The Hongkong and Shanghai Banking Corporation Limited
- Macau Branch

Disclosure of Financial Information
31 December 2012

Report of the Branch management

Principal place of business and activities

The Hongkong and Shanghai Banking Corporation Limited, Macau Branch ("the Branch") is a branch of The Hongkong and Shanghai Banking Corporation Limited. It is domiciled in Macau and has its registered office and principal place of business at Avenida da Praia Grande, No.639, 1st Floor, HSBC Main Branch, Macau. The Hongkong and Shanghai Banking Corporation Limited ("the Bank") produces financial statements available for public use. The Branch is registered as a licensed bank under the Macau Financial System Act under the supervision of the Autoridade Monetaria de Macau ("AMCM").

Branch's activities in Macau

Underpinned by the strong economic performance in Macau and the low interest rates environment globally, HSBC Macau recorded Profit Before Tax of MOP319.3 million in 2012 which was over 2011 by MOP72.5 million or 29%. The net interest margin increased by 16% due to growth of customer advances; net fee income increased by 8% and dealing profits by 7% mainly due to increase of new business and launch of new products. Loan impairment charges were contained below the 2011 level due to stringent management of asset portfolio and quality customer lending as well as recovery of bad debts. Cost management was effective to contain costs below the 2011 level by 2% in achievement of our business strategy.

In 2012, new customer advances grew by 6% in various business sectors attributable to the buoyant Macau economy. Customer deposits shrank slightly by 0.1% as a result of the fierce competition in the local market.

In 2012, we enhanced our banking services and products, and expanded our ATM network to service both personal and corporate customers.

Balance sheet as at 31 December 2012

(Expressed in thousands of Macau Patacas)

	2012		
	Amounts MOP'000	*Reserves, depreciation and provision* MOP'000	*Net amount* MOP'000
Assets			
Cash	272,738	-	272,738
Deposits at AMCM	467,443	-	467,443
Accounts receivables	-	-	-
Current deposits at other local credit institutions	148,370	-	148,370
Current deposits at other overseas credit institutions	139,137	-	139,137
Loans and advances	8,574,608	6,222	8,568,386
Placements to local credit institutions	1,560,000	-	1,560,000
Call and fixed deposits at overseas credit institutions	4,814,256	-	4,814,256
Debtors	57,283	-	57,283
Available-for-sale equity investments	250	-	250
Properties	22,327	20,063	2,264
Equipments	83,017	76,044	6,973
Internal and adjustment accounts	234,259	-	234,259
Total	16,373,688	102,329	16,271,359

Balance sheet as at 31 December 2012 (continued)

(Expressed in thousands of Macau Patacas)

	2012	
	Subtotal	*Total*
	MOP'000	MOP'000
Liabilities		
Current deposits	12,596,348	
Call deposits	88,328	
Fixed deposits	2,181,392	14,866,068
Funding from local credit institutions	85	
Funding from overseas credit institutions	591,552	
Cheques and bills payable	114,008	
Creditors	-	
Other liabilities	25,288	730,933
Internal and adjustment accounts		341,998
Provisions		4,932
Revaluation reserve	(59,765)	
Other reserves	106,130	46,365
Current profit		281,063
		16,271,359

Profit and loss account
for the year ended 31 December 2012

(Expressed in thousands of Macau Patacas)

Profit and loss account

Debit	*2012 Amount* MOP'000	*Credit*	*2012 Amount* MOP'000
Operating costs	23,311	Operating income	268,297
Personnel expenses	61,091	Income from banking services	194,070
Staff costs	9,418	Other operating income	63,967
Supplies by third party	11,918	Other banking income	1,240
Services provided by third party	87,207	Non operating income	-
Other banking expenses	6,180		
Tax expenses	11		
Non operating expenses	784		
Depreciation expenses	3,945		
Provisions	7,240		
Operating profits	316,469		
Total	527,574	**Total**	527,574

Profit and loss account
for the year ended 31 December 2012 (continued)
(Expressed in thousands of Macau Patacas)

Profit and loss account

Debit	*2012 Amount* MOP’000	*Credit*	*2012 Amount* MOP’000
Loss related to prior year	2,819	Operating profit	316,469
Tax on profit	38,206	Income related to prior years	9,800
Additional provision under AMCM rules	7,000	Provision	2,819
Profit	281,063		
Total	329,088	**Total**	329,088

Cash flow statement
for the year ended 31 December 2012
(Expressed in thousands of Macau Patacas)

	2012
	MOP'000
Operating activities	
Profit before taxation	326,269
Adjustments for:	
Depreciation and amortisation	3,945
Employees' options granted cost free by the ultimate holding company	985
Gains less losses on financial investments	-
Impairment release and other credit risk provisions	(2,560)
Other movements in capital contribution related to employee share awards	(376)
	328,263
Decrease/(increase) in operating assets:	
Change in Monetary bills with original maturity of more than three months	(58,888)
Change in placements with banks maturing after one month	346,288
Change in loans and advances to customers	(481,338)
Change in other assets	(255,375)
(Decrease)/increase in operating liabilities:	
Change in deposits from banks	693,265
Change in customer accounts	(198,618)
Change in other liabilities	412,745
Cash generated from operating activities	786,342
Taxation paid	(29,507)
Net cash generated from operating activities	756,835

Cash flow statement
for the year ended 31 December 2012 (continued)
(Expressed in thousands of Macau Patacas)

	2012
	MOP'000
Investing activities	
Purchase of property, plant and equipment	(3,179)
Net cash used in investing activities	(3,179)
Net cash inflow before financing	753,656
Financing activity	
Profit remitted to head office	(217,130)
Net cash used in financing activity	(217,130)
Net increase/(decrease) in cash and cash equivalents	536,526
Cash and cash equivalents at 1 January	5,807,084
Cash and cash equivalents at 31 December	6,343,610
Cash flows from operating activities include:	
Interest received	262,930
Interest paid	28,412

Off-balance-sheet exposures for the year ended 31 December 2012

(Expressed in thousands of Macau Patacas)

(a) Contingent liabilities and commitments

	Contractual amounts *2012* MOP'000
Financial guarantees	1,319,103
Performance guarantees	411,147
Trade related contingencies	628,759
Other commitments	8,070,250

Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. As the facilities may expire without being drawn upon, the contractual amounts do not represent expected future cash flows.

Autoridade Monetária de Macau ("AMCM") requires that general provision be maintained at 1% of the guarantees given by the credit institutions. Specific provisions on contingent credit are made when there is evidence that the guarantees given by the credit institutions are not fully recoverable.

(b) Derivatives

Derivatives refer to financial contracts whose value depends on the value of one or more underlying assets or indices.

Off-balance-sheet exposures
for the year ended 31 December 2012 (continued)
(Expressed in thousands of Macau Patacas)

(b) ***Derivatives (continued)***

The following is a summary of the notional amounts of each significant type of derivative:

	2012 MOP'000
Interest rate contracts	160,166
Exchange rate contracts	2,031,784
	2,191,950

Derivatives arise from forward and swap transactions undertaken in the foreign exchange and equity markets. The notional amounts of these instruments indicate the volume of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

The fair values and credit risk weighted amounts of the aforesaid off-balance sheet exposures are as follows:

	2012	
	Assets MOP'000	*Liabilities* MOP'000
Fair value		
– Interest rate contracts	3,465	3,465
– Exchange rate contracts	11,306	10,706
	14,771	14,171

	2012 MOP'000
Credit risk weighted amounts	
– Interest rate contracts	330
– Exchange rate contracts	7,920

Off-balance-sheet exposures for the year ended 31 December 2012 (continued)

(Expressed in thousands of Macau Patacas)

(b) ***Derivatives (continued)***

Credit risk weighted amount refers to the amount as computed in accordance with AMCM Guideline Notice 013/93-AMCM on capital adequacy and depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 50% for exchange rate and interest rate contracts and from 0% to 100% for other derivative contracts.

The Branch did not enter into any bilateral netting arrangements during the year and accordingly these amounts are shown on a gross basis.

Accounting policies

(a) Statement of compliance

This disclosure of financial information has been prepared in accordance with the requirements as set out in the Guidelines on Disclosure of Financial Information issued by the AMCM.

These financial statements have been prepared in accordance with the requirements as set out in Decree-Law No. 32/93/M and the Macau Financial Reporting Standards ("MFRSs") issued under Administrative Regulation No. 25/2005 of Macau SAR.

(b) Basis of preparation of the financial statements

The Branch is part of The Hongkong and Shanghai Banking Corporation Limited and accordingly it is not a separate legal entity. These financial statements have been prepared from the books and records maintained by the Branch in Macau, which contain evidence of all transactions entered into by the Branch locally but do not necessarily reflect all transactions that may be applicable to the Branch.

The financial statements are presented in thousands of Macau Patacas ("MOP"). The measurement basis used in the preparation of the financial statements is historical cost except for financial instruments classified as trading, designated at fair value through profit or loss and available-for-sale (see accounting policy (c)(ii)).

The preparation of financial statements under MFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised if the revision affects only that year, or in the year of the revision and future years if the revision affects both current and future years.

Judgements made by management in the application of MFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year.

Accounting policies (continued)

(c) Financial instruments

(i) Initial recognition

The Branch classifies its financial instruments into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: held at fair value through profit or loss, loans and receivables, available-for-sale financial assets and other financial liabilities.

Financial instruments are measured initially at fair value, which normally will be equal to the transaction price, plus, in case of a financial asset or financial liability not held at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately.

The Branch recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. A regular way purchase or sale of financial assets is recognised using trade date accounting. From this date, any gains and losses arising from changes in fair value of the financial assets or financial liabilities are recorded.

(ii) Categorisation

Fair value through profit or loss

This category comprises derivatives that do not qualify for hedge accounting. These transactions are accounted for as trading instruments.

Financial assets and liabilities under this category are carried at fair value and are not allowed to be reclassified into or out of this category while held or issued. Changes in the fair value are included in the income statement in the period in which they arise. Upon disposal or repurchase, the difference between the net sale proceeds or the net payment and the carrying value is included in the income statement.

Accounting policies (continued)

(c) Financial instruments (continued)

(ii) Categorisation (continued)

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (a) those that the Branch intends to sell immediately or in the near term, which will be classified as held for trading; (b) those that the Branch, upon initial recognition, designates as held at fair value through profit or loss or as available-for-sale; or (c) those where the Branch may not recover substantially all of its initial investment, other than because of credit deterioration, which will be classified as available-for-sale. Loans and receivables mainly comprise balances with financial institutions and loans and advances to customers.

Loans and receivables are carried at amortised cost using the effective interest rate method, less impairment losses, if any (see accounting policy (e)).

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity where the Branch has the positive intention and ability to hold to maturity, other than (a) those that the Branch, upon initial recognition, designates as held at fair value through profit or loss or as available-for-sale; and (b) those that meet the definition of loans and receivables.

Held-to-maturity investments are carried at amortised cost using the effective interest rate method less impairment losses, if any (see accounting policy (e)).

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any other categories. They include financial assets intended to be held for an indefinite period of time, but which may be sold in response to needs for liquidity or changes in the market environment.

Available-for-sale financial assets are carried at fair value. Unrealised gains and losses arising from changes in fair value are recognised directly in the available-for-sale financial assets reserve except for foreign exchange gains and losses on monetary items such as debt securities and impairment losses which are recognised in the income statement.

Accounting policies (continued)

(c) Financial instruments (continued)

(ii) Categorisation (continued)

Available-for-sale financial assets (continued)

Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments are carried at cost less impairment losses, if any (see accounting policy (e)).

When available-for-sale financial assets are sold, the difference between the net sale proceeds and the carrying value, together with the accumulated fair value adjustments in the available-for-sale financial assets reserve are treated as gains or losses on disposal.

Other financial liabilities

Financial liabilities, other than trading liabilities and those designated as held at fair value through profit or loss, are measured at amortised cost using the effective interest rate method.

(iii) Fair value measurement principles

The fair value of financial instruments is based on their quoted market prices, where available, at the balance sheet date without any deduction for estimated future selling costs. Financial assets are priced at current bid prices, while financial liabilities are priced at current ask prices.

Where quoted market prices are not available and discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the balance sheet date applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the balance sheet date.

(iv) Derecognition

A financial asset is derecognised when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset together with substantially all the risks and rewards of ownership, have been transferred.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

Accounting policies (continued)

(c) Financial instruments (continued)

(v) Embedded derivatives

An embedded derivative is a component of a hybrid (combined) instrument that includes both the derivative and a host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. Embedded derivatives are separated from the host contract and accounted for as a derivative when (a) the economic characteristics and risks of the embedded derivative are not clearly and closely related to the host contract; and (b) the hybrid (combined) instrument is not designated as held at fair value through profit or loss.

When the embedded derivative is separated, the host contract is accounted for in accordance with note (ii) above.

(d) Property, plant and equipment

Property, plant and equipment are stated in the balance sheet at cost less accumulated depreciation and impairment losses (accounting policy (e)). Depreciation is calculated on a straight-line basis to write off the cost of fixed assets over their estimated useful lives as follows:

– Bank premises	2% p.a.
– Furniture and equipment	10% - 25% p.a.

No amortisation is provided for land held on a perpetual lease.

Where parts of an item of property and equipment have different useful lives, the cost or valuation of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually.

Gains or losses arising from the retirement or disposal of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement on the date of retirement or disposal.

Accounting policies (continued)

(e) Impairment of assets

The carrying amount of the Branch's assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, the carrying amount is reduced to the estimated recoverable amount by means of a charge to the income statement. The carrying value of loans and receivables is adjusted through use of an allowance account rather than a direct write off.

(i) Loans and receivables

Impairment losses on loans and receivables are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets). Receivables with a short duration are not discounted if the effect of discounting is immaterial.

The total allowance for credit losses consists of two components: individual impairment allowances and collective impairment allowances.

The Branch first assesses whether objective evidence of impairment exists for financial assets that are individually significant, and collectively for financial assets that are not individually significant. If the Branch determines that no objective evidence of impairment exists for an individually assessed financial asset it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

The individual impairment allowance is based upon management's best estimate of the present value of the cash flows which are expected to be received discounted at the original effective interest rate. In estimating these cash flows, management makes judgments about the borrower's financial situation and the net realisable value of any underlying collateral or guarantees in favour of the Branch. Each impaired asset is assessed on its own merits.

In assessing the need for collective impairment allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, the Branch makes assumptions both to define the way the Branch models inherent losses and to determine the required input parameters, based on historical experience and current economic conditions.

Accounting policies (continued)

(e) Impairment of assets (continued)

(i) Loans and receivables (continued)

The accuracy of the impairment allowances the Branch makes depends on how well the Branch can estimate future cash flows for individually assessed impairment allowances and the model assumptions and parameters used in determining collective impairment allowances. While this necessarily involves judgment, the Branch believes that the impairment allowances on loans and advances to customers are reasonable and supportable.

Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates that can be linked objectively to an event occurring after the write-down, will result in a change in the impairment allowances on loans and receivables and will be charged or credited to the income statement. A reversal of impairment losses is limited to the loans and receivables' carrying amount that would have been determined had no impairment loss been recognised in prior years.

Loans and receivables with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Branch has made concessions that it would not otherwise consider. Renegotiated loans and receivables are subject to ongoing monitoring to determine whether they remain impaired or past due.

When there is no reasonable prospect of recovery, the loan and related interest receivables are written off.

(ii) Held-to-maturity investments

Impairment on held-to-maturity investments is considered at both an individual and collective level. The individual impairment allowance is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the asset's original effective interest rate, where the effect of discounting is material.

All significant assets found not to be individually impaired and any assets not individually assessed for impairment are then collectively assessed for any impairment that has been incurred but not yet identified.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement. A reversal of impairment losses shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

Accounting policies (continued)

(e) Impairment of assets (continued)

(iii) Available-for-sale financial assets

When there is objective evidence that an available-for-sale financial asset is impaired, the cumulative loss that had been recognised directly in equity is removed from equity and is recognised in the income statement. The amount of the cumulative loss that is recognised in the income statement is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in the income statement.

Impairment losses recognised in the income statement in respect of available-for-sale equity securities are not reversed through the income statement. Any subsequent increase in the fair value of such assets is recognised directly in equity.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in the income statement.

(iv) Other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased:

– property, plant and equipment; and

– other assets.

If any such indication exists, the asset’s recoverable amount is estimated.

– Calculation of recoverable amount

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

Accounting policies (continued)

(e) Impairment of assets (continued)

(iv) Other assets (continued)

– Recognition of impairment losses

An impairment loss is recognised in the income statement whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

– Reversals of impairment losses

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognised.

(f) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits and term deposits with maturities below one month, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(g) Employee benefits

(i) Short term employee benefits

Salaries, annual bonuses, paid annual leave, leave passage and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees of the Branch. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

Accounting policies (continued)

(g) Employee benefits (continued)

(ii) Pension

The Branch operates two pension plans which include both a defined benefit and a defined contribution plan.

Costs in respect of defined contribution plans are charged as an expense over the period to which the employee service relates.

The costs recognised for funding defined benefit plans are determined using the projected unit credit method, with annual actuarial valuations performed on the plan. Actuarial differences that arise are recognised in reserves and presented in the statement of recognised income and expense in the period they arise. Past service costs are recognised immediately to the extent the benefits are vested, and are otherwise recognised on a straight-line basis over the average period until the benefits are vested. The current service costs and any past service costs together with the unwinding of the discount on the plan liabilities, less the expected return on plan assets are charged to operating expenses.

(iii) Share-based payments

The cost of 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, with a corresponding credit to "Share option reserve". The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately with a corresponding credit to "Share option reserve".

The fair value of options granted is determined by using appropriate valuation models, taking into account the terms and conditions upon which the options were granted. Market performance conditions are taken into account when estimating the fair value of the options 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. The fair value of shares in the ultimate holding company which are granted to employees is measured by reference to the market price on grant date.

Accounting policies (continued)

(g) Employee benefits (continued)

(iii) Share-based payments (continued)

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.

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

(h) Income tax

(i) Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case they are recognised in equity.

(ii) Current tax is the expected tax payable on the taxable income for the year, calculated using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

(iii) Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions that are currently not applicable to the Branch, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

Accounting policies (continued)

(h) Income tax (continued)

(iii) (continued)

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

(iv) Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if, and only if the Branch has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Branch intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or

- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on the same taxable entity.

(i) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Branch has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

Accounting policies (continued)

(j) Revenue recognition

Provided it is probable that the economic benefits will flow to the Branch and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in the income statement as follows:

(i) Interest income

Interest income for all interest-bearing financial instruments is recognised in the income statement using the effective interest rate method.

The effective interest rate method is a method of calculating the amortised cost of a financial asset and of allocating the interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset. When calculating the effective interest rate, the Branch estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

For impaired loans, the accrual of interest income based on the original terms of the loan is discontinued, but any increase in the present value of impaired loans due to the passage of time is reported as interest income.

(ii) Fee and commission income

Fee and commission income is recognised when the corresponding services are provided.

(k) Translation of foreign currencies

Foreign currency transactions during the year are translated into Macau Patacas at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Macau Patacas at the exchange rate ruling at the balance sheet date. Exchange gains and losses on these foreign currency translations are dealt with in the income statement. Non-monetary assets denominated in foreign currencies that are stated at fair value are translated into Macau Patacas at the exchange rates ruling at the time the fair value was established.

Accounting policies (continued)

(l) Related parties

(a) A person, or a close member of that person's family, is related to the Branch if that person:

  (i) has control or joint control over the Branch;

  (ii) has significant influence over the Branch; or

  (iii) is a member of the key management personnel of the Branch or the Branch's parent.

(b) An entity is related to the Branch if any of the following conditions applies:

  (i) The entity and the Branch are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

  (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

  (iii) Both entities are joint ventures of the same third party.

  (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

  (v) The entity is a post-employment benefit plan for the benefit of employees of either the Branch or an entity related to the Branch.

  (vi) The entity is controlled or jointly controlled by a person identified in (a).

  (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity.

Significant Related party transactions

(Expressed in thousands of Macau Patacas)

Material related party transactions

The Branch entered into the following material related party transactions.

Transactions with group companies

During the year, the Branch entered into transactions with related parties in the ordinary course of its banking business including lending, acceptance and placement of inter-bank deposits, correspondent banking transactions and off-balance sheet transactions. The transactions were priced at the relevant market rates at the time of each transaction.

The amount of related-party transactions during the year and outstanding balances at the end of the year are set out below:

	Fellow subsidiaries 2012 MOP'000	*The Hongkong and Shanghai Banking Corporation, Hong Kong Branch 2012* MOP'000
Interest income	15,649	13,328
Interest expense	(53)	(344)
Fee and commission income	21,167	4,687
Fee and commission expense	(1,070)	(776)
Other operating income	192	-
Operating expenses	(13,759)	(57,340)
For the year ended 31 December	22,126	(40,445)

Significant Related party transactions (continued)

(Expressed in thousands of Macau Patacas)

Material related party transactions (continued)

Transactions with group companies (continued)

	Fellow subsidiaries 2012 MOP'000	*The Hongkong and Shanghai Banking Corporation, Hong Kong Branch 2012* MOP'000
Cash and short-term funds	2,447,411	1,543,573
Interest receivable	1,830	1,081
Placement with banks maturing after one month	256,560	214,313
Deposits from financial institution	457,387	789,410
Other assets	-	10,040
Other liabilities	-	4,712
As at 31 December	3,163,188	2,563,129

No impairment allowance was made in respect of the above loans to and placements with related parties.

The Branch's immediate parent is The Hongkong and Shanghai Banking Corporation Limited, which is incorporated in Hong Kong and the Branch's ultimate parent is HSBC Holdings plc, which is incorporated in the United Kingdom. Both the immediate and ultimate parent companies produce consolidated financial statements for public use.

Credit risk management

(Expressed in thousands of Macau Patacas)

The Branch's credit risk is primarily attributable to customer advances and debt investments issued by banks. The Branch manages this risk as follows:

In respect of customer advances, individual credit evaluations are performed on all customers requiring credit. Normally, the Branch obtains collateral from customers.

Investments are normally in liquid securities issued by banks and quoted on a recognised stock exchange and with counterparties that have high credit ratings.

At the balance sheet date, the Branch's greatest concentration of credit risk on one market sector was 37.2% of total customer advances.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet after deducting any impairment allowance and adjustment of mark to market value if applicable.

Credit risk management (continued)

(Expressed in thousands of Macau Patacas)

(a) Geographical distribution of credit risk exposures

The geographical distribution is based on the countries where the counterparties were operated or located after taking into account any transfer of risk. In general, such transfer of risk takes place if the claims are guaranteed by a party in a country which is different from that of the counterparty or if the claims are on an overseas branch of a bank whose head office is located in another country.

Exposures to individual countries or jurisdiction, groups of countries or regions within countries amounting to 10% or more of the relevant major types of credit exposures at balance sheet date are shown as follows:

	2012		
Region	*Gross loans and commitments* MOP	*Debt securities* MOP	*Financial derivatives* MOP
Macau SAR	13,353,710	1,560,000	900,399
in which:			
– banks	-	-	-
– governments and public sectors	-	1,560,000	-
– others	13,353,710	-	900,399
Hong Kong SAR	3,055,710	-	1,291,551
in which:			
– banks	-	-	-
– governments and public sectors	-	-	-
– others	3,055,710	-	1,291,551
	16,409,420	1,560,000	2,191,950

Credit risk management (continued)

(Expressed in thousands of Macau Patacas)

(a) Geographical distribution of credit risk exposures (continued)

Geographic region with higher than or equal to 10% of the total loans and advances to customers at balance sheet date are shown as follows:

	2012	
	Gross loans and advances	*Past due or impaired*
	MOP’000	MOP’000
Macau	6,766,668	133,290
Hong Kong	1,573,311	15,816
	8,339,979	149,106

Credit risk management (continued)

(Expressed in thousands of Macau Patacas)

(b) ***Loans and advances to customers analysed by industry sector***

	2012
	MOP'000
Industry distribution of exposures	
– Manufacturing	988,096
– Electricity, gas and water	-
– Construction and public works	43,360
– Trade (wholesale and retail)	1,814,987
– Restaurants, hotels and related activities	23,082
– Transport, warehouse and communications	33,000
– Individuals for house purchases	3,190,036
– Individuals for other purposes	508,661
– Others	1,967,164
	8,568,386

According to AMCM's requirements, a general provision is made at 1% of the aggregated balance of loans and advances (with overdue days less than 3 months), guarantees and contingent assets. As at 31 December 2012, the amounts of specific provision by industry sector are shown as follows:

	2012
	MOP'000
– Manufacturing	5,137
– Individuals for house purchases	666
– Individuals for other purposes	419
	6,222

Credit risk management (continued)

(Expressed in thousands of Macau Patacas)

(c) Analysis on assets and liabilities by remaining maturity

	2012							
	On demand MOP'000	*Within 1 month* MOP'000	*3 months or less but over 1 month* MOP'000	*1 year or less but over 3 months* MOP'000	*3 years or less but over 1 year* MOP'000	*Over 3 years* MOP'000	*Within an indefinite period* MOP'000	*Total* MOP'000
Assets								
Cash and balances with other financial institutions	986,665	124,796	-	-	-	-	309,901	1,421,362
Placements with banks and other financial institutions	-	4,247,177	264,881	207,035	-	-	-	4,719,093
Securities issued by AMCM	-	720,000	320,000	520,000	-	-	-	1,560,000
Loans and advances to customers	210,860	1,656,942	1,166,953	669,583	942,371	3,921,677	-	8,568,386
	1,197,525	6,748,915	1,751,834	1,396,618	942,371	3,921,677	309,901	16,268,841
Liabilities								
Deposits and balances of banks and financial institutions	116,417	-	-	-	-	-	-	116,417
Deposits from Head Office and other branches	170,906	536,985	-	54,833	206,172	-	-	968,896
	287,323	536,985	-	54,833	206,172	-	-	1,085,313

Credit risk management (continued)

(Expressed in thousands of Macau Patacas)

(d) ***Analysis on past due assets***

The ageing analysis of advances to customers that are past due is as follows:

	2012
	MOP'000
Gross advances to customers that are past due	
– six months or less but over three months	2,294
– one year or less but over six months	-
– over one year	5,003
	7,297

	2012
	MOP'000
Value of collateral on past due loans and advance	
– six months or less but over three months	1,370
– one year or less but over six months	-
– over one year	1,157
	2,527

	2012
	MOP'000
Amount of specific provision made on past due loans and advance	
– six months or less but over three months	1,012
– one year or less but over six months	-
– over one year	5,210
	6,222

As at 31 December 2012, there were no other assets that have been past due for bank and non-bank customers.

Market risk management

(Expressed in thousands of Macau Patacas)

Market risk

Market risk is the risk that movements in foreign exchange rates, interest rates, credit spreads, or equity and commodity prices will result in profits or losses to the Branch. 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 Branch monitors market risk separately for trading portfolios and non-trading portfolios. Trading portfolios include positions arising from market-making in exchange rate, interest rate, credit and equity derivative instruments, as well as in debt and equity securities. Trading risks arise either from customer-related business or from proprietary position-taking.

Interest rate risk management

(Expressed in thousands of Macau Patacas)

Interest rate risk

Interest rate risk arises principally from mismatches between the future yield on assets and our 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.

As part of the Bank's Asset, Liability and Capital Management ('ALCM') structure, we have established the Asset and Liability Management Committee ('ALCO') and Balance Sheet Management ('BSM') at the Branch level. In order to manage this risk optimally, all interest rate risk is transferred to BSM.

The transfer of interest rate risk to books managed by BSM is usually achieved by a series of internal deals between the business units and these books. When the behavioural characteristics of a product differ from its contractual characteristics, the behavioural characteristics are assessed to determine the true underlying interest rate risk. Local ALCOs regularly monitor all such behavioural assumptions and interest rate risk positions, to ensure they comply with interest rate risk limits established by senior management.

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

Once interest rate risk has been consolidated in BSM, the net exposure is typically managed through the use of interest rate swaps within agreed limits.

We also monitor the sensitivity of projected net interest income under varying interest rate scenarios. We aim, through its management of interest rate risk, to mitigate the impact of prospective interest rate movements which could reduce future net interest income, whilst balancing the cost of such hedging activities on the current net revenue stream.

Operational risk management

(Expressed in thousands of Macau Patacas)

Operational risk is the risk of loss arising from fraud, unauthorised activities, error, omission, inefficiency, systems failure or external events. It is inherent in every business organisation and covers a wide spectrum of issues.

The Branch manages this risk through a controls-based environment in which processes are documented, authorisation is independent and transactions are reconciled and monitored. This is supported by an independent programme of periodic reviews undertaken by internal audit, and by monitoring external operational risk events, which ensure that the Branch stays in line with industry best practice and takes account of lessons learnt from publicised operational failures within the financial services industry.

The Branch has codified its operational risk management process by issuing a high level standard, supplemented by more detailed formal guidance. This explains how the Branch manages operational risk by identifying, assessing, monitoring, controlling and mitigating the risk, rectifying operational risk events, and implementing any additional procedures required for compliance with local regulatory requirements. The standard covers the following:

- operational risk management responsibility is assigned to senior management within the business operation;
- information systems are used to record the identification and assessment of operational risks and to generate appropriate, regular management reporting;
- assessments are undertaken of the operational risks facing each business and the risks inherent in its processes, activities and products. Risk assessment incorporates a regular review of identified risks to monitor significant changes;
- operational risk loss data is collected and reported to senior management. Aggregate operational risk losses are recorded and details of incidents above a materiality threshold are reported to the HSBC Group’s Audit Committee; and
- risk mitigation, including insurance, is considered where this is cost-effective.

Foreign exchange risk management

(Expressed in thousands of Macau Patacas)

Foreign currency risk

The Branch is exposed to currency risks primarily arising from financial instruments that are denominated in United States dollars ("USD") and other major currencies. As the USD is pegged to the Hong Kong dollar ("HKD") which is in turn pegged to Patacas, the Branch considers the risk of movements in exchange rates between the HKD and the USD, and to Patacas to be insignificant. In respect of financial instruments denominated in other currencies, the Branch ensures that the net exposure is kept to an acceptable level by buying or selling foreign currencies at spot rates where necessary to address short-term imbalances.

As most of the Branch's financial instruments at 31 December 2012 and 2011 were denominated in either HKD or USD, management does not consider there to be any significant currency risk associated with them.

The following table indicates the net long/(short) position of currencies other than MOP:

	2012 MOP'000
HKD	568,020
USD	(781,261)
Other currencies	(53,037)

Foreign exchange risk management (continued)

(Expressed in thousands of Macau Patacas)

Foreign currency risk

Analysis on foreign currencies with net position constitute not less than 10% of the total net position in all currencies:

	2012			
	United States Dollars	*Hong Kong Dollars*	*Other foreign currencies*	*Total*
In thousand of MOP equivalent				
Assets				
Cash and balances at central banks	1,385	199,220	2,130	202,735
Items in course of collection from banks	-	69,505	-	69,505
Loans and advances to banks	818	9,683	407,500	418,001
Loans and advances to customers	1,730,262	5,366,320	170,348	7,266,930
Other assets	33,650	639,877	106,345	779,872
Prepayments and accrued income	2,914	10,799	892	14,605
Balances with intragroup	3,047,606	398,048	1,015,859	4,461,513
Spot assets	4,816,635	6,693,452	1,703,074	13,213,161

Foreign exchange risk management (continued)

(Expressed in thousands of Macau Patacas)

Foreign currency risk (continued)

	2012			
In thousand of MOP equivalent	*United States Dollars*	*Hong Kong Dollars*	*Other foreign currencies*	*Total*
Liabilities				
Deposits by customers	(4,523,371)	(5,492,736)	(1,421,241)	(11,437,348)
Items in the course of transmission to other banks	-	(90,526)	-	(90,526)
Other liabilities	(754,086)	(23,114)	(188,337)	(965,537)
Accruals and deferred income	(507)	(1,604)	(2,338)	(4,449)
Reserve	(2,295)	-	-	(2,295)
Balances with intragroup	(217,717)	(440,283)	(90,365)	(748,365)
Spot liabilities	(5,497,976)	(6,048,263)	(1,702,281)	(13,248,520)
Forward purchase	975,923	267,673	650,864	1,894,460
Forward sales	(1,075,843)	(344,842)	(704,694)	(2,125,379)
Net long non-structural position	(781,261)	568,020	(53,037)	(266,278)

Liquidity risk management
(Expressed in thousands of Macau Patacas)

The Branch's policy is to monitor its liquidity requirements and its compliance with lending covenants daily, including the terms of borrowings from other group entities, to ensure that it maintains sufficient reserves of cash, readily realisable marketable securities or committed lines of funding (from major financial institutions or other group companies) to satisfy its contractual and reasonably foreseeable obligations as they fall due.

As part of the Bank's Asset, Liability and Capital Management ("ALCM") structure, we have established the Asset and Liability Management Committee ("ALCO") at the Branch level. The terms of reference of ALCO includes the monitoring and control of liquidity and funding.

Liquidity risk management (continued)

(Expressed in thousands of Macau Patacas)

The following table summarizes the key quantitative indicators for liquidity risk for the year ended 31 December 2012:

(a)	The arithmetic mean of the minimum weekly amount of cash in hand that is required to be held	444,928
(b)	The arithmetic mean of the average weekly amount of cash in hand	504,128
(c)	The arithmetic mean of the specified liquid assets at the end of each month	10,269,534
(d)	The average ratio of specified liquid assets to total basic liabilities at the end of the month	62.2%
(e)	The arithmetic mean of its one-month liquidity ratio in the last week of each month	764.5%
(f)	The arithmetic mean of its three-month liquidity ratio in the last week of each month	284.9%

The above ratios and figures calculations are computed based on the data extracted from the weekly and monthly returns submitted to AMCM.

Other information

(Expressed in thousands of Macau Patacas)

(a) ***Capital commitments***

There were no capital commitments outstanding at 31 December not provided for in the financial statements.

(b) ***Operating lease commitments***

At 31 December, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	2012
	MOP'000
Within 1 year	4,454
After 1 year but within 5 year	134
	4,588

Other information in relation to positions of Head Office, The Hongkong and Shanghai Banking Corporation Limited

(Expressed in Hong Kong dollars)

The Branch is one of the branches of The Hongkong and Shanghai Banking Corporation Limited ("the Bank") and therefore it is not required to prepare consolidated accounts. Unless otherwise stated, all information disclosed below is extracted from the corresponding information in the most recently available annual audited consolidated financial statements of the HSBC group of which the Branch is a member.

The audited consolidated financial statements can be accessed through various channels, including its website (http://www.hsbc.com.hk). For more comprehensive understanding of the financial position and results of operations of HSBC, the information disclosed below should be read in conjunction with the audited consolidated financial statements.

(a) Consolidated capital adequacy ratio

	2012
	%
Capital adequacy ratio at 31 December	
Total capital ratio at 31 December	14.3
Core capital ratio at 31 December	13.7

Capital adequacy ratios at 31 December, 2012 were compiled in accordance with the Banking (Capital) Rules ("the Capital Rules") issued by the Hong Kong Monetary Authority under Section 98A of the Hong Kong Banking Ordinance for the implementation of the "Basel II" capital accord, which became effective on 1 January, 2007. In accordance with the Capital Rules, the Bank has adopted the foundation internal ratings-based approach for the calculation of the risk-weighted assets for credit risk and the internal models approach for the calculation of market risk and standardised approach for operational risk.

The basis of consolidation for regulatory purposes is different from the basis of consolidation for accounting purposes. Subsidiaries included in consolidation for regulatory purposes are specified in a notice from the HKMA in accordance with section 98(2) of the Banking Ordinance. Subsidiaries not included in consolidation for regulatory purposes are securities and insurance companies that are authorised and supervised by a regulator and are subject to supervisory arrangements regarding the maintenance of adequate capital to support business activities comparable to those prescribed for authorised institutions under the Banking (Capital) Rules and the Banking Ordinance. The Bank's shareholdings in these subsidiaries are deducted from its core capital and supplementary capital as determined in accordance with Part 3 of the Banking (Capital) Rules.

Other information in relation to positions of Head Office, The Hongkong and Shanghai Banking Corporation Limited (continued)

(Expressed in Hong Kong dollars)

(b) Capital and reserves

	2012
	HKD million
Total capital	58,969
Total reserves	133,790

(c) Consolidated assets, liabilities and profits position

	2012
	HKD million
Total assets	6,065,327
Total liabilities	5,592,249
Total gross loans and advances to customers	2,349,043
Deposits and balances of banks and other financial institutions	244,135
Deposits from customers	3,874,884
Profit before taxation	108,729

(d) Shareholders with qualifying holdings

The Branch is one the branches of The Hongkong and Shanghai Banking Corporation Limited ("the Bank"). The ultimate holding company of the Bank is HSBC Holdings plc, which is incorporated in England. There are no shareholders with major holdings in HSBC Holdings ordinary shares.

Other information in relation to positions of Head Office, The Hongkong and Shanghai Banking Corporation Limited (continued)

(e) Board of Directors

The Board of Directors of the Bank comprises:

Executive directors

Stuart T Gulliver, *Chairman*
Peter Wong Tung Shun, *Chief Executive*
Naina L Kidwai
Rose Lee Wai Mun

Non-executive directors

Dr William Fung Kwok Lun, SBS, OBE, *Deputy Chairman*
Laura Cha May Lung, GBS, *Deputy Chairman*
Graham John Bradley
Dr Raymond Ch'ien Kuo Fung, GBS, CBE
Victor Li Tzar Kuoi
Zia Mody
Christopher D Pratt
James Riley
Andreas Sohmen-Pao
T Brian Stevenson, SBS
Dr Rosanna Wong Yick-ming, DBE
Marjorie Yang Mun Tak
Tan Sri Dr Francis Yeoh Sock Ping, CBE

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Summary of External Auditors' Report

To the Chief Executive Officer of The Hongkong and Shanghai Banking Corporation Limited – Macau Branch
(Branch of a commercial bank with limited liability incorporated in Hong Kong Special Administrative Region)

We have audited the financial statements of The Hongkong and Shanghai Banking Corporation Limited – Macau Branch for the year 2012 in accordance with the Auditing Standards and the Technical Auditing Standards of the Macau Special Administrative Region. In our report dated 15 May 2013, we expressed an unqualified opinion on the financial statements.

The audited financial statements referred to above comprise the balance sheet as at 31 December 2012, and the income statement, statement of recognized income and expense, and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The accompanying summarised financial statements prepared by the management were derived from the audited financial statements referred to above and the books and records of the Branch. In our opinion, page 3 to page 7 of the summarised financial statements are consistent, in all material respects, with the audited financial statements and the books and records of the Branch.

For a better understanding of the financial position and the results of its operation for the period of The Hongkong and Shanghai Banking Corporation Limited – Macau Branch and the scope of our audit, the summarised financial statements should be read in conjunction with the audited financial statements and our independent auditor's report thereon.

Lei Iun Mei, Certified Public Accountant
KPMG

Macau, 15 May 2013