities. The three lines of defence are summarised below:

- The first line of defence owns the risks and is responsible for identifying, recording, reporting and managing them in line with risk appetite, and ensuring that the right controls and assessments are in place to mitigate them.
- The second line of defence sets the policy and control standards for managing specific risk areas, provides advice and guidance in relation to the risk, and challenges the first line of defence on effective risk management.
- The third line of defence is the Group's Internal Audit function, which provides independent assurance that our risk management approach and processes are designed and operating effectively.

CREDIT RISK

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

2. Risk management *(continued)*

Credit risk *(continued)*

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

Credit approval authorities are delegated by the Group Board to the Group Chief Executive together with the authority to sub-delegate them.

The Credit Risk sub-function in Global Risk is responsible for the key policies and processes for managing credit risk, which include formulating Group credit policies and risk rating frameworks, guiding the Group's appetite for credit risk exposures, undertaking independent reviews and objective assessment of credit risk, and monitoring performance and management of portfolios.

The principal objectives of our credit risk management are:

- to maintain across the HSBC Group a strong culture of responsible lending, and robust risk policies and control frameworks;
- to both partner and challenge our businesses in defining implementing and continually re-evaluating our risk appetite under actual and scenario conditions; and
- to ensure there is independent, expert scrutiny of credit risks, their costs and their mitigation.

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

Key risk management processes

Expected credit loss provisioning process

The expected credit loss ('ECL') provisioning process comprises three main areas: modelling and data, implementation; and governance.

Modelling and data
The Group has established modelling and data processes which are subject to internal model risk governance including independent review of significant model developments.

Implementation
The Group's centralised impairment engine performs the expected credit loss calculation using data, which is subject to a number of validation checks and enhancements, from a variety of client, finance and risk systems. Where possible, these checks and processes are performed in a globally consistent and centralised manner.

Governance
The Banking Group has established a forum with representatives from Credit Risk, and Finance in order to review and approve the impairment results.

Credit concentration

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or such counterparties are engaged in similar activities or operate in the same geographical areas or industry sectors so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. The Group's credit risk limits to counterparties in the financial and sovereign sectors are managed centrally to optimise the use of credit availability and to avoid excessive risk concentration. The Banking Group remains responsible for its own credit exposures. We use a number of controls and measures to minimise undue concentration of exposures in our portfolios across industries, countries and products, including portfolio and counterparty limit approval and review controls and stress testing at a Group level.

2. Risk management *(continued)*

Credit risk *(continued)*

Credit quality

Our risk rating system facilitates the internal ratings-based approach under the Basel framework adopted by the Group. The five credit quality classifications each encompass a range of granular internal credit rating grades assigned to wholesale and retail lending businesses, and the external ratings attributed by external agencies to debt securities.

Wholesale Lending

Wholesale lending use a customer risk rating ('CRR') 10-grade scale summarising a more granular 23-grade scale of obligor probability of default ('PD'). All corporate customers are rated using the 10-grade or 23-grade scale, depending on the degree of sophistication of the Basel approach adopted for the exposure.

Each CRR band is associated with an external rating grade by reference to long-run default rates for that grade, represented by the average of issuer-weighted historical default rates. This mapping between internal and external ratings is indicative and may vary over time.

Retail Lending

Retail lending credit quality is based on a 12-month point-in-time ('PIT') probability-weighted probability of default ('PD').

Right to offset

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

MARKET RISK

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

The Banking Group monitors market risk separately for trading portfolios and non-trading portfolios and use similar management policies and measurement techniques. Our objective is to manage and control market risk exposures while maintaining a market profile consistent with our risk appetite. The Banking Group does not have significant traded risk exposure.

Market risk is managed and controlled through limits approved by the Banking Group's Risk Management Meeting ('RMM"). These limits are allocated across business lines principally Global Markets. The Banking Group risk limits are determined for each portfolio and 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.

The Banking Group is required to assess the market risks which arise on each product in its business and to transfer these risks to either its local Global Markets unit for management, or to separate books managed under the supervision of ALCO. The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to manage such risks professionally.

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.

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

2. Risk management *(continued)*

Value at Risk ("VAR")

Value at risk ('VaR') is a technique for estimating potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. The use of VaR is integrated into market risk management and calculated for all trading positions regardless of how we capitalise them.

In addition, we calculate VaR for non-trading portfolios to have a complete picture of risk. Where we do not calculate VaR explicitly, we use alternative tools as summarised in the 'Stress testing' section below.

Our models are predominantly based on historical simulation that incorporates the following features:

- historical market rates and prices, which are calculated with reference to foreign exchange rates, commodity prices, interest rates, equity prices and the associated volatilities;
- potential market movements utilised for VaR, which are calculated with reference to data from the past two years; and
- VaR measures, which are calculated to a 99% confidence level and use a one-day holding period.

The models also incorporate the effect of option features on the underlying exposures. The nature of the VaR models means that an increase in observed market volatility will lead to an increase in VaR without any changes in the underlying positions.

VaR model limitations

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

- Use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those that are extreme in nature.
- The use of a one-day holding period for risk management purposes of trading and non-trading books assumes that this short period is sufficient to hedge or liquidate all positions.
- The use of a 99% confidence level does not take into account losses that might occur beyond this level of confidence.
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

Stress testing

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

The Group carries out stress testing at a regional level in HBAP and at a global level in Group using data from internal systems, with relevant results provided to the management of the Banking Group. A standard set of scenarios is utilised consistently across all sites within the Group.

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

2. Risk management *(continued)*

Market risk *(continued)*

Currency risk

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

Foreign currency risk exposure is disclosed in Note 27. A sensitivity analysis is not presented as the sensitivity range is immaterial due to the Banking Group FX exposure being materially hedged.

Interest rate risk

Interest rate risk in the banking book is the risk of an adverse impact to earnings or capital due to changes in market interest rates. It is generated by our non-traded assets and liabilities, specifically loans, deposits and financial instruments that are not held for trading intent or that are held in order to hedge positions held with trading intent.

This risk is monitored and controlled by the Asset Liability Capital Management (“ALCM”) function. This includes reviewing and challenging the business prior to the release of new products and in respect of proposed behavioural assumptions used for hedging activities. The ALCM function is also responsible for maintaining and updating the transfer pricing framework, informing the ALCO of the Group’s overall banking book interest rate risk exposure and managing the balance sheet in conjunction with Balance Sheet Management (“BSM”). Interest rate risk in the banking book is transferred to and managed by BSM, and also monitored by Wholesale Market Risk, Product Control and ALCM functions with reference to established risk.

BSM manages the banking book interest rate positions transferred to it within the market risk limits approved by RMM. Risk acts as a second line of defence. The global businesses can only transfer non-trading assets and liabilities to BSM provided BSM can economically hedge the risk it receives.

Any interest rate risk that BSM cannot economically hedge is not transferred and will remain within the global business where the risks originate.

Within the Group a number of measures are used to monitor and control interest rate risk in the banking book, including non-traded VaR, net interest income sensitivity and economic value of equity (‘EVE’). An interest rate sensitivity analysis is not presented as the sensitivity range is immaterial to the Banking Group.

2. Risk management *(continued)*

LIQUIDITY AND FUNDING RISK

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

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

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

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

Policies and procedures

Management of liquidity and funding is primarily undertaken locally in HBAP's operating entities in compliance with the Group's liquidity and funding risk framework ('LFRF') and with practices and limits set by the Group Management Board through the Group Risk Management Meeting and approved by the Group Board. These limits vary according to the depth and liquidity of the market in which the entities operate. It is HBAP's general policy that each banking entity should be self-sufficient when funding its own operations.

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

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

- projecting cash flows under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet liquidity and funding ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- managing the concentration and profile of term funding;
- 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.

2. Risk Management *(continued)*

Liquidity and funding risk *(continued)*

Liquidity and funding risk management framework

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

- stand-alone management of liquidity and funding by operating entity;
- minimum LCR requirement for each operating entity;
- minimum NSFR requirement for each operating entity;
- legal entity depositor concentration limit;
- three-month and 12-month cumulative rolling term contractual maturity limits covering deposits from banks, deposits from non-bank financial institutions and securities issued;
- annual internal liquidity adequacy assessment process ("ILAAP") by principal operating entity;
- minimum LCR requirement by currency;
- intra-day liquidity;
- liquidity funds transfer pricing; and
- forward-looking funding assessments.

Liquidity coverage ratio

(Unaudited)

The LCR aims to ensure that a bank has sufficient unencumbered high-quality liquid assets ('HQLA') to meet its liquidity needs in a 30-calendar-day liquidity stress scenario. HQLA consist of cash or assets that can be converted into cash at little or no loss of value in markets.

As at 31 December 2019, the Banking Group was within the risk tolerance level in accordance with the Group's LFRF.

Net stable funding ratio

(Unaudited)

We are required to maintain sufficient stable funding. The Net Stable Funding Ratio ('NSFR') measures stable funding relative to required stable funding, and reflects a bank's long-term funding profile (funding with a term of more than a year). It is designed to complement the LCR.

As at 31 December 2019, the Banking Group was within the risk tolerance level established in accordance with the Group's LFRF.

Depositor concentration and term funding maturity concentration

(Unaudited)

The LCR and NSFR metrics assume a stressed outflow based on a portfolio of depositors within each deposit segment.

The validity of these assumptions is challenged if the underlying depositors do not represent a large enough portfolio so that a depositor concentration exists. Deposit concentration is measured and monitored at a legal entity basis.

Operating entities are also exposed to term re-financing concentration risk if the current maturity profile results in future maturities being overly concentrated in any defined period.

As at 31 December 2019, the Banking Group was within the risk tolerance levels established in accordance with the Group's LFRF.

2. Risk management *(continued)*

RESILIENCE RISK

Resilience risk is the risk that we are unable to provide critical services to our customers, affiliates and counterparties, as a result of sustained and significant operational disruption. Resilience risk arises from failures or inadequacies in processes, people, systems or external events. These may be driven by rapid technological innovation, changing behaviours of our consumers, cyber-threats, cross-border dependencies and third-party relationships.

Resilience risk provides guidance and stewardship to our businesses and global functions about how we can prevent, adapt, and learn from resilience-related threats when something goes wrong. We view resilience through six lenses: strategic change and emerging threats; third-party risk; information and data resilience; payments and processing resilience; systems and cyber resilience; and protective security risk.

Key risk management processes

Operational resilience is our ability to adapt operations to continue functioning when an operational disturbance occurs. We measure resilience in terms of the maximum disruption period or their impact tolerance that we are willing to accept for a business service. Resilience risk cannot be managed down to zero, so we concentrate on critical business and strategic change programmes that have the highest potential to threaten our ability to provide continued service to our customers. Our resilience strategy is focused on the establishment of robust back-up plans, detailed response methods, alternative delivery channels and recovery options.

Review of Banking Group's Risk Management systems

No formal reviews of the Banking Group's risk management systems were undertaken by external parties during the year ended 31 December 2019.

2. Risk management *(continued)*

REGULATORY COMPLIANCE RISK

Regulatory compliance risk is the risk that we fail to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice, and incur fines and penalties and suffer damage to our business as a consequence.

Regulatory compliance risk arises from the risks associated with breaching our duty to our customers and other counterparties, inappropriate market conduct and breaching other regulatory requirements.

Regulatory compliance risk management

Key developments in 2019
There were no material changes to the policies and practices for the management of regulatory compliance risk in 2019, except for the initiatives that we undertook to raise our standards in relation to the conduct of our business, as described below under 'Conduct of business'.

Governance and structure
The Regulatory Compliance sub-function provides independent, objective oversight and challenge, and promotes a compliance orientated culture that supports the business in delivering fair outcomes for customers, maintaining the integrity of financial markets and achieving our strategic objectives.

Regulatory Compliance is part of the Compliance function, which is headed by the Group Chief Compliance Officer. Regulatory Compliance is structured as a global function with regional and country Regulatory Compliance teams, which support and advise each global business and global function.

Key risk management processes
Global policies and procedures require the prompt identification and escalation of any actual or potential regulatory breach to Regulatory Compliance. Reportable events are escalated to the RMM.

Conduct of business
In 2019, we continued to promote and encourage good conduct through our people's behaviour and decision making in order to deliver fair outcomes for our customers, and to maintain financial market integrity. During 2019:

- We submitted the Banking Groups action plan to the Financial Markets Authority ('FMA') and the Reserve Bank of New Zealand ('RBNZ') that will enable us to address the recommendations made by the regulators following their review of conduct and culture in the banking industry in New Zealand in 2018. Work on the action plan will continue through 2020 and 2021, with formal updates to be submitted to FMA and RBNZ in Q2 and Q3 2020.
- Globally, the Group further defined roles and responsibilities for our people as part of the enterprise risk management framework across the Group to consider the customer in decision making and action.
- We delivered the Group's fifth annual global mandatory training course on conduct, and reinforced the importance of conduct by highlighting examples of good conduct.

FINANCIAL CRIME AND FRAUD RISK

Financial crime and fraud risk is the risk that we knowingly or unknowingly help parties to commit or to further potentially illegal activity through the Group.

Financial crime and fraud risk is:

- measured by reference to identified metrics, incident assessments, regulatory feedback and the judgement and assessment of our financial crime risk teams.
- monitored against our financial crime risk metrics, the results of the monitoring and control activities of the second line of defence functions, and the results of internal and external audits and regulatory inspections.
- managed by establishing and communicating appropriate policies and procedures, training employees in them, and monitoring activity to help ensure their observance. Proactive risk control and/or remediation work is undertaken where required.

Financial crime and fraud risk is governed through the Financial Crime Risk Management Committee, which is chaired by the CEO. The Committee helps to enable compliance with the letter and the spirit of all applicable financial crime compliance laws and regulations, as well as our own standards, values and policies relating to financial crime risks.

2. Risk management *(continued)*

Financial crime and fraud risk *(continued)*

Key risk management processes

We continued to deliver an anti-bribery and corruption transformation programme to further enhance the policies and controls around identifying and managing the risks of bribery and corruption across our business. Our transformation programme continued to focus on our anti-fraud and anti-tax evasion capabilities. Further enhancements have been made to our governance and policy frameworks, and to our management information reporting on standardised financial crime controls. We are investing in the next generation of capabilities to fight financial crime by applying advanced analytics and Artificial Intelligence. We remain committed to enhancing our risk assessment capabilities, and aim to deliver more proactive risk management and improve the customer experience.

INTERNAL AUDIT

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

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

Though some audit cycles are predetermined by regulatory or similar stipulations, in general, audits throughout the Group are carried out on a frequency determined primarily by the risk grading allocated to the business unit at the time of the previous audit, with units considered to represent greater risks being audited at more frequent intervals. There are no regulatory stipulations governing the internal audit cycles of the Banking Group.

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

The most recent publicly available disclosures on risk management processes and capital adequacy requirements of HBAP Group and HSBC Holdings plc (“Group”) can be found at HSBC Holdings plc’s website, www.hsbc.com.

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

	Banking Group	
Dollars in Thousands	**12 months 31.12.19**	12 months 31.12.18
3. Operating income		
(a) Net interest income		
Interest income		
Advances to banks	**8,927**	12,685
Financial instruments[1]	**9,633**	8,809
Advances to customers	**143,102**	155,336
Related parties – HBAP	**14,458**	11,453
Related parties – other	**360**	225
Other	**4**	311
	176,484	188,819
Interest expense		
Deposits by banks	**(1,936)**	(3,148)
Customer deposits	**(45,810)**	(44,289)
Debt securities	**(17,261)**	(14,908)
Related parties – HBAP	**(31,623)**	(41,508)
Related parties – other	**(179)**	(77)
Lease liability	**(70)**	-
Other	**(5)**	(168)
	(96,884)	(104,098)
(b) Net trading income[2]		
Foreign exchange gains /(losses)	**9,139**	11,112
(Losses) /gains on revaluation of derivatives	**(434)**	(21)
Credit valuation adjustments on derivatives	**68**	8
Debit valuation adjustments on derivatives	**(7)**	13
(Loss) /gain on hedging instrument in fair value hedge	**322**	(4)
(Loss) /gain on hedged item in fair value hedge	**(356)**	(23)
	8,732	11,085
(c) Other net operating income		
Fee and commission income		
Lending and credit facility fees	**17,832**	20,659
Custody and clearing fees	**5,865**	6,239
Other fees and commissions from:		
– Third parties	**10,114**	10,934
– Related parties - HBAP	**4,110**	84
– Related parties - other	**2,037**	2,861
	39,958	40,777
Fee and commission expense		
Brokerage expense	**(2,466)**	(2,389)
Other fees and commissions to:		
– Third parties	**(362)**	(152)
– Related parties - HBAP	**(587)**	(471)
– Related parties - other	**(200)**	(356)
	(3,615)	(3,368)
Other income		
Related parties - other	**507**	496
	36,850	37,905

1 Interest income from Financial Instruments consists solely of financial assets measured at fair value through other comprehensive income.

2 Trading income consists solely of income and expenses derived from assets and liabilities held at fair value through profit or loss.

All other items of income and expense are derived solely from financial assets and liabilities measured at amortised cost.

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

	Banking Group	
Dollars in Thousands	**12 months 31.12.19**	12 months 31.12.18
4. Operating expenses		
Rental expense		
Premises[1]	**-**	1,826
Equipment	**104**	106
	104	1,932
Depreciation and amortisation		
Right of use assets[1]	**1,607**	-
Leasehold improvements	**213**	174
Equipment, fixtures and fittings	**425**	349
Intangibles	**362**	560
	2,607	1,083
Staff costs		
Salaries & other staff expenses	**31,926**	29,970
Defined contribution pension costs	**2,219**	2,000
Share based payments	**334**	267
Other	**1,466**	1,075
	35,945	33,312
Other		
Related party management and technical fees – HBAP	**18,400**	15,444
Related party management and technical fees – other	**5,812**	4,090
Donations	**92**	97
Other operating expenses	**8,712**	10,043
	33,016	29,674
	71,672	66,001

[1] The impact on right of use asset has been recognised from 1 January 2019 following the adoption of NZ IFRS 16. Comparatives have not been restated.

5. Auditor's remuneration

	12 months 31.12.19	12 months 31.12.18
Total fees paid to principal auditor by the Banking Group		
Audit and review of financial statements	**589**	559
Taxation compliance services	**10**	15
Employee immigration services	**-**	8
Total fees paid to principal auditor	**599**	582

The amounts in the table above are presented exclusive of goods and services tax ('GST')

In addition to the above, taxation compliance fees of $6 thousand were paid to the principal auditor by HBAP (2018: $6 thousand).

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

Dollars in Thousands	**31.12.19**	31.12.18
	Banking Group	
6. Advances to customers		
Overdrafts	**40,253**	65,328
Residential mortgages	**2,019,910**	1,769,794
Term lending	**2,518,903**	2,160,208
Trade finance receivables	**81,578**	133,362
Total gross advances to customers	**4,660,644**	4,128,692
Expected credit loss allowance	**(3,640)**	(4,480)
Total net advances to customers	**4,657,004**	4,124,212

7. Additional mortgage information

Residential mortgages by loan-to-value ratio (LVR)

Dollars in Thousands	***Banking Group***			
	Principal Amount			
LVR Range	**Does not exceed 80%**	**Exceeds 80% and not 90%**	**Exceeds 90%**	**Total**
31 December 2019 (Unaudited)				
Value of exposures on balance sheet	**1,974,941**	**43,454**	**1,515**	**2,019,910**
Value of exposures off balance sheet	**216,559**	**793**	**-**	**217,352**
Total value of exposures	**2,191,500**	**44,247**	**1,515**	**2,237,262**

If the LVR of a residential mortgage is unknown, the residential mortgage is classified as “exceeds 90%”.

Dollars in Thousands	**31.12.19**	31.12.18
	Banking Group	
8. Asset quality – gross exposure		
Gross exposure of past due but not individually impaired advances to customers		
Less than 30 days	**24,636**	39,707
At least 30 days but less than 60 days	**498**	611
At least 60 days but less than 90 days	**1**	15
At least 90 days	**92**	-
Total past due but not individually impaired	**25,227**	40,333

Percentage of total gross Advances to customers	***Banking Group***			
	31.12.19		31.12.18	
	Stage 1 & 2	**Stage 3**	Stage 1 & 2	Stage 3
Fully collateralised	**54%**	**83%**	55%	48%
Partially collateralised	**4%**	**17%**	2%	52%
Not collateralised	**42%**	**-**	43%	-

The collateral measured in the above tables consists of fixed first charges on real estate, and charges over cash and marketable financial instruments. The values in the tables represent the expected market value on an open market basis. No adjustment has been made to the collateral for any expected costs of recovery. Marketable securities are measured at their fair value.

Other types of collateral such as unsupported guarantees and floating charges over the assets of a customer’s business are not measured in the above tables. While such mitigants have value, often providing rights in insolvency, their assignable value is not sufficiently certain and they are therefore assigned no value for disclosure purposes.

Collateral is generally not held over advances to banks, or over amounts due from related parties.

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

8. Asset quality – gross exposure *(continued)*

The following disclosure provides a reconciliation by stage of the Banking Group's gross exposure/nominal amount and allowances for loans and advances to banks and customers, including loan commitments and financial guarantees. Movements are calculated on a quarterly basis and therefore fully capture stage movements between quarters. If movements were calculated on a year-to-date basis they would only reflect the opening and closing position of the financial instrument.

The transfers of financial instruments represents the impact of stage transfers upon the gross carrying/nominal amount and associated allowance for ECL.

Changes in 'New financial assets originated or purchased', 'assets derecognised (including final repayments)' and 'net further lending/repayment' represent the impact from volume movements within the Banking Group's lending portfolio.

Wholesale – Gross exposures / nominal amount of advances to banks and customers, including loan commitments and financial guarantees by expected credit loss allowance stage

	12 months ended 31 December 2019			
Dollars in Thousands	**Stage 1**	**Stage 2**	**Stage 3[1]**	**Total**
Total wholesale exposures				
As at 1 January 2019	**3,922,465**	**155,024**	**2,920**	**4,080,409**
Transfer of financial instruments:				
Transfer from Stage 1 to 2	**(517,621)**	**517,621**	**-**	**-**
Transfer from Stage 2 to 1	**510,536**	**(510,536)**	**-**	**-**
Transfer to Stage 3	**-**	**-**	**-**	**-**
Transfer from Stage 3	**-**	**-**	**-**	**-**
Net further lending/repayment	**279,999**	**50,681**	**(191)**	**330,489**
Asset derecognised (including final repayments)	**(1,047,354)**	**(128,935)**	**-**	**(1,176,289)**
New financial assets originated or purchased	**1,324,279**	**-**	**-**	**1,324,279**
As at 31 December 2019 – Total wholesale credit exposure	**4,472,304**	**83,855**	**2,729**	**4,558,888**

Retail – Gross exposures / nominal amount of advances to customers, including loan commitments and financial guarantees by expected credit loss allowance stage

	12 months ended 31 December 2019			
Dollars in Thousands	**Stage 1**	**Stage 2**	**Stage 3[1]**	**Total**
Total retail exposures				
As at 1 January 2019	**1,976,545**	**42,570**	**2,512**	**2,021,627**
Transfer of financial instruments:				
Transfer from Stage 1 to 2	**(55,002)**	**55,002**	**-**	**-**
Transfer from Stage 2 to 1	**50,635**	**(50,635)**	**-**	**-**
Transfer to Stage 3	**(12,604)**	**(2,955)**	**15,559**	**-**
Transfer from Stage 3	**-**	**552**	**(552)**	**-**
Net further lending/repayment	**(74,429)**	**(15,534)**	**(3,523)**	**(93,486)**
Asset derecognised (including final repayments)	**(232,953)**	**(3,994)**	**(46)**	**(236,993)**
New financial assets originated or purchased	**577,454**	**-**	**-**	**577,454**
As at 31 December 2019 – Total retail credit exposure	**2,229,646**	**25,006**	**13,950**	**2,268,602**

[1] Wholesale exposures are assessed as credit impaired on an individual basis while retail exposures are assessed as credit impaired on a collective basis.

Total gross exposures increased $725 million during the year to 31 December 2019. This was primarily driven by net further lending to wholesale customers of $330 million. New financial assets originated, net of assets derecognised and final repayments was $148 million for wholesale exposure and $340 million for retail exposure.

The residential mortgage model used to calculate retail expected credit loss was refined in 2019 to make improvements in model inputs and resulted in a reallocation of some accounts between ECL stages.

There are no assets under administration as at 31 December 2019 (31 December 2018: nil). The aggregate amount as at 31 December 2019 of any undrawn balances on lending commitments to counterparties for whom drawn balances are classified as individually impaired, before deducting allowances for credit impairment loss where applicable, is $183 thousand (December 2018: $115 thousand).

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

8. Asset quality – gross exposure *(continued)*

Wholesale – Gross exposures / nominal amount of advances to banks and customers, including loan commitments and financial guarantees by expected credit loss allowance stage

	12 months ended 31 December 2018			
Dollars in Thousands	**Stage 1**	**Stage 2**	**Stage 3[1]**	**Total**
Total wholesale exposures				
As at 1 January 2018	3,825,723	767,264	6,411	4,599,398
Transfer of financial instruments:				
Transfer from Stage 1 to 2	(327,900)	327,900	-	-
Transfer from Stage 2 to 1	296,513	(296,513)	-	-
Transfer to Stage 3	-	-	-	-
Transfer from Stage 3	-	-	-	-
Net further lending/repayment[2]	(4,120)	(60,100)	(2,224)	(66,444)
Asset derecognised (including final repayments)	(2,062,651)	(583,527)	-	(2,646,178)
New financial assets originated or purchased	2,194,900	-	-	2,194,900
Assets written off	-	-	(1,267)	(1,267)
Other	-	-	-	-
As at 31 December 2018 – Total wholesale credit Exposure[2]	3,922,465	155,024	2,920	4,080,409

Retail – Gross exposures / nominal amount of advances to customers, including loan commitments and financial guarantees by expected credit loss allowance stage

	12 months ended 31 December 2018			
Dollars in Thousands	**Stage 1**	**Stage 2**	**Stage 3[1]**	**Total**
Total retail exposures				
As at 1 January 2018	1,852,524	43,257	2,973	1,898,754
Transfer of financial instruments:				
Transfer from Stage 1 to 2	(61,358)	61,358	-	-
Transfer from Stage 2 to 1	65,651	(65,651)	-	-
Transfer to Stage 3	-	(531)	531	-
Transfer from Stage 3	-	-	-	-
Net further lending/repayment[2]	(118,938)	8,674	(917)	(111,181)
Asset derecognised (including final repayments)	(211,477)	(4,537)	(75)	(216,089)
New financial assets originated or purchased	450,143	-	-	450,143
Assets written off	-	-	-	-
Other	-	-	-	-
As at 31 December 2018 – Total retail credit exposure[2]	1,976,545	42,570	2,512	2,021,627

[1] Wholesale exposures are assessed as credit impaired on an individual basis while retail exposures are assessed as credit impaired on a collective basis.

[2] Gross exposure comparatives have been amended to correct for $217 million (Stage 1: $214 million; Stage 2: $3 million) of retail loan commitments that were incorrectly reported as wholesale exposures.

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

9. Asset quality – expected credit loss

The following disclosure provides a reconciliation by stage of the Banking Group's expected credit loss for loans and advances to banks and customers, including loan commitments and financial guarantees. The basis of disclosure is the same as discussed in Note 8.

The net remeasurement of ECL arising from stage transfers represents the increase or decrease due to these transfers, for example, moving from a 12-month (stage 1) to a lifetime (stage 2) ECL measurement basis. Net remeasurement excludes the underlying customer risk rating /probability of default movements of the financial instruments transferring stage. This is captured, along with other credit quality movements in the 'net new lending and changes to risk parameters (model inputs)' line item. Changes in 'New financial assets originated or purchased', 'assets derecognised (including final repayments)' and 'net new lending and changes to risk parameters (model inputs)' represent the impact from volume movements within the Banking Group's lending portfolio.

Wholesale - Expected credit loss on advances to banks and customers, including loan commitments and financial guarantees

	12 months ended 31 December 2019			
Dollars in Thousands	**Stage 1**	**Stage 2**	**Stage 3[1]**	**Total**
Expected credit loss allowance				
As at 1 January 2019	**(2,132)**	**(3,114)**	**(906)**	**(6,152)**
Transfer of financial instruments:				
Transfer from Stage 1 to 2	**489**	**(489)**	**-**	**-**
Transfer from Stage 2 to 1	**(2,160)**	**2,160**	**-**	**-**
Transfer to Stage 3	**-**	**-**	**-**	**-**
Transfer from Stage 3	**-**	**-**	**-**	**-**
Net re-measurement of ECL arising from transfer of stage	**1,403**	**(320)**	**-**	**1,083**
Net new lending and changes to risk parameters (model inputs)	**863**	**985**	**475**	**2,323**
Asset derecognised (including final repayments)	**142**	**59**	**-**	**201**
New financial assets originated or purchased	**(810)**	**-**	**-**	**(810)**
As at 31 December 2019 – total expected credit loss	**(2,205)**	**(719)**	**(431)**	**(3,355)**
ECL on wholesale loans and advances to banks and customers including loan commitments and financial guarantees - profit or loss charge/(release) for the period	**73**	**(2,395)**	**(475)**	**(2,797)**
Write-Off / (Recoveries)	**-**	**-**	**-**	**-**
ECL on other financial assets profit or loss charge / (release)	**-**	**-**	**-**	**-**
Other movements	**(22)**	**-**	**-**	**(22)**
Total ECL profit or loss charge / (release) for the year	**51**	**(2,395)**	**(475)**	**(2,819)**

Retail - Expected credit loss on advances to customers, including loan commitments and financial guarantees

	12 months ended 31 December 2019			
Dollars in Thousands	**Stage 1**	**Stage 2**	**Stage 3[1]**	**Total**
Expected credit loss allowance				
As at 1 January 2019	**(1,000)**	**(128)**	**(38)**	**(1,166)**
Transfer of financial instruments:				
Transfer from Stage 1 to 2	**29**	**(29)**	**-**	**-**
Transfer from Stage 2 to 1	**(115)**	**115**	**-**	**-**
Transfer to Stage 3	**-**	**10**	**(10)**	**-**
Transfer from Stage 3	**-**	**(31)**	**31**	**-**
Net re-measurement of ECL arising from transfer of stage	**95**	**(4)**	**-**	**91**
Net new lending and changes to risk parameters (model inputs)	**1,006**	**(52)**	**(1,321)**	**(367)**
Asset derecognised (including final repayments)	**127**	**15**	**3**	**145**
New financial assets originated or purchased	**(234)**	**-**	**-**	**(234)**
As at 31 December 2019 – total expected credit loss	**(92)**	**(104)**	**(1,335)**	**(1,531)**
ECL on retail loans and advances to customers including loan commitments and financial guarantees - profit or loss charge/(release) for the period	**(908)**	**(24)**	**1,297**	**365**
Write-Off / (Recoveries)	**-**	**-**	**-**	**-**
ECL on other financial assets profit or loss charge / (release)	**-**	**-**	**-**	**-**
Other movements	**-**	**-**	**-**	**-**
Total ECL profit or loss charge / (release) for the year	**(908)**	**(24)**	**1,297**	**365**

The movement in expected credit losses for other assets are excluded from the tables above as they are not material.

[1] Wholesale exposures are assessed as credit impaired on an individual basis while retail exposures are assessed as credit impaired on a collective basis.

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

9. Asset quality – expected credit loss *(continued)*

Expected credit loss on wholesale exposures decreased during the year, mainly due to improved credit outlooks resulting in the transfer of some stage 2 exposures to stage 1 and repayments by some customers where ECL had been calculated on a life-time loss basis.

Expected credit loss on retail exposures increased during the year, mainly because the residential mortgage model used to calculate retail expected credit loss was refined in 2019 to make improvements in model inputs and resulted in a reallocation of some accounts between ECL stages.

Wholesale - Expected credit loss on advances to banks and customers, including loan commitments and financial guarantees

	12 months ended 31 December 2018			
Dollars in Thousands	**Stage 1**	**Stage 2**	**Stage 3[1]**	**Total**
Expected credit loss allowance				
As at 1 January 2018	(2,211)	(4,956)	(3,688)	(10,855)
Transfer of financial instruments:				
Transfer from Stage 1 to 2	266	(266)	-	-
Transfer from Stage 2 to 1	(2,772)	2,772	-	-
Transfer to Stage 3	-	-	-	-
Transfer from Stage 3	-	-	-	-
Net re-measurement of ECL arising from transfer of stage	2,037	(966)	-	1,071
Net new lending and changes to risk parameters (model inputs)	140	(3,474)	1,515	(1,819)
Asset derecognised (including final repayments)	1,383	3,789	-	5,172
New financial assets originated or purchased	(967)	-	-	(967)
Assets written off	-	-	1,267	1,267
Other	(8)	(13)	-	(21)
As at 31 December 2018 – total expected credit loss	(2,132)	(3,114)	(906)	(6,152)
ECL on wholesale loans and advances to banks and customers including loan commitments and financial guarantees - profit or loss charge/(release) for the period	(79)	(1,842)	(2,782)	(4,703)
Write-Off / (Recoveries)	-	-	1,267	1,267
ECL on other financial assets profit or loss charge / (release)	-	-	-	-
Other movements	16	-	-	16
Total ECL profit or loss charge / (release) for the year	(63)	(1,842)	(1,515)	(3,420)

Retail - Expected credit loss on advances to customers, including loan commitments and financial guarantees

	12 months ended 31 December 2018			
Dollars in Thousands	**Stage 1**	**Stage 2**	**Stage 3[1]**	**Total**
Expected credit loss allowance				
As at 1 January 2018	(1,024)	(107)	(21)	(1,152)
Transfer of financial instruments:				
Transfer from Stage 1 to 2	37	(37)	-	-
Transfer from Stage 2 to 1	(155)	155	-	-
Transfer to Stage 3	-	2	(2)	-
Transfer from Stage 3	(3)	-	3	-
Net re-measurement of ECL arising from transfer of stage	72	(317)	-	(245)
Net new lending and changes to risk parameters (model inputs)	205	95	(91)	209
Asset derecognised (including final repayments)	133	79	75	287
New financial assets originated or purchased	(264)	-	-	(264)
Other	(1)	2	(2)	(1)
As at 31 December 2018 – total expected credit loss	(1,000)	(128)	(38)	(1,166)
ECL on retail loans and advances to customers including loan commitments and financial guarantees - profit or loss charge/(release) for the period	(24)	21	17	14
Write-Off / (Recoveries)	-	-	(438)	(438)
ECL on other financial assets profit or loss charge / (release)	-	-	-	-
Other movements	-	-	-	-
Total ECL profit or loss charge / (release) for the year	(24)	21	(421)	(424)

The movement in expected credit losses for other assets are excluded from the tables above as they are not material.

[1] The wholesale Stage 3 ECL reflects the allowance on assets assessed as credit impaired on an individual basis and the retail Stage 3 ECL reflects the allowance for assets that are credit impaired on a collective basis.

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

9. Asset quality – expected credit loss *(continued)*

Credit quality classification

	Financial Investments	Wholesale Lending		Retail Lending	
	External credit rating	Internal credit rating	12 month probability of default %	Internal credit rating	12 month probability weighted PD %
Quality classification					
Strong	A- and above	CRR1 to CRR2	0 - 0.169	Band 1 and 2	0.000 - 0.500
Good	BBB+ to BBB-	CRR3	0.170 - 0.740	Band 3	0.501 - 1.500
Satisfactory	BB+ to B and unrated	CRR4 to CRR5	0.741 - 4.914	Band 4 and 5	1.501 - 20.000
Sub-standard	B- to C	CRR6 to CRR8	4.915 – 99.999	Band 6	20.001 - 99.999
Impaired	Default	CRR9 to CRR10	100	Band 7	100.00

Distribution of financial instruments to which the impairment requirements in NZ IFRS 9 are applied, by credit quality and stage allocation

Dollars in Thousands	12 months ended 31 December 2019							
	Strong	Good	Satisfactory	Sub-standard	Credit Impaired	Total	Allowance for ECL	Net
Advances to customers at AC								
- stage 1	**3,294,407**	**953,486**	**321,951**	**-**	**-**	**4,569,844**	**(1,673)**	**4,568,171**
- stage 2	**-**	**13,077**	**61,227**	**-**	**-**	**74,304**	**(219)**	**74,085**
- stage 3	**-**	**-**	**-**	**-**	**16,496**	**16,496**	**(1,748)**	**14,748**
Advances to banks at AC[1]								
- stage 1	**5,019**	**-**	**-**	**-**	**-**	**5,019**	**(2)**	**5,017**
- stage 2	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
- stage 3	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Loan and other credit-related commitments								
- stage 1	**1,414,574**	**437,771**	**165,038**	**-**	**-**	**2,017,383**	**(564)**	**2,016,819**
- stage 2	**8,956**	**9,950**	**6,990**	**-**	**-**	**25,896**	**(432)**	**25,464**
- stage 3	**-**	**-**	**-**	**-**	**153**	**153**	**(14)**	**139**
Financial guarantees and similar contracts								
- stage 1	**64,981**	**34,111**	**10,587**	**25**	**-**	**109,704**	**(58)**	**109,646**
- stage 2	**46**	**169**	**8,446**	**-**	**-**	**8,661**	**(172)**	**8,489**
- stage 3	**-**	**-**	**-**	**-**	**30**	**30**	**(4)**	**26**
At 31 Dec 2019	**4,787,983**	**1,448,564**	**574,239**	**25**	**16,679**	**6,827,490**	**(4,886)**	**6,822,604**

Balances related to Cash with central banks, Amounts due from related parties and Other assets do not have a material ECL balance.

1. Advances to banks at Amortised Cost excludes ‘Items in the course of collection from other banks’.

The residential mortgage model used to retail calculate expected credit loss was refined in 2019 to make improvements in model inputs and resulted in a reallocation of some accounts between ECL stages.

9. Asset quality – expected credit loss *(continued)*

Distribution of financial instruments to which the impairment requirements in NZ IFRS 9 are applied, by credit quality and stage allocation

	12 months ended 31 December 2018							
Dollars in Thousands								
	Strong	Good	Satisfactory	Sub-standard	Credit Impaired	Total	Allowance for ECL	Net
Advances to customers at AC								
- stage 1	3,145,348	696,347	137,205	-	-	3,978,900	(2,584)	3,976,316
- stage 2	15,763	47,433	81,429	40	-	144,665	(952)	143,713
- stage 3	-	-	-	-	5,127	5,127	(944)	4,183
Advances to banks at AC[1]								
- stage 1	6,656	-	-	-	-	6,656	(1)	6,655
- stage 2	-	-	-	-	-	-	-	-
- stage 3	-	-	-	-	-	-	-	-
Loan and other credit-related commitments								
- stage 1	1,072,949	566,020	185,560	-	-	1,824,529	(499)	1,824,030
- stage 2	9,910	6,247	13,741	-	-	29,898	(1,650)	28,248
- stage 3	-	-	-	-	305	305	-	305
Financial guarantees and similar contracts								
- stage 1	78,077	6,469	4,379	-	-	88,925	(48)	88,877
- stage 2	3,825	12,014	7,185	7	-	23,031	(640)	22,391
- stage 3	-	-	-	-	-	-	-	-
At 31 Dec 2018	4,332,528	1,334,530	429,499	47	5,432	6,102,036	(7,318)	6,094,718

Balances related to Cash with central banks, Amounts due from related parties and Other assets do not have a material ECL balance.

1. Advances to banks at Amortised Cost excludes 'Items in the course of collection from other banks'.

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

	Banking Group	
Dollars in Thousands	**31.12.19**	31.12.18
10. Change in expected credit loss		
Change in Expected Credit Losses		
Advances to customers		
- New allowances net of allowance releases	**841**	5,750
- Recoveries of amounts previously written off	**-**	438
- Amounts written off	**-**	(1,267)
	841	4,921
Loan commitments and guarantees	**1,613**	(1,040)
Other financial assets	**40**	(37)
Change in Expected Credit Loss	**2,494**	3,844

11. Concentrations of credit risk

Maximum exposure to credit 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 expected credit loss. The credit risk exposure does not take into account the fair value of any collateral, in the event of other parties failing to perform their obligations under financial instruments.

	Banking Group	
Dollars in Thousands	**31.12.19**	31.12.18
On-balance sheet credit exposures		
Cash and demand balances with central banks	**675,760**	529,852
Advances to banks	**10,702**	6,704
Financial investments	**541,559**	421,975
Derivative financial instruments	**83,323**	49,986
Advances to customers	**4,657,004**	4,124,212
Amounts due from related parties	**632,251**	855,678
Other assets	**21,070**	24,044
	6,621,669	6,012,451
Off-balance sheet credit exposures	**2,934,201**	2,547,252
Total credit exposures	**9,555,870**	8,559,703

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	**2,268,627**	2,011,992
Banks and financial institutions	**2,341,345**	2,303,459
Commercial and industrial	**1,620,467**	1,422,266
Commercial real estate and construction	**952,730**	883,896
Electricity, telecommunication and other utilities	**951,519**	682,667
Wholesale and retail trade	**656,664**	592,963
Agriculture, forestry and mining	**106,123**	126,899
Transport	**270,709**	259,830
Government	**257,738**	243,851
Other	**129,948**	31,880
	9,555,870	8,559,703

Concentrations of credit risk by geographical area

New Zealand	**7,907,281**	6,863,226
Hong Kong	**692,044**	867,231
United States	**292,653**	193,262
Australia	**190,211**	194,847
China	**124,007**	141,119
Great Britain	**92,629**	80,275
Other Overseas	**257,045**	219,743
	9,555,870	8,559,703

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

12. Concentrations of funding risk

	Banking Group	
Dollars in Thousands	**31.12.19**	31.12.18
Concentrations of funding by product		
Deposits by banks	**347,859**	228,503
Customer deposits	**3,538,301**	3,058,901
Debt securities	**924,917**	689,748
Amounts due to related parties	**1,676,580**	1,921,719
	6,487,657	5,898,871
Concentrations of funding by industry		
Individual	**1,860,016**	1,803,644
Banks and financial institutions	**3,178,557**	3,066,147
Commercial and industrial	**797,004**	393,543
Commercial real estate and construction	**114,423**	132,702
Wholesale and retail trade	**180,369**	174,193
Agriculture, forestry and mining	**62,227**	108,948
Transport	**69,955**	22,877
Electricity, telecommunication and other utilities	**10,103**	13,054
Government	**25,807**	5,683
Other	**189,196**	178,080
	6,487,657	5,898,871
Concentrations of funding by geographical area		
New Zealand	**3,275,271**	2,645,531
Hong Kong	**1,775,062**	2,047,722
China	**207,505**	197,393
Great Britain	**367,613**	202,328
United States	**253,736**	248,749
Other Overseas	**608,470**	557,148
	6,487,657	5,898,871

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

	Banking Group	
Dollars in Thousands	**31.12.19**	31.12.18

13. Customer deposits

Current accounts	**2,054,957**	1,813,605
Savings and deposit accounts	**1,483,344**	1,242,075
Other deposit accounts	**-**	3,221
Total customer deposits at amortised cost	**3,538,301**	3,058,901

14. Debt securities

Certificates of deposit issued	**24,917**	89,748
Medium term notes issued	**900,000**	600,000
	924,917	689,748

There are no debt securities on demand.

15. Additional financial disclosures on the balance sheet

Total interest earning and discount bearing assets	**6,517,276**	5,938,422
Total interest and discount bearing liabilities	**6,284,347**	5,692,369
Total liabilities net of amounts due to related parties	**4,937,820**	4,065,584

16. Other assets

Accrued interest receivable – third party	**11,201**	13,443
Acceptances and endorsements	**5,439**	7,605
Other	**5,083**	3,367
	21,723	24,415

Transaction fees receivable of $374 thousand (December 2018: $5 thousand) in respect of third party deals, but collected through Group intermediaries, are included within the Other balance.

17. Other liabilities

Accrued interest payable	**12,182**	11,258
Accruals and deferred income	**10,766**	9,791
Acceptances and endorsements	**5,441**	7,610
Lease liabilities[1]	**1,899**	-
Other	**13,240**	19,943
	43,528	48,602

Accruals as at 31 December 2019 include $6.9 million for employee entitlements (December 2018: $7.2 million).

[1] Lease liabilities have been recognised from 1 January 2019 following adoption of NZ IFRS 16. Comparatives have not been restated.

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

18. Segment reporting

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

The Banking Group's operations are closely integrated and, accordingly, the presentation of data includes internal allocations of certain items of income and expenses. Allocations include the cost of certain support services and functions to the extent they can be meaningfully attributed. Costs which cannot be allocated to business segments are included in Corporate Centre. Business segments also pay and receive interest to and from Balance Sheet Management. All transactions are undertaken on an arm's length basis.

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

Business Segments

The Banking Group comprises the following main business segments:

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

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

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

- *Corporate Centre*
  Includes Balance Sheet Management, the results of our financing operations and central support costs with associated recoveries.

	Banking Group **12 months ended 31.12.19**				
Dollars in Thousands	**RBWM**	**CMB**	**GBM**	**Corporate Centre**	**Aggregated**
Net interest income	**33,110**	**32,073**	**5,293**	**9,124**	**79,600**
Net trading income/ (loss)	**1,381**	**4,184**	**5,316**	**(2,149)**	**8,732**
Net fee and commission income	**333**	**28,006**	**7,210**	**794**	**36,343**
Other income	**1**	**506**	**-**	**-**	**507**
Net operating income before loan impairment charges	**34,825**	**64,769**	**17,819**	**7,769**	**125,182**
Change in expected credit loss	**(328)**	**2,826**	**(4)**	**-**	**2,494**
Net operating income	**34,497**	**67,595**	**17,815**	**7,769**	**127,676**
Operating expense	**(28,804)**	**(31,500)**	**(9,246)**	**(2,122)**	**(71,672)**
Operating profit before tax	**5,693**	**36,095**	**8,569**	**5,647**	**56,004**
Advances to customers	**2,051,346**	**2,605,658**	**-**	**-**	**4,657,004**
Customer deposits	**1,918,842**	**1,377,981**	**241,478**	**-**	**3,538,301**

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

18. Segment reporting *(continued)*

	Banking Group **12 months ended 31.12.18**				
Dollars in Thousands	**RBWM**	**CMB**	**GBM**	**Corporate Centre**	**Aggregated**
Net interest income	37,091	33,907	5,784	7,939	84,721
Net trading income/ (loss)	1,112	4,475	5,213	285	11,085
Net fee and commission income	458	30,917	6,845	(811)	37,409
Other income	1	487	-	8	496
Net operating income before loan impairment charges	38,662	69,786	17,842	7,421	133,711
Change in expected credit loss	530	3,304	10	-	3,844
Net operating income	39,192	73,090	17,852	7,421	137,555
Operating expense	(27,218)	(28,878)	(8,508)	(1,397)	(66,001)
Operating profit before tax	11,974	44,212	9,344	6,024	71,554
Advances to customers	1,803,795	2,320,417	-	-	4,124,212
Customer deposits	1,846,117	990,371	222,413	-	3,058,901

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

	Banking Group	
Dollars in Thousands	**12 months 31.12.19**	12 months 31.12.18
19. Taxation		
Current tax expense		
Current tax expense	**15,334**	19,387
	15,334	19,387
Deferred tax expense		
Origination and reversal of temporary differences	**506**	745
	506	745
Total income tax expense included in profit after tax	**15,840**	20,132
Reconciliation of effective tax rate		
Operating profit before tax	**56,004**	71,554
Income tax using the domestic corporation tax rate (28%)	**15,681**	20,035
Non-deductible expenses	**159**	97
	15,840	20,132

Dollars in Thousands	Banking Group			
Recognised deferred tax assets and liabilities	Balance at 1 January	Credit / (charge) to profit or loss	(Credit) / Charges to reserves[1]	Balance at 31 December
2019				
Accelerated capital allowances	**1,887**	**178**	**-**	**2,065**
Provision for loan impairment	**2,065**	**(693)**	**-**	**1,372**
Other provisions	**546**	**21**	**-**	**567**
Income deferred for accounting purposes	**277**	**(12)**	**-**	**265**
Other intangible assets	**-**	**-**	**-**	**-**
Tax deductible premium	**(3,595)**	**-**	**-**	**(3,595)**
Net deferred tax asset / (liability)	**1,180**	**(506)**	**-**	**674**
2018				
Accelerated capital allowances	1,432	455	-	1,887
Provision for loan impairment	1,621	(1,301)	1,745	2,065
Other provisions	524	22	-	546
Income deferred for accounting purposes	335	(58)	-	277
Other intangible assets	(137)	137	-	-
Tax deductible premium	(3,595)	-	-	(3,595)
Net deferred tax asset / (liability)	180	(745)	1,745	1,180

1 The balance charged to reserves represents the deferred tax impact from the 'provision for loan impairment' upon adoption of NZ IFRS 9.

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

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

20. Goodwill and intangible assets

2019	Goodwill	Customer relationships purchased	Software	Total
Cost				
At 1 January	**15,744**	**8,798**	**5,910**	**30,452**
Additions	**-**	**-**	**1,714**	**1,714**
At 31 December	**15,744**	**8,798**	**7,624**	**32,166**
Accumulated amortisation and impairment				
At 1 January	**(2,043)**	**(8,798)**	**(5,106)**	**(15,947)**
Amortisation charge for the year	**-**	**-**	**(362)**	**(362)**
At 31 December	**(2,043)**	**(8,798)**	**(5,468)**	**(16,309)**
Net carrying value	**13,701**	**-**	**2,156**	**15,857**
2018				
Cost				
At 1 January	15,744	8,798	5,089	29,631
Additions	-	-	821	821
At 31 December	15,744	8,798	5,910	30,452
Accumulated amortisation and impairment				
At 1 January	(2,043)	(8,311)	(5,033)	(15,387)
Amortisation charge for the year	-	(487)	(73)	(560)
At 31 December	(2,043)	(8,798)	(5,106)	(15,947)
Net carrying value	13,701	-	804	14,505

Goodwill

The Banking Group's goodwill arises from the acquisition of a portfolio of loans and deposits within our Retail Banking and Wealth Management business and from the acquisition of custody and clearing business within our Global Banking and Markets business.

Goodwill is assessed at each reporting date for indicators of impairment as it is not amortised. Impairment is assessed on the basis of the cash-generating unit ("CGU") as defined in NZ IAS 36.

The recoverable amount of the CGU is determined based on value-in-use calculations. These calculations use discounted cash flow projections based on profit forecasts approved by management as part of the rolling operating plan process. The rolling operating plan covers a detailed one year time frame, approved by HBAP senior management. Profit forecasts greater than one year are estimated by Banking Group management based on their assessment of sustainable growth.

Key assumptions underlying the valuation relate to management's assessment of key business drivers, including balance sheet growth, net interest margins, fee generation, bad debts, operating expenses and terminal value within RBWM and customer transaction volumes, share market turnover and value, fee structures, operating expenses and terminal value within custody and clearing. Management utilises 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 each business segment and an annual sustainable growth rate of 2.4% which is equal to the 5 year forecasted GDP growth rate for New Zealand based on New Zealand Treasury forecasts (2018: 2.8% which is equal to the HSBC forecast growth in GDP for New Zealand over the last 2 years.)

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

20. Goodwill and intangible assets *(continued)*

Goodwill (continued)

a) Goodwill arising from the acquisition of loan and deposit portfolio

The applicable CGU is considered to be the whole RBWM business. The carrying amount that relates to this CGU at 31 December 2019 is $12.8 million (December 2018: $12.8 million).

The discounted cash flow model has used a two year profit projection, a discount rate (pre-tax) of 9.8% (December 2018: 9.5%), growth rates for revenues of -4.0% and expenses of 2.6% in the next two years supported by December 2019 actual results and approved budgets (December 2018: one year growth rates for revenue of 13.8% and expenses of 7.5%).

b) Goodwill arising from the acquisition of custody and clearing business in New Zealand

The applicable CGU is considered to be the custody and clearing business unit within the GBM business. The carrying value that relates to this CGU at 31 December 2019 is $0.86 million (December 2018: $0.86 million).

The discounted cash flow model has used a two year profit projection, a discount rate (pre-tax) of 11.1% (December 2018: 11.4%), growth rate for revenues of -21.2% and direct expenses of -6.9% in the next two years supported by December 2019 actual results and approved budgets (December 2018: one year growth rates for revenue of -8.4% and expenses of 2.5%).

Other Intangible Assets

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

Software is amortised on a straight line basis over 5 years, within operating expenses.

Customer relationships are amortised on a straight-line basis over 12 years based on a statistical analysis of expected customer life. The customer relationships are now fully amortised (December 2018: fully amortised).

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

21. Related party transactions

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

The balances for derivative financial instruments with related parties have been disclosed in Note 22. Transactions with related parties during the year have been disclosed in Notes 3 and 4.

Key management personnel are those who, directly or indirectly, have the authority for planning, directing or controlling the activities of the Banking Group. Key management personnel for the Banking Group represent the members of the New Zealand Executive Committee who are employees of the Banking Group.

Advances to key management personnel are offered in the ordinary course of business on normal commercial terms and conditions, no more favourable than those given to other employees or customers. Advances are on terms of repayment that range between fixed and variable, all of which have been made in accordance with the Banking Group's lending policies.

	Banking Group	
Dollars in Thousands	**31.12.19**	31.12.18
Key management compensation		
(a) Salaries and other short-term benefits	**4,041**	3,572
(b) Post-employment benefits	**229**	239
(c) Share-based payments expenses recognised	**159**	146
	4,429	3,957
Advances to key management		
(d) Advances to key management personnel	**1,394**	4,303

(e) Shares, options and other incentive plans

HSBC Restricted Share Award Scheme

	2019	2018
Number of awards awarded	**11,835**	9,465

The total fair value of the shares awarded under the restricted share award scheme as at 31 December 2019 is $52 thousand when converted into NZ dollars (December 2018: $98 thousand).

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

The fair value of the shares granted under the HSBC Restricted Share Award Scheme is £5.92 (December 2018: £6.52).

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

	Banking Group	
Dollars in Thousands	**31.12.19**	31.12.18
21. Related party transactions *(continued)*		
Amounts due from related parties		
On demand	**37,181**	11,252
Other short term	**595,070**	844,426
	632,251	855,678
The Hongkong and Shanghai Banking Corporation Limited (HBAP):		
HBAP Hong Kong	**577,809**	834,741
HBAP Japan	**10,259**	9,082
HBAP Sri Lanka	**7,158**	2,219
HBAP Australia	**6,410**	6,034
HBAP Singapore	**60**	1,081
HBAP Other	**37**	16
Other:		
HUSI North America	**21,945**	799
HSBC France	**4,994**	108
HSBC Bank plc UK Ops	**3,299**	1,338
Other	**280**	260
	632,251	855,678
Amounts due to related parties		
On demand	**451,580**	371,719
Other short term	**500,000**	200,000
Long term	**725,000**	1,350,000
	1,676,580	1,921,719
The Hongkong and Shanghai Banking Corporation Limited (HBAP):		
HBAP Hong Kong	**1,436,739**	1,771,853
HBAP Singapore	**47,074**	46,214
HBAP Philippines	**2,634**	347
HBAP Japan	**2,077**	1,904
HBAP Other	**4,256**	3,995
Other:		
HSBC Bank Plc UK Ops	**127,636**	56,197
HUSI North America	**14,333**	8
HSBC Bank (China) Company Limited	**5,992**	2,383
HSBC Bank Plc	**5,261**	-
HSBC Trinkaus and Burkhardt AG	**5,022**	979
Other	**25,556**	37,839
	1,676,580	1,921,719

Interest Free Funding

The Banking Group has received an interest free loan from HBAP of $194 million (December 2018: $194 million) to support the thin capitalisation ratio imposed under New Zealand tax law. This loan has no repayment terms and is recorded within amounts due to related parties.

Repatriation of capital to HBAP

The Banking Group repatriated profits of $42.133 million (December 2018: $46.584 million) to HBAP during the year.

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

22. Derivative financial instruments

	Banking Group					
Dollars in Thousands	**31.12.19**			31.12.18		
	Contract amount	Assets	Liabilities	Contract amount	Assets	Liabilities
Related Party						
Trading derivatives						
Exchange rate contracts[1]	**4,188,677**	**80,474**	**3,209**	3,052,610	35,474	15,095
Interest rate contracts	**21,800**	**1,317**	**-**	42,800	1,226	1,516
Total derivatives with related parties		**81,791**	**3,209**		36,700	16,611
Related party breakdown						
HBAP Group		**81,791**	**3,209**		36,696	16,548
HSBC Bank plc		**-**	**-**		4	63
Other		**-**	**-**		-	-
		81,791	**3,209**		36,700	16,611
Other						
Trading derivatives						
Exchange rate contracts[1]	**3,089,660**	**1,522**	**79,512**	2,213,841	11,783	31,530
Interest rate contracts	**21,800**	**10**	**1,315**	42,800	1,503	1,225
		1,532	**80,827**		13,286	32,755
Hedging derivatives						
Fair value hedging derivatives	**100,000**	**-**	**1,417**	151,000	-	1,769
		-	**1,417**		-	1,769
Total derivatives with other parties		**1,532**	**82,244**		13,286	34,524
Total derivative financial instruments		**83,323**	**85,453**		49,986	51,135

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

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

23. Fair value of financial instruments

Determination of fair value of financial instruments carried at fair value

Fair values are determined according to the following hierarchy:

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

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

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

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

		Banking Group **31.12.19**		
Dollars in Thousands	**Level 1**	**Level 2**	**Level 3**	**TOTAL**
ASSETS				
Financial investments	**508,062**	**33,475**	**22**	**541,559**
Derivatives financial instruments	**-**	**83,323**	**-**	**83,323**
LIABILITIES				
Derivatives financial instruments	**-**	**85,453**	**-**	**85,453**

		Banking Group 31.12.18		
Dollars in Thousands	Level 1	Level 2	Level 3	TOTAL
ASSETS				
Financial investments	409,504	12,449	22	421,975
Derivatives financial instruments	-	49,986	-	49,986
LIABILITIES				
Derivatives financial instruments	-	51,135	-	51,135

There have been no transfers between levels 1 and 2 in the year to 31 December 2019 (December 2018: Nil).

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

Methodologies

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

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

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

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

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

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

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

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

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

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

Fair Value of financial instruments not carried at fair value

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

	Banking Group **31.12.19**				
	Fair Value				**Carrying value**
Dollars in Thousands	**Level 1**	**Level 2**	**Level 3**	**Total**	
ASSETS					
Advances to customers	**-**	**-**	**4,656,037**	**4,656,037**	**4,657,004**
LIABILITIES					
Customer deposits	**-**	**3,540,003**	**-**	**3,540,003**	**3,538,301**
Debt securities	**-**	**925,083**	**-**	**925,083**	**924,917**
Amounts due to related parties	**-**	**1,673,248**		**1,673,248**	**1,676,580**

	Banking Group **31.12.18**				
	Fair Value				**Carrying value**
Dollars in Thousands	**Level 1**	**Level 2**	**Level 3**	**Total**	
ASSETS					
Advances to customers	-	-	4,123,652	4,123,652	4,124,212
LIABILITIES					
Customer deposits	-	3,060,202	-	3,060,202	3,058,901
Debt securities	-	702,452	-	702,452	689,748
Amounts due to related parties	-	1,923,502	-	1,923,502	1,921,719

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

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

24. Interest rate risk – repricing schedule

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

	Banking Group							
Dollars in Millions	*Up to 3 months*	*Over 3 months and up to 6 months*	*Over 6 months and up to 1 year*	*Over 1 year and up to 2 years*	*Over 2 years*	*Total interest bearing*	*Non interest bearing*	*Total*
31 December 2019								
Financial Assets								
Cash and demand balances with central banks	**676**	**-**	**-**	**-**	**-**	**676**	**-**	**676**
Advances to banks	**11**	**-**	**-**	**-**	**-**	**11**	**-**	**11**
Financial investments	**172**	**32**	**-**	**124**	**214**	**542**	**-**	**542**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**-**	**83**	**83**
Advances to customers	**2,915**	**462**	**414**	**714**	**152**	**4,657**	**-**	**4,657**
Amounts due from related parties	**632**	**-**	**-**	**-**	**-**	**632**	**-**	**632**
Other assets	**-**	**-**	**-**	**-**	**-**	**-**	**22**	**22**
Total financial assets	**4,406**	**494**	**414**	**838**	**366**	**6,518**	**105**	**6,623**
Financial Liabilities								
Deposits by banks	**348**	**-**	**-**	**-**	**-**	**348**	**-**	**348**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**-**	**85**	**85**
Customer deposits	**3,000**	**344**	**149**	**16**	**18**	**3,527**	**11**	**3,538**
Debt securities	**825**	**-**	**-**	**-**	**100**	**925**	**-**	**925**
Amounts due to related parties	**1,147**	**-**	**56**	**254**	**25**	**1,482**	**194**	**1,676**
Other liabilities	**-**	**-**	**1**	**-**	**1**	**2**	**42**	**44**
Total financial liabilities	**5,320**	**344**	**206**	**270**	**144**	**6,284**	**332**	**6,616**
Off-balance sheet financial instruments								
Net notional interest rate contracts	**75**	**-**	**-**	**(75)**	**-**	**-**	**-**	**-**
31 December 2018								
Financial Assets								
Cash and demand balances with central banks	530	-	-	-	-	530	-	530
Advances to banks	7	-	-	-	-	7	-	7
Financial investments	152	2	25	83	160	422	-	422
Derivative financial instruments	-	-	-	-	-	-	50	50
Advances to customers	2,640	310	352	756	66	4,124	-	4,124
Amounts due from related parties	856	-	-	-	-	856	-	856
Other assets	-	-	-	-	-	-	24	24
Total financial assets	4,185	312	377	839	226	5,939	74	6,013
Financial Liabilities								
Deposits by banks	229	-	-	-	-	229	-	229
Derivative financial instruments	-	-	-	-	-	-	51	51
Customer deposits	2,548	336	131	12	19	3,046	13	3,059
Debt securities	690	-	-	-	-	690	-	690
Amounts due to related parties	1,603	-	75	50	-	1,728	194	1,922
Other liabilities	-	-	-	-	-	-	49	49
Total financial liabilities	5,070	336	206	62	19	5,693	307	6,000
Off-balance sheet financial instruments								
Net notional interest rate contracts	125	-	(25)	(25)	(75)	-	-	-

25. Liquidity risk management

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

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

	Banking Group	
Dollars in Thousands	**31.12.19**	**31.12.18**
Demand balances with the central bank	**675,760**	529,852
Financial Investments	**541,537**	421,953
	1,217,297	951,805

Maturity Analysis - Balance sheet expected settlement

The table below analyses the Banking Group's assets and liabilities by the amount expected to be recovered or settled before, and after twelve months from the reporting period. Customer Deposits are presented on a contractual basis, however as part of our normal banking operations, the Banking Group expects a large proportion of these balances to be retained.

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

	Banking Group		
Dollars in Millions	*Under 12 months*	*Over 12 months*	*Total*
31 December 2019			
Assets			
Cash and demand balances with central banks	**676**	**-**	**676**
Advances to banks	**11**	**-**	**11**
Financial investments	**203**	**338**	**541**
Derivative financial instruments	**82**	**1**	**83**
Advances to customers	**1,094**	**3,563**	**4,657**
Amounts due from related parties	**632**	**-**	**632**
Other assets	**22**	**-**	**22**
Property, plant and equipment	**1**	**2**	**3**
Deferred tax asset	**-**	**1**	**1**
Goodwill and Intangible assets	**-**	**16**	**16**
Total	**2,721**	**3,921**	**6,642**
Liabilities			
Deposits by banks	**348**	**-**	**348**
Derivative financial instruments	**83**	**3**	**86**
Customer deposits	**3,501**	**37**	**3,538**
Debt securities	**25**	**900**	**925**
Amounts due to related parties	**940**	**737**	**1,677**
Other liabilities	**40**	**3**	**43**
Current tax liabilities	**1**	**-**	**1**
Total	**4,938**	**1,680**	**6,618**
Net assets	**(2,217)**	**2,241**	**24**

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

25. Liquidity risk management *(continued)*

Maturity Analysis - Balance sheet expected settlement *(continued)*

	Banking Group		
Dollars in Millions	*Under 12 months*	*Over 12 months*	*Total*
31 December 2018			
Assets			
Cash and demand balances with central banks	530	-	530
Advances to banks	7	-	7
Financial investments	179	243	422
Derivative financial instruments	47	3	50
Advances to customers	842	3,282	4,124
Amounts due from related parties	856	-	856
Other assets	24	-	24
Property, plant and equipment	-	1	1
Deferred tax asset	-	1	1
Goodwill and Intangible assets	-	15	15
Total	2,485	3,545	6,030
Liabilities			
Deposits by banks	228	-	228
Derivative financial instruments	47	4	51
Customer deposits	3,017	42	3,059
Debt securities	90	600	690
Amounts due to related parties	572	1,350	1,922
Other liabilities	43	6	49
Current tax liabilities	5	-	5
Total	4,002	2,002	6,004
Net assets	(1,517)	1,543	26

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

25. Liquidity risk management *(continued)*

Maturity Analysis – undiscounted cash flows basis

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

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

			Banking Group					
Dollars in Millions	*On Demand*	*0-1 month*	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*	*No specific maturity*	*Total*
31 December 2019								
Financial Liabilities								
Deposits by banks	**348**	**-**	**-**	**-**	**-**	**-**	**-**	**348**
Customer deposits	**2,090**	**359**	**562**	**498**	**37**	**3**	**-**	**3,549**
Debt securities	**-**	**10**	**4**	**28**	**920**	**-**	**-**	**962**
Amounts due to related parties	**439**	**-**	**150**	**353**	**759**	**-**	**-**	**1,701**
Other liabilities	**7**	**15**	**10**	**8**	**4**	**-**	**-**	**44**
Total non-derivative financial liabilities	**2,884**	**384**	**726**	**887**	**1,720**	**3**	**-**	**6,604**
Derivative financial instruments – held for trading purposes	**-**	**62**	**20**	**1**	**1**	**-**	**-**	**84**
Derivative financial instruments – held for hedging purposes (net settled) (Inflow) / outflow	**-**	**-**	**-**	**-**	**1**	**-**	**-**	**1**
Total undiscounted derivatives	**-**	**62**	**20**	**1**	**2**	**-**	**-**	**85**
Undrawn loan commitments	**655**	**-**	**1,569**	**-**	**-**	**-**	**-**	**2,224**
31 December 2018								
Financial Liabilities								
Deposits by banks	229	-	-	-	-	-	-	229
Customer deposits	2,022	192	317	503	40	2	-	3,076
Debt securities	-	-	94	12	626	-	-	732
Amounts due to related parties	372	2	4	216	1,359	-	-	1,953
Other liabilities	7	18	14	4	6	-	-	49
Total non-derivative financial liabilities	2,630	212	429	735	2,031	2	-	6,039
Derivative financial instruments – held for trading purposes	46	-	-	-	-	3	-	49
Derivative financial instruments – held for hedging purposes (net settled) (Inflow) / outflow	-	-	-	-	1	1	-	2
Total undiscounted derivatives	46	-	-	-	1	4	-	51
Undrawn loan commitments	683	-	1,387	-	-	-	-	2,070

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

26. Offsetting financial asset and financial liabilities

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously ("the offset criteria"). The Banking Group has no financial instruments that meet the offset criteria at 31 December 2019 (2018: nil).

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

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

		Amounts subject to enforceable netting arrangements but not offset in the balance sheet		
Dollars in Millions	**Gross amounts presented in the balance sheet**	**Related financial instruments**	**Cash collateral received**	**Net amount**
31 December 2019				
Derivative financial assets	**83**	**(1)**	**-**	**82**
Financial assets	**83**	**(1)**	**-**	**82**
Derivative financial liabilities	**85**	**(1)**	**-**	**84**
Financial liabilities	**85**	**(1)**	**-**	**84**
31 December 2018				
Derivative financial assets	50	(11)	-	39
Financial assets	50	(11)	-	39
Derivative financial liabilities	51	(11)	-	40
Financial liabilities	51	(11)	-	40

27. Foreign currency risk exposure

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

	Banking Group	
Dollars in Millions	**Audited 31.12.19**	Audited 31.12.18
Receivable / (payable)		
AUD	**-**	-
GBP	**-**	-
USD	**(0.1)**	(0.1)
Other	**0.1**	0.1
	-	-

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

28. Market risk exposures

Aggregate market risk exposures are derived in accordance with the Reserve Bank of New Zealand document, Capital Adequacy Framework (Standardised Approach) (BS2A) and is calculated on a six monthly basis.

The period end exposure is the exposure as at the end of the period reported. The peak exposure is the peak end-of-day market risk exposure over the six months up to 31 December 2019 at the close of each business day. The peak is calculated separately for each category of exposure and may not have occurred at the same time.

	Banking Group	
Dollars in Millions	*Implied risk weighted exposure*	*Notional capital charge*
Exposure at 31 December 2019 (Unaudited)		
Interest rate risk	**69.38**	**5.55**
Foreign currency risk	**0.25**	**0.02**
Equity risk	**-**	**-**
Peak exposure period 1 July 2019 to 31 December 2019 (Unaudited)		
Interest rate risk	**86.25**	**6.90**
Foreign currency risk	**0.38**	**0.03**
Equity risk	**-**	**-**

29. Share awards

The Branch participated in the following share compensation plans operated by the Group for the acquisition of HSBC Holdings plc shares. The awards were granted at nil consideration. No awards have been granted to substantial shareholders, suppliers of goods and services, or in excess of the individual limit of each share plan.

a) *HSBC Holdings Group International Employee Share Purchase Plan*

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

	31.12.19 ***Number of shares***	31.12.18 *Number of shares*
Shares at beginning of the year	**5,320**	5,551
New shares granted during the year	**4,411**	3,344
Shares released during the year	**(2,090)**	(2,806)
Shares forfeited during the year	**(297)**	(10)
Shares cancelled during the year	**(344)**	(755)
Shares transferred in during the year	**1,124**	-
Shares transferred out during the year	**(735)**	(4)
Shares outstanding at the end of the year	**7,389**	5,320

29. Share awards *(continued)*

b) ***HSBC Restricted Share Award Scheme***

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

	31.12.19 *Number of shares*	31.12.18 *Number of shares*
Shares at beginning of the year	**21,179**	25,073
New shares granted during the year	**11,835**	9,465
Additional shares arising from scrip dividends	**762**	1,002
Shares released during the year	**(12,143)**	(14,361)
Shares forfeited during the year	**-**	-
Shares transferred in during the year	**3,353**	-
Shares transferred out during the year	**(1,524)**	-
Shares outstanding at the end of the year	**23,462**	21,179

Calculation of fair values

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

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

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

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

	Banking Group	
Dollars in Thousands	**31.12.19**	31.12.18
30. Lease commitments		
Future rentals in respect of operating leases are:		
Within one year	**2,817**	2,557
Between one year and two years	**2,661**	2,843
Between two years and five years	**7,268**	7,011
Over five years	**12,075**	12,598
	24,821	25,009

Lease commitments includes $21.6 million (31 December 2018: $21.6 million) of commitments in respect of right of use assets that are not yet available for use.

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

Dollars in Thousands	***Banking Group*** **31.12.19**	31.12.18

31. Contingent liabilities and other commitments

Contingent liabilities and commitments

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

	31.12.19	31.12.18
Direct credit substitutes	**133,589**	124,807
Transaction related contingent items	**576,624**	343,401
Trade related contingent items	**164,686**	174,210
Commitments, maturity one year or more	**1,420,943**	1,282,096
Commitments, maturity up to one year	**638,359**	622,738
	2,934,201	2,547,252

Capital commitments

	31.12.19	31.12.18
Contracted expenditure	**1,683**	1,040

32. Custodial services

The financial statements of the Banking Group include income in respect of custodial services provided to customers. It is HBAP who contracts with the customers. The securities are held in the name of the HBAP's nominee company, HSBC Nominees (New Zealand) Limited. As at 31 December 2019, securities held by the nominee company on behalf of the Branch's customers were excluded from the nominee company and the Banking Group's Balance Sheet. The value of securities held by the nominee company at 31 December 2019 was $72,890 million (2018: $70,731 million).

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

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

33. Insurance, securitisation, funds management and other fiduciary activities

The Banking Group is not involved in the origination, marketing or servicing of securitisation schemes.

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

The Banking Group does not market or distribute insurance products.

The Banking Group is not involved in the establishment, marketing, or sponsorship of trust, funds management, or other fiduciary activities.

34. Structured entities

Structured entities

The Banking Group enters into transactions with unconsolidated structured entities in the normal course of business to facilitate customer transactions and for specific investment opportunities to earn income in the form of interest and fees. The Banking Group's arrangements that involve structured entities are authorised centrally prior to being established to ensure appropriate purpose and governance. The Banking Group has interests in an unconsolidated securitisation vehicle providing funding through the subscription of notes issued by the structured entity. The primary source of debt service and security is derived from the underlying assets of the structured entity. All lending is subject to the Banking Group's credit approval process. The total assets of the unconsolidated structured entity at reporting date was $755 million (December 2018: $589 million). The total assets and commitments of the Banking Group in the unconsolidated structured entity at reporting date was $77 million and nil respectively (December 2018: $87 million and $10 million). This reflects the maximum exposure to loss in relation to those interests regardless of the probability of the loss being incurred. This is stated gross of the effects of any collateral arrangements entered into to mitigate the Banking Groups exposure to loss. On balance sheet amounts are included in 'advances to customers'.

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

35. Subsequent events

The ECL at 31 December 2019 was estimated based on a range of forecast economic conditions as at that date. The World Health Organisation declared the coronavirus (COVID-19) to be a global pandemic on 11 March 2020 and the outbreak has spread across many countries, causing significant disruption to business and economic activity. As this declaration was made after the reporting date, the Banking Group does not believe it constitutes an "Adjustable Event", as defined in accordance with NZ IAS 10 Events after the Reporting Period. The impact on GDP and other key indicators will be considered when determining the severity and likelihood of downside economic scenarios that will be used to estimate ECL under NZ IFRS 9 in subsequent reporting periods.

The New Zealand Government and the Reserve Bank of New Zealand have also announced a number of initiatives and support packages, which includes supporting banking system liquidity, in response to the escalating actions taken to combat COVID-19.

The Banking Group is working through these schemes in partnership with the public sector and other financial institutions and the resulting impact on the Banking Group's operations is uncertain, however the Directors have no reason to believe the Banking Group will be unable to maintain its operations for the foreseeable future.

36. Capital adequacy ratios of HBAP Group

The approaches used in calculating the HBAP Group's regulatory capital and risk weighted assets are in accordance with the Hong Kong Monetary Authority Banking (Capital) Rules . The HBAP Group uses the advanced internal ratings-based approach to calculate its credit risk for the majority of its non-securitisation exposures. For securitisation exposures, the HBAP Group uses the securitisation internal ratings-based approach, securitisation external ratings-based approach, securitisation standardised approach or securitisation fall-back approach to determine credit risk for its banking book securitisation exposures. For counterparty credit risk, the group uses both the current exposure method and an internal models approach to calculate its default risk exposures. For market risk, the HBAP Group uses an internal models approach to calculate its general market risk for the risk categories of interest rate and foreign exchange (including gold) exposures, and equity exposures. The HBAP Group also uses an internal models approach to calculate its market risk in respect of specific risk for interest rate exposures and equity exposures. The HBAP Group uses the standardised (market risk) approach for calculating other market risk positions, as well as trading book securitisation exposures, and the standardised (operational risk) approach to calculate its operational risk.

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

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

	Unaudited 31.12.19	Unaudited 31.12.18
Basel III Capital Ratios		
Common Equity Tier 1 (CET1) capital	**17.2%**	16.5%
Tier 1 capital	**18.8%**	17.8%
Total capital	**21.0%**	19.8%

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

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

37. Profitability, size and asset quality of HBAP Group

Dollars in HK$ millions	**Audited 12 months ended 31.12.19**	Audited 12 months ended 31.12.18
Profitability		
Net profit after tax	**115,040**	112,116
Net profit after tax over the previous 12 month period, as a percentage of average total assets	**1.4%**[1]	1.4%[1]
Size		
Total assets	**8,661,714**	8,263,454
Percentage increase in total assets over the previous 12 months period	**4.8%**	4.0%
Asset quality		
HKFRS 9 Stage 3 and POCI gross carrying value[3]	**18,097**	20,627
HKFRS 9 Stage 3 and POCI ECL[2, 4]	**(9,383)**	(10,050)
HKFRS 9 Stage 1 and 2 ECL[2]	**(9,003)**	(7,355)
HKFRS 9 Stage 3 gross carrying value[3] / Total assets	**0.2%**	0.2%
HKFRS 9 Stage 3 and POCI ECL[2,4] / Stage 3 and POCI gross carrying value[3]	**51.8%**	48.7%

1 Average total assets for HBAP Group is not publicly available. This calculation uses a two-point average of total assets as at the end of the reported period and the comparative period ended 12 months earlier.
2 ECL on advances to banks and customers including loan commitments and financial guarantees, and other financial assets. The Banking Group considers this balance to be the best representation of 'total collective credit impairment allowance'.
3 Gross carrying value of advances to banks and customers, including nominal value of loan commitments and financial guarantees and other financial assets. The Banking Group considers this balance to be the best representation of 'total individually impaired assets'.
4 The Banking Group considers this balance to be the best representation of 'total individual credit impairment allowance'.

Directors' and New Zealand Chief Executive Officer's Statements

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

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

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

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

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

over the year ended 31 December 2019.

This Disclosure Statement has been signed for and on behalf of the Directors of The Hongkong and Shanghai Banking Corporation Limited (as listed on pages 4 and 5) by their attorney, Christopher David Gosse Russell, and also in his capacity as Chief Executive Officer:

Christopher David Gosse Russell
Chief Executive Officer
New Zealand Branch

3 April 2020

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

Independent auditor's report

To the Directors of The Hongkong and Shanghai Banking Corporation Limited

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

This report includes our:

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

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

We have audited the Banking Group's financial statements required by Clause 25 of the Order and the supplementary information required by Schedules 4, 7, 11 and 13 of the Order which comprises:

- the balance sheet as at 31 December 2019;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended;
- the notes to and forming part of the financial statements, which include a statement of significant accounting policies; and
- the supplementary information required by Schedules 4, 7, 11 and 13 of the Order.

Our opinion

In our opinion:

- the Banking Group's financial statements (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 9, 11 and 13 of the Order and included within Notes 2, 7, 8, 9, 15, 24, 25, 28, 32, 33, 36 and 37):
  i. comply with generally accepted accounting practice in New Zealand;
  ii. comply with NZ IFRS and IFRS; and
  iii. give a true and fair view of the financial position of the Banking Group as at 31 December 2019, and its financial performance and cash flows for the year then ended.
- the supplementary information disclosed in accordance with Schedules 4, 7, 11 and 13 of the Order and included within Notes 2, 8, 9, 15, 24, 25, 32, 33 and 37:
  i. has been prepared, in all material respects, in accordance with the guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act 1989 or any conditions of registration;
  ii. is in accordance with the books and records of the Banking Group; and
  iii. fairly states, in all material respects, the matters to which it relates in accordance with those Schedules.

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Basis for opinion

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

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

Our audit approach

Overview

An audit is designed to obtain reasonable assurance about whether the financial statements are free from material misstatement.

Overall materiality: $2.69 million.

We agreed with the Directors of The Hongkong and Shanghai Banking Corporation Limited that we would report to them misstatements identified during our audit above $134,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

We have two key audit matters:

- Impairment of advances to customers; and
- IT access management.

Materiality

The scope of our audit was influenced by our application of materiality.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall Banking Group materiality for the financial statements as a whole, as set out above. These, together with qualitative considerations, helped us to determine the scope of our audit, the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Overall materiality	$2.69 million
How we determined it	Approximately 5% of operating profit before tax.
Rationale for the materiality benchmark applied	We applied this benchmark because, in our view, it is the benchmark against which the performance of the Banking Group is most commonly measured by users and is a generally accepted benchmark.

Audit scope

We designed our audit by assessing the risks of material misstatement in the financial statements and our application of materiality. As in all of our audits, we also addressed the risk of management override of internal controls including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the financial statements as a whole, taking into account the structure of the Banking Group, the accounting processes and controls, and the industry in which the Banking Group operates. Certain operational processes which are critical to financial reporting for the Banking Group are undertaken outside of New Zealand. We worked with PwC member firms engaged in the HSBC Holdings plc group audit to understand and examine processes that

supported material balances, classes of transactions and disclosures within the Banking Group's financial statements. This enabled us to evaluate the effectiveness of the controls over those processes and consider the implications for the remainder of our audit work.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements for the current year. We have two key audit matters, which are impairment of advances to customers and IT access management. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	How our audit addressed the key audit matter
Impairment of advances to customers As disclosed in note 9 of the financial statements, the Banking Group's expected credit loss (ECL) on advances to customers is $4.9 million as at 31 December 2019. This is the second year that ECL has been reported under NZ IFRS 9. The underlying processes and controls have continued to mature during the year, with an increased focus on back-testing. The Banking Group has also updated certain ECL models during the year. The credit environment has remained relatively benign during the year, in part due to low interest rates. However, there are a growing number of specific risks. The audit approach critically assesses the more significant judgemental decisions made by management, in particular the severity and likelihood of multiple economic scenarios that form part of the forward economic guidance and their impact on ECL; the determination of wholesale customer credit ratings and the impact they had on the determination of significant increases in credit risk; the appropriateness of post-model adjustments made to reflect model and data limitations; and the estimation of specific impairment for wholesale exposures that had defaulted. As a result, whilst the current levels of delinquencies and defaults remains low, the audit risk in relation to the impairment of advances to customers remains significant.	*Stage 1, 2 and 3 collectively assessed ECL* Using our credit risk modelling experts, we performed risk based substantive testing of models that were updated during the year for compliance with NZ IFRS 9 and IFRS 9. In addition, model performance monitoring controls were tested, including back-testing of performance of models. We reviewed the updates to the scripts used in the underlying tool to calculate ECL to ensure that they reflected approved updates to models, parameters and inputs. We tested the inputs of critical data into source systems and the flow and transformation of data between source systems to the impairment calculation engine. Substantive testing was performed over the critical data used in the year-end ECL calculation. We tested the review and challenge of multiple economic scenarios by an expert panel and internal governance committee, and assessed the reasonableness and likelihood of these scenarios using our economics experts. The severity and magnitude of the scenarios were compared to external forecasts and data from historical economic downturns, and the sensitivities of the scenarios on the ECL were considered. We observed challenge forums to assess the ECL output and approval of post-model adjustments. Relevant economic, political and other events were considered in assessing the completeness of post model adjustments. *Stage 3 individually assessed ECL* We tested the approval of the key inputs, assumptions and discounted cash-flows that support the impairment allowances for all significant individually assessed loans.

Key Audit Matter	How our audit addressed the Key Audit Matter
IT access management The audit approach relies extensively on automated controls and therefore on the effectiveness of controls over IT systems. The IT systems are predominantly managed by the wider HSBC Holdings plc group. For certain key IT systems relevant to the financial reporting process of the Banking Group, controls over access to applications, operating systems and data in the financial reporting process required improvements. Access management controls are critical to ensure that changes to applications and underlying data are made in an appropriate manner. Appropriate access and change controls contribute to mitigating the risk of potential fraud or errors as a result of changes to applications and data. Management responsible for managing the IT systems for the Banking Group has implemented remediation activities that have contributed to progress being made in reducing the risk associated with access management in the financial reporting process. Controls continue to require some improvement going forward.	Access rights were tested over applications, operating systems and databases relied upon for financial reporting. Specifically, the audit tested that: • new access requests for joiners were properly reviewed and authorised; • user access rights were removed on a timely basis when an individual left or changed role; • access rights to applications, operating systems and databases were periodically monitored for appropriateness; and • highly privileged access was restricted to appropriate personnel. Other areas that we assessed included password policies, security configurations, controls over changes to code, data and configurations and that the ability to make such change via privileged operating system or database access in the production environment was appropriately restricted. As a consequence of the control deficiencies identified, a range of other procedures were performed: • where access outside of policy was identified, we understood the nature of the access, and, where required, obtained additional evidence on whether that access had been exploited; • testing of controls to manage monitoring of business access; • additional substantive testing was performed on manual journals and specific year-end reconciliations (i.e. bank account and suspense account reconciliations) and confirmations with external counterparties; • testing was performed on other compensating controls such as transaction approvals by the appropriate delegated authorities; and • a list of users' access permissions was obtained and manually compared to other access lists where segregation of duties was deemed to be of higher risk, for example, assessing segregation of duties between user access to front office and back office treasury systems.

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

The Directors of The Hongkong and Shanghai Banking Corporation Limited (the 'Directors') are responsible for the other information included in the Disclosure Statement. The other information comprises the information required to be included in the Disclosure Statement in accordance with Schedule 2 of the Order and is included on pages 2 to 9, 11 and 75. Our opinion on the financial statements and supplementary information does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements and the supplementary information, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is

materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the financial statements and supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy)

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

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

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

Auditor's responsibilities for the audit of the financial statements and supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy)

Our objectives are to obtain reasonable assurance about whether the financial statements and the supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 7, 28 and 36) disclosed in accordance with Clause 25 and Schedules 4, 7, 11 and 13 of the Order, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (NZ) and ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located at the External Reporting Board's website at:
https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/

This description forms part of our auditor's report.

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

We also report in accordance with the requirements of Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the financial statements and supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 7, 28 and 36) for the year ended 31 December 2019:

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

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

We have examined the supplementary information relating to credit and market risk exposures and capital adequacy required by Schedule 9 of the Order as disclosed in Notes 7, 28 and 36 of the financial statements of the Banking Group for the year ended 31 December 2019.

Our conclusion

Based on our review, nothing has come to our attention that causes us to believe that the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 7, 28 and 36, is not, in all material respects, disclosed in accordance with Schedule 9 of the Order.

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

Basis for our conclusion

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

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

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

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

Our responsibility is to express a conclusion, whether, based on our review, the supplementary information relating to credit and market risk exposures and capital adequacy, disclosed in Notes 7, 28 and 36, is not, in all material respects, disclosed in accordance with Schedule 9 of the Order.

A review of the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 7, 28 and 36 in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with ISAs (NZ) and ISAs. Accordingly we do not express an audit opinion on the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 7, 28 and 36.

Auditor independence

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

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

Who we report to

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

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

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants
3 April 2020

Auckland

HSBC