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Presentation of information

This document comprises the *Interim Financial Statements 2017* for HSBC Bank Middle East Limited ('the bank') and its subsidiary undertakings (together 'the group'). It contains Condensed Financial Statements, together with the Auditor's review report. References to 'HSBC' or 'the HSBC Group' within this document mean HSBC Holdings plc together with its subsidiaries.

In accordance with IAS 34 the *Interim Report* is intended to provide an update on the *Annual Report and Accounts 2016* and therefore focuses on events during the first six months of 2017 rather than duplicating information previously reported.

Condensed Financial Statements

Consolidated income statement

	Half-year to	
	30 Jun 2017 US\$000	30 Jun 2016 US\$000
	<i>Notes</i>	
Net interest income	464,702	465,152
– interest income	538,917	533,544
– interest expense	(74,215)	(68,392)
Net fee income	225,067	245,981
– fee income	258,686	275,755
– fee expense	(33,619)	(29,774)
Net trading income	118,075	154,420
– trading income excluding net interest income	126,047	162,831
– net interest expense on trading activities	(7,972)	(8,411)
Net (expense)/income from financial instruments designated at fair value	(60)	7,733
Gains less losses from financial investments	(4,784)	12,689
Dividend income	1,327	1,482
Other operating income, net	81,495	33,952
Net operating income before loan impairment charges and other credit risk provisions	885,822	921,409
Loan impairment charges and other credit risk provisions	(87,514)	(33,199)
Net operating income	798,308	888,210
Employee compensation and benefits	(254,317)	(262,494)
General and administrative expenses	(168,883)	(156,007)
Depreciation and impairment of property, plant and equipment	(7,077)	(6,626)
Amortisation and impairment of intangible assets	(2,945)	(3,005)
Total operating expenses	(433,222)	(428,132)
Operating profit	365,086	460,078
Share of profit in associates	139	1,007
Profit before tax	365,225	461,085
Tax expense	(66,308)	(86,070)
Profit for the period	298,917	375,015
Attributable to:		
– shareholders of the parent company	298,905	374,673
– non-controlling interests	12	342
Profit for the period	298,917	375,015

The accompanying notes on pages 8 to 16 form an integral part of these financial statements.

Condensed Financial Statements (unaudited)

Consolidated statement of comprehensive income

	Half-year to	
	30 Jun 2017 US\$000	30 Jun 2016 US\$000
Profit for the period	298,917	375,015
Other comprehensive income/(expense)		
Items that will be reclassified subsequently to profit or loss when specific conditions are met:		
Available-for-sale investments	(790)	(18,261)
– fair value losses	(3,754)	(9,860)
– fair value losses/(gains) reclassified to the income statement	777	(9,381)
– amounts reclassified to the income statement in respect of impairment losses	2,646	1,097
– income taxes	(459)	(117)
Cash flow hedges	5,508	13,308
– fair value gains	6,120	14,786
– income taxes	(612)	(1,478)
Exchange differences	(5,995)	(4,364)
Items that will not be reclassified subsequently to profit or loss:		
Changes in fair value of financial liabilities designated at fair value due to movement in own credit risk	(2,600)	–
– before income taxes	(2,600)	–
– income taxes	–	–
Other comprehensive expense for the period, net of tax	(3,877)	(9,317)
Total comprehensive income for the period	295,040	365,698
Attributable to:		
– shareholders of the parent company	295,028	365,356
– non-controlling interests	12	342
Total comprehensive income for the period	295,040	365,698

The accompanying notes on pages 8 to 16 form an integral part of these financial statements.

Consolidated statement of financial position

	Notes	At	
		30 Jun 2017 US\$000	31 Dec 2016 US\$000
Assets			
Cash and balances at central banks		465,818	462,057
Items in the course of collection from other banks		67,114	47,053
Trading assets	10	562,205	182,406
Derivatives	10	1,125,372	1,319,251
Loans and advances to banks		6,408,709	6,249,298
Loans and advances to customers	4,5	18,666,621	21,010,573
Reverse repurchase agreements – non-trading		1,063,907	1,050,843
Financial investments	10	6,537,680	6,582,181
Assets held for sale		–	851,691
Prepayments, accrued income and other assets		845,548	684,891
Current tax assets		2,518	3,881
Interests in associates		1,797	1,658
Intangible assets		12,270	13,458
Deferred tax assets		209,234	209,111
Total assets		35,968,793	38,668,352
Liabilities and equity			
Liabilities			
Deposits by banks		1,916,024	3,246,654
Customer accounts		22,710,330	22,588,927
Repurchase agreements – non-trading		79,893	–
Items in the course of transmission to other banks		97,210	90,415
Trading liabilities	10	1,451,261	1,496,561
Financial liabilities designated at fair value	7,10	403,950	401,592
Derivatives	10	1,158,028	1,409,040
Debt securities in issue	8	2,098,113	2,645,483
Liabilities of disposal groups held for sale		–	804,272
Accruals, deferred income and other liabilities		1,518,525	1,617,334
Current tax liabilities		128,269	149,666
Provisions		48,869	43,789
Deferred tax liabilities		–	523
Total liabilities		31,610,472	34,494,256
Equity			
Called up share capital	15	931,055	931,055
Share premium account	15	61,346	–
Other reserves		(107,998)	(106,760)
Retained earnings		3,469,809	3,345,703
Total shareholders' equity		4,354,212	4,169,998
Non-controlling interests		4,109	4,098
Total equity		4,358,321	4,174,096
Total liabilities and equity		35,968,793	38,668,352

The accompanying notes on pages 8 to 16 form an integral part of these financial statements.

G Elhedery

Chief Executive Officer and Deputy Chairman

Condensed Financial Statements (unaudited)

Consolidated statement of cash flows

	Half-year to	
	30 Jun 2017 US\$000	30 Jun 2016 US\$000
Profit before tax	365,225	461,085
Cash flows from operating activities		
Adjustments for:		
Net loss/(gain) from investing activities	2,438	(13,581)
Share of profits in associates	(139)	(1,007)
Other non-cash items included in profit before tax	91,425	18,064
Change in operating assets	1,833,770	196,274
Change in operating liabilities	(2,615,827)	(857,122)
Elimination of exchange differences ¹	8,933	(14,082)
Dividends received from associates	—	1,312
Contribution paid for defined benefit plans	—	(536)
Tax paid	(86,345)	(130,722)
Net cash used in operating activities	(400,520)	(340,315)
Cash flows from investing activities		
Purchase of financial investments	(2,194,300)	(3,509,890)
Proceeds from the sale and maturity of financial investments	1,266,794	1,687,309
Purchase of property, plant and equipment	(3,521)	(7,715)
Proceeds from sale of property, plant and equipment	2,020	—
Net purchase of intangible assets	(1,759)	(828)
Net cash flows from other investing activities	124,938	16,900
Net cash used in investing activities	(805,828)	(1,814,224)
Cash flows from financing activities		
Dividends paid to shareholders of the parent company	(163,000)	(420,000)
Net cash used in financing activities	(163,000)	(420,000)
Net decrease in cash and cash equivalents	(1,369,348)	(2,574,539)
Cash and cash equivalents at 1 Jan	7,208,806	8,996,879
Exchange differences in respect of cash and cash equivalents	50,456	11,603
Cash and cash equivalents at 30 Jun	5,889,914	6,433,943

¹ Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on a line-by-line basis, as details cannot be determined without unreasonable expense.

The accompanying notes on pages 8 to 16 form an integral part of these financial statements.

Consolidated statement of changes in equity

	Other reserves								
	Called up share capital and share premium	Retained earnings	Available-for-sale fair value reserve	Cash flow hedging reserve	Foreign exchange reserve	Merger and other reserves	Total shareholders' equity	Non-controlling interests	Total equity
	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000
At 1 Jan 2017	931,055	3,345,703	17,139	(3,358)	(105,220)	(15,321)	4,169,998	4,098	4,174,096
Profit for the period	–	298,905	–	–	–	–	298,905	12	298,917
Other comprehensive income (net of tax)	–	(2,573)	(512)	5,508	(6,300)	–	(3,877)	–	(3,877)
– available-for-sale investments	–	–	(790)	–	–	–	(790)	–	(790)
– cash flow hedges	–	–	–	5,508	–	–	5,508	–	5,508
– changes in fair value of financial liabilities designated at fair value arising from changes in own credit risk	–	(2,600)	–	–	–	–	(2,600)	–	(2,600)
– exchange differences	–	27	278	–	(6,300)	–	(5,995)	–	(5,995)
Total comprehensive income for the period	–	296,332	(512)	5,508	(6,300)	–	295,028	12	295,040
Ordinary share issued	61,346	–	–	–	–	–	61,346	–	61,346
Dividends to shareholders	–	(163,000)	–	–	–	–	(163,000)	–	(163,000)
Exercise and lapse of share options and vesting of share awards	–	(5,859)	–	–	–	–	(5,859)	–	(5,859)
Cost of share-based payment arrangements	–	5,333	–	–	–	–	5,333	–	5,333
Other movements	–	(8,700)	66	–	–	–	(8,634)	(1)	(8,635)
At 30 Jun 2017	992,401	3,469,809	16,693	2,150	(111,520)	(15,321)	4,354,212	4,109	4,358,321
At 1 Jan 2016	931,055	3,899,654	35,019	(8,384)	(98,964)	(15,321)	4,743,059	3,236	4,746,295
Profit for the period	–	374,673	–	–	–	–	374,673	342	375,015
Other comprehensive income (net of tax)	–	(30)	(18,255)	13,308	(4,340)	–	(9,317)	–	(9,317)
– available-for-sale investments	–	–	(18,261)	–	–	–	(18,261)	–	(18,261)
– cash flow hedges	–	–	–	13,308	–	–	13,308	–	13,308
– changes in fair value of financial liabilities designated at fair value arising from changes in own credit risk	–	–	–	–	–	–	–	–	–
– exchange differences	–	(30)	6	–	(4,340)	–	(4,364)	–	(4,364)
Total comprehensive income for the period	–	374,643	(18,255)	13,308	(4,340)	–	365,356	342	365,698
Ordinary share issued	–	–	–	–	–	–	–	–	–
Dividends to shareholders	–	(920,000)	–	–	–	–	(920,000)	–	(920,000)
Exercise and lapse of share options and vesting of share awards	–	–	–	–	–	–	–	–	–
Cost of share-based payment arrangements	–	–	–	–	–	–	–	–	–
Other movements	–	(1,738)	35	–	–	–	(1,703)	–	(1,703)
At 30 Jun 2016	931,055	3,352,559	16,799	4,924	(103,304)	(15,321)	4,186,712	3,578	4,190,290

The accompanying notes on pages 8 to 16 form an integral part of these financial statements.

Notes on the Condensed Financial Statements (unaudited)

1 Legal status and principal activities

The group has its place of incorporation and head office in Dubai International Financial Centre ('DIFC'), in the United Arab Emirates, under a category 1 licence issued by the Dubai Financial Services Authority ('DFSA').

The group's registered office is Level 1, Gate Village Building 8, Dubai International Financial Centre, Dubai, United Arab Emirates.

The group through its branch network and subsidiary undertakings provides a range of banking and related financial services in the Middle East and North Africa.

The ultimate parent company of the group is HSBC Holdings plc, which is incorporated in England.

2 Basis of preparation and significant accounting policies

(a) Compliance with International Financial Reporting Standards

The interim condensed consolidated financial statements of the group have been prepared in accordance with IAS 34 'Interim Financial Reporting' ('IAS 34') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the European Union ('EU'). These interim condensed consolidated financial statements should be read in conjunction with the *Annual Report and Accounts 2016*.

At 30 June 2017, there were no unendorsed standards effective for the half-year ended 30 June 2017 affecting these interim condensed consolidated financial statements, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group.

Standards applied during the half-year to 30 June 2017

The group has adopted the requirements of IFRS 9 'Financial Instruments' relating to the presentation of gains and losses on financial liabilities designated at fair value from 1 January 2017. As a result, the effects of changes in those liabilities' credit risk is presented in other comprehensive income with the remaining effect presented, when required, in profit or loss. As permitted by the transitional requirements of IFRS 9, comparatives have not been restated. Adoption increased profit before tax by US\$2.6 million with the opposite effect on other comprehensive income, with no effect on net assets.

(b) Use of estimates and judgements

Management believes that the group's critical accounting estimates and judgements are those which relate to the impairment of loans and advances, the valuation of financial instruments, provisions and the recognition of deferred tax asset. There was no change in the current period to the critical accounting estimates and judgements applied in 2016, which are stated in the *Annual Report and Accounts 2016*.

(c) Composition of the group

Lebanon

On 16 November 2016, the bank entered into an agreement with BLOM BANK S.A.L. to sell the banking operations in Lebanon and on 16 June 2017 completed the disposal.

(d) Future accounting developments

Information on future accounting developments and their potential effect on the financial statements of the group are provided in the *Annual Report and Accounts 2016*. The IFRS 9 'Financial Instruments' Programme's focus is on the preparation for the parallel run which will commence during the second half of 2017 in accordance with the project plan. Until this work is sufficiently advanced, we will not have a reliable understanding of the potential impact on the financial statements and any consequential effects on regulatory capital requirements.

(e) Accounting policies

Except as described above, the accounting policies applied by the group for these interim condensed consolidated financial statements are consistent with those described in the *Annual Report and Accounts 2016*, as are the methods of computation.

3 Dividends

Dividends paid to shareholders of the parent company

	Half-year to			
	30 Jun 2017		30 Jun 2016	
	Per share US\$	Total US\$000	Per share US\$	Total US\$000
Dividends paid on ordinary shares				
In respect of previous year:				
– fourth interim dividend	0.0269	25,000	0.2256	210,000
In respect of current year:				
– first interim dividend	0.1482	138,000	0.2256	210,000
– special dividend	–	–	0.5369	500,000
Total	0.1751	163,000	0.9881	920,000

4 Concentration of loans and advances

	Gross loans and advances to customers	
	Total US\$000	As a % of total gross loans %
At 30 Jun 2017		
Personal	4,144,402	20.93
– residential mortgages	1,984,485	10.02
– other personal	2,159,917	10.91
Corporate and commercial	14,756,349	74.54
– commercial, industrial and international trade	7,917,975	39.99
– commercial real estate	599,606	3.03
– other property-related	1,413,324	7.14
– government	1,211,261	6.12
– other commercial	3,614,183	18.26
Financial		
– non-bank financial institutions	897,168	4.53
Total gross loans and advances to customers	19,797,919	100.00
Impaired loans		
– as a percentage of gross loans and advances to customers	7.02%	
Total impairment allowances		
– as a percentage of gross loans and advances to customers	5.71%	
At 31 Dec 2016		
Personal	4,331,090	19.55
– residential mortgages	2,027,406	9.15
– other personal	2,303,684	10.40
Corporate and commercial	15,451,630	69.74
– commercial, industrial and international trade	7,731,352	34.90
– commercial real estate	538,966	2.43
– other property-related	1,613,438	7.28
– government	1,361,029	6.14
– other commercial	4,206,845	18.99
Financial		
– non-bank financial institutions	2,372,320	10.71
Total gross loans and advances to customers	22,155,040	100.00
Impaired loans		
– as a percentage of gross loans and advances to customers	6.81%	
Total impairment allowances		
– as a percentage of gross loans and advances to customers	5.17%	

5 Loan impairment charges and other credit risk provisions

	Half-year to	
	30 Jun 2017 US\$000	30 Jun 2016 US\$000
Loan impairment charges on loans and advances	87,077	28,299
– new allowances net of allowance releases	98,356	39,484
– recoveries of amounts previously written off	(11,279)	(11,185)
Impairment charges on debt securities and other credit risk provisions	437	4,900
Total	87,514	33,199

Notes on the Condensed Financial Statements (unaudited)

Movement in impairment allowances on loans and advances to customers and banks

	2017				2016			
	Customers				Customers			
	Banks individually assessed	Individually assessed	Collectively assessed	Total	Banks individually assessed	Individually assessed	Collectively assessed	Total
	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000
At 1 Jan	–	946,230	198,237	1,144,467	17,994	950,079	271,098	1,239,171
Amounts written off	–	(53,880)	(58,280)	(112,160)	(16,395)	(96,293)	(57,766)	(170,454)
Recoveries of loans and advances previously written off	–	4	11,275	11,279	–	–	11,185	11,185
Charge/(release) to income statement	–	37,786	49,291	87,077	(1,599)	39,539	(9,641)	28,299
Exchange and other movements	–	1,520	(885)	635	–	2,915	31	2,946
At 30 Jun	–	931,660	199,638	1,131,298	–	896,240	214,907	1,111,147

6 Segment analysis

The basis used to identify the group's reporting segments are discussed in the *Annual Report and Accounts 2016*.

Profit/(loss) for the period

	2017					
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Corporate Centre	Total
	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000
Half-year to 30 Jun						
Net interest income/(expense)	196,179	108,325	111,473	–	48,725	464,702
Net fee income/(expense)	55,019	72,895	100,950	–	(3,797)	225,067
Net trading income/(expense)	19,248	14,789	90,150	–	(6,112)	118,075
Other income/(expenses)	12,770	9,623	3,400	99	52,086	77,978
Net operating income before loan impairment charges and other credit risk	283,216	205,632	305,973	99	90,902	885,822
Loan impairment charges and other credit risk provisions	(35,697)	(32,506)	(19,311)	–	–	(87,514)
Net operating income	247,519	173,126	286,662	99	90,902	798,308
Total operating expenses	(163,257)	(106,111)	(120,235)	(99)	(43,520)	(433,222)
Operating profit	84,262	67,015	166,427	–	47,382	365,086
Share of profit in associates	–	–	–	–	139	139
Profit before tax	84,262	67,015	166,427	–	47,521	365,225
By geographical region						
U.A.E.	71,025	38,488	139,080	–	37,856	286,449
Qatar	7,227	14,043	32,715	–	2,462	56,447
Rest of Middle East	6,010	14,484	(5,368)	–	7,203	22,329
Profit before tax	84,262	67,015	166,427	–	47,521	365,225

Profit/(loss) for the period (continued)

	2016					Total US\$000
	Retail Banking and Wealth Management US\$000	Commercial Banking US\$000	Global Banking and Markets US\$000	Global Private Banking US\$000	Corporate Centre US\$000	
Half-year to 30 Jun						
Net interest income/(expense)	199,337	120,083	97,414	(8)	48,326	465,152
Net fee income/(expense)	63,119	82,962	101,808	—	(1,908)	245,981
Net trading income/(expense)	23,250	22,870	116,700	2	(8,402)	154,420
Other income/(expenses)	2,423	3,181	15,952	57	34,243	55,856
Net operating income before loan impairment charges and other credit risk	288,129	229,096	331,874	51	72,259	921,409
Loan impairment charges and other credit risk provisions	(56,328)	16,573	6,556	—	—	(33,199)
Net operating income	231,801	245,669	338,430	51	72,259	888,210
Total operating expenses	(165,054)	(111,313)	(116,149)	(51)	(35,565)	(428,132)
Operating profit	66,747	134,356	222,281	—	36,694	460,078
Share of profit in associates	—	—	—	—	1,007	1,007
Profit before tax	66,747	134,356	222,281	—	37,701	461,085
By geographical region						
U.A.E.	57,801	88,016	178,909	—	26,425	351,151
Qatar	4,864	21,357	28,229	—	4,310	58,760
Rest of Middle East	4,082	24,983	15,143	—	6,966	51,174
Profit before tax	66,747	134,356	222,281	—	37,701	461,085

Balance sheet information

	2017					Total US\$000
	Retail Banking and Wealth Management US\$000	Commercial Banking US\$000	Global Banking and Markets US\$000	Global Private Banking US\$000	Corporate Centre US\$000	
At 30 Jun						
Loans and advances to customers (net)	3,844,144	6,067,786	8,753,839	—	852	18,666,621
Interest in associates	—	—	—	—	1,797	1,797
Total assets	3,861,646	6,480,746	13,024,739	—	12,601,662	35,968,793
Customer accounts	10,921,311	4,657,198	6,605,437	—	526,384	22,710,330
Total liabilities	11,069,756	5,663,735	10,712,270	—	4,164,711	31,610,472
At 31 Dec						
	2016					
Loans and advances to customers (net)	4,045,873	6,333,490	10,618,598	—	12,612	21,010,573
Interest in associates	—	—	—	—	1,658	1,658
Total assets	4,308,355	6,963,158	14,308,069	—	13,088,770	38,668,352
Customer accounts	10,617,868	5,325,799	6,066,278	—	578,982	22,588,927
Total liabilities	11,356,923	6,615,091	10,191,701	—	6,330,541	34,494,256

7 Financial liabilities designated at fair value

	At	
	30 Jun 2017 US\$000	31 Dec 2016 US\$000
Debt securities in issue	403,950	401,592

At 30 June 2017, the accumulated amount of change in fair value attributable to changes in credit risk was a loss of US\$1.8 million (30 June 2016: US\$5.8 million gain).

8 Debt securities in issue

	30 Jun 2017		31 Dec 2016	
	Carrying amount US\$000	Fair value US\$000	Carrying amount US\$000	Fair value US\$000
Medium-term notes	2,846,828	2,847,079	3,556,580	3,556,181
Non-equity preference shares	950,000	875,965	950,000	859,235
Total debt securities in issue	3,796,828	3,723,044	4,506,580	4,415,416
Included within:				
– trading liabilities	(1,294,765)	(1,294,765)	(1,459,505)	(1,459,505)
– financial liabilities designated at fair value (Note 7)	(403,950)	(403,950)	(401,592)	(401,592)
Total	2,098,113	2,024,329	2,645,483	2,554,319

9 Risk management

The group's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk.

The interim condensed consolidated financial statements do not include all risk management information and disclosures required in the annual financial statements, they should be read in conjunction with the *Annual Report and Accounts 2016*.

There have been no material changes to our policies and practices regarding risk management and governance as described in the *Annual Report and Accounts 2016*.

10 Fair values of financial instruments

The accounting policies, control framework and the hierarchy used to determine fair values at 30 June 2017 are consistent with those applied in the *Annual Report and Accounts 2016*.

Financial instruments carried at fair value and bases of valuation

	30 Jun 2017				31 Dec 2016			
	Level 1 Quoted market price US\$000	Level 2 Using observable inputs US\$000	Level 3 With significant unobservable inputs US\$000	Total US\$000	Level 1 Quoted market price US\$000	Level 2 Using observable inputs US\$000	Level 3 With significant unobservable inputs US\$000	Total US\$000
Recurring fair value measurements								
Assets								
Trading assets	–	562,205	–	562,205	–	182,406	–	182,406
Derivatives	–	1,059,818	65,554	1,125,372	–	1,312,021	7,230	1,319,251
Financial investments: available for sale	–	6,407,105	130,575	6,537,680	–	6,511,701	70,480	6,582,181
Liabilities								
Trading liabilities	–	1,451,261	–	1,451,261	–	1,496,561	–	1,496,561
Financial liabilities designated at fair value	–	403,950	–	403,950	–	401,592	–	401,592
Derivatives	–	1,092,474	65,554	1,158,028	–	1,401,810	7,230	1,409,040

Fair value valuation bases

Financial instruments measured at fair value using a valuation technique with significant unobservable inputs – Level 3

	Assets			Liabilities	
	Available for sale US\$000	Derivatives US\$000	Total US\$000	Derivatives US\$000	Total US\$000
Private equity and strategic investments	130,575	–	130,575	–	–
Other derivatives	–	65,554	65,554	65,554	65,554
At 30 Jun 2017	130,575	65,554	196,129	65,554	65,554
Private equity and strategic investments	70,480	–	70,480	–	–
Other derivatives	–	7,230	7,230	7,230	7,230
At 31 Dec 2016	70,480	7,230	77,710	7,230	7,230

The basis for determining the fair value of the financial instruments in the table above is explained in the *Annual Report and Accounts 2016*.

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy

Movement in Level 3 financial instruments

	Assets		Liabilities
	Available for sale US\$000	Derivatives US\$000	Derivatives US\$000
At 1 Jan 2017	70,480	7,230	7,230
Total gains/(losses) recognised in profit or loss	(2,647)	58,324	58,324
– trading income/(expense) excluding net interest income	–	58,324	58,324
– gains less losses from financial investments	(2,647)	–	–
Total gains/(losses) recognised in other comprehensive income ('OCI')	1,396	–	–
– available-for-sale investments: fair value gains/(losses)	1,370	–	–
– exchange differences	26	–	–
Purchases	61,346	–	–
Sales	–	–	–
Transfers in	–	–	–
At 30 Jun 2017	130,575	65,554	65,554
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 30 Jun 2017	(2,647)	65,554	(65,554)
– trading income/(expense) excluding net interest income	–	65,554	(65,554)
– gains less losses from financial investments	(2,647)	–	–
At 1 Jan 2016	102,624	2,222	20,999
Total gains/(losses) recognised in profit or loss	2,527	1,610	(17,601)
– trading income/(expense) excluding net interest income	–	1,610	(17,601)
– gains less losses from financial investments	2,527	–	–
Total gains/(losses) recognised in other comprehensive income ('OCI')	(12,808)	–	–
– available-for-sale investments: fair value gains/(losses)	(12,793)	–	–
– exchange differences	(15)	–	–
Purchases	–	–	–
Sales	(22,012)	–	–
Transfers in	149	3,398	3,832
At 31 Dec 2016	70,480	7,230	7,230
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 30 Jun 2016	(1,097)	10,421	(5,055)
– trading income/(expense) excluding net interest income	–	10,421	(5,055)
– gains less losses from financial investments	(1,097)	–	–

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

Sensitivity of Level 3 fair values to reasonably possible alternative assumptions

	30 Jun 2017				31 Dec 2016			
	Reflected in profit or loss		Reflected in OCI		Reflected in profit or loss		Reflected in OCI	
	Favourable changes US\$000	Un-favourable changes US\$000	Favourable changes US\$000	Un-favourable changes US\$000	Favourable changes US\$000	Un-favourable changes US\$000	Favourable changes US\$000	Un-favourable changes US\$000
Derivatives, trading assets and trading liabilities	6,555	(6,555)	–	–	723	(723)	–	–
Financial investments: available for sale	2,282	(1,141)	10,776	(5,387)	2,566	(1,283)	3,106	(2,241)
Total	8,837	(7,696)	10,776	(5,387)	3,289	(2,006)	3,106	(2,241)

1 Derivatives, trading assets and trading liabilities are presented as one category to reflect the manner in which these instruments are risk managed.

Sensitivity of Level 3 fair values to reasonably possible alternative assumptions by instrument type

	30 Jun 2017				31 Dec 2016			
	Reflected in profit or loss		Reflected in OCI		Reflected in profit or loss		Reflected in OCI	
	Favourable changes US\$000	Un-favourable changes US\$000	Favourable changes US\$000	Un-favourable changes US\$000	Favourable changes US\$000	Un-favourable changes US\$000	Favourable changes US\$000	Un-favourable changes US\$000
Private equity and strategic investments	2,282	(1,141)	10,776	(5,387)	2,566	(1,283)	3,106	(2,241)
Other derivatives	6,555	(6,555)	–	–	723	(723)	–	–
Total	8,837	(7,696)	10,776	(5,387)	3,289	(2,006)	3,106	(2,241)

Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable parameters using statistical techniques. The statistical techniques aim to apply a 95% confidence interval. When parameters are not amenable to statistical analysis, the quantification of uncertainty is judgemental, but is also guided by the 95% confidence interval.

When the fair value of a financial instrument is affected by more than one unobservable assumption, the above table reflects the most favourable or the most unfavourable change from varying the assumptions individually.

Notes on the Condensed Financial Statements (unaudited)

Key unobservable inputs to Level 3 financial instruments

The table below lists key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 30 Jun 2017. The core range of inputs is the estimated range within which 90% of the inputs fall.

There has been no change to the key unobservable inputs to Level 3 financial instruments and inter-relationships therein which are detailed in the *Annual Report and Accounts 2016*.

Quantitative information about significant unobservable inputs in Level 3 valuations

	Fair value		Full range of inputs		Core range of inputs	
	Assets	Liabilities	Lower	Higher	Lower	Higher
	US\$000	US\$000				
Private equity and strategic investments	130,575	–	n/a	n/a	n/a	n/a
Interest rate derivatives	137	137	47.0%	98.7%	61.6%	98.2%
FX derivatives	65,405	65,405	5.5%	7.5%	5.5%	7.5%
Equity derivatives	12	12	21.7%	21.7%	21.7%	21.7%
At 30 Jun 2017	196,129	65,554				
Private equity and strategic investments	70,480	–	n/a	n/a	n/a	n/a
Interest rate derivatives	33	33	45.3%	98.5%	57.1%	98.0%
FX derivatives	7,197	7,197	0.6%	3.6%	0.6%	3.6%
Equity derivatives	–	–	–	–	–	–
At 31 Dec 2016	77,710	7,230				

11 Credit quality of financial instruments

The five credit quality classifications set out and defined in the *Annual Report and Accounts 2016* describe the credit quality of the group's lending, debt securities portfolios and derivatives. These classifications each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending businesses, as well as the external ratings attributed by external agencies to debt securities. There is no direct correlation between internal and external ratings at granular level, except to the extent each falls within a single quality classification.

The following tables set out the group's distribution of financial instruments by measures of credit quality.

Distribution of financial instruments by credit quality

	30 Jun 2017								
	Neither past due not impaired				Past due not impaired	Impaired	Total gross amount	Impairment allowances	Total
	Strong	Good	Satisfactory	Sub-standard					
	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000
Cash and balances at central banks	337,209	128,609	–	–	–	–	465,818	–	465,818
Items in the course of collection from other banks	–	–	67,114	–	–	–	67,114	–	67,114
Trading assets	215,351	72,346	234,809	39,699	–	–	562,205	–	562,205
Derivatives	861,133	130,339	130,190	3,710	–	–	1,125,372	–	1,125,372
Loans and advances to customers held at amortised cost	8,305,699	4,154,917	4,518,488	522,713	907,125	1,388,977	19,797,919	(1,131,298)	18,666,621
– personal	3,173,915	626,870	–	–	106,856	236,761	4,144,402	(212,065)	3,932,337
– corporate and commercial	4,544,735	3,528,047	4,514,894	271,947	791,653	1,105,073	14,756,349	(888,050)	13,868,299
– non-bank financial institutions	587,049	–	3,594	250,766	8,616	47,143	897,168	(31,183)	865,985
Loans and advances to banks held at amortised cost	5,440,175	603,856	346,099	18,579	–	–	6,408,709	–	6,408,709
Reverse repurchase agreements – non-trading	775,953	87,981	199,973	–	–	–	1,063,907	–	1,063,907
Financial investments	1,713,868	–	4,693,237	–	–	–	6,407,105	–	6,407,105
– treasury and other eligible bills	250,130	–	1,301,725	–	–	–	1,551,855	–	1,551,855
– debt securities	1,463,738	–	3,391,512	–	–	–	4,855,250	–	4,855,250
Assets held for sale	–	–	–	–	–	–	–	–	–
Other assets	93,288	202,275	376,083	36,864	48,649	73	757,232	–	757,232
– endorsements and acceptances	88,996	202,165	243,249	36,864	48,648	73	619,995	–	619,995
– accrued income and other	4,292	110	132,834	–	1	–	137,237	–	137,237
At 30 Jun 2017	17,742,676	5,380,323	10,565,993	621,565	955,774	1,389,050	36,655,381	(1,131,298)	35,524,083

Distribution of financial instruments by credit quality (continued)

	31 Dec 2016								
	Neither past due not impaired				Past due but not impaired	Impaired	Total gross amount	Impairment allowances	Total
Strong	Good	Satisfactory	Sub-standard	US\$000					
Cash and balances at central banks	312,761	149,296	—	—	—	—	462,057	—	462,057
Items in the course of collection from other banks	—	—	47,053	—	—	—	47,053	—	47,053
Trading assets	93,352	25,012	62,489	1,553	—	—	182,406	—	182,406
Derivatives	914,292	313,204	88,999	2,756	—	—	1,319,251	—	1,319,251
Loans and advances to customers held at amortised cost	9,781,824	5,398,238	4,057,746	548,852	859,290	1,509,090	22,155,040	(1,144,467)	21,010,573
– personal	3,301,608	661,429	—	—	131,176	236,877	4,331,090	(225,209)	4,105,881
– corporate and commercial	4,510,920	4,736,376	3,969,583	289,778	717,780	1,227,193	15,451,630	(910,883)	14,540,747
– non-bank financial institutions	1,969,296	433	88,163	259,074	10,334	45,020	2,372,320	(8,375)	2,363,945
Loans and advances to banks held at amortised cost	5,093,444	474,252	667,317	14,285	—	—	6,249,298	—	6,249,298
Reverse repurchase agreements – non-trading	564,931	485,912	—	—	—	—	1,050,843	—	1,050,843
Financial investments	1,650,332	—	4,861,369	—	—	—	6,511,701	—	6,511,701
– treasury and other eligible bills	—	—	1,274,331	—	—	—	1,274,331	—	1,274,331
– debt securities	1,650,332	—	3,587,038	—	—	—	5,237,370	—	5,237,370
Assets held for sale	240,404	69,401	295,159	206,347	14,458	21,810	847,579	(10,615)	836,964
Other assets	42,951	157,284	319,609	44,134	22,672	16,846	603,496	—	603,496
– endorsements and acceptances	40,045	157,278	211,278	44,134	21,846	16,846	491,427	—	491,427
– accrued income and other	2,906	6	108,331	—	826	—	112,069	—	112,069
At 31 Dec 2016	18,694,291	7,072,599	10,399,741	817,927	896,420	1,547,746	39,428,724	(1,155,082)	38,273,642

12 Contingent liabilities, contractual commitments and guarantees

	30 Jun 2017	31 Dec 2016
	US\$000	US\$000
Guarantees and other contingent liabilities		
Guarantees	13,984,182	14,815,185
Commitments		
Documentary credits and short-term trade-related transactions	458,385	326,826
Forward asset purchases	24,142	—
Standby facilities, credit lines and other commitments to lend	15,693,177	16,699,583
Total	16,175,704	17,026,409

The above table discloses the nominal principal amounts which represents the maximum amounts at risk should contracts be fully drawn upon and clients default. As a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of these nominal principal amounts is not representative of future liquidity requirements.

Guarantees and other commitments

The principal types of guarantees generally provided in the normal course of the group's banking business, and other contractual commitments, are consistent with those detailed in the *Annual Report and Accounts 2016*.

13 Legal proceedings and regulatory matters

The group is party to legal proceedings and regulatory matters in a number of jurisdictions arising out of its normal business operations. Apart from the matters described below, the group considers that none of these matters are material. While the outcome of legal proceedings and regulatory matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of these matters as at 30 June 2017. Any provision recognised does not constitute an admission of wrongdoing or legal liability. It is not practicable to provide an aggregate estimate of potential liability for our legal proceedings and regulatory matters as a class of contingent liabilities.

Anti-money laundering and sanctions-related

(Matters relevant to HBME as a subsidiary of HSBC operating in the Middle East)

In October 2010, HSBC Bank USA entered into a consent order with the Office of the Comptroller of the Currency (the 'OCC'), and HSBC North America Holdings Inc. ('HNAH') entered into a consent order with the Federal Reserve Board (the 'FRB') (each an 'Order' and together, the 'Orders'). These Orders required improvements to establish an effective compliance risk management programme across HSBC's US businesses, including risk management related to the Bank Secrecy Act ('BSA') and anti-money laundering ('AML') compliance. HSBC Bank USA is not currently in compliance with the OCC Order. Steps are being taken to address the requirements of the Orders.

Notes on the Condensed Financial Statements (unaudited) | Independent Review Report by PricewaterhouseCoopers Limited to HSBC Bank Middle East Limited

In December 2012, HSBC Holdings, HNAH and HSBC Bank USA entered into agreements with US and UK government agencies regarding past inadequate compliance with the BSA, AML and sanctions laws. Among those agreements, HSBC Holdings and HSBC Bank USA entered into a five-year deferred prosecution agreement (the 'US DPA') with, among others, the US Department of Justice ('DoJ'); HSBC Holdings consented to a cease-and-desist order, and HSBC Holdings and HNAH consented to a civil money penalty order with the FRB.

HSBC Holdings also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions, as well as an undertaking with the UK FCA to comply with certain forward-looking AML and sanctions-related obligations. In addition, HSBC Bank USA entered into civil money penalty orders with the Financial Crimes Enforcement Network of the US Treasury Department and the OCC.

Under these agreements, HSBC Holdings and HSBC Bank USA made payments totalling US\$1.9 billion to US authorities and undertook various further obligations, including, among others, to continue to cooperate fully with the DoJ in any and all investigations, not to commit any crime under US federal law subsequent to the signing of the agreement, and to retain an independent compliance monitor (the 'Monitor'). In February 2017, the Monitor delivered his third annual follow-up review report.

Through his country-level reviews, the Monitor identified potential anti-money laundering and sanctions compliance issues that the DoJ and HSBC are reviewing further. The potential consequences of breaching the US DPA could include the imposition of additional terms and conditions on HSBC, an extension of the agreement, including its monitorship, or the criminal prosecution of HSBC, which could, in turn, entail further financial penalties and collateral consequences. Additional consequences of breaching the DPA orders could have a material adverse effect on HSBC's business, financial condition and results of operations, including loss of business and withdrawal of funding, restrictions on performing dollar-clearing functions through HSBC Bank USA or revocation of bank licences.

These settlements with US and UK authorities have led to private litigation, and do not preclude further private litigation related to HSBC's compliance with applicable BSA, AML and sanctions laws or other regulatory or law enforcement actions for BSA, AML, sanctions or other matters not covered by the various agreements.

Since November 2014 three lawsuits have been filed in federal court in New York and Illinois against HBME and various other HSBC companies and other defendants, on behalf of plaintiffs who are, or are related to, victims of terrorist attacks in Iraq and Jordan. In each case, it is alleged that the defendants aided and abetted the unlawful conduct of various sanctioned parties in violation of the US Anti-Terrorism Act. These actions are at an early stage.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these lawsuits, including the timing or any possible impact on HSBC, which could be significant.

14 Related party transactions

There were no changes in the related party transactions described in the *Annual Report and Accounts 2016* that have had a material effect on the financial position or performance of HSBC in the half-year to 30 June 2017. All related party transactions that took place in the half-year to 30 June 2017 were similar in nature to those disclosed in the *Annual Report and Accounts 2016*.

15 Called up share capital and share premium

On 29 June 2017 (the 'transaction date'), the bank acquired 10.01% stake in HSBC Bank A.S. in Turkey from HSBC Bank plc. The acquisition was settled through the issuance of one ordinary share, which was allotted to its sole shareholder, HSBC Middle East Holdings BV, with a nominal value of US\$1.00, at a premium of US\$61.3 million recognised as share premium account as at the transaction date.

16 Events after the balance sheet date

These accounts were approved by the Board of Directors on 30 July 2017 and authorised for issue.

Independent Review Report to HSBC Bank Middle East Limited

Review report on condensed consolidated interim financial information to the board of directors of HSBC Bank Middle East Limited

Introduction

We have reviewed the accompanying condensed consolidated interim statement of financial position of HSBC Bank Middle East Limited and its subsidiaries (the 'group') as at 30 June 2017 and the related condensed consolidated statements of income, comprehensive income, changes in equity and cash flows for the six month period then ended and notes, comprising a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and presentation of this condensed consolidated interim financial information in accordance with with International Accounting Standard 34 – 'Interim Financial Reporting' as adopted by the European Union. Our responsibility is to express a conclusion on this condensed consolidated interim financial information based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, 'Review of interim financial information performed by the independent auditor of the entity'. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed consolidated interim financial information is not prepared, in all material respects, in accordance with International Accounting Standard 34 'Interim Financial Reporting' as adopted by the European Union.

PricewaterhouseCoopers Limited

30 July 2017

David R Cox

Place: Dubai, United Arab Emirates

HSBC BANK MIDDLE EAST LIMITED

Incorporated in the Dubai International Financial Centre number – 2199

Regulated by the Dubai Financial Services Authority.

REGISTERED OFFICE

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