The Hongkong and Shanghai Banking Corporation Limited

New Zealand Banking Group

Disclosure Statement

31 December 2018

Disclosure Statement
For the Year Ended 31 December 2018

Contents	Page

General Disclosures

Registered Bank

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

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

New Zealand Branch

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

New Zealand Head Office:
1 Queen Street
Auckland
New Zealand

New Zealand Banking Group

The New Zealand Banking Group ("Banking Group") is the New Zealand operations of HBAP and all New Zealand incorporated subsidiaries of HBAP. The entities that have been considered for aggregation to form the Banking Group are detailed in the Notes to 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 and associated companies.

Ultimate Holding Company

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

Access to parental disclosures

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

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)*

Government Guarantee

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

Other Material Matters

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

Pending Proceedings and Arbitration

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

Auditor

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

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

New Zealand Chief Executive Officer /Responsible Person

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

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

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

Dealings with Responsible Person

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

Board of Directors of HBAP

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

^* John Michael Flint (Chairman)
Bachelor of Arts (Hons) in Economics, Portsmouth Polytechnic, 1989
Group Chief Executive and Executive Director, HSBC Holdings plc

Peter Tung Shun Wong (Deputy Chairman and Chief Executive)
Bachelor of Arts, Indiana University, 1974; Master of Business Administration, Indiana University, 1976;
Master of Science, Indiana University, 1979

General Disclosures *(continued)*

Board of Directors of HBAP (*continued*)

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

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

* **Graham John Bradley**
Bachelor of Arts and Bachelor of Laws (Hons I), Sydney University, 1971;
Master of Laws, Harvard University, 1973
Company Director

Louisa Wai Wan Cheang
Bachelor of Social Sciences, The University of Hong Kong, 1985
Vice-Chairman and Chief Executive, Hang Seng Bank Limited

Dr Christopher Wai Chee Cheng, GBS, OBE
Bachelor of Business Administration, University of Notre Dame, 1969; Master of Business Administration, Columbia University, 1979; Doctorate in Social Sciences honoris causa, The University of Hong Kong, 2011; Honorary Degree of Doctor of Business Administration; Hong Kong Polytechnic University, 2014
Chairman, Wing Tai Properties Limited

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

Yiu Kwan Choi
Higher Certificate in Accountancy, Hong Kong Polytechnic University, 1976
Company Director

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

* **Jennifer Xinzhe Li**
Bachelor of Arts, Tsinghua University, Beijing, China, 1990
Master of Business Administration, University of British Columbia, Vancouver, Canada, 1994
General Managing Partner, Changcheng Investment Partners

^ **Victor Tzar Kuoi Li**
Bachelor of Science degree in Civil Engineering, and a Master of Science degree in Civil Engineering, Stanford University, 1986; Doctor of Laws, honoris causa (LL.D), University of Western Ontario, 2009
Chairman and Managing Director of CK Asset Holdings Limited, and
Chairman and a Group Co-managing Director of CK Hutchison Holdings Limited

* **Bin Hwee Quek (née Chua)**, JP
Bachelor of Accountancy (Hons), The University of Singapore, 1979
Chartered Accountant, Institute of Singapore Chartered Accountants, 2013
Company Director

General Disclosures *(continued)*

Board of Directors of HBAP (*continued*)

 # Kevin Anthony Westley, BBS
Bachelor of Arts (Hons), University of London (LSE), 1970; Chartered Accountant, Institute of Chartered Accountants in England and Wales, 1973
Company Director

 # Marjorie Mun Tak Yang, GBS
B.Sc. in Mathematics, Massachusetts Institute of Technology, 1974; Master of Business Administration, Harvard Business School, 1976
Chairman, Esquel Holdings Inc.

 # * Tan Sri Dr Francis Sock Ping Yeoh, CBE
Bachelor of Science (Hons) in Civil Engineering, University of Kingston, UK, 1978; Honorary Doctorate of Engineering, University of Kingston, 2004
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. John Michael Flint resides in the United Kingdom, Zia Mody resides in India, Graham John Bradley resides in Australia, Tan Sri Dr 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

John Michael Flint has been appointed as a non-executive Director and the Chairman of the Board with effect from 16 January 2018 and 21 February 2018 respectively.

Stuart Thomson Gulliver stepped down as a Director and Chairman of the Board on 20 February 2018.

John Robert Slosar stepped down as an independent non-executive director of the Board at the conclusion of the Board meeting on 24 July 2018.

There have been no other changes in the composition of the Board of Directors since 31 December 2017.

Directors' Policy on Conflicts of Interests

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."

Directors' Interests in Contracts

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

General Disclosures *(continued)*

Audit Committee

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

Credit Rating

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

	Current Rating	Previous Rating (if changed in the previous two years)	Date of Change
Moody's Investor Service Inc.	Aa3 (stable outlook)	Aa2 (negative outlook)	27 September 2017
Standard & Poor's Corporation	AA- (stable outlook)	Not changed	-
Fitch IBCA Inc.	AA- (stable outlook)	Not changed	-

Rating scales are:

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

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

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

Conditions of Registration

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

These conditions of registration apply on and after 1 January 2018.

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 65%, 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 15% 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 2018, 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 ended on the last day of June 2018 and the second ends on the last day of December 2018.

Changes to Conditions of Registration since the 30 June 2018 Disclosure Statement

There were no changes in the conditions of registration between 30 June 2018 and 31 December 2018.

CONTENTS

HISTORICAL SUMMARY OF FINANCIAL STATEMENTS

FIVE YEAR COMPARISON

	Banking Group				
	Audited Year ended 31 December				
Dollars in Thousands	**2018**	2017	2016	2015	2014
Summary of Financial Results					
Interest income	**188,819**	167,356	174,238	230,879	206,493
Interest expense	**(104,098)**	(79,554)	(93,279)	(135,843)	(116,554)
Net interest income	**84,721**	87,802	80,959	95,036	89,939
Net trading income	**11,085**	6,868	8,552	14,704	8,650
Other net operating income	**37,905**	35,453	34,654	36,632	34,725
Net operating income before credit impairment charges	**133,711**	130,123	124,165	146,372	133,314
Loan impairment (charges) / releases	**-**	(3,288)	1,429	35,140	18,046
Change in expected credit loss and other credit impairment charges	**3,844**	-	-	-	-
Net operating income	**137,555**	126,835	125,594	181,512	151,360
Operating expenses	**(66,001)**	(61,331)	(61,205)	(63,841)	(58,926)
Operating profit before tax	**71,554**	65,504	64,389	117,671	92,434
Income tax expense	**(20,132)**	(18,394)	(18,081)	(33,032)	(25,978)
Profit after tax	**51,422**	47,110	46,308	84,639	66,456
Retained profit repatriated	**(46,584)**	(47,174)	(77,290)	(72,585)	(21,026)
Balance Sheet					
Total assets	**6,029,755**	6,404,765	5,086,021	5,591,088	5,308,720
of which: Individually impaired assets[1]	**5,127**	9,384	2,833	3,503	121,913
Total Liabilities	**6,003,914**	6,379,409	5,060,948	5,536,733	5,264,771
Head Office Account	**23,099**	22,747	22,811	53,793	41,739
Total Equity	**25,841**	25,356	25,073	54,355	43,949

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

1. Balances reported for 2018 are calculated under NZ IFRS 9, all prior year balances are calculated under NZ IAS 39 and are not directly comparable.

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2018

		Banking Group	
		12 months ended	
Dollars in Thousands	Note	**31.12.18**	31.12.17
Interest income	3	**188,819**	167,356
Interest expense	3	**(104,098)**	(79,554)
Net interest income		**84,721**	87,802
Net trading income	3	**11,085**	6,868
Other net operating income	3	**37,905**	35,453
Net operating income before credit impairment charges		**133,711**	130,123
Loan impairment (charges) / releases	10	**-**	(3,288)
Change in expected credit loss and other credit impairment (charges) / releases	10	**3,844**	-
Net operating income		**137,555**	126,835
Operating expenses	4	**(66,001)**	(61,331)
Operating profit before tax		**71,554**	65,504
Income tax expense	19	**(20,132)**	(18,394)
Profit after tax attributable to owners of the Banking Group		**51,422**	47,110
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		**42**	-
Income taxes		**(11)**	-
Available-for-sale financial asset:			
Fair value gains / (losses) other comprehensive income		**-**	517
Income taxes		**-**	(90)
Other comprehensive income / (expense) for the year		**31**	427
Total comprehensive income for the year attributable to owners of the Banking Group		**51,453**	47,537

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 2018

		Banking Group	
		12 months ended	
Dollars in Thousands	Note	**31.12.18**	31.12.17
Head Office Account *			
At beginning of the year		**22,747**	22,811
Changes in initial application of NZ IFRS 9	1	**(4,486)**	-
Restated balance at beginning of the year		**18,261**	22,811
Repatriation to Head Office		**(46,584)**	(47,174)
Profit after tax		**51,422**	47,110
At end of the year		**23,099**	22,747
Available-for-Sale Reserve			
At beginning of the year		**1,050**	623
Changes in initial application of NZ IFRS 9	1	**(1,050)**	-
Restated balance at beginning of the year		**-**	623
Fair value changes taken to equity			703
Transferred to the profit or loss		**-**	(186)
Tax on movements and transfers		**-**	(90)
At end of the year		**-**	1,050
Financial assets at Fair Value through Other Comprehensive Income Reserve			
Changes in initial application of NZ IFRS 9	1	**1,055**	-
Restated balance at beginning of the year		**1,055**	-
Fair value changes taken to equity		**18**	-
Transferred to the profit or loss		**24**	-
Tax on movements and transfers		**(11)**	-
At end of the year		**1,086**	-
Share-based Payment Reserve			
At beginning of the year		**1,559**	1,639
Transferred to the profit or loss		**106**	138
Recycle of capital contribution in respect of pre-funded SBPs		**-**	28
Movement in share-based payment arrangements		**(9)**	(246)
At end of the year		**1,656**	1,559
Equity at end of the year		**25,841**	25,356
Represented by:			
Profit after tax		**51,422**	47,110
Other comprehensive income		**31**	427
Total comprehensive income for the year		**51,453**	47,537
Repatriation to Head Office		**(46,584)**	(47,174)
Movement in share-based payment reserve		**97**	(80)
Changes in initial application of NZ IFRS 9	1	**(4,481)**	-
Equity at beginning of the year		**25,356**	25,073
		25,841	25,356

* 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 2018

		Banking Group	
Dollars in Thousands	Note	**31.12.18**	31.12.17
ASSETS			
Cash and demand balances with central banks		**529,852**	749,892
Advances to banks		**6,704**	27,478
Financial investments		**421,975**	243,560
Derivative financial instruments	22	**49,986**	33,883
Advances to customers	6	**4,124,212**	4,444,132
Amounts due from related parties	21	**855,678**	867,052
Other assets	16	**24,415**	22,945
Property, plant and equipment		**1,248**	1,399
Deferred tax asset	19	**1,180**	180
Goodwill and intangible assets	20	**14,505**	14,244
Total Assets		**6,029,755**	6,404,765
LIABILITIES			
Deposits by banks		**228,503**	274,982
Derivative financial instruments	22	**51,135**	32,798
Customer deposits	13	**3,058,901**	3,154,319
Debt securities	14	**689,748**	388,962
Amounts due to related parties	21	**1,921,719**	2,482,254
Other liabilities	17	**48,602**	41,820
Current tax liabilities		**5,306**	4,274
Total Liabilities		**6,003,914**	6,379,409
Net Assets		**25,841**	25,356
EQUITY			
Head Office account		**23,099**	22,747
Other reserves		**1,086**	1,050
Share-based payment reserve	29	**1,656**	1,559
Total Equity		**25,841**	25,356

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

Christopher David Gosse Russell
22 March 2019
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 2018

	Banking Group	
	12 months ended	
Dollars in Thousands	**31.12.18**	31.12.17
Cash flows from / (to) operating activities		
Interest received	**193,426**	170,160
Fees and commissions	**36,035**	35,285
Realised trading gains	**14,614**	3,590
Interest paid	**(96,912)**	(78,228)
Operating expenses	**(58,307)**	(60,930)
Taxation paid	**(18,366)**	(17,200)
Net cash flows from operating activities before changes in operating assets and liabilities	**70,490**	52,677
Changes in operating assets and liabilities arising from cash flow movements		
Cash was provided net from / applied net (to):		
Advances to customers	**319,971**	(1,000,554)
Amounts due from related parties	**11,206**	(521,206)
Other assets	**(923)**	814
Other liabilities	**496**	5,610
Debt securities issued / (repaid)	**298,283**	56,662
Deposits by banks	**(46,954)**	43,275
Customer deposits	**(95,418)**	36,117
Amounts due to related parties	**(566,889)**	1,306,431
Net change in operating assets and liabilities	**(80,228)**	(72,851)
Net cash flows (to) / from operating activities	**(9,738)**	(20,174)
Cash flows (to) / from investing activities		
Financial investments purchased	**(232,004)**	(88,066)
Financial investments sold	**5,066**	25,001
Financial investments matured	**43,500**	302,300
Acquisition of property, plant and equipment	**(372)**	(259)
Acquisition of intangible assets	**(821)**	-
Net cash flows (to) / from investing activities	**(184,631)**	238,976
Cash flows to financing activities		
Repatriation to head office	**(46,584)**	(47,174)
Net cash flows (to) / from financing activities	**(46,584)**	(47,174)
Net (decrease) / increase in cash and cash equivalents	**(240,953)**	171,628
Effect of exchange rate fluctuations on cash held	**62**	(57)
Cash and cash equivalents at beginning of year	**776,974**	605,403
Cash and cash equivalents at end of year	**536,083**	776,974

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 2018

	Banking Group	
	12 months ended	
Dollars in Thousands	**31.12.18**	31.12.17
Analysis of cash and cash equivalents		
Cash and demand balances with central banks	**529,852**	749,892
Items in the course of collection from other banks[1]	**48**	31
Advances to banks – demand	**6,656**	27,447
Less: items in the course of transmission to other banks[1]	**(473)**	(396)
	536,083	776,974

[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.

Reconciliation of profit after tax to net cash flows from operating activities		
Profit after tax	**51,422**	47,110
Adjustments to reconcile profit after tax to net cash flow from operating activities:		
Change in interest accruals	**4,251**	(1,770)
Change in fair value of derivatives	**2,595**	(3,666)
Depreciation of property, plant and equipment	**523**	536
Amortisation of intangible asset	**560**	809
Amortisation of premium and discounts	**7,542**	5,897
Change in deferred income and accrued expense	**5,237**	(656)
Amortisation of share options granted	**-**	(77)
Impairment charge / (release) on loans and advances	**-**	3,288
Change in expected credit loss	**(3,406)**	-
Loss on disposal of debt securities	**-**	12
Change in current and deferred taxation	**1,766**	1,194
Adjust operating cash flows not included in profit after tax:		
Net change in operating assets and liabilities	**(80,228)**	(72,851)
Net cash flows (to) / from operating activities	**(9,738)**	(20,174)

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:

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.

The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch

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, and financial assets and liabilities at fair value through profit or loss. They are prepared on a going concern basis and the accrual basis of accounting has been adopted. The presentation currency and functional currency is New Zealand dollars. All amounts are rounded to thousands of New Zealand dollars and all references to "$" is to New Zealand dollars unless otherwise stated.

Comparative figures

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

There have been no material changes to comparative figures.

Authorisation of financial statements

These financial statements were authorised for issue on 22 March 2019 by Christopher David Gosse Russell on behalf of the directors of The Hongkong and Shanghai Banking Corporation Limited.

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

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

Future accounting developments

NZ IFRS 16 Leases

NZ IFRS 16 '*Leases*' has an effective date for annual periods beginning on or after 1 January 2019. NZ IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under NZ IAS 17 '*Leases*'. Lessees will recognise a 'right of use' ('ROU') asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease, and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as under NZ IAS 17.

At 1 January 2019, the Banking Group expects to adopt the standard using a modified retrospective approach where the cumulative effect of initially applying the standard is recognised an adjustment to the opening balance of retained earnings and comparatives are not restated. The implementation is expected to increase assets (ROU assets) by approximately $2 million and increase financial liabilities by approximately $2 million with no effect on net assets or retained earnings.

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

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

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

Changes in accounting policies

The Banking Group has adopted the requirements of NZ IFRS 9 *'Financial Instruments'* ('NZ IFRS 9') from 1 January 2018, including the adoption of 'Prepayment Features with Negative Compensation (Amendments to NZ IFRS 9)' which is effective for annual periods beginning on or after 1 January 2019 with early adoption permitted. NZ IFRS 9 includes an accounting policy choice to continue to apply hedge accounting under NZ IAS 39 *'Financial Instruments: Recognition and Measurement'* hedge accounting, which the Banking Group has exercised. The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application. As permitted by NZ IFRS 9, the Banking Group has not restated comparatives and accordingly comparative information may not be directly comparable. Adoption of NZ IFRS 9 reduced net assets at 1 January 2018 by $4.5 million as set out on page 26.

In addition, the Banking Group has adopted the requirements of NZ IFRS 15 *'Revenue from Contracts with Customers'* and a number of interpretations and amendments to standards which have had an insignificant effect on the aggregated financial statements of the Banking Group.

Accounting policy changes from implementing NZ IFRS 9

Set out below are the new or substantially revised accounting policies implementing NZ IFRS 9 which replace the existing NZ IAS 39 policies from 1 January 2018 with respect to classification and measurement and impairment. The accounting policies on hedge accounting are unchanged and are not repeated.

(a) 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.

(b) 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 'Gains (losses) arising from derecognition of debt instruments measured at fair value through other comprehensive income'. Financial assets measured at FVOCI are included in the impairment calculations and impairment is recognised in the profit or loss.

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

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

Changes in accounting policies *(continued)*

(c) 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. Otherwise equity securities are measured at fair value through profit or loss (except for dividend income which is recognised in profit or loss).

(d) 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.

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

Changes in accounting policies *(continued)*

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; and
- 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. 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.

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.

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

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

Changes in accounting policies *(continued)*

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.

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 scores 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.

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

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

Changes in accounting policies *(continued)*

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

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.

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

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

Changes in accounting policies *(continued)*

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.

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 four 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.

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

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

Changes in accounting policies *(continued)*

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 as a provision.

Forward-looking economic inputs

The Banking Group will in general apply three forward-looking global economic scenarios determined by Group with reference to external forecast distributions, the Consensus Economic Scenario approach. 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, unemployment, interest rates, inflation and commercial property 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.

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

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

Changes in accounting policies *(continued)*

Reconciliation of balance sheet as at 31 December 2017 and 1 January 2018

Dollars in Thousands	Measurement category NZ IAS 39	Measurement category NZ IFRS 9	NZ IAS 39 31.12.17	NZ IFRS 9 changes to classification and measurement	NZ IFRS 9 Remeasurement due to ECL	**NZ IFRS 9 01.01.18**
ASSETS						
Cash and demand balances with central bank	AC	AC	749,892	-	-	**749,892**
Advances to banks	AC	AC	27,478	-	(2)	**27,476**
Financial investments	AFS	FVOCI	243,560	-	-	**243,560**
Derivative financial instruments	FVPL	FVPL	33,883	-	-	**33,883**
Advances to customers	AC	AC	4,444,132	-	(4,439)	**4,439,693**
Amounts due from related parties	AC	AC	867,052	-	-	**867,052**
Other assets	AC	AC	22,945	-	(8)	**22,937**
Property, plant and equipment	N/A	N/A	1,399	-	-	**1,399**
Deferred tax asset	N/A	N/A	180	-	1,745	**1,925**
Goodwill and intangible assets	N/A	N/A	14,244	-	-	**14,244**
Total Assets			6,404,765	-	(2,704)	**6,402,061**
LIABILITIES						
Deposits by banks	AC	AC	274,982	-	-	**274,982**
Derivative financial instruments	FVPL	FVPL	32,798	-	-	**32,798**
Customer deposits	AC	AC	3,154,319	-	-	**3,154,319**
Debt securities	AC	AC	388,962	-	-	**388,962**
Amounts due to related parties	AC	AC	2,482,254	-	-	**2,482,254**
Other liabilities	AC	AC	41,820	-	1,777	**43,597**
Current tax liabilities	N/A	N/A	4,274	-	-	**4,274**
Total Liabilities			6,379,409	-	1,777	**6,381,186**
Net Assets			25,356	-	(4,481)	**20,875**
EQUITY						
Head office account	N/A	N/A	22,747	-	(4,486)	**18,261**
Other reserves[1]	N/A	N/A	1,050	-	5	**1,055**
Share-based payment reserve	N/A	N/A	1,559	-	-	**1,559**
Total Equity			25,356	-	(4,481)	**20,875**

AC - Amortised Cost; FVPL - Fair value through profit or loss; FVOCI – Fair value through other comprehensive income
AFS – Available-for-sale; N/A – Not applicable

[1] While NZ IFRS 9 ECL has no effect on the carrying value of FVOCI financial assets, which remain measured at fair value, the adoption of NZ IFRS 9 results in a transfer from the FVOCI reserve (formerly AFS reserve) to retained earnings to reflect the cumulative impairment recognised in profit or loss in accordance with NZ IFRS 9 (net of impairment losses previously recognised in profit or loss under NZ IAS 39). The resulting cumulative expected credit losses recognised in 'Retained earnings' on financial assets measured at FVOCI on adoption of NZ IFRS 9 is $5,000.

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

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

Changes in accounting policies *(continued)*

Reconciliation of impairment allowances

The following table is a comparison of impairment allowances determined in accordance with NZ IAS 39 and NZ IAS 37 to the corresponding impairment allowance determined in accordance with NZ IFRS 9 as at 1 January 2018.

	NZ IAS 39 / NZ IAS 37 as at 31 December 2017				**NZ IFRS 9 at 1 January 2018**			
Dollars in Thousands	Collective	Individual	Total	Transition	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Advances to customers	1,279	4,510	5,789	4,439	**2,778**	**3,741**	**3,709**	**10,228**
Advances to banks	-	-	-	2	**2**	**-**	**-**	**2**
Other assets	-	-	-	8	**4**	**4**	**-**	**8**
Off balance sheet loan commitments and financial guarantees	-	-	-	1,777	**455**	**1,322**	**-**	**1,777**
Total allowance for Credit losses	1,279	4,510	5,789	6,226	**3,239**	**5,067**	**3,709**	**12,015**

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

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

Critical accounting estimates and judgements in applying accounting policies

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

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

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

Loan impairment

The implementation of NZ IFRS 9 resulted in a change to the assessment of the critical accounting estimates and judgements related to impairment of financial assets. In determining 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 are newly adopted, there has 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.

Further information on these accounting estimates and judgements can be found in the earlier 'Changes in accounting policies' section.

Valuation of financial instruments

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

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

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

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

Critical accounting estimates and judgements in applying accounting policies *(continued)*

Valuation of financial instruments *(continued)*

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

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

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.

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

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

PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies should be read in conjunction with the new NZ IFRS 9 policies detailed in the 'Changes in accounting policies' note.

Financial assets & financial liabilities – Derecognition

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

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 FVTPL. 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.

Where the derivatives are managed with debt securities issued by the group that are designated at fair value, the contractual interest is shown in 'Interest expense' together with the interest payable on the issued debt.

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.

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.

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 is the grantor of its equity instruments for all share awards across the Group. The Banking Group uses the share-based payment reserve to record the corresponding amount relating to share options granted to employees of the Banking Group and represents an effective capital contribution. A cancellation that occurs during the vesting period is treated as an acceleration of vesting, and the expense recognised immediately in the profit or loss for the amount that would otherwise have been recognised over the vesting period.

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

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

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

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.

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

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

Interest income and expenses

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. However, as an exception to this, interest on debt securities issued by the Banking Group that are designated under the fair value option and derivatives managed in conjunction with those debt securities are included in interest expense. Interest on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the 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. All other 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 we have fully provide 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.

Net income/(expense) from financial instruments measured at fair value through profit or loss includes 'Net income from financial instruments held for trading or managed on a fair value basis'. This element is comprised of the net trading income, which includes all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with the related interest income, expense and dividends; and it also includes all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets and liabilities measured at fair value through profit or loss.

Leases

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

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.

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

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

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.

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

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

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

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 profit or loss except to the extent that it relates to items recognised directly in other comprehensive income or equity, in which case it is recognised in other comprehensive income.

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

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

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

Tax related to fair value re-measurement of Financial Assets measured at FVOCI, which are charged or credited directly to other comprehensive income, is also credited or charged directly to other comprehensive income and is subsequently recognised in profit or loss when the deferred gain or loss is recognised in profit or loss.

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

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

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

Accounting policies applicable prior to 1 January 2018

Impairment of loans and advances

Losses for impaired loans are recognised when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Losses that may arise from future events are not recognised.

Debt & equity securities

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

Individually assessed loans and advances

The factors considered in determining whether a loan is individually significant for the purposes of assessing impairment include the size of the loan, the number of loans in the portfolio, the importance of the individual loan relationship and how this is managed. Loans that are determined to be individually significant will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective methodology.

Loans considered as individually significant are typically to corporate and commercial customers, are for larger amounts and are managed on an individual basis. For these loans, HSBC considers on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired.

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

Impairment losses are calculated by discounting the expected future cash flows of a loan, which include expected future receipts of contractual interest, at the loan's original effective interest rate or an approximation thereof, and comparing the resultant present value with the loan's current carrying amount.

Collectively assessed loans and advances

Impairment is assessed collectively to cover losses that have been incurred but have not yet been identified on loans subject to individual assessment or for homogeneous groups of loans that are not considered individually significant, which are generally retail lending portfolios.

Write-off of loans and advances

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

Reversals of impairment

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

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

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

Accounting policies applicable prior to 1 January 2018

Available-for-sale securities

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

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

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

If the available-for-sale financial asset is impaired, the difference between its acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the profit or loss, is recognised in the profit or loss. In assessing objective evidence of impairment at the reporting date, the Banking Group considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows.

Net Fees

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

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

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

2. Risk Management

RISK POLICIES

The Banking Group operates under an Enterprise Risk Management Framework ('ERMF'), which governs our overall approach to managing risk. Other frameworks help us manage specific risks such as operational risk. These frameworks are used throughout the Banking Group and together, they ensure the Group:

- manages risk in the same way across the Banking Group;
- has a strong risk culture: managing risk is simply part of how we work;
- is aware of risks and takes better decisions as a result;
- only takes the right type and amount of risk to grow our business safely;
- delivers fair outcomes for customers and maintain the orderly and transparent operation of financial markets.

Our risk taxonomy identifies 29 risk types grouped under 3 categories: Financial Risk, Non-Financial Risk and Transverse Risks. The Banking Group manages all the different types of risks that affect the Banking Group and reports on them consistently with other Group operations.

We use a 'three lines of defence' model to manage risk. This defines who is responsible for doing what to identify, assess, measure, manage, monitor, and mitigate our risks. Enterprise wide exposure to these risks is monitored by the Executive Committee ("EXCO"), and focussed governance forums including the Banking Group's Risk Management Meeting ("RMM"), Asset and Liability Management Committee ("ALCO"). Membership includes all the relevant Risk Owners, Risk Stewards and Risk Assurance representatives.

Credit risk

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

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

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 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.

2. Risk Management *(continued)*

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 government sectors are managed centrally to optimise the use of credit availability and to avoid excessive risk concentration. The Banking Group remains responsible for its own credit exposures. In addition to the portfolio management undertaken at Group level, 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.

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

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 use a 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.

Previously, we disclosed retail lending credit quality under IAS 39, which was based on expected-loss percentages. Now, retail lending credit quality is disclosed on an IFRS 9 basis, which is based on a 12-month point-in-time (‘PIT’) probability-weighted probability of default (‘PD’).

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. The Banking Group does not have significant traded risk exposure.

Market risk is managed and controlled through limits approved by the 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.

2. Risk Management *(continued)*

Market risk *(continued)*

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.

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. Where there is not an approved internal model, we use the appropriate regulatory rules to capitalise exposures.

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 extreme ones.
- The use of a holding period assumes that all positions can be liquidated or the risks offset during that period, which may not fully reflect the market risk arising at times of severe illiquidity, when the holding period may be insufficient to liquidate or hedge all positions fully.
- 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.

2. Risk Management *(continued)*

Stress Testing

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

The Group carries out stress testing at a regional level in HBAP and at a global level in Group using data from internal systems, 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 is immaterial. This is consistent with the comparable period.

Currency risk

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

Foreign currency risk exposure is disclosed in Note 27. A sensitivity analysis is not performed 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 performed as the sensitivity range is immaterial to the Banking Group.

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

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.

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

2. Risk Management *(continued)*

Liquidity and funding *(continued)*

Policies and procedures

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

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

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

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

Liquidity and funding risk management framework

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.

2. Risk Management *(continued)*

Liquidity and funding *(continued)*

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 2018, 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 2018, 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 2018, the Banking Group was within the risk tolerance levels established in accordance with the Group's LFRF.

Operational risk

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

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

HSBC's Operational Risk Management Framework ('ORMF') is our overarching approach for managing operational risk.

The ORMF defines minimum standards and processes, and the governance structure for the management of operational risk and internal control in global businesses and global functions. The ORMF has been codified in a high-level standards manual, supplemented with detailed policies, which describes our approach to identifying, assessing, monitoring and controlling operational risk and gives guidance on mitigating action to be taken when weaknesses are identified.

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

2. Risk Management *(continued)*

Operational risk *(continued)*

We have a dedicated Global Operational Risk sub-function within our Global Risk function. It is responsible for establishing and maintaining the ORMF, monitoring the level of operational losses and the internal control environment supported by their second line of defence functions. It supports the Chief Risk Officer. The sub-function is also responsible for preparation of operational risk reporting at Group level, including reports for consideration by the RMM. A formal governance structure provides oversight of the sub-function's management.

Key risk management processes

Business managers throughout the Group are responsible for maintaining an acceptable level of internal control commensurate with the scale and nature of operations, and for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The ORMF helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

A Group-wide risk management system is used to record the results of the operational risk management process. Operational risk and control self-assessments, along with issue and action plans, are entered and maintained by business units. Business and functional management monitor the progress of documented action plans to address shortcomings. To help ensure that operational risk losses are consistently reported and monitored at Group level, all Group companies are required to report individual losses when the net loss is expected to exceed $10,000, and to aggregate all other operational risk losses under $10,000. Losses are entered into the Group-wide risk management system and reported to governance on a monthly basis.

Internal audit

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

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

Though some audit cycles are predetermined by regulatory or similar stipulations, in general, audits throughout the Group are carried out on a frequency determined primarily by the risk grading allocated to the business unit at the time of the previous audit, with units considered to represent greater risks being audited at more frequent intervals. 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 31.12.18**	12 months 31.12.17
3. Operating income		
(a) Net interest income		
Interest income		
Advances to banks	**12,685**	9,734
Financial Instruments[1]	**8,809**	8,874
Advances to customers	**155,336**	145,264
Related parties – HBAP	**11,453**	3,115
Related parties – other	**225**	300
Other	**311**	69
	188,819	167,356
Interest expense		
Deposits by banks	**(3,148)**	(2,712)
Customer deposits	**(44,289)**	(39,588)
Debt securities	**(14,908)**	(6,788)
Related parties – HBAP	**(41,508)**	(30,404)
Related parties – other	**(77)**	(62)
Other	**(168)**	-
	(104,098)	(79,554)
(b) Net trading income[2]		
Foreign exchange gains /(losses)	**11,112**	4,966
(Losses) /gains on revaluation of derivatives	**(21)**	2,123
Credit valuation adjustments on derivatives	**8**	4,096
Debit valuation adjustments on derivatives	**13**	(4,131)
(Loss) /gain on hedging instrument in fair value hedge	**(4)**	(556)
(Loss) /gain on hedged item in fair value hedge	**(23)**	370
	11,085	6,868
(c) Other net operating income		
Fee and commission income		
Lending and credit facility fees	**20,659**	16,322
Custody and clearing fees	**6,239**	6,754
Other fees and commissions from:		
– Third parties	**10,934**	12,566
– Related parties - HBAP	**84**	346
– Related parties - other	**2,861**	2,149
	40,777	38,137
Fee and commission expense		
Brokerage expense	**(2,389)**	(2,232)
Other fees and commissions to:		
– Third parties	**(152)**	(63)
– Related parties - HBAP	**(471)**	(100)
– Related parties - other	**(356)**	(302)
	(3,368)	(2,697)
Other income		
Related parties - other	**496**	13
	496	13
	37,905	35,453

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 31.12.18**	12 months 31.12.17
4. Operating expenses		
Rental expense		
Premises	**1,826**	2,047
Equipment	**106**	146
	1,932	2,193
Depreciation and amortisation		
Leasehold improvements	**174**	190
Equipment, fixtures and fittings	**349**	346
Intangibles	**560**	809
	1,083	1,345
Staff costs		
Salaries & other staff expenses	**29,970**	28,303
Defined contribution pension costs	**2,000**	1,945
Share based payments	**267**	275
Other	**1,075**	1,678
	33,312	32,201
Other		
Related party management and technical fees – HBAP	**15,444**	12,827
Related party management and technical fees – other	**4,090**	2,673
Donations	**97**	95
Other operating expenses	**10,043**	9,997
	29,674	25,592
	66,001	61,331

5. Auditor's remuneration

Total fees paid to principal auditor by the Banking Group		
Audit and review of financial statements	**559**	565
Taxation compliance services	**15**	15
Employee immigration services	**8**	90
Total fees paid to principal auditor	**582**	670

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

In addition to the above, taxation compliance fees of $5.5 thousand were paid to the principal auditor by HBAP (2017: $7.3 thousand).

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

	Banking Group	
Dollars in Thousands	**31.12.18**	31.12.17
6. Advances to customers		
Overdrafts	**65,328**	136,959
Mortgages	**1,769,794**	1,656,668
Term lending	**2,160,208**	2,510,062
Non-eligible bills	**133,362**	146,232
Total gross advances to customers	**4,128,692**	4,449,921
Expected credit loss allowance	**(4,480)**	-
Provisions for loan impairment	**-**	(5,789)
Total net advances to customers	**4,124,212**	4,444,132

7. Additional mortgage information

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

	Banking Group			
Dollars in Thousands	Principal Amount			
LVR Range	**Does not exceed 80%**	**Exceeds 80% and not 90%**	**Exceeds 90%**	**Total**
31 December 2018 (Unaudited)				
Value of exposures on balance sheet	**1,754,259**	**13,823**	**1,712**	**1,769,794**
Value of exposures off balance sheet	**213,645**	**216**	**5**	**213,866**
Total value of exposures	**1,967,904**	**14,039**	**1,717**	**1,983,660**

	Banking Group	
Dollars in Thousands	**31.12.18**	31.12.17
8. Asset quality – Gross exposure		
Gross exposure of past due but not individually impaired advances to customers		
Less than 30 days	**39,707**	26,736
At least 30 days but less than 60 days	**611**	929
At least 60 days but less than 90 days	**15**	540
At least 90 days	**-**	2
Total past due but not individually impaired	**40,333**	28,207

	Banking Group	
Percentage of total gross Advances to customers	**31.12.18**	31.12.17
Fully collateralised	**55%**	50%
Partially collateralised	**2%**	6%
Not collateralised	**43%**	44%

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)*

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

Dollars in Thousands	Stage 1	Stage 2 (12 months ended 31 December 2018)	Stage 3	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	**209,803**	**(57,365)**	**(2,224)**	**150,214**
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	**4,136,388**	**157,759**	**2,920**	**4,297,067**

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

Dollars in Thousands	Stage 1	Stage 2 (12 months ended 31 December 2018)	Stage 3	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	**(332,861)**	**5,939**	**(917)**	**(327,839)**
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	**1,762,622**	**39,835**	**2,512**	**1,804,969**

There are no assets under administration as at 31 December 2018 (31 December 2017: nil). The aggregate amount as at 31 December 2018 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 $115 thousand (December 2017: $344 thousand).

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

Dollars in Thousands	***Banking Group*** 31.12.17
8. Asset quality – Gross exposure for advances to customers	
(Prior year disclosures under NZ IAS 39)	
Neither past due nor impaired	
Grade 1-3	4,322,486
Grade 4-5	89,844
Total neither past due nor impaired	4,412,330
Gross individually impaired assets	
Balance at the beginning of the year	2,833
Transfers from performing	9,369
Transfers to performing	(466)
Write-offs	-
Repayment	(2,352)
Balance at the end of the year	9,384
Individual provision for loan impairment	
Balance at the beginning of the year	1,148
New and additional provisions charged to profit or loss	3,689
Provisions released during the year to profit or loss	(327)
Write-offs	-
Discount unwind	-
Balance at the end of the year	4,510
Collective provision for loan impairment	
Balance at the beginning of the year	1,269
Charge/(Releases) during the year to profit or loss	10
Balance at the end of the year	1,279
Total provisions for loan impairment	5,789

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

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

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

8. Asset quality – Gross exposure for advances to customers *(continued)*
(Prior year disclosures under NZ IAS 39)

Other financial assets neither past due nor impaired

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

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

		Banking Group		
Dollars in Thousands	**Total**	**Grade 1-2**	**Grade 3**	**Grade 4-5**
31 December 2017				
Cash and demand balances with central banks	749,892	749,892	-	-
Advances to banks	27,478	27,478	-	-
Financial Investments	243,560	243,560	-	-
Derivative financial instruments	33,883	24,212	8,533	1,138
Amounts due from related parties	867,052	867,052	-	-

The credit quality of financial assets is assessed by reference to a Group standard credit rating system.

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

Grade 3 represents satisfactory risk, and includes corporate facilities that require closer monitoring and mortgages with higher loan to value ratios.

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

Grades 6 and 7 relate to impaired loans and advances.

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

9. Asset quality – Expected Credit Loss

Total Expected Credit Loss Allowance

	NZ IFRS 9 assessment at 31 December 2018			
Dollars in Thousands	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Advances to customers	**(2,584)**	**(952)**	**(944)**	**(4,480)**
Advances to banks	**(1)**	**-**	**-**	**(1)**
Other assets	**(7)**	**(45)**	**-**	**(52)**
Off balance sheet loan commitments and financial guarantees	**(547)**	**(2,290)**	**-**	**(2,837)**
Total Expected Credit Loss Allowance	**(3,139)**	**(3,287)**	**(944)**	**(7,370)**

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**	**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 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)**

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

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

9. Asset quality – Expected Credit Loss *(continued)*

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**	**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 loans and advances to banks and 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 table above as they are not material.

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

9. Asset quality – Expected Credit Loss *(continued)*

Credit quality classification

	Financial Investments	Wholesale lending and derivatives		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 2018							
	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	-	-	-	-	-	-	-	-
Debt instruments at FVOCI								
- stage 1	**421,953**	-	-	-	-	**421,953**	-	**421,953**
- stage 2	-	-	-	-	-	-	-	-
- stage 3	-	-	-	-	-	-	-	-
At 31 Dec 2018	**4,754,481**	**1,334,530**	**429,499**	**47**	**5,432**	**6,523,989**	**(7,318)**	**6,516,671**

Balances related to Other financial assets measured at amortised cost, Cash with central banks, and Amounts due from related parties 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	**31.12.18**	31.12.17
10. Change in Expected Credit Loss and loan impairment charges		
Change in Expected Credit Losses assessed under NZ IFRS 9		
Advances to customers		
- New allowances net of allowance releases	**5,750**	-
- Recoveries of amounts previously written off	**438**	-
- Amounts written off	**(1,267)**	
	4,921	-
Loan commitments and guarantees	**(1,040)**	-
Other financial assets	**(37)**	-
Loan impairment charges assessed under NZ IAS 39		
Individually assessed impairment (charges) / releases		
- New charges	**-**	(3,689)
- Releases	**-**	327
- Recoveries	**-**	84
	-	(3,278)
Collectively assessed impairment charge	**-**	(10)
Change in Expected Credit Loss and loan impairment charges	**3,844**	-
Loan impairment (charges) / releases	**-**	(3,288)

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

	Banking Group	
Dollars in Thousands	**31.12.18**	31.12.17
On-balance sheet credit exposures		
Cash and demand balances with central banks	**529,852**	749,892
Advances to banks	**6,704**	27,478
Financial investments	**421,975**	243,560
Derivative financial instruments	**49,986**	33,883
Advances to customers	**4,124,212**	4,444,132
Amounts due from related parties	**855,678**	867,052
Other assets	**24,044**	22,945
	6,012,451	6,388,942
Off-balance sheet credit exposures	**2,547,252**	2,693,885
Total credit exposures	**8,559,703**	9,082,827

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

Concentrations of credit risk by industry

Individual	**1,948,504**	1,886,458
Commercial and industrial	**1,585,847**	2,266,261
Commercial real estate and construction	**883,895**	992,798
Banks and financial institutions	**2,366,947**	2,203,082
Agriculture, forestry and mining	**126,899**	136,047
Transport	**259,829**	183,831
Energy	**445,319**	543,889
Government	**243,851**	210,808
Other	**698,612**	659,653
	8,559,703	9,082,827

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

11. Concentrations of credit risk *(continued)*

	Banking Group	
Dollars in Thousands	**31.12.18**	31.12.17
Concentrations of credit risk by geographical area		
New Zealand	**6,863,226**	7,374,018
Hong Kong	**867,231**	768,630
Australia	**194,847**	325,547
China	**141,119**	166,921
Great Britain	**80,275**	73,141
United States	**193,262**	220,088
Other Overseas	**219,743**	154,482
	8,559,703	9,082,827

12. Concentrations of funding risk

	Banking Group	
Dollars in Thousands	**31.12.18**	31.12.17
Concentrations of funding by product		
Deposits by banks	**228,503**	274,982
Customer deposits	**3,058,901**	3,154,319
Debt securities	**689,748**	388,962
Amounts due to related parties	**1,921,719**	2,482,254
	5,898,871	6,300,517
Concentrations of funding by industry		
Agriculture, forestry and mining	**115,146**	72,423
Manufacturing	**303,163**	328,310
Wholesale and retail trade	**174,193**	177,601
Accommodation and restaurants	**13,110**	45,983
Banking and finance	**2,863,770**	3,174,191
Property and business services	**203,773**	279,754
Local authorities	**5,683**	7,807
Individual	**2,005,154**	2,003,828
Other	**214,879**	210,620
	5,898,871	6,300,517
Concentrations of funding by geographical area		
New Zealand	**2,645,531**	2,336,604
China	**197,393**	243,914
Great Britain	**202,328**	240,735
Hong Kong	**2,047,722**	2,617,242
United States	**248,749**	249,408
Other Overseas	**557,148**	612,614
	5,898,871	6,300,517

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

	Banking Group	
Dollars in Thousands	**31.12.18**	31.12.17

13. Customer deposits

Current accounts	**1,813,605**	2,078,063
Savings and deposit accounts	**1,242,075**	1,070,112
Other deposit accounts	**3,221**	6,144
Total customer deposits at amortised cost	**3,058,901**	3,154,319

14. Debt securities

Certificates of deposit issued	**89,748**	188,962
Medium term notes issued	**600,000**	200,000
	689,748	388,962

There are no debt securities on demand.

15. Additional financial disclosures on the balance sheet

Total interest earning and discount bearing assets	**5,938,422**	6,331,941
Total interest and discount bearing liabilities	**5,692,369**	6,073,643
Total liabilities net of amounts due to related parties	**4,065,584**	3,884,046

16. Other assets

Accrued interest receivable – third party	**13,443**	13,805
Acceptances and endorsements	**7,605**	5,873
Other	**3,367**	3,267
	24,415	22,945

Transaction fees receivable of $5 thousand (December 2017: $1.6 million) in respect of third party deals, but collected through Group intermediaries, are included within the Other balance.

17. Other liabilities

Accrued interest payable	**11,258**	10,569
Accruals and deferred income	**9,791**	9,691
Acceptances and endorsements	**7,610**	5,873
Other	**19,943**	15,687
	48,602	41,820

Accruals as at 31 December 2018 include $7.2 million for employee entitlements (December 2017: $6.5 million).

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, formed of senior management of each business unit, acts as the Banking Group's chief operating decision-maker and assesses the Banking Group's performance on this basis.

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 31.12.18				
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	**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**
Other net operating income	**459**	**31,404**	**6,845**	**(803)**	**37,905**
Operating income	**38,662**	**69,786**	**17,842**	**7,421**	**133,711**
Change in expected credit loss	**530**	**3,304**	**10**	**-**	**3,844**
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)*

18. Segment reporting *(continued)*

	Banking Group 12 months ended 31.12.17				
Dollars in Thousands	RBWM	CMB	GBM	Corporate Centre	Aggregated
Net interest income	35,844	35,549	4,616	11,793	87,802
Net trading income	1,413	3,343	3,544	(1,432)	6,868
Other net operating income	718	23,896	9,105	1,734	35,453
Operating income	37,975	62,788	17,265	12,095	130,123
Loan impairment (charges) / release	329	(3,617)	-	-	(3,288)
Operating expense	(23,197)	(28,205)	(8,926)	(1,003)	(61,331)
Operating profit before tax	15,107	30,966	8,339	11,092	65,504
Advances to customers	1,690,823	2,753,309	-	-	4,444,132
Customer deposits	1,861,490	1,101,031	191,798	-	3,154,319

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

Dollars in Thousands	**Banking Group** 12 months **31.12.18**	12 months 31.12.17
19. Taxation		
Current tax expense		
Current tax expense	**19,387**	18,658
	19,387	18,658
Deferred tax expense		
Origination and reversal of temporary differences	**745**	(264)
	745	(264)
Total income tax expense included in profit after tax	**20,132**	18,394
Reconciliation of effective tax rate		
Operating profit before tax	**71,554**	65,504
Income tax using the domestic corporation tax rate (28%)	**20,035**	18,341
Non-deductible expenses	**97**	53
Under / (over) provided in prior periods	**-**	-
Other permanent differences	**-**	-
	20,132	18,394

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
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**
2017				
Accelerated capital allowances	836	596	-	1,432
Provision for loan impairment	676	945	-	1,621
Other provisions	1,991	(1,467)	-	524
Income deferred for accounting purposes	350	(15)	-	335
Other intangible assets	(342)	205	-	(137)
Tax deductible premium	(3,595)	-	-	(3,595)
Net deferred tax asset / (liability)	(84)	264	-	180

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

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

Dollars in Thousands	***Banking Group***

20. Goodwill and intangible assets

2018	Goodwill	Customer relationships purchased	Software	Total
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**

2017	Goodwill	Customer relationships purchased	Software	Total
Cost				
At 1 January	15,744	8,798	5,060	29,602
Additions	-	-	29	29
At 31 December	15,744	8,798	5,089	29,631
Accumulated amortisation and impairment				
At 1 January	(2,043)	(7,578)	(4,957)	(14,578)
Amortisation charge for the year	-	(733)	(76)	(809)
At 31 December	(2,043)	(8,311)	(5,033)	(15,387)
Net carrying value	13,701	487	56	14,244

Goodwill

The Banking Group goodwill arises from 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 utilise local market data as well as Group expertise and experience to validate key assumptions.

The most significant variable underlying the valuation is the terminal value. Terminal value is calculated using a stable growth model. The key variables used to calculate terminal value are the post-tax discount rate of each business segment and an annual sustainable growth rate of 2.8% which is equal to the 2 year forecasted GDP growth rate for New Zealand based on HSBC forecasts (2017: 2.1% which is equal to the average growth in GDP for New Zealand over the last 10 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 2018 is $12.8 million (December 2017: $12.8 million).

The discounted cash flow model has used a one year profit projection, a discount rate (pre-tax) of 9.5% (December 2017: 9.5%), growth rates for revenues of 13.8% and expenses of 7.5% in the next year supported by December 2018 actual results and approved budgets, and a terminal value of $266 million (December 2017: $243 million).

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 2018 is $0.86 million (December 2017: $0.86 million).

The discounted cash flow model has used a one year profit projection, a discount rate (pre-tax) of 11.4% (December 2017: 11.4%), growth rate for revenues of (8.4)% and direct expenses of 2.5% in the next year supported by December 2018 actual results and approved budgets, and a terminal value of $71 million (December 2017: $71 million).

Other Intangible Assets

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

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

Customer relationships are amortised on a straight-line basis over 12 years based on a statistical analysis of expected customer life. The customer relationships are now fully amortised (December 2017: 8 months).

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

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

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

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	**31.12.18**	31.12.17
Key management compensation		
(a) Salaries and other short-term benefits	**3,410**	3,402
(b) Post-employment benefits	**170**	168
(c) Share-based payments expenses recognised	**146**	104
	3,726	3,674
Advances to key management		
(d) Advances to key management personnel	**4,303**	3,665

(e) Shares, options and other incentive plans

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

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

(ii) HSBC Restricted Share Award Scheme

	2018	2017
Number of options awarded	**9,465**	9,595

The total fair value of the options awarded under the restricted share award scheme as at 31 December 2018 is $98 thousand when converted into NZ dollars at grant date (December 2017: $108 thousand).

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

The fair value of the share option granted under the HSBC Restricted Share Award Scheme is £6.52 (December 2017: £5.96).

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

	Banking Group	
Dollars in Thousands	**31.12.18**	31.12.17
21. Related party transactions *(continued)*		
Amounts due from related parties		
On demand	**11,252**	5,653
Other short term	**844,426**	861,399
	855,678	867,052
The Hongkong and Shanghai Banking Corporation Limited (HBAP):		
Hong Kong Branch	**834,741**	710,247
Australia Branch	**6,034**	148,510
Singapore Branch	**1,081**	32
Sri Lanka Branch	**2,219**	4,735
Tokyo Branch	**9,082**	1,801
Other	**16**	17
Other:		
HSBC Bank plc	**1,338**	393
HUSI Non-Insurance North America	**799**	270
HSBC Bank (China) Company	**129**	818
Other	**239**	229
	855,678	867,052
Amounts due to related parties		
On demand	**371,719**	538,760
Other short term	**200,000**	165,237
Long term	**1,350,000**	1,778,257
	1,921,719	2,482,254
The Hongkong and Shanghai Banking Corporation Limited (HBAP):		
Hong Kong Branch	**1,771,853**	2,359,855
Singapore Branch	**46,214**	38,426
Australia Branch	**1,054**	361
Philippines Branch	**347**	1,422
Other	**4,827**	6,552
Other:		
HSBC Bank USA	**25**	6,799
HSBC Bank Plc UK Ops	**56,197**	28,746
HSBC Bank Canada	**245**	5,584
HSBC Trinkaus and Burkhardt	**979**	5,285
HSBC Bank (Singapore) Ltd	**3,023**	384
Other	**36,955**	28,840
	1,921,719	2,482,254

Interest Free Funding

The Banking Group has received an interest free loan from HBAP of $194 million (December 2017: $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.

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

22. Derivative financial instruments

Dollars in Thousands	Banking Group **31.12.18** Contract amount	Assets	Liabilities	31.12.17 Contract amount	Assets	Liabilities
Related Party						
Trading derivatives						
Exchange rate contracts[1]	**3,052,610**	**35,474**	**15,095**	2,142,932	20,468	11,628
Interest rate contracts	**42,800**	**1,226**	**1,516**	48,800	1,055	1,481
Total derivatives with related parties		**36,700**	**16,611**		21,523	13,109
Related party breakdown						
HBAP Group		**36,696**	**16,548**		21,362	13,084
HSBC Bank plc		**4**	**63**		161	11
Other		**-**	**-**		-	14
		36,700	**16,611**		21,523	13,109
Other						
Trading derivatives						
Exchange rate contracts[1]	**2,213,841**	**11,783**	**31,530**	1,015,644	10,870	16,845
Interest rate contracts	**42,800**	**1,503**	**1,225**	48,800	1,458	1,053
		13,286	**32,755**		12,328	17,898
Hedging derivatives						
Fair value hedging derivatives	**151,000**	**-**	**1,769**	151,000	32	1,791
		-	**1,769**		32	1,791
Total derivatives with other parties		**13,286**	**34,524**		12,360	19,689
Total derivative financial instruments		**49,986**	**51,135**		33,883	32,798

[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* 31.12.18**		
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**

		Banking Group 31.12.17		
Dollars in Thousands	Level 1	Level 2	Level 3	TOTAL
ASSETS				
Financial investments	243,041	497	22	243,560
Derivatives financial instruments	-	33,883	-	33,883
LIABILITIES				
Derivatives financial instruments	-	32,798	-	32,798

There have been no transfers between levels 1 and 2 in the year to 31 December 2018 (December 2017: Nil).

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

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* 31.12.18**				
	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**

	Banking Group 31.12.17				
	Fair Value				Carrying value
Dollars in Thousands	Level 1	Level 2	Level 3	Total	
ASSETS					
Advances to customers	-	-	4,438,924	4,438,924	4,444,132
LIABILITIES					
Customer deposits	-	3,155,238	-	3,155,238	3,154,319
Debt securities	-	389,354	-	389,354	388,962
Amounts due to related parties	-	2,485,059	-	2,485,059	2,482,254

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 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)**	**-**	**-**	**-**
31 December 2017								
Financial Assets								
Cash and demand balances with central banks	750	-	-	-	-	750	-	750
Advances to banks	27	-	-	-	-	27	-	27
Financial investments	-	1	-	74	169	244	-	244
Derivative financial instruments	-	-	-	-	-	-	34	34
Advances to customers	2,979	170	499	625	171	4,444	-	4,444
Amounts due from related parties	867	-	-	-	-	867	-	867
Other assets	-	-	-	-	-	-	22	22
Total financial assets	4,623	171	499	699	340	6,332	56	6,388
Financial Liabilities								
Deposits by banks	275	-	-	-	-	275	-	275
Derivative financial instruments	-	-	-	-	-	-	33	33
Customer deposits	2,651	321	127	19	17	3,135	19	3,154
Debt securities	389	-	-	-	-	389	-	389
Amounts due to related parties	2,275	-	-	-	-	2,275	207	2,482
Other liabilities	-	-	-	-	-	-	42	42
Total financial liabilities	5,306	405	327	19	17	6,074	301	6,375
Off-balance sheet financial instruments								
Net notional interest rate contracts	151	-	-	(51)	(100)	-	-	-

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

25. Liquidity risk management

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

Liquid assets are assets which are readily convertible to cash to meet the Banking Group's liquidity requirement. Liquid assets consist of demand balances with the central bank, 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	**31.12.18**	31.12.17
Demand balances with the central bank	**529,852**	749,892
Financial Investments	**421,953**	243,538
	951,805	993,430

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.

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 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 - Balance sheet expected settlement *(continued)*

	Banking Group		
Dollars in Millions	*Under 12 months*	*Over 12 months*	*Total*
31 December 2017			
Assets			
Cash and demand balances with central banks	750	-	750
Advances to banks	27	-	27
Financial investments	1	243	244
Derivative financial instruments	24	10	34
Advances to customers	857	3,587	4,444
Amounts due from related parties	867	-	867
Other assets	23	-	23
Property, plant and equipment	-	1	1
Deferred tax asset	-	-	-
Goodwill and Intangible assets	-	14	14
Total	2,549	3,855	6,404
Liabilities			
Deposits by banks	275	-	275
Derivative financial instruments	24	9	33
Customer deposits	3,110	44	3,154
Debt securities	389	-	389
Amounts due to related parties	704	1,778	2,482
Other liabilities	40	2	42
Current tax liabilities	4	-	4
Total	4,546	1,833	6,379
Net assets	(1,997)	2,022	25

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 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**
31 December 2017								
Financial Liabilities								
Deposits by banks	275	-	-	-	-	-	-	275
Customer deposits	2,080	208	386	452	46	2	-	3,174
Debt securities	-	-	106	289	-	-	-	395
Amounts due to related parties	552	79	78	15	1,789	-	-	2,513
Other liabilities	6	16	14	4	2	-	-	42
Total non-derivative financial liabilities	2,913	303	584	760	1,837	2	-	6,399
Derivative financial instruments – held for trading purposes	30	-	-	-	-	-	-	30
Derivative financial instruments – held for hedging purposes (net settled) (Inflow) / outflow	-	-	-	1	2	-	-	3
Total undiscounted derivatives	30	-	-	1	2	-	-	33
Undrawn loan commitments	971	-	1,182	-	-	-	-	2,153

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 2018 (2017: 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 2018				
Derivative financial assets	**50**	**(11)**	**-**	**39**
Financial assets	**50**	**(11)**	**-**	**39**
Deposits by banks	**229**	**-**	**-**	**229**
Derivative financial liabilities	**51**	**(11)**	**-**	**40**
Financial liabilities	**280**	**(11)**	**-**	**269**
31 December 2017				
Derivative financial assets	34	(11)	-	23
Financial assets	34	(11)	-	23
Deposits by banks	279	-	-	279
Derivative financial liabilities	33	(11)	-	22
Financial liabilities	312	(11)	-	301

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 31.12.18**	Audited 31.12.17
Receivable / (payable)		
AUD	**-**	-
GBP	**-**	-
USD	**(0.1)**	-
Other	**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 2018 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 2018 (Unaudited)		
Interest rate risk	**132.50**	**10.60**
Foreign currency risk	**0.025**	**0.02**
Equity risk	**-**	**-**
Peak exposure period 1 July 2018 to 31 December 2018 (Unaudited)		
Interest rate risk	**186.38**	**14.91**
Foreign currency risk	**0.5**	**0.04**
Equity risk	**-**	**-**

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

29. Share options

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

a) *HSBC Holdings 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.

	31.12.18 *Number of shares*	31.12.17 *Number of shares*
Shares at beginning of the year	**5,551**	15,433
New shares granted during the year	**3,344**	2,576
Additional shares arising from scrip dividends	**-**	-
Shares released during the year	**(2,806)**	(318)
Shares forfeited during the year	**(10)**	(144)
Shares cancelled during the year	**(755)**	(60)
Shares transferred in during the year	**-**	37
Shares transferred out during the year	**(4)**	(11,973)
Shares outstanding at the end of the year	**5,320**	5,551

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

29. Share options *(continued)*

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

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

The subscription to this share option plan had been closed in 2013 and therefore no share option was granted in 2018 (2017: Nil).

	Banking Group			
	31.12.18		31.12.17	
	Weighted average exercise price	*Number of options*	*Weighted average exercise price*	*Number of options*
Share options at beginning of the year	-	-	£4.84	**6,304**
Share options granted during the year	-	-		-
Share options exercised during the year	-	-	£5.31	**(2,373)**
Share options expired during the year	-	-	£5.10	**(567)**
Share options cancelled during the year	-	-		-
Share options forfeited during the year	-	-	£4.46	**(3,364)**
Share options transferred in during the year	-	-		-
Share options transferred out during the year	-	-		-
Share options outstanding at the end of the year	-	-		-
Share options exercisable at the end of the period	-	-	-	-

There were no options exercised under this plan in 2018. The weighted average share price on the dates on which options were exercised was £5.31 in the year ended 31 December 2017.

There were no options outstanding under this plan at 31 December 2018. (2017: Nil)

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

29. Share options *(continued)*

c) *HSBC Restricted Share Award Scheme*

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

	31.12.18 *Number of shares*	31.12.17 *Number of shares*
Shares at beginning of the year	**25,073**	34,587
New shares granted during the year	**9,465**	7,903
Additional shares arising from scrip dividends	**1,002**	1,692
Shares released during the year	**(14,361)**	(18,423)
Shares forfeited during the year	**-**	(686)
Shares transferred in during the year	**-**	-
Shares transferred out during the year	**-**	-
Shares outstanding at the end of the year	**21,179**	25,073

Calculation of fair values

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

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

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

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

	Banking Group	
Dollars in Thousands	**31.12.18**	31.12.17
30. Lease commitments		
Future rentals in respect of operating leases are:		
Within one year	**2,557**	2,718
Between one year and two years	**2,843**	2,317
Between two years and five years	**7,011**	7,199
Over five years	**12,598**	14,971
	25,009	27,205

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

	Banking Group	
Dollars in Thousands	**31.12.18**	31.12.17

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.

Direct credit substitutes	**124,807**	72,114
Transaction related contingent items	**343,401**	301,244
Trade related contingent items	**174,210**	158,825
Commitments, maturity one year or more	**1,282,096**	1,523,560
Commitments, maturity up to one year	**622,738**	638,142
	2,547,252	2,693,885

Capital commitments

Contracted expenditure	**1,040**	210

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 2018, 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 2018 was $70,731 million (2017: $72,594 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 acts as Security Trustee for itself and other lenders in connection with facilities made available to one borrower.

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

The Banking Group does not perform any funds management services.

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.

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

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 $589 million (December 2017: $496 million). The total assets and commitments of the Banking Group in the unconsolidated structured entity at reporting date was $87 million and $10 million respectively (December 2017: $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

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

36. Capital adequacy ratios of HBAP Group

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

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

The capital requirements of HKMA are at least equal to those specified under the Basel framework ("Basel III"). HBAP Group exceeds the minimum capital ratio requirements as specified by the HKMA as at 31 December 2018 and 31 December 2017.

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 31.12.18	Unaudited 31.12.17
Basel III Capital Ratios		
Common Equity Tier 1 (CET1) capital	**16.5%**	15.9%
Tier 1 capital	**17.8%**	17.0%
Total capital	**19.8%**	18.9%

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 31.12.18**	Audited 12 months ended 31.12.17
Profitability		
Net profit after tax	**112,116**	96,018
Net profit after tax over the previous 12 month period, as a percentage of average total assets	**1.4%**[1]	1.2%[1]
Size		
Total assets	**8,263,454**	7,943,346
Percentage increase in total assets over the previous 12 months period	**4.0%**	5.2%
Asset quality		
Individually impaired assets	**-**	15,543
HKFRS 9 Stage 3 and POCI gross carrying value[3]	**20,627**	-
HKAS 39 Individual impairment provision against advances to customers	**-**	(8,229)
HKAS 39 Collective impairment provision against advances to customers	**-**	(4,816)
HKFRS 9 Stage 3 and POCI ECL[2]	**(10,050)**	-
HKFRS 9 Stage 1 and 2 ECL[2]	**(7,355)**	-
HKAS 39 Individually impaired assets / Total assets	**-**	0.2%
HKAS 39 Individual impairment provision / individually impaired assets	**-**	52.9%
HKFRS 9 Stage 3 gross carrying value[3] / Total assets	**0.2%**	-
HKFRS 9 Stage 3 and POCI ECL[2] / Stage 3 and POCI gross carrying value[3]	**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.
3 Gross carrying value of advances to banks and customers, including nominal value of loan commitments and financial guarantees and other financial assets.

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 2018.

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

Christopher David Gosse Russell
Chief Executive Officer
New Zealand Branch

22 March 2019

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

Independent auditor's report

To the Directors of The Hongkong and Shanghai Banking Corporation Limited

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

This report includes our:

- audit opinion on the financial statements prepared in accordance with Clause 25 of the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended) (the 'Order'), New Zealand Equivalents to International Financial Reporting Standards ('NZ IFRS') and International Financial Reporting Standards ('IFRS');
- 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 2018;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended;
- the notes to the financial statements, which include 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 2018, 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.

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: $3.4 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 $170,000 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	$3.4 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 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 $7.4 million as at 31 December 2018. As this is the first year of adoption of NZ IFRS 9 *Financial Instruments* and IFRS 9 *Financial Instruments*, there is limited experience available to back-test the ECL charge and allowance against actual results. There has been a significant increase in the number of data inputs required for the impairment calculation. Data inputs are sourced from a number of systems that have not been used previously for the preparation of the accounting records. This increases the risk around completeness and accuracy of certain data used to create assumptions and operate the models. The global and New Zealand credit environments have remained relatively benign for an extended period of time, in part due to the low interest rate environment, and the relative strength of the global and New Zealand economies. However, there are a number of headwinds to the global economy as well as New Zealand specific risks. 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* Model performance monitoring controls were tested, including periodic policy and independent model reviews, back testing of performance, and approval of model changes. We also performed risk based substantive testing of models for compliance with NZ IFRS 9 and IFRS 9 using our credit risk modelling experts. We tested the review and challenge of multiple economic scenarios determined by an expert panel and internal governance committee, and assessed the reasonableness of the multiple economic scenarios and variables. We tested the inputs of critical data, into source systems, and the flow and transformation of data between source systems to the impairment calculation system. We also performed substantive testing over the critical data used in the year end ECL calculation. We assessed management's user acceptance testing over the automated calculation of ECL to ensure it is performed in line with business requirements, as well as independently reviewing the underlying system script to validate that the calculation operated as we would have expected. We observed review and challenge forums to assess the ECL output and approval 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 significant individual impairments, and substantively tested all 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 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 reducing the risk over access management in the financial reporting process. However, issues related to privileged access and business user access remained unresolved on parts of the technology infrastructure, requiring our audit approach to respond to the risks presented.	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 moved 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 were independently assessed included password policies, security configurations, controls over changes to applications and databases and that business users, developers and production support did not have access to change applications, the operating system or databases in the production environment. As a consequence of the deficiencies identified, a range of other procedures were performed: • where inappropriate access was identified, we understood the nature of the access, and, where possible, obtained additional evidence on the appropriateness of the activities performed; • 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 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 11 and 81. Our opinion on the financial statements and supplementary information does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements and supplementary information, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the 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 2018:

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 2018.

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 areas of taxation compliance and employee immigration 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
22 March 2019

Auckland

HSBC