HSBC Bank Australia Ltd
A.B.N. 48 006 434 162

Financial Report

Year Ended 31 December 2012

HSBC

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Directors Report

The Directors of HSBC Bank Australia Limited (the "Company" or the "Bank") submit their report, together with the financial report of the Company and of the consolidated entity, being the Company and its controlled entities, for the financial year ended 31 December 2012 and the auditor's report thereon.

DIRECTORS

The Directors of the Company at any time during or since the end of the financial year are:

Graham J Bradley AM	Non-Executive Chairman	
Carol J Austin	Non-Executive Director	
Alexander A Flockhart CBE	Non-Executive Director	Resigned 30 April 2012
Guy D Harvey-Samuel	Non-Executive Director	
Richard G Humphry AO	Non-Executive Director	
Anthony W Cripps	Chief Executive Officer*	Appointed 24 December 2012
Paulo C T Maia	Chief Executive Officer	Resigned 15 December 2012
Michael J Arnold	Chief Financial Officer	Appointed 15 December 2012

* Prior to being appointed Chief Executive Officer, Mr Cripps was appointed a Non-Executive Director on 17 July 2012.

PRINCIPAL ACTIVITIES

The principal activities of the consolidated entity during the financial year were the provision of financial services comprising lending, deposit taking, domestic and international trade finance, custodial securities services, payments & cash management, money market services, interest rate and foreign currency trading and services, capital markets services, financial advice and futures clearing services.

The Company is a public limited company incorporated in Australia. The registered office is Level 32, HSBC Centre, 580 George Street Sydney.

RESULT OF OPERATIONS

In 2012, HSBC Bank Australia Limited and its controlled entities reported a profit from continuing operations before tax of $196m, a decrease of 23.4% from 2011. Profits declined principally as a result of higher loan impairment charges related primarily to one large credit relationship coupled with an increase in litigation provisions. This was partly offset by notable growth in fee income across all businesses, largely attributable to increased credit card activities and trade related fees.

Total assets were $24.6 billion, up 2.5% from 2011 due principally to growth in residential mortgages and cards portfolios. The Bank also continues to hold high levels of liquid assets in line with HSBC Group policy.

The Bank continued to grow its capital base and strengthen its capital ratios further in preparation for the transition to Basel III. Total Capital ratio under the Australian Prudential Regulation Authority's (APRA) standards increased from 10.6% to 11.3% largely due to profit retention throughout the year. The Bank is well positioned to meet APRA's early adoption of the Basel III capital reforms on 1 January 2013 and will continue to maintain a strong capital position ensuring compliance with expected Basel III changes and to maintain sufficient profits for future growth. Tier 1 capital was 8.9% at 31 December 2012 (8.4% at 31 December 2011). Risk Weighted Assets grew 2.1% on a combined basis in 2012.

DIVIDENDS

Dividends paid or declared by the Company to members since the end of the previous financial year were $40.0m (2011: $88.0m), which was comprised of $37.0m (2011: $85.0m) paid on Ordinary Shares and $3.0m (2011: $3.0m) paid on Preference Shares. Dividend payments decreased from 2011 to 2012 reflecting a reduction in profits.

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

HSBC Bank Australia Limited continued to maintain a strong liquidity policy in line with the HSBC Group, which, together with a strong capital position ensured that the Company was able to effectively service its longstanding commitment to its customers as well as strengthen its competitive position in the domestic market. In the opinion of the Directors, there were no significant changes in the state of affairs of the Company or the consolidated entity during the financial year under review.

ENVIRONMENTAL REGULATION

The Company and its controlled entities are not subject to any particular or significant environmental regulation under a law of the Commonwealth or of a State or Territory.

EVENTS SUBSEQUENT TO REPORTING DATE

There has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity, in future financial years.

LIKELY DEVELOPMENTS

Information about likely developments in the operations of the consolidated entity and the expected results of those operations in future financial years has not been included in this report because disclosure of the information would be likely to result in unreasonable prejudice to the consolidated entity.

NON-AUDIT SERVICES

During the financial year KPMG, the consolidated entity’s auditor, has performed certain other services in addition to their statutory duties.

The Directors have considered the non-audit services provided during the financial year by KPMG and in accordance with written advice provided by resolution of the audit committee, are satisfied that the provision of those non-audit services by the Company’s auditor is compatible with, and did not compromise, the auditor independence requirements of the Corporations Act 2001 for the following reasons:

- All non-audit assignments were approved in accordance with the process set out in HSBC Holdings plc’s Audit Committee terms of reference on the agreed framework for engaging auditors for non-audit services; and
- The non-audit services provided do not undermine the general principles relating to auditor independence as set out in Professional Statement F1 *Professional Independence*, as they did not involve reviewing or auditing the auditor’s own work, acting in a management or decision making capacity for the Company, acting as an advocate for the Company or jointly sharing risks and rewards.

Details of the amounts paid to the auditor of the consolidated entity, KPMG, and its related practices for audit and non-audit services provided during the year are set out in note 7 of the financial statements.

LEAD AUDITOR’S INDEPENDENCE DECLARATION

The lead auditor's independence declaration is set out on page 84 and forms part of the Directors' Report for the year ended 31 December 2012.

INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS

During the financial year, the consolidated entity has caused to be paid premiums in respect of contracts insuring all the directors and certain officers of the Company and its controlled entities against any liability incurred in their role as directors or officers of the entity, except where:

a) the liability arises out of conduct involving a wilful breach of duty; or
b) there has been a contravention of Sections 182 and/or 183 of the Corporations Act 2001.

The Directors have not included details of the nature of liabilities covered or the amount of premium paid in respect of the directors' and officers' liability contracts, as such disclosure is prohibited under the terms of the contract.

DIRECTORS' BENEFITS

No director of the Company has, since the end of the previous financial year, received or become entitled to receive a benefit (other than a benefit included in the aggregate amount of remuneration received or due and receivable by Directors shown in the consolidated financial statements) by reason of a contract made by the Company, a controlled entity or a related body corporate with the director or with a firm in which the director is a member, or with an entity in which the director has a substantial interest, other than that disclosed in the attached financial statements.

ROUNDING OFF OF AMOUNTS

The Company is of the kind referred to in an ASIC Class Order 98/100 dated 10 July 1998 (updated by CO 05/641 effective 28 July 2005 and CO 06/51 effective 31 January 2006) and, in accordance with that Class Order, amounts in this report and the accompanying financial statements, where appropriate, have been rounded to the nearest million dollars except where otherwise stated.

The report is made with a resolution of the Directors.

Graham J Bradley
Chairman

Anthony W Cripps
Director

Dated at Sydney this 14th day of February 2013.

Income Statements

For The Year Ended 31 December 2012

		Consolidated		Company	
		2012	2011	2012	2011
	Note	$'m	$'m	$'m	$'m
Interest income	4(i)	1,283.3	1,395.4	1,283.3	1,395.4
Interest expense	4(ii)	(676.7)	(810.0)	(681.5)	(811.6)
Net interest income		606.6	585.4	601.8	583.8
Fee and commission income	4(iv)	234.0	201.9	234.6	202.8
Fee and commission expense	4(iv)	(36.2)	(31.0)	(31.9)	(30.2)
Net fee and commission income		197.8	170.9	202.7	172.6
Net trading income/(loss)	4(v)	(22.0)	(24.2)	(22.0)	(24.2)
Net loss from financial instruments designated at fair value	4(vi)	(0.3)	-	(0.3)	-
Net gain/(loss) from disposal of financial investments	4(vii)	1.8	(1.1)	1.8	(1.1)
Other operating income	4(iii)	61.5	43.4	61.6	46.7
Net other operating income/(loss)		41.0	18.1	41.1	21.4
Operating income before loan impairment charges, recoveries and other credit risk provisions		845.4	774.4	845.6	777.8
Loan impairment charges, recoveries and other credit risk provisions	5	(135.0)	(53.3)	(135.0)	(57.9)
Net operating income		710.4	721.1	710.6	719.9
Operating expenses					
- staff costs	6	(251.7)	(250.3)	(251.7)	(250.3)
- premises and equipment	6	(53.3)	(51.7)	(53.1)	(51.7)
- administrative expenses	6	(117.4)	(106.4)	(117.4)	(106.4)
- other expenses	6	(92.6)	(57.0)	(92.6)	(57.2)
Total operating expenses		(515.0)	(465.4)	(514.8)	(465.6)
Profit before income tax		195.4	255.7	195.8	254.3
Income tax expense	8	(60.9)	(78.5)	(60.9)	(77.1)
Profit for the period		134.5	177.2	134.9	177.2
Attributable to:					
Equity holders of the parent		134.5	177.2	134.9	177.2

The notes on pages 14 to 80 are an integral part of these consolidated financial statements.

Statements Of Financial Position

As At 31 December 2012

		Consolidated		Company	
		2012	2011	2012	2011
	Note	$'m	$'m	$'m	$'m
ASSETS					
Cash and balances at central banks	30(b)	430.5	398.0	430.5	398.0
Items in the course of collection from other banks		1.1	1.6	1.1	1.6
Derivatives	10	54.6	91.5	54.6	91.5
Loans and advances to banks	28(b)	216.8	1,979.6	216.8	1,979.6
Loans and advances to customers	9	16,019.6	15,769.8	16,019.6	15,769.8
Financial investments	11	5,653.2	4,586.2	5,653.2	4,586.2
Property plant & equipment	12	26.2	28.4	26.2	28.4
Intangible assets	14	58.9	59.3	58.9	59.3
Other assets	15	2,038.6	970.4	2,019.3	973.6
Deferred tax assets	16(a)	73.5	77.1	73.5	77.1
TOTAL ASSETS		24,573.0	23,961.9	24,553.7	23,965.1
LIABILITIES AND EQUITY					
Deposits by banks		655.2	644.5	655.2	644.5
Customer accounts		18,547.0	17,790.3	18,546.9	17,790.3
Trading liabilities	17	300.9	260.4	300.9	260.4
Financial liabilities designated at fair value	17	39.7	-	39.7	-
Items in the course of transmission to other banks		26.3	22.1	26.3	22.1
Derivatives	10	109.2	113.6	109.2	113.6
Debt securities on issue	19	1,157.1	1,387.0	930.7	1,106.8
Provisions for liabilities and charges	20	101.4	49.7	101.4	49.7
Other liabilities	21	1,976.9	2,149.4	2,183.3	2,432.4
Employee benefits	22	33.4	30.0	33.4	30.0
Subordinated liabilities	18	242.0	242.0	242.0	242.0
TOTAL LIABILITIES		23,189.1	22,689.0	23,169.0	22,691.8
NET ASSETS		1,383.9	1,272.9	1,384.7	1,273.3
EQUITY					
Share capital	23	811.0	811.0	811.0	811.0
Reserves		17.0	2.8	17.0	2.8
Retained earnings		555.9	459.1	556.7	459.5
TOTAL EQUITY		1,383.9	1,272.9	1,384.7	1,273.3

The notes on pages 14 to 80 are an integral part of these consolidated financial statements.

Statements Of Comprehensive Income

For The Year Ended 31 December 2012

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
Profit for the period		134.5	177.2	134.9	177.2
Other comprehensive income:					
Available for sale investments:					
- Fair value gains taken to equity		68.3	13.7	68.3	13.7
- Net amount transferred to the income statement		(41.1)	(23.2)	(41.1)	(23.2)
- Deferred tax on items taken directly to or transferred from equity		(8.2)	3.2	(8.2)	3.2
Cash flow hedges:					
- Net amount transferred to income statement		0.7	3.9	0.7	3.9
- Effective portion of changes in fair value		(1.3)	(5.7)	(1.3)	(5.7)
- Deferred tax on items taken directly to or transferred from equity		0.2	0.5	0.2	0.5
Other comprehensive income/ (expense) taken to equity during the period		18.6	(7.6)	18.6	(7.6)
Total comprehensive income for the period		153.1	169.6	153.5	169.6
Attributable to:					
Equity holders of the parent		153.1	169.6	153.5	169.6

The notes on pages 14 to 80 are an integral part of these consolidated financial statements.

Statements Of Changes in Equity

For The Year Ended 31 December 2012 - Consolidated

$'m	Share capital	Available for Sale Reserve	Cash flow Hedging Reserve	Capital contribution Reserve	Retained Profits	Total
Balance at 1 January 2012	811.0	(3.0)	(4.5)	10.3	459.1	1,272.9
Total comprehensive income for the year						
Profit for the year	-	-	-	-	134.5	134.5
Other comprehensive income, net of income tax						
Cash flow hedges						
- Effective portion of changes in fair value	-	-	(0.9)	-	-	(0.9)
- Net amount transferred to profit and loss	-	-	0.5	-	-	0.5
Available for sale assets						
- Net Change in fair value	-	47.8	-	-	-	47.8
- Net amount transferred to Profit and loss	-	(28.7)	-	-	-	(28.7)
Total other comprehensive income	-	19.1	(0.4)	-	-	18.7
Total comprehensive income for year	-	19.1	(0.4)	-	134.5	153.2
Transactions with Owners, recorded directly in equity						
Contributions by and distributions to owners						
- Share based payments						
contributed in the year	-	-	-	6.1	-	6.1
recycled to Profit and loss	-	-	-	(2.3)	2.3	-
other	-	-	-	(8.3)	-	(8.3)
- Dividends to equity holders	-	-	-	-	(40.0)	(40.0)
Total Contributions by and distributions to owners	-	-	-	(4.5)	(37.7)	(42.2)
Balance at 31 December 2012	811.0	16.1	(4.9)	5.8	555.9	1,383.9

The notes on pages 14 to 80 are an integral part of these consolidated financial statements.

Statements Of Changes in Equity (continued)

For The Year Ended 31 December 2011 - Consolidated

$'m	Share capital	Available for Sale Reserve	Cash flow Hedging Reserve	Capital contribution Reserve	Retained Profits	Total
Balance at 1 January 2011	811.0	3.3	(3.2)	8.8	369.4	1,189.3
Total comprehensive income for the year						
Profit for the year	-	-	-	-	177.2	177.2
Other comprehensive income, net of income tax						
Cash flow hedges	-	-	-	-	-	-
- Effective portion of changes in fair value	-	-	(4.0)	-	-	(4.0)
- Net amount transferred to profit and loss	-	-	2.7	-	-	2.7
Available for sale assets						
- Net Change in fair value	-	9.6	-	-	-	9.6
- Net amount transferred to Profit and loss	-	(15.9)	-	-	-	(15.9)
Total other comprehensive income	-	(6.3)	(1.3)	-	-	(7.6)
Total comprehensive income for year	-	(6.3)	(1.3)	-	177.2	169.6
Transactions with Owners, recorded directly in equity						
Contributions by and distributions to owners						
- Share based payments						
contributed in the year	-	-	-	6.2	-	6.2
recycled to Profit and loss	-	-	-	(0.5)	0.5	-
other	-	-	-	(4.2)	-	(4.2)
- Dividends to equity holders	-	-	-	-	(88.0)	(88.0)
Total Contributions by and distributions to owners	-	-	-	1.5	(87.5)	(86.0)
Balance at 31 December 2011	811.0	(3.0)	(4.5)	10.3	459.1	1,272.9

The notes on pages 14 to 80 are an integral part of these consolidated financial statements.

Statements Of Changes in Equity (continued)

For The Year Ended 31 December 2012 - Company

$'m	Share capital	Available for Sale Reserve	Cash flow Hedging Reserve	Capital contribution Reserve	Retained Profits	Total
Balance at 1 January 2012	811.0	(3.0)	(4.5)	10.3	459.5	1,273.3
Total comprehensive income for the year						
Profit for the year	-	-	-	-	134.9	134.9
Other comprehensive income, net of income tax						
Cash flow hedges						
- Effective portion of changes in fair value	-	-	(0.9)	-	-	(0.9)
- Net amount transferred to profit and loss	-	-	0.5	-	-	0.5
Available for sale assets						
- Net Change in fair value	-	47.8	-	-	-	47.8
- Net amount transferred to Profit and loss	-	(28.7)	-	-	-	(28.7)
Total other comprehensive income	-	19.1	(0.4)	-	-	18.7
Total comprehensive income for year	-	19.1	(0.4)	-	134.9	153.6
Transactions with Owners, recorded directly in equity						
Contributions by and distributions to owners						
- Share based payments						
contributed in the year	-	-	-	6.1	-	6.1
recycled to Profit and loss	-	-	-	(2.3)	2.3	-
other	-	-	-	(8.3)	-	(8.3)
- Dividends to equity holders	-	-	-	-	(40.0)	(40.0)
Total Contributions by and distributions to owners	-	-	-	(4.5)	(37.7)	(42.2)
Balance at 31 December 2012	811.0	16.1	(4.9)	5.8	556.7	1,384.7

The notes on pages 14 to 80 are an integral part of these consolidated financial statements.

Statements Of Changes in Equity (continued)

For The Year Ended 31 December 2011 - Company

$'m	Share capital	Available for Sale Reserve	Cash flow Hedging Reserve	Capital contribution Reserve	Retained Profits	Total
Balance at 1 January 2011	811.0	3.3	(3.2)	8.8	369.8	1,189.7
Total comprehensive income for the year						
Profit for the year	-	-	-	-	177.2	177.2
Other comprehensive income, net of income tax						
Cash flow hedges						
- Effective portion of changes in fair value	-	-	(4.0)	-	-	(4.0)
- Net amount transferred to profit and loss	-	-	2.7	-	-	2.7
Available for sale assets						
- Net Change in fair value	-	9.6	-	-	-	9.6
- Net amount transferred to Profit and loss	-	(15.9)	-	-	-	(15.9)
Total other comprehensive income	-	(6.3)	(1.3)	-	-	(7.6)
Total comprehensive income for year	-	(6.3)	(1.3)	-	177.2	169.6
Transactions with Owners, recorded directly in equity						
Contributions by and distributions to owners						
- Share based payments						
contributed in the year	-	-	-	6.2	-	6.2
recycled to Profit and loss	-	-	-	(0.5)	0.5	-
other	-	-	-	(4.2)	-	(4.2)
- Dividends to equity holders	-	-	-	-	(88.0)	(88.0)
Total Contributions by and distributions to owners	-	-	-	1.5	(87.5)	(86.0)
Balance at 31 December 2011	811.0	(3.0)	(4.5)	10.3	459.5	1,273.3

The notes on pages 14 to 80 are an integral part of these consolidated financial statements.

Statements of Cash flows

For The Year Ended 31 December 2012

		Consolidated		Company	
		2012	2011	2012	2011
	Note	$'m	$'m	$'m	$'m
Cash Flows from Operating Activities					
Interest received		1,288.4	1,384.4	1,292.1	1,372.8
Interest paid		(698.2)	(815.3)	(702.7)	(805.9)
Other operating income received		238.0	185.7	243.3	187.6
Other expenses paid		(551.6)	(485.4)	(556.7)	(485.1)
Loans and bills advanced		(458.8)	(1,646.5)	(435.2)	(1,649.7)
Net increase in deposits and other borrowings		645.7	1,482.9	568.8	1,406.3
Net decrease in trading assets		32.5	26.5	32.5	26.5
Net increase / (decrease) in trading liabilities		40.5	54.9	40.5	54.9
Cash inflows / (outflows) from movements in other assets/liabilities		(0.4)	112.3	(0.4)	111.8
Income tax paid		(45.6)	(58.9)	(45.6)	(58.9)
Net cash provided by/(used in) operating activities	30	490.5	240.6	436.6	160.3
Cash Flows from Investing Activities					
Net decrease / (increase) in investment securities		(1,034.7)	(1,137.7)	(1,034.7)	(1,137.7)
Purchase of property, plant and equipment		(6.1)	(19.5)	(6.1)	(19.5)
Proceeds from the sale of investments		-	1.6	-	1.6
Dividends received from controlled entities		-	-	-	3.3
Net cash used in investing activities		(1,040.8)	(1,155.6)	(1,040.8)	(1,152.3)
Cash Flows from Financing Activities					
Net increase / (decrease) in debt securities on issue		(190.2)	195.3	(136.3)	272.2
Subordinated debt (redeemed) / issued		-	(200.0)	-	(200.0)
Dividends paid		(40.0)	(88.0)	(40.0)	(88.0)
Net cash used in financing activities		(230.2)	(92.7)	(176.3)	(15.8)
Net increase / (decrease) in cash and cash equivalents held		(780.5)	(1,007.7)	(780.5)	(1,007.8)
Cash and cash equivalents at the beginning of the year		2,706.4	3,714.2	2,706.4	3,714.8
Cash and cash equivalents at the end of the year	30	1,925.9	2,706.5	1,925.9	2,706.4

The notes on pages 14 to 80 are an integral part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

1. REPORTING ENTITY

HSBC Bank Australia Limited (the Company) is a company domiciled in Australia. The consolidated financial report of the Company for the year ended 31 December 2012 comprises the Company and its subsidiaries (together referred to as the "consolidated entity" or "group"). References to '"HSBC", "the Group" or 'the HSBC Group" within this document mean HSBC Holdings plc together with its subsidiaries. The Company and group are for-profit entities.

2. BASIS OF PREPARATION

a) Statement of compliance

The financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards ("AASBs"), including Australian Interpretations, adopted by the Australian Accounting Standards Board ("AASBs") and the Corporations Act 2001. The consolidated financial report of the consolidated entity and the financial report of the Company comply with International Financial Reporting Standards ("IFRS") and interpretations adopted by the International Accounting Standards Board ("IASB").

The financial report was authorised for issue by the Board of Directors on 14 February 2013.

b) Basis of measurement

The financial report is prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, trading assets/liabilities, assets and liabilities designated at fair value and financial instruments classified as available-for-sale. The methods used to measure fair values are discussed further in note 29.

c) Functional and Presentational Currency

The financial report is presented in Australian dollars, which is the Bank's functional currency.

The Company is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 (updated by CO 05/641 effective 28 July 2005 and CO 06/51 effective 31 January 2006) and in accordance with that Class Order, amounts in the financial report and Directors' Report have been rounded off to the nearest million dollars, unless otherwise stated.

d) Critical accounting estimates and judgements in applying accounting policies

The preparation of a financial report in conformity with AASBs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities, income and expenses. Use of available information and application of judgement are inherent in the formation of estimates. Actual results in the future may differ from those reported.

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

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

- *Loan impairment*

Application of the consolidated entity's methodology for assessing loan impairment, as set out in note 3(f), involves considerable judgment and estimation.

For individually significant loans, judgment is required in determining first, whether there are indications that an impairment loss may have already been incurred, and then estimating the amount and timing of expected cash flows, which form the basis of the impairment loss that is recorded.

Notes to the Consolidated Financial Statements

2. BASIS OF PREPARATION (continued)

d) Critical accounting estimates and judgements in applying accounting policies (cont)

For collectively assessed loans, judgment is involved in selecting and applying the criteria for grouping together loans with similar credit characteristics, as well as in selecting and applying the statistical and other models used to estimate the losses incurred for each group of loans in the reporting period. The benchmarking of loss rates, the assessment of the extent to which historical losses are representative of current conditions and the ongoing refinement of modelling methodologies provide a means of identifying changes that may be required, but the process is inherently one of estimation.

· *Valuation of financial Instruments*
The consolidated entity's accounting policy for valuation of financial instruments is included in note 3(j) and is discussed further within note 10 'Derivatives' and note 28 'Additional Financial Instrument disclosures'.

When fair values are determined by using valuation techniques which refer to observable market data because independent prices are not available, management will consider the following when applying a valuation model:

(i) The likelihood and expected timing of future cash flows on the instrument. These cash flows are usually governed by the terms of the instrument, although management judgement may be required when the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt,
(ii) An appropriate discount rate for the instrument. Management determines this rate based on its assessment of the appropriate spread of the rate for the instrument over the risk-free rate; and
(iii) Judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative models.

When valuing instruments by reference to comparable instruments, management takes into account the maturity, structure, liquidity, credit rating and other market factors of the instrument with which the position held is being compared. When valuing instruments on a model basis using the fair value of underlying components, management also considers the need for adjustments to take account of factors such as bid-offer spread, credit profile, model uncertainty and any other factors market participants would consider in the valuation of that instrument. These adjustments are based on defined policies which are applied consistently across the group.

When unobservable market data have a significant impact on the valuation of derivatives, the entire initial change in fair value indicated by the valuation model is recognised on one of the following bases: over the life of the transaction on an appropriate basis; in the income statement when the inputs become observable; or when the transaction matures or is closed out.
Financial instruments measured at fair value through profit or loss comprise financial instruments held for trading and financial instruments designated at fair value. Changes in their fair value directly impact the group's income statement in the period in which they occur.

A change in the fair value of a financial asset which is classified as 'available-for sale' is recorded directly in equity and other comprehensive income until the financial asset is sold, when the cumulative change in fair value is charged or credited to the income statement. When a decline in the fair value of an available-for sale financial asset has been recognised directly in equity and other comprehensive income and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is removed from equity and recognised in the income statement, reducing the group's operating profit.

· *Impairment of available-for-sale financial investments*
Judgment is required in determining whether or not a decline in fair value of an available-for-sale financial investment below its original costs is of such a nature as to constitute impairment, and thus whether an impairment loss needs to be recognised under AASB 139.

· *Provision for liabilities and charges*
The consolidated entity assesses whether it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation as a result of past events. These calculations involve an estimation of the potential loss and likelihood of that loss.

Notes to the Consolidated Financial Statements

2. BASIS OF PREPARATION (continued)

· *Impairment of goodwill*

Note 14 contains information about the assumptions and their risk factors relating to goodwill impairment. The consolidated entity assesses whether goodwill is impaired at least annually in accordance with the accounting policy in note 3(o). These calculations involve an estimation of the recoverable amount of the cash-generating units to which the goodwill is allocated.

e) Accounting Developments

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2012, and have not been applied in preparing these consolidated financial statements. None of these are expected to have a significant effect on the financial statements of the consolidated entity, except for AASB 9 Financial Instruments, which becomes mandatory in the consolidated entity's 2015 consolidated financial statements and could change the classification and measurement of financial assets. The consolidated entity does not plan to adopt this standard early and the extent of the impact has not been determined.

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statement. Certain comparative amounts have been reclassified to conform with the current year presentation.

a) Principles of Consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Investments in subsidiaries are carried at their cost of acquisition, less provision for diminution, in the Company's financial statements.

(ii) Special purpose entities

Special purpose entities are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets, or the execution of specific borrowing or lending transactions. The financial statements of special purpose entities are included in the consolidated entity's financial statements where the substance of the relationship is that the consolidated entity controls the special purpose entity.

(iii) Transactions eliminated on consolidation

Intragroup balances and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

b) Foreign Currency Transactions

Items included in each of the entities of the consolidated entity are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The consolidated entity's financial statements are presented in Australian dollars which is the Bank's functional and presentation currency.

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Australian dollars at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Australian dollars at foreign exchange rates ruling at the dates the fair value was determined.

Notes to the Consolidated Financial Statements

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

c) Interest income and expense

Interest income and expense for all interest-bearing financial instruments, except those classified as held-for-trading or designated at fair value, are recognised in 'Interest income' and 'Interest expense' in the Income Statement using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the consolidated entity estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the consolidated entity that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

Interest on impaired financial assets is recognised at the original effective interest rate of the financial asset applied to the impaired carrying amount.

d) Non Interest income

Fee income is earned from a diverse range of services provided by the group to its customers. Fee income is accounted for as follows:

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

Net Trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with related interest income, expense and dividends. Income and expenses arising from economic hedging activities which do not qualify for hedge accounting under AASB 139, as well as from ineffective portion of qualifying hedges, are also included in 'Net trading income'.

Net income from financial instruments designated at fair value comprises all gains and losses from changes in the fair value of such financial assets and financial liabilities, together with interest income and expense and dividend income attributable to those financial instruments.

Dividend income is recognised when the right to receive payment is established.

e) Loans and Advances to Banks and Customers

Loans and advances to banks and customers include loans and advances originated by the consolidated entity, which are not intended to be sold in the short term and have not been classified either as held for trading or designated at fair value. Loans and advances are recognised when cash is advanced to borrowers. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment losses (see note 3(f)).

Loan and advances classified as held for trading or designated at fair value are reported as trading instruments, or financial instruments designated at fair value, respectively (notes 3(g) and 3(h)).

Notes to the Consolidated Financial Statements

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

f) Impairment of loans and advances

Losses for impaired loans are promptly recognised when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances are calculated on individual loans and on groups of loans assessed collectively. Impairment losses are recorded as charges to the income statement. The carrying amount of impaired loans on the balance sheet is reduced through the use of impairment allowance accounts. Losses expected from future events are not recognised.

(i) Individually assessed loans

The factors considered in determining that a loan is individually significant for the purposes of assessing impairment include:

- the size of the loan;
- the number of loans in the portfolio;
- the importance of the individual loan relationship, and how this is managed; and
- whether volumes of defaults and losses are sufficient to enable a collective assessment methodology to be applied.

Loans considered as individually significant are typically to corporate and commercial customers and are for larger amounts, which are managed on an individual relationship basis. Retail lending portfolios are generally assessed for impairment on a collective basis as the portfolios generally consist of large pools of homogeneous loans.

For all loans that are considered individually significant, the group assesses on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired. The criteria used by the group to determine that there is such objective evidence include:

- known cash flow difficulties experienced by the borrower;
- past due contractual payments of either principal or interest;
- breach of loan covenants or conditions;
- the probability that the borrower will enter bankruptcy or other financial realisation; and
- a significant downgrading in credit rating by an external credit rating agency.
- For those loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:
- the group's aggregate exposure to the customer;
- the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors' commitments ranking ahead of, or pari passu with, the group and the likelihood of other creditors continuing to support the company;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding;
- the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and
- when available, the secondary market price of the debt.

Impairment losses are calculated by discounting the expected future cash flows of a loan at its original effective interest rate and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

Notes to the Consolidated Financial Statements

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

f) Impairment of loans and advances (continued)

(ii) Collectively assessed loans
Impairment losses are calculated on a collective basis in two different scenarios:

– for homogeneous groups of loans that are not considered individually significant; and
– in respect of losses which have been incurred but have not yet been identified on loans subject to individual assessment for impairment (see section (i)).

· *Homogeneous groups of loans*
Statistical methods are used to determine impairment losses on a collective basis for homogeneous groups of loans that are not considered individually significant, because individual loan assessment is impracticable.

Losses in these groups of loans are recorded on an individual basis when individual loans are written off, at which point they are removed from the group. Two alternative methods are used to calculate allowances on a collective basis:

· when appropriate empirical information is available, the group utilises a roll rate methodology. This methodology employs statistical analyses of historical data and experience of delinquency and default to estimate the amount of loans that will eventually be written off as a result of the events occurring before the balance sheet date which the group is not able to identify on an individual loan basis, and that can be reliably estimated. Under this methodology, loans are grouped into ranges according to the number of days past due and statistical analysis is used to estimate the likelihood that loans in each range will progress through the various stages of delinquency, and ultimately prove irrecoverable. Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio, and the carrying amount of the portfolio. In certain highly developed markets, sophisticated models also take into account behavioural and account management trends as revealed in, for example, bankruptcy and rescheduling statistics.
· when the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll rate methodology, the group adopts a basic formulaic approach based on historical loss rate experience.

In normal circumstances, historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio, though sometimes it provides less relevant information about the inherent loss in a given portfolio at the balance sheet date, for example, when there have been changes in economic, regulatory or behavioural conditions which result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models. In these circumstances, the risk factors are taken into account by adjusting the impairment allowances derived solely from historical loss experience.

These additional portfolio risk factors may include recent loan portfolio growth and product mix, unemployment rates, bankruptcy trends, geographic concentrations, loan product features (such as the ability of borrowers to repay adjustable-rate loans where reset interest rates give rise to increases in interest charges), economic conditions such as national and local trends in housing markets and interest rates, portfolio seasoning, account management policies and practices, current levels of write-offs, changes in laws and regulations and other items which can affect customer payment patterns on outstanding loans, such as natural disasters. These risk factors, where relevant, are taken into account when calculating the appropriate level of impairment allowances by adjusting the impairment allowances derived solely from historical loss experience.

Roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

· *Incurred but not yet identified impairment*
Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss. This reflects impairment losses that the group has incurred as a result of events occurring before the balance sheet date, which the group is not able to identify on an individual loan basis, and that can be reliably estimated. These losses will only be individually identified in the future. As soon as information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed on an individual basis for impairment.

Notes to the Consolidated Financial Statements

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

f) Impairment of loans and advances (continued)

The collective impairment allowance is determined after taking into account:

- historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and
- management's experienced judgment as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience.

Management of each identified portfolio determines the estimated period between a loss occurring and its identification.

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

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

(v) Assets acquired in exchange for loans
Non-financial assets acquired in exchange for loans in order to achieve an orderly realization are recorded as assets held for sale and reported in 'Other assets'. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan, net of impairment allowance amounts, at the date of exchange. No depreciation is provided in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recorded as an impairment loss and included in the Income Statement. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative impairment loss, is recognised in the Income Statement.

(vi) Renegotiated loans
Loans that have been individually identified as impaired and whose terms have been subsequently renegotiated and which have been performing satisfactorily for a certain period are no longer treated as impaired.

g) Trading assets and trading liabilities

Treasury bills, loans and advances to and from customers, loans and advances to and from banks, debt securities, structured deposits, equity shares, own debt issued and short positions in securities are classified as held for trading if they have been acquired principally for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. These financial assets or financial liabilities are recognised on trade date when the consolidated entity enters into contractual arrangements with counterparties to purchase or sell securities, and are normally derecognised when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently, their fair values are remeasured. All gains and losses from changes in the fair value of these assets and liabilities, together with related interest income and expense and dividends are recognised in the Income Statement in 'Net trading income' as they arise.

Notes to the Consolidated Financial Statements

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

h) Financial instruments designated at fair value

A financial instrument, other than one held for trading, is classified in this category if it meets the criteria set out below, and is so designated by management. The group may designate financial instruments at fair value when the designation:

- eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities or recognising the gains and losses on them on different bases; examples include unit-linked investment contracts, and certain portfolios of securities and debt issuances that are managed in conjunction with financial assets or liabilities measured on a fair value basis;
- applies to a group of financial assets, financial liabilities, or both, that is managed and its performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and where information about that group of financial instruments is provided internally on that basis to key management personnel; examples include financial assets held to back certain insurance contracts, and certain asset-backed securities; or
- relates to financial instruments containing one or more embedded derivatives that significantly modify the cash flows resulting from those financial instruments, and which would otherwise be required to be accounted for separately; examples include certain debt issuances and debt securities held.

This designation, once made, is irrevocable. Financial assets and financial liabilities are recognised when the group enters the contractual provisions of the arrangements with counterparties, which is generally on trade date, and are normally derecognised when either sold (assets) or extinguished (liabilities). Financial assets and financial liabilities so designated are recognised initially at fair value with transaction costs taken directly to the income statement, and are subsequently re-measured at fair value. Subsequently, the fair values are re-measured, and gains and losses from changes in the fair value therein are recognised in the income statement within 'Net income from financial instruments designated at fair value'.

i) Financial investments

Treasury bills, debt securities and equity shares intended to be held on a continuing basis, other than those designated at fair value, are classified as 'available-for-sale'. Financial investments are recognised on trade date, when the consolidated entity enters into contractual arrangements with counterparties to purchase securities, and are normally derecognised when either the securities are sold or the borrowers repay their obligations.

Available-for-sale securities are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value and changes therein are recognised in equity in the 'Available-for-sale' reserve (Note 24(a) and Statement of changes in equity) until the securities are either sold or impaired. When available-for sale securities are sold, cumulative gains or losses previously recognised in equity are recognised in the income statement as 'Gains/ (losses) from disposal of financial investments'.

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

At each balance sheet date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset or group of assets. Impairments losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated. If the available-for–sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the Income Statement, is removed from equity and recognised in the income statement.

Impairment losses for available-for-sale debt securities and equity are recognised within 'Loan impairment charges, recoveries and other credit risk provisions'.

Notes to the Consolidated Financial Statements

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

i) Financial Investments (continued)

When assessing available-for-sale debt securities for objective evidence of impairment at the reporting date, the group considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. These events may include a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial reorganisation, or the disappearance of an active market for the debt security because of financial difficulties relating to the issuer.

These types of specific events and other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment of a debt security.

Once an impairment loss has been recognised on an available-for-sale financial asset, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the nature of the available-for-sale financial asset concerned:

- for an available-for sale debt security, a subsequent decline in the fair value of the instrument is recognised in the income statement if, and only if, there is objective evidence of impairment. Objective evidence of impairment occurs when as a result of one or more loss events, the estimated future cash flows of the financial asset are impacted that can be reliably measured. Where there is no objective evidence of impairment, the decline in the fair value of the financial asset is recognised directly in equity. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the Income Statement, the impairment loss is reversed through the Income Statement to the extent of the increase in fair value;

- for an available-for sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised directly in equity. Impairment losses recognised on an equity security are not reversed through the Income Statement. Subsequent decreases in the fair value of the available-for-sale equity securities are recognised in the Income Statement, only to the extent that further cumulative impairment losses have been incurred.

j) Valuation of Financial Instruments

All financial instruments are recognised initially at fair value. In the normal course of business, the fair value of a financial instrument on initial recognition is normally the transaction price, i.e. the fair value of the consideration given or received. In certain circumstances, however, the fair value may be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the group recognises a trading gain or loss on inception of the financial instrument, being the difference between the transaction price and the fair value. When unobservable market data have a significant impact on the valuation of financial instruments, the entire initial difference in fair value indicated by the valuation model from the transaction price is not recognised immediately in the income statement but is recognised over the life of the transaction on an appropriate basis, or when the inputs become observable, or the transaction matures or is closed out, or when the group enters into an offsetting transaction.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities. Where independent prices are not available, fair values are determined by using valuation techniques which refer to observable market data. These include comparison with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

For certain investments, fair values may be determined in whole or in part using valuation techniques based on assumptions that are not supported by prices from current market transactions or observable market data.

Notes to the Consolidated Financial Statements

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

k) Sale and repurchase agreements

Where securities are sold subject to a commitment to repurchase them at a predetermined price ('repos'), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to re-sell ('reverse repos') are not recognised on the balance sheet and the consideration paid is recorded in 'Advances to customers' or 'Placings with banks' as appropriate. The difference between the sale and repurchase price is treated as interest income and recognised over the life of the agreement.

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. The transfer of securities to counterparties under these agreements is not normally reflected on the balance sheet. Cash collateral advanced or received is recorded as an asset or a liability respectively.

Securities borrowed are not recognised on the balance sheet. If they are sold on to third parties, an obligation to return the securities is recorded as a trading liability and measured at fair value, and any gains or losses are included in 'Net trading income'.

l) Derivatives and hedge accounting

(i) Derivatives
Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values of exchange-traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models.

Derivatives may be embedded in other financial instruments, for example, a convertible bond with an embedded conversion option. Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract; and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with changes therein recognised in the income statement.

Derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

The method of recognising fair value gains and losses depends on whether derivatives are held for trading or are designated as hedging instruments, and if the latter, the nature of the risks being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement. When derivatives are designated as hedges, the group classifies them as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedges'); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ('cash flow hedges'); or (iii) a hedge of a net investment in a foreign operation ('net investment hedges'). Hedge accounting is applied to derivatives designated as hedging instruments in a fair value, cash flow or net investment hedge provided certain criteria are met.

(ii) Hedge accounting
At the inception of a hedging relationship, the consolidated entity documents the relationship between the hedging instruments and hedged items, its risk management objective and its strategy for undertaking the hedge. The consolidated entity also requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the derivatives that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of hedged items. Interest on designated qualifying hedges is included in 'Net interest income'.

Notes to the Consolidated Financial Statements

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

l) Derivatives and hedge accounting (continued)

Fair value hedge
Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded as 'Net trading income' in the Income Statement, along with changes in the fair value of the asset, liabilities or group thereof, that are attributable to the hedged risk.

If a hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment to the carrying amount of the hedged item is amortised to the Income Statement in 'Net interest income' based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised whereby it is released to the Income Statement immediately.

Cash flow hedge
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity within the cash flow hedging reserve. Any gain or loss in fair value relating to an ineffective portion is recognised immediately in the Income Statement within 'Net trading income'.

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

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

Hedge effectiveness testing

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

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

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

Hedge ineffectiveness is recognised in the Income Statement in 'Net trading income'.

(iii) Derivatives that do not qualify for hedging
All gains and losses from changes in the fair value of any derivative that do not qualify for hedge accounting are recognised immediately in the Income Statement. These gains and losses are reported in 'Net trading income'. The interest on derivatives managed in conjunction with debt securities issued by the consolidated entity which are designated at fair value is recognised in 'Interest expense'. All other gains and losses on these derivatives are reported in 'Net income from financial instruments designated at fair value'.

Notes to the Consolidated Financial Statements

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

m) Derecognition of financial assets and liabilities

Financial assets are derecognised when the rights to receive cash flows from the assets has expired; or when the consolidated entity has transferred its contractual right to receive the cash flows of the financial assets, and substantially all the risks and rewards of ownership; or where control is not retained.

Financial liabilities are derecognised when they are extinguished, that is when the obligation is discharged, cancelled or expires.

n) Offsetting financial assets and financial liabilities

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

Income and expenses are presented on a net basis only when permitted by the accounting standards or for gains or losses arising from a group of similar transactions, such as in the consolidated entity's trading activities.

o) Goodwill and intangible assets

(i) Goodwill
Goodwill arises on business combinations when the cost of acquisition exceeds the fair value of the consolidated entity's share of the identifiable assets, liabilities and contingent liabilities acquired. Any excess of the consolidated entity's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of an acquired business over the cost to acquire is recognised immediately in the Income Statement.

Goodwill is allocated to cash-generating units ('CGUs') for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. Impairment testing is performed at least annually, and whenever there is an indication that the CGU may be impaired, by comparing the recoverable amount of a CGU with the carrying amount of its net assets, including attributable goodwill. The recoverable amount of an asset is the higher of its fair value less cost to sell, and its value in use. Value in use is the present value of the expected future cash flows from a CGU. If the recoverable amount of the CGU is less than the carrying value, an impairment loss is charged to the income statement. Any write-off in excess of the carrying value of goodwill is limited to the fair value of the individual assets and liabilities of the CGU.

Goodwill is stated at cost less accumulated impairment losses, which are charged to the Income Statement (see note 14).

At the date of disposal of a business, attributable goodwill is included in the consolidated entity's share of net assets in the calculation of the gain or loss on disposal.

(ii) Intangible assets
Intangible assets include computer software. Intangible assets that have an indefinite useful life, or are not yet ready for use, are tested for impairment annually.

Intangible assets that have a finite useful life are stated at cost less amortisation and accumulated impairment losses and are amortised over their estimated useful lives. Estimated useful life is the lower of legal duration and expected economic life.

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

HSBC

Notes to the Consolidated Financial Statements

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

p) Property, plant and equipment

(i) Recognition and measurement
Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses (see note 12).

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the cost of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

(ii) Subsequent costs
The consolidated entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the consolidated entity and the cost of the item can be measured reliably. All other costs are recognised in the Income Statement as an expense as incurred.

(iii) Depreciation
Depreciation is charged to the Income Statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. The estimated useful lives in the current and comparative periods are as follows:

· Plant and equipment	3-5 years
· Fixtures and fittings	3-5 years
· Leasehold improvements	life of the leasehold

The residual value, the useful life and the depreciation method applied to an asset are reassessed at least annually.

q) Finance and operating leases

Assets leased to customers under agreements which transfer substantially all the risks and rewards associated with ownership, other than legal title, are classified as finance leases. Where the consolidated entity is a lessor under finance leases the amounts due under the leases, after deduction of unearned charges, are included in ‘Loans and advances to banks’ or ‘Loans and advances to customers’ as appropriate. Finance income receivable is recognised over the periods of the leases so as to give a constant rate of return on the net investment in the leases.

All other leases are classified as operating leases. Where the consolidated entity is the lessee, the leased assets are not recognised on the balance sheet. Rentals payable under operating leases are accounted for on a straight-line basis over the periods of the leases and are included in ‘property and equipment expenses’. Lease incentives received are recognised in the Income Statement as an integral part of the total lease expense.

r) Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

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

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Notes to the Consolidated Financial Statements

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

r) Income tax (continued)

The following temporary differences are not provided for: initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future.

In determining the amount of current and deferred tax the consolidated entity takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. The consolidated entity believes that its accruals for tax liabilities are adequate for all open years based on its assessment of many factors, including interpretations of tax laws and prior experience. This assessment relies on estimates and assumptions and may involve a series of judgements about future events. New information may become available that causes the consolidated entity to change its judgement regarding the adequacy of its existing tax liabilities; such changes to tax liabilities will impact tax expense in the period that the determination is made.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend is recognised.

HSBC Australia Holdings Pty Ltd and its wholly-owned Australian resident entities which include the Company have formed a tax-consolidated group with effect from 1 July 2002 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is HSBC Australia Holdings Pty Limited.

The current and deferred tax amounts for the tax-consolidated group are allocated among the entities in the group using a ‘separate taxpayer within group’ approach whereby each entity in the tax-consolidated group measures its current and deferred taxes as if it continued to be a separately taxable entity in its own right. Intercompany transactions are not eliminated.

Any current tax liabilities (or assets) and deferred tax assets arising from unused tax losses assumed by the head entity from the subsidiaries in the tax consolidated group are recognised in conjunction with any tax funding arrangement amounts (refer below). Any difference between these amounts is recognised by the Company as an equity contribution from or distribution to the head entity.

The members of the tax-consolidated group have entered into a tax funding agreement which sets out the funding obligations of members of the tax-consolidated group in respect of tax amounts. The tax funding agreement requires payments equal to the current tax liability (asset) assumed by the head entity and any tax-loss deferred tax asset assumed by the head entity.

The members of the tax-consolidated group have also entered into a valid Tax Sharing Agreement under the tax consolidation legislation which sets out the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations and the treatment of entities leaving the tax consolidated group.

The Company recognises deferred tax assets arising from unused tax losses of the tax-consolidated group to the extent that it is probable that future taxable profits of the tax-consolidated group will be available against which the asset can be utilised.

Any subsequent period adjustments to deferred tax assets arising from unused tax losses as a result of revised assessments of the probability of recoverability is recognised by the head entity only.

Notes to the Consolidated Financial Statements

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

s) Goods and services tax

Revenue, expenses and assets are recognised net of the amount of goods and services tax ("GST"), except where the amount of GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the Australian Tax Office ("ATO") is included as a current asset or liability in the balance sheet.

Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities, which are recoverable from, or payable to, the ATO are classified as operating cash flows.

t) Employee benefits

(i) Defined contribution plans
Obligations for contributions to defined contribution pension plans are recognised as an expense in the Income Statement as incurred.

(ii) Long-term service benefits
The liability for employee entitlements to long service leave represents the present value of the estimated future cash outflows to be made by the employer resulting from employees' services provided up to the balance date. The provision has been calculated using estimated future increases in wage and salary rates, including related on-costs, and is discounted using the rates attaching to national government securities at balance date that most closely match the terms of maturity of the related liabilities.

(iii) Share-Based Payments
Certain employees are eligible for equity instruments in HSBC Holdings plc, the ultimate parent entity, under various compensation plans as outlined in note 22b). In accordance with AASB 2 'Share-based Payments', these transactions are accounted for as equity settled because:

- HSBC Holdings plc has been determined to be the grantor of its equity instruments for all share award and share option plans across the Group directly to the employees of the Bank; and
- HSBC Holdings plc accounts for these transactions as equity settled, the consolidated entity accounts for these transaction with employee as equity-settled in their separate financial statements

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 the corresponding credit to 'Capital contribution received under shared-based payment'. The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately.

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

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

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 the remaining vesting period.

Notes to the Consolidated Financial Statements

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

t) Employee benefits (continued)

(iv) Termination benefits
Termination benefits are recognised as an expense when the consolidated entity is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date. Termination benefits for voluntary redundancies are recognised if the consolidated entity has made an offer encouraging voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

u) Provisions for liabilities and charges

Provisions for liabilities and charges are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation arising from past events and a reliable estimate can be made of the amount of the obligation.

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

A provision for restructuring is recognised when the consolidated entity has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly. Future operating costs are not provided for.

v) Financial guarantees

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received or receivable. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations.

w) Debt securities on issue, subordinated liabilities, deposits by banks and customers

Debt securities issued for trading purposes or designated at fair value are reported under the appropriate balance sheet captions. Other debt securities in issue and subordinated liabilities are measured at amortised cost using the effective interest method and are reported under ‘Debt securities in issue’ or ‘Subordinated liabilities’.

x) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months’ maturity from the date of acquisition, and include cash and balances at central banks, treasury bills and other eligible bills, loans and advances to banks, and certificates of deposit.

y) Share capital

Shares are classified as equity when there is no contractual obligation to transfer cash or other financial assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax. Incremental costs directly attributable to the issue of equity instruments as consideration for the acquisition of a business are included in the cost of acquisition.

Preference share capital is classified as equity if it is non-redeemable, or redeemable only at the Company’s option, and any dividends are discretionary. Dividends thereon are recognised as distributions within equity upon declaration by the Directors.

Notes to the Consolidated Financial Statements

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
4. BANKING OPERATING INCOME					
(i) **Interest income**					
Loans & advances to banks		48.7	93.1	48.7	93.1
Loans & advances to customers		980.8	1,029.3	980.8	1,029.3
Financial Investments		214.1	209.4	214.1	209.4
Related corporations		39.4	63.3	39.4	63.3
Key management personnel		0.3	0.3	0.3	0.3
		1,283.3	1,395.4	1,283.3	1,395.4
Total interest income		1,283.3	1,400.0	1,283.3	1,400.0
Less:					
- Interest income classified as 'Net trading income'	4(v)	-	(4.6)	-	(4.6)
		1,283.3	1,395.4	1,283.3	1,395.4

Included within various captions under interest income for the year ended 31 December 2012 is a total of $2.5m (2011: $3.2m) accrued on impaired financial assets.

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
(ii) **Interest Expense**					
Deposits by banks		22.0	28.0	22.0	28.0
Customer accounts		520.6	615.9	520.6	615.9
Debt securities on issue		65.0	76.1	54.7	60.1
Subordinated liabilities		16.1	22.4	16.1	22.4
Related corporations		53.0	67.6	68.1	85.2
		676.7	810.0	681.5	811.6
Total interest expense		696.7	820.5	701.5	822.1
Less:					
- Interest expense classified as 'Net trading income'	4(v)	(19.3)	(10.5)	(19.3)	(10.5)
- Interest expense classified as 'Net income / (loss) from financial instruments designated at fair value'	4(vi)	(0.7)	-	(0.7)	-
		676.7	810.0	681.5	811.6
(iii) **Other Operating Income**					
Dividend income		-	-	0.1	3.3
Related corporations		60.6	42.5	60.6	42.5
Other income		0.9	0.9	0.9	0.9
		61.5	43.4	61.6	46.7

Notes to the Consolidated Financial Statements

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
4. BANKING OPERATING INCOME (continued)					
(iv) **Fee and commission income**					
Fees and commissions		221.8	190.8	221.7	190.9
Fee income on fiduciary activities		12.2	11.1	12.9	11.9
		234.0	201.9	234.6	202.8
Fee and commission expense					
Fees and commissions		33.7	29.0	29.4	28.2
Fees payable on fiduciary activities		2.5	2.0	2.5	2.0
		36.2	31.0	31.9	30.2
(v) **Net trading income/(loss)**					
Trading income					
- Exchange rates		(10.6)	(13.3)	(10.6)	(13.3)
- Interest rates		6.2	(4.0)	6.2	(4.0)
- Other		0.5	(1.2)	0.5	(1.2)
		(3.9)	(18.5)	(3.9)	(18.5)
Gains / (losses) from hedging activities:					
Fair value Hedges:					
- Net gain/(loss) on hedged items attributable to the hedged risk		(38.7)	23.6	(38.7)	23.6
- Net gain/(loss) on hedging instruments		39.9	(23.4)	39.9	(23.4)
		1.2	0.2	1.2	0.2
Net interest income on trading activities:					
- Interest income	4(i)	-	4.6	-	4.6
- Interest expense	4(ii)	(19.3)	(10.5)	(19.3)	(10.5)
		(19.3)	(5.9)	(19.3)	(5.9)
Total net trading income/(loss)		(22.0)	(24.2)	(22.0)	(24.2)

Notes to the Consolidated Financial Statements

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
4. BANKING OPERATING INCOME (continued)					
(vi) **Net income / (loss) from financial instruments designated at fair value**					
Change in fair value of financial assets and liabilities designated at fair value		0.4	-	0.4	-
		0.4	-	0.4	-
Net interest income on financial instruments designated at fair value					
- Interest expense	4(ii)	(0.7)	-	(0.7)	-
		(0.7)	-	(0.7)	-
Total net loss from financial instruments designated at fair value		(0.3)	-	(0.3)	-

Gains and losses from changes in the fair value of the consolidated entity's issued debt securities may arise from changes in the consolidated entity's own credit risk.

		Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
(vii) **Net gains/(loss) from disposal of financial investments**					
Net gain/(loss) on disposal of available for sale securities		1.8	(1.1)	1.8	(1.1)
		1.8	(1.1)	1.8	(1.1)

Notes to the Consolidated Financial Statements

		Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
5	**LOAN IMPAIRMENT CHARGES, RECOVERIES AND OTHER CREDIT RISK PROVISIONS**					
(i)	**Loan Impairment Charges, Recoveries And Other Credit Risk Provisions**					
	Income Statement charge					
	Loan impairment charges:					
	- New allowances		143.6	94.5	143.6	94.5
	- Reversal of allowances no longer required		(15.3)	(21.9)	(15.3)	(21.9)
	- Recoveries of amounts previously written off		(25.3)	(19.3)	(25.3)	(14.7)
	Provision charge for commitments, guarantees and similar obligations		32.0	-	32.0	-
			135.0	53.3	135.0	57.9
	- Individually assessed allowances charged		39.0	1.7	39.0	6.4
	- Collectively assessed allowances charged		64.0	51.6	64.0	51.5
	- Other credit risk provisions		32.0	-	32.0	-
	Total loan impairment charges and other credit risk provisions		135.0	53.3	135.0	57.9
	Total outstanding allowances					
	Loans and advances to customers:					
	- Individually assessed allowances	28	93.9	38.4	93.9	38.4
	- Collectively assessed allowances	28	52.0	36.9	52.0	36.9
	Total allowances		145.9	75.3	145.9	75.3

6. OPERATING EXPENSES

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
Staff costs					
Wages and salaries		167.0	170.1	167.0	170.1
Bonuses		34.0	37.8	34.0	37.8
Retirement and termination benefits		25.2	17.6	25.2	17.6
Share-based payment transactions	22(b)	6.1	6.2	6.1	6.2
Other		19.4	18.6	19.4	18.6
		251.7	250.3	251.7	250.3

Notes to the Consolidated Financial Statements

			Consolidated		Company	
		Note	2012 $'m	2011 $'m	2012 $'m	2011 $'m
6.	**OPERATING EXPENSES (continued)**					
	Premises and equipment					
	Property rental		31.4	31.3	31.4	31.3
	Hire of equipment		3.0	4.4	3.0	4.4
	Repairs and maintenance		1.9	2.0	1.7	2.0
	EDP costs		2.3	2.1	2.3	2.1
	Utilities		2.6	2.6	2.6	2.6
	Depreciation		8.6	9.3	8.6	9.3
	Other		3.5	-	3.5	-
			53.3	51.7	53.1	51.7
	Administrative expenses					
	Advertising and marketing		61.6	51.4	61.6	51.4
	Legal and professional fees		5.9	4.8	5.9	4.8
	Communications		8.3	7.0	8.3	7.0
	Business information costs		5.9	4.9	5.9	4.9
	Printing and stationery		11.2	8.5	11.2	8.5
	Travel and entertainment		6.7	6.1	6.7	6.1
	Auditor's remuneration	7	1.6	1.6	1.6	1.6
	Insurance		2.3	2.0	2.3	2.0
	Losses from fraud		3.5	4.5	3.5	4.5
	Contracted services		4.9	8.1	4.9	8.1
	Other		5.5	7.5	5.5	7.4
			117.4	106.4	117.4	106.4
	Other expenses					
	Intercompany management fees	33	54.7	55.8	54.7	56.0
	Provision for contingent liabilities and charges		37.9	-	37.9	-
	Amortisation of intangibles	14	-	1.2	-	1.2
			92.6	57.0	92.6	57.2
7.	**AUDITOR'S REMUNERATION**					
	Audit services					
	Auditor of the consolidated entity - KPMG Australia					
	Audit and review of financial reports		817,580	879,643	817,580	879,643
	Regulatory and other audit services		642,390	611,347	642,390	598,028
			1,459,970	1,490,990	1,459,970	1,477,671
	Other services					
	Auditor of the consolidated entity – KPMG Australia					
	Taxation services		66,785	69,771	66,785	69,771
	Other assurance services		58,000	-	58,000	-
			124,785	69,771	124,785	69,771

Notes to the Consolidated Financial Statements

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
8. INCOME TAX EXPENSE					
Recognised in the Income Statement					
(a) Current tax expense					
Current year		(72.4)	(84.2)	(72.4)	(82.8)
Adjustments for prior years		1.6	(0.1)	1.6	(0.1)
		(70.8)	(84.3)	(70.8)	(82.9)
Deferred tax expense					
Origination and reversal of temporary differences		12.7	6.5	12.7	6.5
Adjustments for prior years		(2.8)	(0.7)	(2.8)	(0.7)
	16(b)	9.9	5.8	9.9	5.8
Total income tax expense in Income Statement		(60.9)	(78.5)	(60.9)	(77.1)
Attributable to:					
Continuing operations		(60.9)	(78.5)	(60.9)	(77.1)
		(60.9)	(78.5)	(60.9)	(77.1)
Numerical reconciliation between tax expense and pre-tax net profit					
Profit for the period		134.5	177.2	134.9	177.2
Total income tax expense		60.9	78.5	60.9	77.1
Profit excluding income tax		195.4	255.7	195.8	254.3
Income tax using the domestic corporation tax rate of 30%		(58.6)	(76.7)	(58.7)	(76.3)
(Increase) / decrease in income tax expense due to:					
Non-deductible expenses		(1.1)	(1.0)	(1.0)	(1.0)
Non-taxable revenue		-	-	-	1.0
		(59.7)	(77.7)	(59.7)	(76.3)
(Under) / over provided in prior years		(1.2)	(0.8)	(1.2)	(0.8)
Income tax expense on pre-tax net profit		(60.9)	(78.5)	(60.9)	(77.1)
(b) Deferred tax recognised directly in equity					
Relating to available for sale and cash flow hedging reserves	16(b)	(8.0)	3.7	(8.0)	3.7
		(8.0)	3.7	(8.0)	3.7

Notes to the Consolidated Financial Statements

9. LOANS AND ADVANCES TO CUSTOMERS AND IMPAIRMENT ALLOWANCES

	Consolidated		Company	
	2012	2011	2012	2011
	$'m	$'m	$'m	$'m
Gross amount of loans not individually impaired	15,923.6	15,721.7	15,923.6	15,721.7
Allowance for collective impairment	(42.7)	(25.8)	(42.7)	(25.8)
Carrying amount	15,880.9	15,695.9	15,880.9	15,695.9
Grossed amount of impaired loans	241.9	123.4	241.9	123.4
Allowance for individual impairment	(93.9)	(38.4)	(93.9)	(38.4)
Allowance for collective impairment	(9.3)	(11.1)	(9.3)	(11.1)
Carrying amount	138.7	73.9	138.7	73.9
Total Loans	16,019.6	15,769.8	16,019.6	15,769.8

Movements in Impairment Allowances

	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
Allowance for individual impairment				
Balance opening	38.4	39.6	38.4	39.6
Impairment charge for the year	39.0	1.7	39.0	6.4
Transfer from provision for contingent liabilities	23.0	-	23.0	-
Net write off	(6.5)	(2.9)	(6.5)	(7.6)
Balance closing	93.9	38.4	93.9	38.4
Allowance for collective impairment				
Balance opening	36.9	33.9	36.9	33.9
Impairment charge for the year	64.0	51.6	64.0	51.5
Net write off	(48.9)	(48.6)	(48.9)	(48.5)
Balance closing	52.0	36.9	52.0	36.9

10. DERIVATIVES

Derivatives are financial instruments that derive their value from the price of an underlying item such as equities, bonds, interest rates, foreign exchange, credit spreads, commodities and equity or other indices.

Derivatives enable users to increase, reduce or alter exposure to credit or market risks. The consolidated entity makes markets in derivatives for its customers and uses derivatives to manage its exposure to credit and market risks.

Derivatives are carried at fair value and shown in the balance sheet as separate totals of assets and liabilities. Asset and liability values represent the cost or benefit to the consolidated entity of replacing all transactions with positive or negative fair value respectively, assuming that all the consolidated entity's relevant counterparties default at the same time, and that transactions can be replaced instantaneously.

Notes to the Consolidated Financial Statements

10. DERIVATIVES (continued)

Derivative assets and liabilities on different transactions are only netted if the transactions are with the same counterparty, a legal right of set-off exists and the cash flows are intended to be settled on a net basis. Changes in the values of derivatives are recognised in accordance with the consolidated entity's accounting policy as described in note 3(l).

Use of derivatives

The consolidated entity transacts derivatives for three primary purposes: to create risk management solutions for clients, for proprietary trading purposes, and to manage and hedge the consolidated entity's own risks. For accounting purposes, derivative instruments are classified as held either for trading or hedging. Derivatives that are held as hedging instruments are formally designated as hedges as defined in AASB 139. All other derivative instruments are classified as held-for trading. The held-for-trading classification includes two types of derivative instruments. The first type are those used in sales and trading activities, and those instruments that are used for risk management purposes but which for various reasons do not meet the qualifying criteria for hedge accounting. The second type of held for trading category includes derivatives managed in conjunction with financial instruments designated at fair value. These activities are described more fully below.

The consolidated entity's derivative activities give rise to significant open positions in portfolios of derivatives. These positions are managed constantly to ensure that they remain within acceptable risk levels, with offsetting deals being utilised to achieve this where necessary. When entering into derivative transactions, the consolidated entity employs the same credit risk management procedures to assess and approve potential credit exposures as are used for traditional lending.

Trading derivatives

Most of the consolidated entity's derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities in derivatives are entered into principally for the purpose of generating profits from short-term fluctuations in price or margin. Positions may be traded actively or be held over a period of time to benefit from expected changes in currency rates, interest rates, equity prices or other market parameters. Trading includes market-making, positioning and arbitrage activities. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume; positioning means managing market risk positions in the expectation of benefiting from favourable movements in prices, rates or indices; arbitrage involves identifying and profiting from price differentials between markets and products.

As mentioned above, other derivatives classified as held-for-trading include non-qualifying hedging derivatives, ineffective hedging derivatives and the components of hedging derivatives that are excluded from assessing hedge effectiveness. Non-qualifying hedging derivatives are entered into for risk management purposes but do not meet the criteria for hedge accounting. These include derivatives managed in conjunction with financial instruments designated at fair value. Ineffective hedging derivatives were previously designated as hedges, but no longer meet the criteria for hedge accounting. Gains and losses from changes in the fair value of derivatives that do not qualify for hedge accounting are reported in 'Net trading income'.

Hedging derivatives

The consolidated entity uses derivatives (principally interest rate swaps) for hedging purposes in the management of its own asset and liability portfolios and structural positions. This enables the consolidated entity to optimise the overall cost of accessing debt capital markets, and to mitigate the market risk, which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities.

The accounting treatment of hedge transactions varies according to the nature of the instrument hedged and the type of hedge transactions. Derivatives may qualify as hedges for accounting purposes if they are fair value hedges or cash flow hedges. These are described under the relevant headings below.

With respect to exchange rate and interest rate contracts, the notional or contractual amounts of these instruments indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Notes to the Consolidated Financial Statements

10. DERIVATIVES (continued)

Fair value of open positions by product type

The following table summarises the fair values of third party and inter company derivatives' open positions by product contract type.

	Consolidated		Company	
	2012	2011	2012	2011
	$'m	$'m	$'m	$'m
Assets:				
Trading derivatives				
Third party				
- Exchange rate	8.5	33.8	8.5	33.8
- Interest rate	1.7	15.6	1.7	15.6
	10.2	49.4	10.2	49.4
Related entities				
- Exchange rate	31.3	22.2	31.3	22.2
- Interest rate	7.8	14.3	7.8	14.3
- Equity	1.3	0.4	1.3	0.4
	40.4	36.9	40.4	36.9
Hedging derivatives				
Third party				
- Interest rate	-	-	-	-
Related entities				
- Interest rate	4.0	5.2	4.0	5.2
	4.0	5.2	4.0	5.2
	54.6	91.5	54.6	91.5
Liabilities:				
Trading derivatives				
Third party				
- Exchange rate	10.0	31.3	10.0	31.3
- Interest rate	-	-	-	-
	10.0	31.3	10.0	31.3
Related entities				
- Exchange rate	11.3	17.6	11.3	17.6
- Interest rate	5.2	25.1	5.2	25.1
- Equity	1.0	2.6	1.0	2.6
	17.5	45.3	17.5	45.3
Hedging derivatives				
Third party				
- Interest rate	0.5	1.8	0.5	1.8
	0.5	1.8	0.5	1.8
Related entities				
- Interest rate	81.2	35.2	81.2	35.2
	81.2	35.2	81.2	35.2
	109.2	113.6	109.2	113.6

Notes to the Consolidated Financial Statements

10. DERIVATIVES (continued)

Fair value hedges

The consolidated entity's fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates.

For qualifying fair value hedges, all changes in the fair value of the derivative and in the fair value of the item in relation to the risk being hedged are recognised in income. If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortised to income as a yield adjustment over the remainder of the hedging period.

The fair values of outstanding derivatives designated as fair value hedges at 31 December 2012 were assets of $0.0m (2011: $0.7m) and liabilities of $70.9m (2011: $25.9m).

	Consolidated		Company	
	2012	2011	2012	2011
	$'m	$'m	$'m	$'m
Gains or losses arising from fair value hedges				
Gains / (losses):				
- on hedging instruments	(38.7)	(23.4)	(38.7)	(23.4)
- on the hedged items attributable to the hedged risk	39.9	23.6	39.9	23.6
	1.2	0.2	1.2	0.2

Cash flow hedges

The consolidated entity is exposed to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio of financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedges of forecast transactions. These are initially recognised directly in equity as gains or losses not recognised in the Income Statement and are transferred to current period earnings when the forecast cash flows affect net profit or loss.

The consolidated entity also enters into 'micro cash flow hedges' where it seeks to hedge the exposure to the variability of future cash flows of an individual floating rate financial asset or financial liability or future cash flows of a forecast transaction attributable to movements in interest rates that could affect reported earnings.

At 31 December 2012, the fair values of outstanding derivatives designated as cash flow hedges of forecast transactions were assets of $4.0m (2011: $4.5m) and liabilities of $10.8m (2011: $11.1m).

Notes to the Consolidated Financial Statements

10. DERIVATIVES (continued)

Cash flow hedges (continued)

The schedule of forecast principal balances on which the expected interest cash flows arise as at 31 December 2012 is as follows:

	3 months or less $'m	More than 3 months but less than 1 year $'m	5 years or less but more than 1 year $'m
Consolidated and company			
At 31 December 2012			
Cash inflows from assets	900.0	300.0	200.0
Cash outflows from liabilities	348.3	348.3	328.3
Net cash inflows / (outflows)	551.7	(48.3)	(128.3)
At 31 December 2011			
Cash inflows from assets	400.0	400.0	200.0
Cash outflows from liabilities	-	135.0	278.0
Net cash inflows / (outflows)	400.0	265.0	(78.0)

Notes to the Consolidated Financial Statements

		Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
11.	**FINANCIAL INVESTMENTS**					
	Available-for-sale securities at fair value					
	- Debt securities		4,249.8	4,026.1	4,249.8	4,026.1
	- Treasury and other eligible bills		1,403.4	560.1	1,403.4	560.2
	- Equity securities		-	-	-	-
			5,653.2	4,586.2	5,653.2	4,586.3
	Available-for-sale securities					
	- Which may not be repledged or resold or are not subject to repledge or resale by counterparties		5,653.2	4,539.9	5,653.2	4,539.9
	- Which may be repledged or resold or are subject to repledge or resale by counterparties		-	46.3	-	46.3
			5,653.2	4,586.2	5,653.2	4,586.2
	Analysis of available for sale securities by issuer:					
	- Government securities and Australian government agencies		2,982.1	1,659.6	2,982.1	1,659.6
	- Banks and building societies		2,656.1	2,926.6	2,656.1	2,926.6
	- Corporate debt and other securities		15.0	-	15.0	-
			5,653.2	4,586.2	5,653.2	4,586.2
12.	**PROPERTY, PLANT & EQUIPMENT**					
	Leasehold improvements at cost					
	Balance at 1 January		57.7	45.2	57.7	45.2
	Assets acquired		3.5	12.5	3.5	12.5
	Assets disposed		-	-	-	-
	Balance at 31 December		61.2	57.7	61.2	57.7
	Furniture, fittings, office equipment at cost					
	Balance at 1 January		59.8	53.3	59.8	53.3
	Assets acquired		2.9	6.5	2.9	6.5
	Assets disposed		-	-	-	-
	Balance at 31 December		62.7	59.8	62.7	59.8
	Leasehold improvements accumulated depreciation					
	Balance at 1 January		(40.5)	(34.9)	(40.5)	(34.9)
	Depreciation charge for the year		(4.5)	(5.6)	(4.5)	(5.6)
	Disposals		-	-	-	-
	Balance at 31 December		(45.0)	(40.5)	(45.0)	(40.5)
	Furniture, fittings, office equipment accumulated depreciation					
	Balance at 1 January		(48.6)	(44.9)	(48.6)	(44.9)
	Depreciation charge for the year		(4.1)	(3.7)	(4.1)	(3.7)
	Disposals		-	-	-	-
	Balance at 31 December		(52.7)	(48.6)	(52.7)	(48.6)
	Carrying amounts					
	At 1 January		28.4	18.7	28.4	18.7
	At 31 December		26.2	28.4	26.2	28.4

Notes to the Consolidated Financial Statements

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
13. GROUP ENTITIES					
(a) SHARES IN CONTROLLED ENTITIES					
Unlisted securities at cost					
Shares in controlled entities at cost		-	-	79.9	79.9
Less: provision for impairment		-	-	(79.9)	(79.9)
		-	-	-	-

(1) Under a previous version of Australian accounting standards, shares in controlled entities were measured at fair value on a class of assets basis. On transition to A-IFRS in 2005, the deemed cost of the investment in controlled entities was the fair value of the net assets.

Over time activities within the subsidiaries have been migrated to HSBC Bank Australia. HSBC Bank Australia is in the process of deregistering dormant legacy entities. As part of this exercise, retained profits and capital have been upstreamed through dividends and capital redemptions from subsidiaries. As a consequence of the deemed cost calculated above, this has resulted in impairments of $79.9m being recognised.

(b) CONTROLLED ENTITIES

All controlled entities are incorporated in Australia.

Name of Entity	Note	2012 %	2011 %	Place of incorporation
Controlling Entity:				
HSBC Bank Australia Limited				Australia
Controlled entities:				
HSBC Custody Nominees (Australia) Limited		100	100	Australia
HSBC Finance Holdings (Australia) Pty Ltd		100	100	Australia
Midland Australia Pty Limited		100	100	Australia
ACN 087 652 113 Pty Ltd		100	100	Australia
Lion Series 2007-1 Trust	(1)	-	-	Australia
Lion Series 2009-1 Trust	(2)	-	-	Australia

(1) Although the Company does not hold any ownership interests in Lion Series 2007-1 Trust, it receives substantially all of the benefits related to the Lion Trust securitisation programme. Consequently, the Company consolidates this entity. This trust was established on 22 April 2007.

(2) The Company established the Lion 2009-1 Trust in July 2009 and purchased $1.6 billion of customer mortgages, enabling the creation of notes eligible for repo with the RBA, as part of consolidated entity's contingency liquidity plan. The Company does not hold any ownership interests in Lion Series 2009-1 Trust. It owns all the notes and receives substantially all of the benefits related to the Lion Trust securitisation programme. As a result, the Company consolidates this entity.

Notes to the Consolidated Financial Statements

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
14. INTANGIBLE ASSETS					
GOODWILL					
Cost and carrying amount					
Opening balance at 1 January		58.7	58.7	58.7	58.7
Closing balance at 31 December		58.7	58.7	58.7	58.7
INTERNALLY DEVELOPED SOFTWARE					
Cost					
Opening balance at 1 January		13.8	13.2	13.8	13.2
Additions/(Disposals)		(0.4)	0.6	(0.4)	0.6
Closing balance at 31 December		13.4	13.8	13.4	13.8
Accumulated Amortisation					
At 1 January		13.2	12.0	13.2	12.0
Amortisation charges for the year		-	1.2	-	1.2
At 31 December		13.2	13.2	13.2	13.2
Carrying amounts					
At 1 January		0.6	1.2	0.6	1.2
At 31 December		0.2	0.5	0.2	0.5
TOTAL INTANGIBLE ASSETS		58.9	59.3	58.9	59.3

Segment allocation of Goodwill

In recognition of Australian Accounting Standard AASB 138: Intangible Assets, the consolidated entity's carrying amount of goodwill as at 31 December 2012 is disclosed for each segment of business.

Retail Banking and Wealth Management	57.4	57.4	57.4	57.4
Global Banking and Markets	1.3	1.3	1.3	1.3
	58.7	58.7	58.7	58.7

Notes to the Consolidated Financial Statements

14. INTANGIBLE ASSETS (continued)

Impairment Tests for Goodwill

Goodwill has been allocated for impairment testing purposes to cash generating units in the following business segments: Retail Banking and Wealth Management, and Global Banking and Markets. Under AASB 136: Impairment of assets, a cash-generating unit to which goodwill has been allocated shall be tested for impairment annually, and whenever there is an indication that the unit may be impaired. The key assumptions in calculating the recoverable amounts of these segments are disclosed below.

i) Retail Banking and Wealth Management

Goodwill allocated to Retail Banking and Wealth Management arose from the acquisition in 2001 by HSBC Bank Australia Limited of NRMA Building Society Group Limited. The Retail Banking and Wealth Management units' impairment test is based on fair value calculations.

Retail Banking and Wealth Management units' fair value has been assessed for the year ended 31 December 2012 by calculating a PE value, with industry average price earning's ratio for retail banks of 11 to 13 applied against the current year earnings of the unit from continuing operations to determine an upper and lower recoverable amount.

This recoverable amount exceeds the carrying amount of goodwill of $57.4m, such that management considers that it is not reasonably possible for the assumed price to earnings ratio to change so significantly as to eliminate this excess.

ii) Global Banking and Markets

The Global Banking and Markets impairment test is based on value in use calculations.

The business and associated clients that were purchased through the State Street acquisition generated a net profit after tax during the year ended 31 December 2012 that exceeded the carrying amounts of the goodwill.

With a carrying goodwill value of $1.3m, discounted cash flow models utilising both two and five year time spans and discount rates of BBSW resulted in a recoverable amount in excess of the carrying amount of the unit.

The recoverable amount exceeds the carrying amount of goodwill of $1.3m, such that management considers that it is not reasonably possible for the assumed future earnings to change so significantly as to eliminate this excess.

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
15. OTHER ASSETS					
Prepayments and accrued income		114.0	110.4	113.5	113.6
Receivables from related entities		1,568.5	494.5	1,549.7	494.5
Other assets		248.4	215.9	248.4	215.9
Assets held for resale		9.1	7.4	9.1	7.4
Acceptances and endorsements		98.6	142.2	98.6	142.2
		2,038.6	970.4	2,019.3	973.6

In both 2012 and 2011, assets held for resale mainly comprised assets acquired by repossession of collateral for realisation.

Notes to the Consolidated Financial Statements

16. TAX ASSETS AND LIABILITIES

Current tax assets and liabilities

The consolidated entity and the Bank have no current tax assets or liabilities. In accordance with the tax consolidated legislation the immediate parent entity, HSBC Australia Holding Pty Limited (HIHA), as head entity of the Australian tax consolidated group has assumed the current tax liability / (asset) initially recognised by members in the tax consolidated group and in accordance with the Tax Funding Agreement, the members in the tax consolidation group recognise a corresponding intercompany asset / liability to the head entity.

Recognised deferred tax assets and liabilities

a) Deferred tax assets and liabilities are attributable to the following:

Consolidated and Company	Deferred Tax Assets 2012 $'m	Deferred Tax Assets 2011 $'m	Deferred Tax Liabilities 2012 $'m	Deferred Tax Liabilities 2011 $'m	Net Deferred Tax Assets 2012 $'m	Net Deferred Tax Assets 2011 $'m
Loans and advances to customers	6.3	14.9	(0.6)	(7.2)	5.7	7.7
Debt securities on issue - asset	-	-	-	-	-	-
Tangible fixed assets	16.1	15.8	-	-	16.1	15.8
Trading assets/ derivatives	-	-	-	-	-	-
Prepayments and accrued income	0.1	0.1	(0.9)	-	(0.8)	0.1
Customer accounts	-	-	(3.0)	-	(3.0)	-
Debt securities on issue - liabilities	-	-	-	-	-	-
Trading liabilities/ derivatives	-	-	-	-	-	-
Other liabilities/ accrued expenses	24.2	25.1	(0.2)	(0.1)	24.0	25.0
Accruals and deferred income	10.5	10.4	-	-	10.5	10.4
Provision for contingent liabilities and commitments	25.8	14.9	-	-	25.8	14.9
Cash flow hedging reserve	2.2	2.0	-	-	2.2	2.0
Available for sale securities reserve	-	1.2	(7.0)	-	(7.0)	1.2
Total tax assets/(liabilities)	85.2	84.4	(11.7)	(7.3)	73.5	77.1

b) Movement in temporary differences during the year

Consolidated and Company	Balance 1 Jan 12 $'m	Recognised in income $'m	Recognised in equity $'m	DTA Transfer to HIHA $'m	Balance 31 Dec 12 $'m
Loans and advances to customers	7.7	2.8	-	(4.8)	5.7
Debt securities on issue - asset	-	-	-	-	-
Tangible fixed assets	15.8	0.3	-	-	16.1
Trading assets/ derivatives	-	-	-	-	-
Prepayments and accrued income	0.1	(0.9)	-	-	(0.8)
Other assets	-	(3.0)	-	-	(3.0)
Customer accounts	-	-	-	-	-
Debt securities on issue - liabilities	-	-	-	-	-
Trading liabilities/ derivatives	-	-	-	-	-
Other liabilities/accrued expenses	25.0	(1.0)	-	-	24.0
Accruals and deferred income	10.4	0.8	-	(0.7)	10.5
Provision for contingent liabilities and commitments	14.9	10.9	-	-	25.8
Cash flow hedging reserve	2.0	-	0.2	-	2.2
Available for sale securities reserve	1.2	-	(8.2)	-	(7.0)
	77.1	9.9	(8.0)	(5.5)	73.5

Notes to the Consolidated Financial Statements

16. TAX ASSETS AND LIABILITIES (continued)

b) Movement in temporary differences during the last year

Consolidated and Company	**Balance 1 Jan 11 $'m**	**Recognised in income $'m**	**Recognised in equity $'m**	**DTA Transfer to HIHA $'m**	**Balance 31 Dec 11 $'m**
Loans and advances to customers	39.5	0.9	-	(32.7)	7.7
Debt securities on issue - asset	3.4	(1.0)	-	(2.4)	-
Tangible fixed assets	13.1	2.7	-	-	15.8
Trading assets/ derivatives	(50.9)	4.2	-	46.7	-
Prepayments and accrued income	0.2	(0.1)	-	-	0.1
Customer accounts	(5.0)	(1.0)	-	6.0	-
Debt securities on issue - liabilities	1.0	0.1	-	(1.1)	-
Trading liabilities/ derivatives	51.3	(4.8)	-	(46.5)	-
Other liabilities/accrued expenses	23.5	1.5	-	-	25.0
Accruals and deferred income	12.6	3.3	-	(5.5)	10.4
Provision for contingent liabilities and commitments	14.9	-	-	-	14.9
Cash flow hedging reserve	1.4	-	0.6	-	2.0
Available for sale securities reserve	(1.9)	-	3.1	-	1.2
	103.1	5.8	3.7	(35.5)	77.1

During 2012 further pre-TOFA financial arrangements were identified to which the election to apply the transitional provisions of the TOFA legislation to pre-TOFA financial arrangements, applied. This resulted in the transfer of an additional $5.5m of relevant net deferred tax assets to the consolidated Head Entity, HSBC Australia Holdings Pty Limited (HIHA) (2011: $35.5m).

		Consolidated		**Company**	
		2012	**2011**	**2012**	**2011**
	Note	**$'m**	**$'m**	**$'m**	**$'m**
17. TRADING LIABILITIES & FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE					
TRADING LIABILITIES					
Balances with related entities		-	1.0	-	1.0
Bonds and medium-term notes		110.5	119.1	110.5	119.1
Customer accounts		190.4	140.3	190.4	140.3
		300.9	260.4	300.9	260.4
FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE					
Debt Securities in issue		39.7	-	39.7	-
		39.7	-	39.7	-

Notes to the Consolidated Financial Statements

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m

18. SUBORDINATED LIABILITIES

Subordinated debt due March 2018, callable from March 2013	42.0	42.0	42.0	42.0
Subordinated debt due November 2020, callable from November 2015	200.0	200.0	200.0	200.0
	242.0	242.0	242.0	242.0

Regulatory approval is required from Australian Prudential Regulation Authority (“APRA”), Financial Services Authority (“FSA”) and Hong Kong Monetary Authority (“HKMA”) before any of the subordinated debt can be repaid.

19. DEBT SECURITIES ON ISSUE

Certificate of deposit	420.7	473.8	420.7	473.8
Bonds and medium-term notes	736.4	913.2	510.0	633.0
	1,157.1	1,387.0	930.7	1,106.8

20. PROVISIONS FOR LIABILITIES AND CHARGES

Balance at 1 January	49.7	49.7	49.7	49.7
New provisions	72.6	-	72.6	-
Provisions utilised	(28.2)	-	(28.2)	-
Other	7.3	-	7.3	-
Balance at 31 December	101.4	49.7	101.4	49.7

A significant component of the new provisions for liabilities and charges relate to litigation provisions. HSBC Bank Australia Limited was one of 20 defendant banks named in proceedings concerning the Bell Group of companies. The proceedings were brought by the liquidators of several Bell Group companies who challenged the defendant banks’ entitlement to receive the proceeds of realisation of Bell Group assets in the early 1990s. Judgment was delivered on 28 October 2008 and final orders were handed down on 30 April 2009.

HSBC Bank Australia Limited, along with the other defendant banks, was found liable to repay its share of the monies received from the Bell Group plus interest. The defendant banks appealed the decision. Judgment was handed down by the Court of Appeal of the Supreme Court of Western Australia on 17 August 2012. By a majority decision, the defendant banks were unsuccessful in the appeal and the amount of interest payable was increased. HSBC Bank Australia Limited considers that appropriate provisioning has been made for this matter. The defendant banks have applied for special leave to appeal to the High Court of Australia, however, the outcome and timing of the application for special leave and, if granted, the appeal are uncertain. HSBC Bank Australia Limited is also entitled to lodge a claim as a creditor in the liquidation of the Bell Group.

HSBC does not expect the case to result in a significant adverse effect on the financial position of the consolidated entity. Whilst the outcome of the matter is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of such legal proceeding as at 31 December 2012.

Notes to the Consolidated Financial Statements

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
21. OTHER LIABILITIES					
Payables to related entities		1,653.7	1,762.8	1,860.8	2,046.6
Accruals and deferred income		159.8	176.4	158.9	175.4
Other liabilities		64.8	68.0	65.0	68.2
Acceptances and endorsements		98.6	142.2	98.6	142.2
		1,976.9	2,149.4	2,183.3	2,432.4
22. EMPLOYEE BENEFITS					
Liability for annual leave		9.9	9.9	9.9	9.9
Payable to related entity with respect to share based payments		9.1	6.7	9.1	6.7
Liability for long service leave		14.4	13.4	14.4	13.4
Total employee benefits		33.4	30.0	33.4	30.0

a) Defined contribution plans

The consolidated entity and company makes contributions to the staff superannuation scheme, a defined contribution plan. The amount recognised as expense was $15.3m for the year ended 31 December 2012 (2011: $16.4m).

b) Share based payments

The consolidated entity's key management personnel and employees participate in both discretionary and voluntary HSBC Holdings plc compensation plans. Discretionary share plans include performance and restricted/achievement share awards. Discretionary options plans are the Executive Share Option Plan and the Group Share Option Plan (ESOP/GSOP).

Sharesave, a voluntary compensation plan eligible to all employees, is a savings related share option plan.

During 2012, $6.1m (2011: $6.2m) was charged to the Income Statement by the Company and the consolidated entity in respect of share-based transactions settled in equity. This expense was computed from the fair values of the share-based payment transactions when contracted, arising under employee share awards made in accordance with HSBC Holdings plc's reward structures.

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
23. CAPITAL					
Issued Capital					
656,795,689 ordinary shares fully paid		751.0	751.0	751.0	751.0
6,000 non-redeemable preference shares		60.0	60.0	60.0	60.0
		811.0	811.0	811.0	811.0

Notes to the Consolidated Financial Statements

23. CAPITAL (Con'd)

Ordinary shares
Holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholder meetings. In the event of winding up of the Company, ordinary shareholders rank after all other shareholders and creditors and are fully entitled to any proceeds of liquidation.

The Company does not have authorised capital or par value in respect of its issued shares.

Preference shares
Subject to a declaration by the Directors, the holders of preference shares have an entitlement to dividends at a rate of 5% per annum subject to certain conditions being met by the Company as set out in the Memorandum and Articles of Association. The key condition prior to the dividend being declared is that shareholder funds exceed $500 million and the dividend is paid out of current year profits available for distribution. The dividend entitlement is non-cumulative.

24. RESERVES AND RETAINED EARNINGS

(a) Reserves

Available for sale securities reserve
The available for sale securities reserve includes the cumulative net change in the fair value of available-for-sale investments until the investment is derecognised.

Cash flow hedging reserve
The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

Capital contribution reserve
This reserve represents the capital contribution received by the consolidated entity from the ultimate parent entity, HSBC Holdings plc, in respect of the various share based payment schemes in operation.

(b) Dividends

Dividends to shareholders of the parent company amounted to $40.0m in 2012 (2011: $88.0m). Of this, $37.0m (2011:$85.0m) was dividends paid on ordinary share capital and $3.0m (2011: $3.0m) was paid on preference shares classified as equity.

	Company 2012		Company 2011	
	$ per Share	Total $'m	$ per share	Total $'m
Ordinary shares				
Dividend 1	0.032	21.0	0.029	19.0
Dividend 2		-	0.033	22.0
Dividend 3		-	0.033	22.0
Dividend 4	0.024	16.0	0.033	22.0
		37.0		85.0
Preference Shares				
Dividend 1	500.000	3.0	500.000	3.0
		3.0		3.0

Notes to the Consolidated Financial Statements

		Consolidated		Company	
		2012	2011	2012	2011
		$'m	$'m	$'m	$'m
25.	**COMMITMENTS**				
(a)	**Lease commitments**				
	Aggregate non-cancellable operating lease expenditure contracted for at balance date, but not provided for in the financial statements:				
	Payable not later than 1 year	28.7	27.7	28.7	27.7
	Payable between 1 and 5 years	78.6	83.2	78.6	83.2
	Payable over 5 years	27.1	29.7	27.1	29.7
		134.4	140.6	134.4	140.6

The consolidated entity leases property under operating leases expiring from one to ten years. Leases generally provide the consolidated entity with a right of renewal at which time all terms are renegotiated. Lease payments comprise a base amount plus an incremental contingent rental. Contingent rentals are based on either movements in the Consumer Price Index or operating performance criteria.

(b)	**Other commitments**				
	Documentary credits and trade related transactions	207.6	331.0	207.6	331.0
	Undrawn lending facilities	9,052.3	8,908.7	9,052.3	8,908.7
		9,259.9	9,239.7	9,259.9	9,239.7

26. CONTINGENT LIABILITIES

(a)	Contingent liabilities in respect of guarantees given	1,220.5	1,256.4	1,220.5	1,256.4
(b)	Letters of credit and other contingencies	1,301.6	1,165.9	1,301.6	1,165.9

(c) HSBC Bank Australia Limited and its controlled entities have commitments in respect of foreign exchange contracts, futures and options contracts, forward rate agreements, and currency and interest rate swap contracts. The commitments have been entered into in the normal course of business and it is not envisaged that any irrecoverable liability will arise from these contracts.

(d) The consolidated entity is defending an action brought by various external parties. It is not practicable for the Directors to reliably measure any additional contingent liability other than that already provided for in note 20.

27. FIDUCIARY ACTIVITIES

Funds under custody	126,840.2	115,879.3	126,840.2	115,879.3

Consolidated entity provides custody and clearing services to global custodians, fund managers and broker dealers.

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES

(a) Risk management

The consolidated entity's activities involve the analysis, evaluation, acceptance and management of financial risks. The principal financial risks are:

- credit risk;
- liquidity risk;
- market risk (including foreign exchange and interest rate risks);
- operational risk; and
- capital management

The HSBC Group Head Office formulates high-level risk management policies for the HSBC Group worldwide. The group's risk management policies and procedures are subject to a high degree of oversight and guidance to ensure that all types of risk are systematically identified, measured, analysed and actively managed. In addition, internal audit is responsible for the independent review of risk management and the control environment.

The Bank's Audit and Risk Committee of the Board oversees the management of risk within the Bank and the Bank's risk appetite and future risk strategy, including capital and liquidity management strategy. The Bank's Risk Management Committee exercises oversight of the Bank's risk framework.

For the following credit, market risk and liquidity risk management notes, the disclosures are for the consolidated entity as management monitor risk on a consolidated basis and because the market risk, credit risk and liquidity risk of the Company are not considered materially different for separate disclosure. The exception is capital management where this is separately monitored for both the Company and consolidated entity.

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Credit Risk Disclosures

Credit risk is the risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises principally from direct lending, trade finance and leasing business, but also from off-balance sheet products such as guarantees and derivatives, and from the group's holding of debt and other securities. Credit risk generates the largest regulatory capital requirement of the risks we incur. The group has standards, policies and procedures dedicated to controlling and monitoring risk from all such activities. The group's principal credit risk management procedures and policies, which follow policies established by HSBC Group Head Office, include the following:

- Formulating credit policies which are consistent with the Group credit policy and documenting these in detail in dedicated manuals.
- Establishing and maintaining the group's large credit exposure policy. This policy delineates the group's maximum exposures to individual customers, customer groups and other risk concentrations.
- Establishing and complying with lending guidelines on the group's attitude towards, and appetite for, lending to specified market sectors and industries.
- Undertaking an objective assessment of risk. All commercial non-bank credit facilities originated by the group in excess of designated limits are subject to review prior to the facilities being committed to customers.
- Controlling exposures to banks and other financial institutions. The group's credit and settlement risk limits to counterparties in the finance and government sectors are designed to optimise the use of credit availability and avoid excessive risk concentration.
- Managing exposures to debt securities by establishing controls in respect of the liquidity of securities held for trading and setting issuer limits for financial investments. Separate portfolio limits are established for asset-backed securities and similar instruments.
- Controlling cross-border exposures to manage country and cross-border risk through the imposition of country limits with sub-limits by maturity and type of business.
- Controlling exposures to selected industries. When necessary, restrictions are imposed on new business, or exposures in the group's operating entities are capped.
- Maintaining and developing risk ratings in order to categorise exposures meaningfully and facilitate focused management of the attendant risks. Rating methodology is based upon a wide range of financial analytics together with market data-based tools which are core inputs to the assessment of counterparty risk. Although automated risk-rating processes are increasingly used for the larger facilities, ultimate responsibility for setting risk grades rests in each case with the final approving executive. Risk grades are reviewed frequently and amendments, where necessary, are implemented promptly.

Both the HSBC Group Head Office and the consolidated entity's Risk Management Committee ('RMC') receive regular reports on credit exposures. These include information on large credit exposures, concentrations, industry exposures, levels of impairment provisioning and country exposures.

RMC has the responsibility for risk approval authorities and approving definitive risk policies and controls. It monitors risk inherent to the financial services business, receives reports, determines action to be taken and reviews the efficacy of the risk management framework.

EXCO and RMC are supported by a dedicated group risk function headed by the Chief Risk Officer, who is a member of both EXCO and RMC and reports to the Chief Executive.

The Audit and Risk Committee ('ARC') also has responsibility for oversight and advice to the Board on risk matters. The key responsibilities of the ARC in this regard include preparing advice to the Board on the overall risk appetite tolerance and strategy within the group and seeking such assurance as it may deem appropriate that account has been taken of the current and prospective macroeconomic and financial environment. The ARC is also responsible for the periodic review of the effectiveness of the internal control and risk management frameworks and advising the Board on all high level risk matters.

The ARC approves the appointment and removal of the consolidated entity's Chief Risk Officer.

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Credit Risk Disclosures (continued)

Credit exposure

Our credit exposure is spread across a broad range of asset classes, including derivatives, trading assets, loans and advances to customers, loans and advances to banks and financial investments.

The following table presents the maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements (unless such credit enhancements meet accounting offsetting requirements). For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees and similar contracts granted, it is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, it is generally the full amount of the committed facilities.

Maximum exposure to Credit Risk

	Consolidated		Company	
	2012	2011	2012	2011
	$'m	$'m	$'m	$'m
Cash and balances at central banks	430.5	398.0	430.5	398.0
Items in course of collection from other banks	1.1	1.6	1.1	1.6
Derivatives	54.6	91.5	54.6	91.5
Loans and advances to banks	216.8	1,979.6	216.8	1,979.6
Loans and advances to customers	16,019.6	15,769.8	16,019.6	15,769.8
Financial investments - Debt securities	4,249.8	4,026.1	4,249.8	4,026.1
- Treasury and other eligible bill	1,403.4	560.1	1,403.4	560.1
Total financial investments	5,653.2	4,586.2	5,653.2	4,586.2
Other assets				
- Endorsements and acceptances	98.6	142.2	98.6	142.2
- Receivables from related parties	1,568.5	494.5	1,549.7	494.5
- Accrued income	105.4	106.1	105.0	106.1
- Other	246.7	214.0	246.7	214.0
Total other assets	2,019.2	956.8	2,000.0	956.8
Financial guarantees and contingent liabilities	1,220.5	1,256.4	1,220.5	1,256.4
Loan commitments and other credit related commitments	9,259.9	9,268.3	9,259.9	9,268.3
At 31 December	34,875.4	34,308.2	34,856.4	34,308.2

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Credit Risk Disclosures (continued)

Collateral and other credit enhancements

Loans and advances
It is HSBC Group's policy to establish that loans are within the customer's capacity to repay, rather than to rely excessively on security. Depending on the customer's standing and the type of product, facilities may be unsecured. Nevertheless, collateral can be an important mitigant of credit risk.
When appropriate, the consolidated entity is required to implement guidelines on the acceptability of specific classes of collateral or credit risk mitigation, and determine suitable valuation parameters. Such parameters are expected to be conservative, reviewed regularly and supported by empirical evidence. Security structures and legal covenants are required to be subject to regular review to ensure that they continue to fulfil their intended purpose and remain in line with local market practice. The collateral types are as follows:
- in the personal sector, mortgages over residential properties;
- in the commercial and industrial sector, charges over business assets such as premises, stock and debtors;
- in the commercial real estate sector, charges over the properties being financed and personal guarantees; and
- in the financial sector, charges over financial instruments such as debt securities and equities in support of trading facilities.

Collateral held on impaired assets as at 31 December 2012 was $67.4m (2011: $67.1m).

Other financial assets
Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities and other eligible bills are generally unsecured with the exception of asset backed securities and similar instruments, which are secured by pools of financial assets.

Credit quality of loans and advances

Four broad classifications described the credit quality of the HSBC Group’s lending and debt securities portfolios. These classifications each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending business, as well as the external ratings attributed by external agencies to debt securities. There is no direct correlation between the internal and external ratings at granular level, except to the extent each falls within a single quality classification

Quality Classification	**Wholesale lending and Derivatives**	**Retail lending**	**Debt securities/ Other**
Strong	**CRR 1 to CRR 2**	**EL 1 to EL 2**	**A- and above**
Medium	**CRR 3 to CRR 5**	**EL 3 to EL 5**	**B+ to BBB+, and unrated**
Sub-standard	**CRR 6 to CRR 8**	**EL 6 to EL 8**	**B and below**
Impaired	**CRR 9 to CRR 10**	**EL 9 to EL 10**	**Impaired**

The CRR (‘Customer Risk Rating’) 10-grade scale maps to a more granular underlying 23-grade scale of obligor probability of default. These scales are used Group-wide for all individually significant customers, depending on which Basel II approach is adopted for the assets in question. The EL (‘Expected Loss’) 10-grade scale for retail business summarises a more granular 29-grade scale combining obligor and facility/product risk factors in a composite measure, used Group-wide. The external ratings cited above have for clarity of reporting been assigned to the quality classifications defined for internally-rated exposures.

The basis of reporting reflects risk rating systems under the HSBC Group’s Basel II programme and to extend the range of financial instruments covered in the presentation of portfolio quality.

For local reporting purposes, the Bank adopted the APRA Standardised approach to Credit, Market and Operational risk as of 1 January 2008.

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Credit Risk Disclosures (continued)

Credit quality of loans and advances (continued)

CRR fall within the following categories:

1. 'Strong' – Exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/ or low levels of expected loss. Retail accounts operate within product parameters and only exceptionally show any period of delinquency.

2. 'Medium' – Exposures require closer monitoring, with low to moderate default risk. Retail accounts typically show only short periods of delinquency, with losses expected to be minimal following the adoption of recovery processes.

3. 'Sub-standard' – Exposures require varying degrees of special attention and default risk of greater concern. Retail portfolio segments show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes.

4. 'Impaired' – Exposures have been assessed, individually or collectively, as impaired. The HSBC Group observes the conservative disclosure convention, reflected in the quality classification definition above, that all retail accounts delinquent by 90 days or more are considered impaired. Such accounts may occur in any retail EL grade, whereby in the higher quality grades the grading assignment will reflect the offsetting of the impact of delinquency status by credit risk mitigation in one form or another.

Impairment is not measured for financial instruments held in trading portfolios or designated at fair value, as assets in such portfolios are managed according to movements in fair value, and the fair value movement is taken directly through the income statement.

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Credit Risk Disclosures (continued)

Distribution of financial instruments by credit quality

	Neither past due or impaired			Past due but not impaired	Impaired	Total
	Strong $'m	Medium $'m	Sub - Standard $'m	$'m	$'m	$'m
At 31 December 2012						
Cash and balances at central banks	430.5	-	-	-	-	430.5
Items in the course of collection from other banks	1.1	-	-	-	-	1.1
Derivatives	48.6	6.0	-	-	-	54.6
Loans and advances held at amortised cost - gross						
- loans and advances to banks	216.7	-	-	0.1	-	216.8
- loans and advances to customers	11,136.5	4,299.0	100.0	388.1	242.0	16,165.6
	11,353.2	4,299.0	100.0	388.2	242.0	16,382.4
Financial investments						
- treasury and other eligible bills	1,403.4	-	-	-	-	1,403.4
- debt securities	4,249.8	-	-	-	-	4,249.8
	5,653.2	-	-	-	-	5,653.2
Other assets						
- endorsements and acceptances	1.0	96.6	1.0	-	-	98.6
- receivables from related parties	1,568.5	-	-	-	-	1,568.5
- other	244.1	98.0	-	-	10.0	352.1
	1,813.6	194.6	1.0	-	10.0	2,019.2
Total	19,300.2	4,499.6	101.0	388.2	252.0	24,541.0
At 31 December 2011						
Cash and balances at central banks	398.0	-	-	-	-	398.0
Items in the course of collection from other banks	1.6	-	-	-	-	1.6
Derivatives	52.2	39.3	-	-	-	91.5
Loans and advances held at amortised cost - gross						
- loans and advances to banks	1,978.6	-	-	1.0	-	1,979.6
- loans and advances to customers	10,504.1	4,643.7	188.8	385.2	123.4	15,845.2
	12,482.7	4,643.7	188.8	386.2	123.4	17,824.8
Financial investments						
- treasury and other eligible bills	560.1	-	-	-	-	560.1
- debt securities	4,026.1	-	-	-	-	4,026.1
	4,586.2	-	-	-	-	4,586.2
Other assets						
- endorsements and acceptances	18.1	123.6	0.5	-	-	142.2
- receivables from related parties	494.5	-	-	-	-	494.5
- other	228.0	91.9	0.2	-	-	320.1
	740.6	215.5	0.7	-	-	956.8
Total	18,261.3	4,898.5	189.5	386.2	123.4	23,858.9

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Credit Risk Disclosures (continued)

Financial instruments which were past due but not impaired aging analysis

The amounts in the following table reflect exposures designated as past due but not impaired. Examples of exposures designated past due but not impaired include loans that have missed the most recent payment date but on which there is no evidence of impairment; corporate loans fully secured by cash collateral; short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

	Up to 29 days $'m	30-59 days $'m	60-89 days $'m	90-180 days $'m	Over 180 days $'m	Total $'m
At 31 December 2012						
Loans and advances held at amortised cost						
- loans and advances to banks	0.1	-	-	-	-	0.1
- loans and advances to customers	316.8	47.4	22.5	1.4	0.0	388.1
	316.9	47.4	22.5	1.4	0.0	388.2
At 31 December 2011						
Loans and advances held at amortised cost						
- loans and advances to banks	1.0	-	-	-	-	1.0
- loans and advances to customers	339.7	32.5	13.0	-	-	385.2
	340.7	32.5	13.0	-	-	386.2

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Credit Risk Disclosures (continued)

Concentration of exposure
Concentrations of credit risk exist when a number of counterparties are engaged in similar activities, or operate in the same geographical areas or industry sectors and have similar economic characteristics so that their ability to meet contractual obligations is similarly affected by changes in economic, political or other conditions.

Credit Risk Exposure by Industry

	Financial Investments $'m	Loans and Advances to Customers $'m	Loans and Advances to Banks $'m	Derivatives $'m	Total $'m
2012					
Class of Asset					
Property	-	1,320.8	-	1.7	1,322.5
Trade	-	1,181.2	-	2.0	1,183.2
Financial institutions	2,656.1	173.0	216.8	44.8	3,090.7
Manufacturing	-	717.4	-	2.9	720.3
Personal	-	-	-	-	-
-Residential mortgages	-	9,668.6	-	-	9,668.6
-Credit card and other personal lending	-	1,412.1	-	-	1,412.1
Primary industry	-	29.7	-	0.3	30.0
Other	2,997.1	1,516.8	-	2.9	4,516.8
Total gross credit risks	5,653.2	16,019.6	216.8	54.6	21,944.2
2011					
Class of Asset					
Property	-	1,470.0	-	-	1,470.0
Trade	-	1,351.2	-	7.2	1,358.4
Financial institutions	2,926.6	176.2	1,979.6	42.7	5,125.1
Manufacturing	-	653.8	-	11.7	665.5
Personal					
-Residential mortgages	-	9,092.4	-	-	9,092.4
-Credit card and other personal lending	-	1,286.4	-	-	1,286.4
Primary industry	-	40.3	-	5.4	45.7
Other	1,659.6	1,699.5	-	24.5	3,383.6
Total gross credit risks	4,586.2	15,769.8	1,979.6	91.5	22,427.1

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Credit Risk Disclosures (continued)

Renegotiated loans
Restructuring activity is designed to manage customer relationships, maximise collection opportunities and, if possible, avoid foreclosure or repossession. Such activities include extended payment arrangements, approved external debt management plans, deferring foreclosure, modification, loan rewrites and/or deferral of payments pending a change in circumstances. Following restructuring, an overdue consumer account is normally reset from delinquent to current status. Restructuring policies and practices are based on indicators or criteria which, in the judgments of local management, indicate that repayment will probably continue. These policies are required to be kept under continual review and their application varies according to the nature of the market, the product, and the availability of empirically based data. When empirical evidence indicates an increased propensity to default on restructured accounts, the use of roll rate methodology ensures this factor is taken into account when calculating impairment allowances. The value of renegotiated loans in 2012 was $0.9m (2011: $0.7m).

Collateral and Other Credit Enhancements Obtained
The consolidated entity obtained assets by taking possession of collateral held as security, or calling upon other credit enhancements. The carrying amount outstanding as at the year end was as follows:

	Consolidated	
	Carrying amount obtained in:	
	2012	2011
	$'m	$'m
Nature of Assets		
Residential property	9.1	7.4
	9.1	7.4

Repossessed assets are non-financial assets acquired in exchange for loans in order to achieve an orderly realisation, and are reported in the balance sheet within 'Other assets' at the lower of fair value (less costs to sell) and the carrying amount of the loan (net of any impairment allowance).

Repossessed properties are made available for sale in an orderly fashion, with the proceeds used to reduce or repay the outstanding indebtedness. Where excess funds are available after the debt has been repaid, they are available either for other secured lenders with lower priority or are returned to the customer. HSBC does not generally occupy repossessed properties for its business use.

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(c) Liquidity and Funding Management Disclosures

Liquidity relates to the ability of a company to meet its obligations as they fall due. The HSBC Group maintains a stable and diversified funding base of core retail and corporate customer deposits as well as portfolios of highly liquid assets. The objective of the HSBC Group's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due.

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

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

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

It is the responsibility of local management to ensure compliance with local regulatory requirements and limits set by the HSBC Group/regional head office. Liquidity is managed on a daily basis by local treasury functions.

Compliance with liquidity and funding requirements is monitored by the Asset and Liability Management Committee ('ALCO') which report to the group's regional Office on a regular basis. This process includes:

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

Current accounts and savings deposits payable on demand or at short notice form a significant part of our funding, and we place considerable importance on maintaining their stability. For deposits, stability depends upon preserving depositor confidence in our capital strength and liquidity, and on competitive and transparent pricing. Professional markets are accessed for the purposes of providing additional funding, maintaining a presence in local money markets and optimising asset and liability maturities.

Of total liabilities of $23,189.1m at 31 December 2012 (2011: $22,689.0m), funding from customers amounted to $18,547.0m (2011: $17,790.3m) of which $18,524.2m (2011: $17,752.5m) was contractually repayable within one year. However, although the contractual repayments of many customer accounts are on demand or at short notice, in practice short-term deposit balances remain stable as inflows and outflows broadly match.

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(c) Liquidity and Funding Management Disclosures (continued)

Cash flows payable by the consolidated entity under financial liabilities by remaining contractual maturities

	On demand $'m	Due within 3 months $'m	Due between 3 and 12 months $'m	Due between 1 and 5 years $'m	Due after 5 years $'m
At 31 December 2012					
Deposits by banks	655.2	-	-	-	-
Customer accounts	12,425.4	4,595.6	1,636.3	20.4	7.7
Items in the course of transmission to other banks	-	26.3	-	-	-
Debt securities on issue	-	10.0	359.1	636.4	300.5
Financial liabilities designated at fair value	-	0.5	1.6	8.3	50.2
Subordinated liabilities	-	45.6	9.1	224.3	-
Other financial liabilities	1,109.3	252.2	130.5	777.0	1.5
	14,189.9	4,930.2	2,136.6	1,666.4	359.9
Financial guarantee contracts	1,189.3	-	-	-	-
Loan commitments	6,798.8	2,485.3	-	2.1	-
	22,178.0	7,415.5	2,136.6	1,668.5	359.9
At 31 December 2011					
Deposits by banks	594.0	50.6	-	-	-
Customer accounts	11,566.0	5,177.5	1,129.6	38.9	7.7
Items in the course of transmission to other banks	-	22.1	-	-	-
Debt securities on issue	-	126.0	383.3	758.1	408.1
Financial liabilities designated at fair value	-	-	-	-	-
Subordinated liabilities	-	4.4	13.3	287.3	-
Other financial liabilities	1,236.4	375.8	472.3	40.7	1.5
	13,396.4	5,756.4	1,998.5	1,125.0	417.3
Financial guarantee contracts	1,174.3	-	-	-	-
Loan commitments	6,998.5	2,269.7	-	-	-
	21,569.2	8,026.1	1,998.5	1,125.0	417.3

*Financial Guarantees are recognised in the earliest period in which payment is due from the entity.

The balances in the above table will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments. Liabilities in trading portfolios have not been analysed by contractual maturity because trading assets and liabilities are typically held for short periods of time.

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(c) Liquidity and Funding Management Disclosures (continued)

A number of principal measures are used to manage liquidity risk, as described below.

Inherent liquidity risk categorisation
We categorise our operating entities into one of three categories to reflect our assessment of their inherent liquidity risk, considering political, economic and regulatory factors within the operating entities' host country, and also factors specific to the entity itself, such as the local footprint, market share, balance sheet strength and control framework. This assessment is used to determine the severity of the liquidity stress that we expect our operating entities to be able to withstand, as expressed in our principal liquidity risk metrics, being the stressed one month coverage ratio and the advances to core funding ratio.

Core deposits
Our internal framework is based on our categorisation of customer deposits into core and non-core. This characterisation takes into account the inherent liquidity risk categorisation of the entity originating the deposit, the nature of the customer and the size and pricing of the deposit.

Advances to core funding ratio
The group emphasises the importance of core customer deposits as a source of funds to finance lending to customers, and discourages reliance on short-term professional funding. This is achieved by placing limits on banking entities which restrict their ability to increase loans and advances to customers without a corresponding growth in core customer deposits or long term debt funding, this measure is referred to as the 'advances to core funding' ratio.

The ratio describes current loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year. Loans and advances to customers which are part of reverse repurchase arrangements, and where the group receives securities which are deemed to be liquid, are excluded from the advances to core funding ratio.

Advances to core funding ratio

	Consolidated	
	Year Ended 31 December	
	2012	2011
Year End	**101.86%**	**111.31%**
Maximum	112.66%	121.77%
Minimum	101.20%	103.82%
Average	105.92%	112.53%

The Liquidity position as measured by the ACF ratio improved throughout 2012. This was achieved due to the relatively flat growth in Loans and Advances being outpaced by growth in core deposits across all Global Businesses. 69% of external wholesale funding had a residual maturity beyond 1 year.

Projected cash flow scenario analysis
The group uses a number of standard projected cash flow scenarios designed to model both group-specific and market-wide liquidity crises, in which the rate and timing of deposit withdrawals and drawdowns on committed lending facilities are varied, and the ability to access interbank funding and term debt markets and to generate funds from asset portfolios is restricted. The scenarios are modelled by all group banking entities. The appropriateness of the assumptions under each scenario is regularly reviewed. In addition to the group's standard projected cash flows scenarios, individual entities are required to design their own scenarios to reflect specific local market conditions, products and funding bases.

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(c) Liquidity and Funding Management Disclosures (continued)

Contingent liquidity risk
In the normal course of business, the HSBC Group entities provide customers with committed facilities and standby facilities to corporate customers. These facilities increase the funding requirements of the HSBC Group when customers choose to raise drawdown levels over and above their normal utilisation rates. The liquidity risk consequences of increased levels of drawdown are analysed in the form of projected cash flows under different stress scenarios. Limits are set for non-cancellable contingent funding commitments by Group after due consideration of each entity's ability to fund them. The limits are split according to the borrower and the size of the committed line.

(d) Market Risk Disclosures

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

The group monitors market risk separately for trading portfolios and non-trading portfolios. Trading portfolios include positions arising from market-making in exchange 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.

The management of market risk is principally undertaken in Global Markets through risk limits approved by the group's Executive Committee. Wholesale and Market Risk, an independent unit within the Risk function, develops risk management policies and measurement techniques.

Risk limits are determined for each location and, within location, for each portfolio. Limits are set by product and risk type with market liquidity being a principal factor in determining the level of limits set. Limits are set using a combination of risk measurement techniques, including position limits, sensitivity limits, as well as value at risk limits at a portfolio level. Similarly, option risks are controlled through full revaluation limits in conjunction with limits on the underlying variables that determine each option's value.

Value at risk ("VaR")
One of the principal tools used by the group to monitor and limit market risk exposure is VAR. VAR is a technique which estimates the potential losses that could occur on risk positions taken due to movements in market rates and prices over a specified time horizon and to a given level of confidence (99% for the group). VAR is calculated daily.

The group uses a historical simulation model which derives plausible future scenarios from historical market data. Potential movements in market prices are calculated with reference to market data from the last two years. The model used assumes a 1-day holding period, as this reflects the way the risk positions are managed.

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

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a 1-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a 1-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The group recognises these limitations by augmenting the VAR limits with other position and sensitivity limit structures, as well as with stress testing, both on individual portfolios and on a consolidated basis. The group's stress testing regime provides senior management with an assessment of the impact of extreme events on the market risk exposures of the group.

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(d) Market Risk Disclosures (continued)

Trading

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

In addition, at both portfolio and position levels, market risk in trading portfolios is monitored and controlled using a complementary set of techniques such as VAR and present value of a basis point, together with stress and sensitivity testing and concentration limits. These techniques quantify the impact on capital of defined market movements.

Total and trading VaR for the consolidated entity was as follows:

	Total VaR Year Ended 31 December		Trading VaR Year Ended 31 December	
	2012 $'m	2011 $'m	2012 $'m	2011 $'m
At 31 December	5.0	5.0	0.0	0.2
Average	5.8	2.5	0.1	0.1
Maximum	7.4	5.1	0.3	0.6
Minimum	4.1	1.1	0.0	0.1

Total VaR at 31 December 2012 has remained steady at $5.0m from 30 December 2011, however average VaR in 2012 is $3.3m higher than the 2011 average. An increased level of liquid assets to satisfy liquidity requirements, combined with the level of PVBP exposure held in the portfolio resulted in an increased average VaR over the course of 2012.

Total Trading VaR at 31 December 2012 has decreased from $0.2m in 2011 to $0.0m in 2012 due to a decrease in the magnitude of the PVBP exposure held in the Trading book.

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(d) Market Risk Disclosures (continued)

Present Value of a Basis Point ("PVBP")
The HSBC Group has adopted the PVBP measurement as the standard approach to measuring and setting market risk interest rate limits.

The present value of a basis point ("PVBP") is one of the most widely used and accepted methods for quantifying outright interest rate risk. It expresses the impact on the present value of a position of a one basis point increase in the interest rate used to calculate the present value e.g. a change from 5.00% to 5.01%. This is a more accurate expression of interest rate sensitivity and exposure than any other method and is the most appropriate methodology for portfolios where the value of the transactions is very sensitive to interest rate movements.

Therefore all interest rate exposure limits for the banking book are expressed in the form of forward PVBP limits which have an overall total limit. There are also PVBP sub-limits by time buckets which are based on HSBC Group defined futures buckets which cover the period from today out to 33 years (or tenor that is applicable in each particular trading book).

The utilisation calculations used by the HSBC Group and the consolidated entity are:

- a single currency transaction will contribute limit utilisation in that currency.
- a forward FX transaction will contribute limit utilisation in two currencies.
- exposure is created in each forward period up to maturity.
- the PVBP calculation is based on an increase of one basis point in interest rates.
- a positive cash flow in the future will show a negative PVBP and a negative cash flow will show a positive PVBP exposure.
- all risk sensitivity exposures are measured in USD equivalent, local currency exposures are converted at the applicable spot foreign exchange rate to their USD equivalent.
- utilisation across different currencies within time bands is calculated gross and utilisation within a currency across different time bands is calculated net.

The relevant PVBP limit for each currency covering the time bands of allowable transactions is approved annually. In addition there will be an overall total PVBP limit for the trading book.

Credit Spread Delta ("CS01")
The HSBC Group employs a similar measure to PVBP for a basis point increase in credit spreads of underlying securities held in the trading book. CS01 measures the change in present value for a 1bps parallel upward shift in the underlying credit spread curve. The CS01 risk measure then highlights the sensitivity of bond values to changes in underlying credit spreads.

CS01 limits are maintained at an entity level and approved annually. The limits are further broken down into Moody's/ S&P rating buckets (i.e. AAA, AA, A and BBB), as well as measuring the CS01 exposure against the obligor level again classified by Moody's/S&P rating buckets.

Non-trading portfolios
The principal objective of market risk management of non-trading portfolios is to optimise net interest income.

Market risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on optionality in certain product areas, for example, mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand, for example, current accounts. In order to manage this risk optimally, market risk in non-trading portfolios is transferred to Treasury or to separate books managed under the supervision of ALCO.

The transfer of market risk to books managed by Treasury or supervised by ALCO is usually achieved by a series of internal deals between the business units and these books. When the behavioural characteristics of a product differ from its contractual characteristics, the behavioural characteristics are assessed to determine the true underlying interest rate risk.

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(d) Market Risk Disclosures (continued)

ALCO is required to regularly monitor all such behavioural assumptions and interest rate risk positions, to ensure they comply with interest rate risk limits established 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 market risk has been consolidated in Global Market or ALCO-managed books, the net exposure is typically managed through the use of interest rate swaps within agreed limits.

Within the consolidated entity, banking entities also monitor the sensitivity of projected net interest income under varying interest rate scenarios. The consolidated entity aims, through its management of market risk in non-trading portfolios, to mitigate the impact of prospective interest rate movements which could reduce future net interest income, whilst balancing the cost of such hedging activities on the current net revenue stream.

(**e) Operational Risk Disclosures**

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.

HSBC 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 HSBC stays in line with industry best practice and takes account of lessons learned from publicised operational failures within the financial services industry.

HSBC has codified its operational risk management process by issuing a high level standard, supplemented by more detailed formal guidance. This explains how HSBC 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 processes undertaken are by reference to scale and nature of each HSBC operation. The HSBC standard covers the following:

- operational risk management responsibility is assigned to senior management within each 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 at the business unit level. Aggregate operational risk losses are recorded and details of incidents above a materiality threshold are reported to Group Head Office. A regular report on operational losses is made to Group Audit Committee and the Risk Management Meeting; and
- a risk mitigation, including insurance, is considered where this is cost-effective.

The HSBC Group maintains and tests contingency facilities to support operations in the event of disasters.

Additional reviews and tests are conducted in the event that any HSBC office is affected by a business disruption event, to incorporate lessons learnt in the operational recovery from those circumstances. Plans have been prepared for the continued operation of the HSBC Group's business, with reduced staffing levels, should a flu pandemic occur.

Notes to the Consolidated Financial Statements

(f) Capital Management

The Bank, is an Authorised Deposit Taking Institution ("ADI") and is subject to APRA regulation under the authority of the Banking Act 1959.

The local regulator sets and monitors the Bank and consolidated entity's capital requirements under a tiered approach to the measurement of the entity's capital adequacy covering:

- Level 1 – Bank; and
- Level 2 – consists of the consolidated group, excluding non-controlled subsidiaries and subsidiaries with non financial operations and securitisation special purpose vehicles.

The capital adequacy framework under the Basel II regime, implemented since January 2008, seeks to promote regulatory capital requirements that are more comprehensive and sensitive to risk and therefore more aligned to the risk appetites of individual banks. It closely aligns regulatory capital with economic capital and introduces a spectrum of risk measurement approaches. The application of Pillar 2 in Australia is intended to ensure individual banks hold adequate capital to support their individual risk profiles and to encourage institutions to develop and apply improved risk management techniques in monitoring and managing risks.

APRA adopts a risk-based capital assessment framework generally consistent with the guidelines agreed by the Basel Committee on Banking Supervision: A Revised Framework ("Basel II"). APRA requires ADIs to maintain a minimum ratio of total capital to total risk weighted assets (RWAs) of at least 8% at both level 1 and level 2, with at least half of this capital in the form of Tier 1 capital. In addition, individual ADIs are subject to APRA imposed specific minimum capital ratios, referred to as Prudential Capital Ratio (PCR), which may be higher than the standard minimum of 8%. The bank is required to be above allocated PCR at all times and should immediately inform APRA of any breach with details of planned remedial action to be initiated to redress capital shortfall. The Board approved internal capital policy establishes capital floors above PCR allowing for adequate buffers to deal with potential capital pressures and to account for overall risk profile of the bank.

The Bank has adopted the standardised approach to credit risk and operational risk with relevant capital requirements based on standards mandated by APRA.

The Bank capital position at both level 1 and 2 is monitored on a continuous basis and reported monthly to the ALCO. The Bank capital ratios were in compliance with APRA set minimum capital adequacy requirements and Board approved targets and triggers throughout 2012.

APRA has refined the definition of Tier 1 capital to coincide with the implementation of AIFRS for regulatory reporting on July 2006 and again with the implementation of Basel II regime in January 2008. A three component structure to Tier 1 reaffirms APRA approach to de-couple the definition of capital from the Australian Accounting Standards.

- Fundamental capital – comprised of ordinary shares, retained earnings, general reserves, current year earnings net of tax expenses, declared dividends and minority interests. To constitute at least 75% of net Tier 1 capital.
- Residual capital – comprised of all other items qualifying for Tier 1 status, including preference shares and innovative Tier 1 instruments. Limited to a maximum of 25% of net Tier 1 capital with innovative Tier 1 capital limited to 15% of net Tier 1 capital. Any excesses to be transferred to upper tier 2 capital.
- Innovative capital – to include instruments that may contain an incentive for the issuer to call, such as a step up provision or an option to convert to ordinary shares. Any other Tier 1 instruments not in the form of shares.

For any component of capital to be included in the bank capital base it must satisfy prudential requirements, both in form and substance. A component of capital at level 1 cannot be upgraded to a higher category of capital when reported at level 2. Any planned reduction of capital, other than dividend payments not exceeding the bank after tax earnings in the financial year to which those relate, must be authorised by APRA.

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(f) Capital Management (continued)

The bank's main strategic capital objectives are to:

- Meet regulatory capital requirements while minimising shareholders equity through diversification of capital resources;
- Maintain capital ratios above internally set benchmarks to ensure against unanticipated losses and allow continued operation as a going concern;
- Deliver payments of annual dividends; and
- Operate within a set leverage ratio

The Bank and consolidated entity's regulatory capital position at 31 December was as follows:

	Consolidated	
	2012	**2011**
	$'m	**$'m**
NOTES TO CAPITAL MANAGEMENT		
TIER 1		
Paid-up capital	751.0	751.0
Retained profits brought forward	440.2	356.4
Current year profit	94.5	89.1
Current year earnings – deferred income	1.3	2.8
General reserve reversal	(8.3)	(10.4)
Recycling of capital contribution reserve to retained profits	2.3	0.5
Non-cumulative non-redeemable preference shares	60.0	60.0
Less: capital expenses – software costs & IT development expenditure	(0.4)	(0.8)
Less: goodwill	(58.7)	(58.7)
Less: available for sale reserve	-	(2.8)
Less: deferred taxation (excluding deferred tax on portfolio provision, part of general provisioning)	(61.8)	(68.5)
Unrealised (gains)/losses on bank own credit worthiness	0.8	0.2
Less: Equity and other capital investments in holding companies of ADI's (and equivalent entities overseas), (50% Tier 1)	-	-
TOTAL TIER 1 CAPITAL	**1,220.9**	**1,118.8**
TIER 2		
Subordinated debt	242.0	242.0
General reserve for credit loss	87.3	68.7
Deferred Tax on general reserve for credit loss	(11.7)	(8.6)
Available for sale reserve (profit)	10.5	-
Less: Equity and other capital investments in holding companies of ADI's (and equivalent entities overseas), (50% Tier 2)	-	-
TOTAL TIER 2 CAPITAL	**328.1**	**302.1**
TOTAL CAPITAL BASE	**1,549.0**	**1,420.9**
Tier 1 capital ratio (minimum 6%)	**8.93%**	**8.36%**
Total capital ratio	**11.33%**	**10.61%**

Notes to the Consolidated Financial Statements

28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(f) Capital Management (continued)

Tier 1 Capital has grown in 2012 due to increased earnings after tax allied with the strategy to retain a 50% proportion of profits to fund growth. The Tier 1 Capital ratio has grown as compared to 2011 in line with the strategy to increase buffers in anticipation of increased capital requirements under Basel III.

29. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Fair values of financial instruments carried at fair value
Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Financial instruments measured at fair value on an ongoing basis include trading assets and liabilities, instruments designated at fair value, derivatives, and financial investments classified as available-for-sale (including treasury and other eligible bills, debt securities, and equity securities).

Determination of fair value of financial instruments carried at fair value

Fair values are determined according to the following hierarchy:

(a) Level 1 - Quoted market price
Financial instruments with quoted prices for identical instruments in active markets.

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

(c) Level 3 - Valuation technique with significant non-observable inputs
Financial instruments valued using models where one or more significant inputs are not observable.

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

The majority of valuation techniques employ only observable market data, and so the reliability of the fair value measurement is high. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are not observable. For these instruments, the fair value derived is more judgemental.

'Not observable' in this context means that there is little or no current market data available from which to determine the level at which an arm's length transaction would likely occur, but it generally does not mean that there is absolutely no market data available upon which to base a determination of fair value (historical data may, for example, be used). Furthermore, the assessment of hierarchy level is based on the lowest level of input that is significant to the fair value of the financial instrument. Consequently, the level of uncertainty in the determination of the unobservable inputs will generally give rise to valuation uncertainty that is less than the fair value itself.

The valuation models used where quoted market prices are not available incorporate certain assumptions that the HSBC Group anticipates would be used by a market participant to establish fair value. Where the HSBC Group anticipates that there are additional considerations not included within the valuation model, adjustments may be adopted outside the model. Examples of such adjustments are:

- Credit risk adjustment: an adjustment to reflect the credit worthiness of the over-the-counter derivatives counterparties.
- Market data/ model uncertainty: an adjustment to reflect uncertainties in fair values based on uncertain market data inputs (e.g. as a result of illiquidity) or in areas where the choice of valuation model is particularly subjective.

Notes to the Consolidated Financial Statements

29. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Transaction costs are not included in the fair value calculation. Trade origination costs such as brokerage, fee expenses, and post-trade costs are included in operating expenses. The future cost of administering the over-the-counter derivative portfolio is also not included in fair value, but is expensed as incurred.

A detailed description of the valuation techniques applied to instruments of particular interest follow:

- Loans: Loans are valued from broker quotes and/ or market data consensus providers where available. Where unavailable, fair value will be determined based on an appropriate credit spread derived from other market instruments issued by the same or comparable entities.
- Debt securities, Treasury and eligible bills: These instruments are valued based on quoted market prices from an exchange, dealer, broker, industry group or pricing service, where available. When they are unavailable, the fair value is determined by reference to quoted market prices for similar instruments, adjusted as appropriate for the specific circumstances of the instruments.
- Derivatives: Over-the-counter (i.e. non-exchange traded) derivatives are valued using valuation models. Valuation models calculate the present value of expected future cash flows, based upon 'no-arbitrage' principles. For many vanilla derivatives products, such as interest rate swap and European options, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some discrepancy in practice. Inputs to valuation models are determined from observable market data wherever possible, including prices available from exchanges, dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices via model calibration procedures. Finally, some inputs are not observable, but can generally be estimated from historic data or other sources. Examples of inputs that are generally observable include foreign exchange spot and forward rates, benchmark interest rate curves and volatility surfaces for commonly traded option products. Examples of inputs that may be unobservable include volatility surfaces, in whole or in part, for less commonly traded option products, and correlations between market factors.
- Debt securities in issues – designated at fair value: In certain circumstances, the group applies the fair value option to own debt in issue. Where available, the fair value will be based upon quoted prices in an active market for the specific instrument concerned. Where not available, the fair value will be based upon an Own Issuance Curve constructed from HSBC Bank Australia Limited funding grid as well as the credit gradient grid which is based on Credit Default Swap Spreads for HSBC Holdings Plc. The fair value of their instruments therefore includes the effect of own credit spread. Gains and losses arising from changes in the credit spread of liabilities issued by the group reverse over the contractual life of the debt.
- Issued structured notes and certain hybrid instrument liabilities are included within trading liabilities, and marked at fair value. The credit spread applied to these instruments is derived from the spreads at which the group issues structured notes. These market spreads are significantly tighter than credit spreads observed in vanilla debt or credit default swap markets.

Notes to the Consolidated Financial Statements

29. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Consolidated	Quoted Market Price $'m	Valuation techniques - Using observable inputs $'m	Valuation techniques - With significant unobservable inputs $'m	Total Third Party $'m	Amount with HSBC* $'m	Total $'m
At 31 December 2012						
Assets						
Trading assets	-	-	-	-	-	-
Derivatives	-	10.2	-	10.2	44.4	54.6
Available for sale investments	2,562.4	3,090.8	-	5,653.2	-	5,653.2
Liabilities						
Trading liabilities	-	266.6	34.3	300.9	-	300.9
Financial liabilities designated at fair value	-	39.7	-	39.7		39.7
Derivatives	-	10.5	-	10.5	98.7	109.2
At 31 December 2011						
Assets						
Trading assets	-	-	-	-	-	-
Derivatives	-	49.3	0.1	49.4	42.1	91.5
Available for sale investments	1,893.2	2,693.1	-	4,586.3	-	4,586.3
Liabilities						
Trading liabilities	-	224.1	35.3	259.4	1.0	260.4
Derivatives	-	33.0	0.1	33.1	80.5	113.6

*Transactions with HSBC are predominantly instruments based on observable inputs. As described below the risk associated instruments with significant unobservable inputs are all backed out to other HSBC entities.

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

The following table provides a reconciliation of the movement between opening and closing balances of external Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs:

Consolidated	Liabilities Held for Trading 2012 $'m	Liabilities Held for Trading 2011 $'m
At 1 January	35.3	9.5
Total gains or losses recognised in profit or loss	1.6	(0.7)
Settlements	6.7	10.4
Transfer in / (out) of Level 3	(9.2)	16.1
At 31 December	34.4	35.3
Total gains or losses recognised in profit or loss relating to those liabilities held at the end of the reporting period	1.6	(0.7)
Total gains or losses recognised in profit or loss at the end of the reporting period	1.6	(0.7)

Notes to the Consolidated Financial Statements

29. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Effects of changes in significant non-observable assumptions to reasonably possible alternatives:

The trading liabilities valued using a valuation technique with significant unobservable inputs relate to certain structured notes issued by the Company. The embedded derivatives contained within these notes are 'back to back' with an identical but offsetting inter-company derivative transaction with a HSBC 'Risk Taking' site. Accordingly there will be no net change to the Company or the consolidated entity of changes in significant non observable assumptions to reasonably possible alternatives as any change in market value of trading liabilities will be exactly offset by the change in value of the offsetting inter-company derivatives.

Changes in fair value recorded in the Income Statement

The following table details changes in fair values recognised in the Income Statement during the period, where the fair value is estimated using valuation techniques that incorporate significant assumptions that are not supported by prices from observable current market transactions in the same instrument, and are not based on observable market data:

- the table details the total change in fair value of these instruments; it does not isolate that component of the change that is attributable to the non-observable component; and
- instruments valued with significant non-observable inputs are frequently dynamically hedged with instruments valued using observable inputs; the table does not include any changes in fair value of these hedges.

Transfer in Level 1, Level 2 and Level 3

Transfer out of Level 3 to Level 2 occurred in respect of certain trading liabilities as valuations in these liabilities become observable during the year.

Fair value of financial instruments not carried at fair value

The fair values of financial instruments that are not recognised at fair value on the balance sheet are calculated as described below.

The calculation of fair value incorporates the group's estimate of the amount at which financial assets could be exchanged, or financial liabilities settled, between knowledgeable, willing parties in an arm's length transaction.

The following types of financial instruments are measured at amortised cost unless they are held for trading or designated at fair value through profit or loss. Where assets or liabilities are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the assets or liabilities so hedged includes a fair value adjustment for the hedged risk only. Fair values at the balance sheet date of the assets and liabilities set out below are estimated for the purpose of disclosure as follows:

- Advances to customers – The fair value of advances to customers is estimated using discounted cash flow models, using an estimate of the discount rate that a market participant would use in valuing instruments with similar maturity, repricing and credit risk characteristics. The fair value of a loan portfolio reflects both loan impairments at the balance sheet date and estimates of market participants' expectation of credit losses over the life of the loans.
- Financial investments – The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that take into consideration either the prices of, or future earning streams of, equivalent quoted securities.
- Deposits and customers accounts – The fair value of deposits and customer accounts is estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of deposits repayable on demand is assumed to be the amount payable on demand at the balance sheet date.
- Debt securities in issue and subordinated liabilities – The fair value of debt securities in issue and subordinated liabilities is based on quoted market prices for the same or similar instruments at the balance sheet date.

Notes to the Consolidated Financial Statements

29. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

The following table lists those financial instruments for which their carrying amounts are a reasonable approximation of fair values because, for example, they are short term in nature or reprice to current market rates frequently:

Assets
Cash and balances at central banks
Items in the course of collection from other banks
Endorsements and acceptances
Short-term receivables within 'Other assets'
Accrued income

Liabilities
Items in the course of transmission to other banks
Endorsements and acceptances
Short-term payables within 'Other liabilities'
Accruals

The following table provides an analysis of the fair value of financial instruments not measured at fair value in the balance sheet. For all other instruments the fair value is equal to the carrying value:

	31 December 2012		31 December 2011	
Consolidated	**Carrying value $'m**	**Fair value $'m**	**Carrying value $'m**	**Fair value $'m**
Assets				
Loan and advances to banks	216.8	216.8	1,979.6	1,979.6
Loan and advances to customers	16,019.6	16,051.3	15,769.8	15,766.6
Liabilities				
Deposit by banks	655.2	655.2	644.5	644.5
Customer accounts	18,547.0	18,571.4	17,790.3	17,790.3
Debt securities in issue	1,157.1	1,161.7	1,387.0	1,385.6
Subordinated liabilities	242.0	242.1	242.0	242.1

Notes to the Consolidated Financial Statements

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
30. NOTES TO THE STATEMENT OF CASH FLOWS					
(a) Reconciliation of net cash flows from operating activities to operating profit after income tax					
Profit for the period		134.5	177.2	134.7	177.2
Depreciation and amortisation		8.7	10.5	8.7	10.5
Decrease / (increase) in interest receivable		5.1	(11.1)	8.8	(22.6)
Increase in interest payable		(21.5)	(5.3)	(25.7)	5.7
Loan impairment charges		103.0	53.3	103.0	57.9
Loss on the sale of investments		(1.8)	1.1	(1.8)	1.1
Increase in deferred taxes		3.6	26.0	3.6	26.0
Decrease/ (increase) in provisions		51.7	-	51.7	
Decrease/ (increase) in provision for employee entitlements		1.0	(4.0)	1.0	(4.0)
Decrease in intercompany receivable account		(15.2)	19.5	(15.2)	19.5
Increase/ (decrease) in sundry debtors		-	(19.8)	-	(24.3)
Decrease/ (increase) in sundry creditors		(38.1)	(36.9)	(38.4)	(36.5)
Changes in operating assets and liabilities					
Net decrease in trading assets		32.5	26.5	32.5	26.5
Net increase in trading liabilities		40.5	54.9	40.5	54.9
Cash inflows/(outflows) from movements in other assets/liabilities		(0.4)	112.3	(0.4)	111.8
Loans and bills sold and matured / (advanced)		(458.8)	(1,646.5)	(435.2)	(1,649.7)
Net increase in deposits and other borrowings		645.7	1,482.9	568.8	1,406.3
Cash flows from operations		490.5	240.6	436.6	160.3

Notes to the Consolidated Financial Statements

	Note	Consolidated 2012 $'m	Consolidated 2011 $'m	Company 2012 $'m	Company 2011 $'m
30. NOTES TO THE STATEMENT OF CASH FLOWS (continued)					
(b) Reconciliation of cash and cash equivalents					
Cash and cash equivalents at the end of the financial year as shown in the statement of cash flows are reconciled to the related items in the balance sheet as follows:					
Cash and balances at central banks		430.5	398.0	430.5	398.0
Placings with banks with remaining maturity 1 month or less		24.2	1,905.6	24.2	1,905.6
Securities purchased from related entities under agreements to resell		1,471.2	402.8	1,471.2	402.8
Total cash and cash equivalents		1,925.9	2,706.4	1,925.9	2,706.4

(c) Financing facilities

At 31 December 2012, the consolidated entity had a committed standby facility of $578.3m (2011: $601.5m) from a related corporation. At 31 December 2012 and 31 December 2011, the facility was unused.

The total external subordinated liabilities on issue at 31 December 2012 were $242.0m (2011: $242.0m).

31. ASSETS PLEDGED AS SECURITY FOR LIABILITIES AND COLLATERAL ACCEPTED AS SECURITY FOR ASSETS

Collateral accepted as security for assets
In respect of reverse repurchase agreements, the fair value of collateral held by the consolidated entity which was permitted to be sold or repledged amounted to $1,451.6m (2011: $2,292.0m), and by the Company of $1,451.6m (2011: $2,292.0m). The fair value of such collateral actually sold or repledged by the consolidated entity amounted to $0.0m (2011: $0.0m) and by the Company of $0.0m (2011: $0.0m).

No debt securities have been pledged as collateral to secure liabilities as a result of sale and repurchase agreements.

These transactions are conducted under terms that are usual and customary to collateralised transactions, including, where relevant, standard repurchase agreements.

Notes to the Consolidated Financial Statements

32. SECURITISATIONS AND OTHER STRUCTURED TRANSACTIONS

The consolidated entity enters into transactions from time to time by which it transfers recognised financial assets directly to the third parties or to special purpose entities. These transfers may give rise to the full or partial derecognition of the financial assets concerned.

- Full derecognition occurs when the consolidated entity transfers its contractual right to receive cash flows from the financial assets, or retains the right but assumes an obligation to pass on the cash flows from the assets, and transfers substantially all the risks and rewards of ownership. The risks include credit, interest rate, currency, prepayment and other price risks.
- Partial derecognition occurs when the Bank sells or otherwise transfers financial assets in such a way that some but not substantially all of the risks and rewards of ownership are transferred but control is retained. These financial assets are recognised on the balance sheet to the extent of the bank's continuing involvement.

The carrying amount of the assets not derecognised and their associated liabilities are:

	Consolidated				Company			
	Carrying amount of asset		Carrying amount of related liability		Carrying amount of asset		Carrying amount of related liability	
	2012	2011	2012	2011	2012	2011	2012	2011
	$'m	$'m	$'m	$'m	$'m	$'m	$'m	$'m
Debt Securities sold under arrangements to repurchase	-	46.3	-	-	-	46.3	-	-
Loans and advances to customers (1)	220.5	274.8	220.5	274.8	220.5	274.8	220.5	274.8
Total	220.5	274.8	220.5	274.8	220.5	274.8	220.5	274.8

(1) The Bank has performed two mortgage loan securitisations, whereby it has sold mortgage loans to the Lion Series 2007-1 Trust (launched in April 2007) and the Lion Series 2009-1 Trust (launched in July 2009) who funded their purchases through the issue of securities to external investors (Lion Series 2007-1 Trust) and the Bank (Lion Series 2009-1 Trust). The Bank provides swaps and services (including servicing and trust management) to the Trusts on an arms length basis in accordance with the APRA Prudential Guidelines (APS120 "Securitisation") and is entitled to the residual income from each of the Trusts. In addition the Bank provides a liquidity facility to the Lion Series 2009-1 Trust.

As outlined in Note 13 b) the purpose of the Lion Series 2009-1 securitisation was to create instruments that were eligible to be repoed with the Reserve Bank of Australia. Since none of the instruments have been repoed with the Reserve Bank of Australia, no assets have been deemed to be transferred to the Lion Series 2009-1 Trust.

The mortgage loans within the Lion Series 2007-1 Trust are not considered to meet the criteria for derecognition in AASB 139 for both the pass through tests and the transfer of risks and rewards tests. To reflect the cash flows that have occurred, a loan between the Trust and the Bank is recognised at an interest rate that reflects the combined contractual arrangements between the Trust and the Bank ("the imputed loan"). The implied interest rate represents the flows from the imputed loan, the interest rate swaps and the residual distribution payable to the Bank.

No assets (2011: $nil) were transferred in the year that did not qualify for derecognition.

Notes to the Consolidated Financial Statements

33. RELATED PARTY DISCLOSURES

Controlling Entities

The ultimate chief entity of the wholly owned group is HSBC Holdings plc, a company incorporated in England and Wales.

Ownership interest in related parties

Interests held in related parties are set out in Note 13.

	Consolidated		Company	
	2012 $	2011 $	2012 $	2011 $
Amounts receivable from or payable to related parties				
Aggregate amounts receivable:				
Other related entities	1,568,579,457	494,531,354	1,549,744,502	494,531,354
Aggregate amounts payable:				
Other related entities	1,655,180,248	1,763,771,208	1,862,262,858	2,047,657,820
Aggregate of amounts received or receivable from or paid or payable to related parties during the year				
Interest revenue:				
Other related entities	39,383,810	63,266,921	39,383,810	63,266,921
Key management personnel	305,820	310,153	305,820	310,153
Interest expense:				
Other related entities	53,447,954	68,634,134	68,497,105	86,239,383
Management fees paid:				
Other related corporations	54,660,287	55,827,808	54,660,287	56,027,808
Management fees received:				
Other related corporations	60,604,967	42,545,887	60,604,967	42,545,887
Fee income:				
Other related corporations	4,887,814	3,491,449	4,887,814	3,491,449
Fee expense:				
Other related corporations	4,897,038	1,778,488	4,897,038	1,778,488
Dividend income:				
Wholly owned subsidiaries	-	33,275	118,482	3,282,162
Dividend expense:				
Controlling entities	40,000,000	88,000,000	40,000,000	88,000,000

Notes to the Consolidated Financial Statements

33. RELATED PARTY DISCLOSURES (continued)

Transactions with related parties

All transactions with related parties during the financial year were conducted on normal commercial terms and conditions.

Various related entities were counterparties in respect of certain foreign exchange contracts, swap contracts and forward rate agreements undertaken by the consolidated entity. All such contracts are undertaken at arms length under normal commercial terms and conditions.

Loans and lease receivables outstanding as at balance date included $142,605,675 (Consolidated) (2011: $197,655,307), which were guaranteed by The Hongkong and Shanghai Banking Corporation Limited and other related corporations under normal commercial terms and conditions.

Management accounting and administrative services were provided by the Company to certain related entities free of charge within the Group. Otherwise these services are charged on a time and cost basis.

34. KEY MANAGEMENT PERSONNEL DISCLOSURES

The following were key management personnel of the consolidated entity at any time during the reporting period and unless otherwise indicated were key management personnel for the entire period:

Executive Directors:

Anthony W Cripps (Chief Executive Officer)	Appointed 24 December 2012
Paulo C T Maia (Chief Executive Officer)	Resigned 15 December 2012
Michael J Arnold (Chief Financial Officer)	Appointed 15 December 2012

Non-Executive Directors:

Graham J Bradley (Non-Executive Chairman)	
Carol J Austin (Non-Executive Director))	
Anthony W Cripps (Non-Executive Director)	Appointed 17 July 2012
Alexander A Flockhart (Non-Executive Director)	Resigned 30 April 2012
Guy D Harvey-Samuel (Non-Executive Director)	
Richard G Humphry (Non-Executive Director)	

Executives:

Robert Agati (Company Secretary)	
Michael J Arnold (Chief Financial Officer)	
Francine Biddulph (Head of Human Resources)	
Kate Epworth (Head of Group Communications)	
Graham Heunis (Head of Retail Banking and Wealth Management)	
James M J C Hogan (Head of Commercial Banking)	
Brenton Hush (Chief Technology and Services Officer)	
Charlotte Middleton (Chief Risk Officer)	Appointed 16 January 2012
Paddy Padmanabhan (Chief Risk Officer)	Resigned 31 March 2012
Bridget Powell (General Counsel)	
Gavin Powell (Head of Markets)	
Chris Russell (Head of Global Banking)	
Vic Wolff (Head of Marketing)	

Notes to the Consolidated Financial Statements

34. KEY MANAGEMENT PERSONNEL DISCLOSURES (continued)

Transactions with key management personnel

The key management personnel compensations included in 'staff costs' (see note 6) are as follows:

	Consolidated 2012 $	Consolidated 2011 $	Company 2012 $	Company 2011 $
Short term employee benefits				
Cash salary, fees and short-term compensated absences	5,510,853	4,979,847	5,510,853	4,979,847
Short-term cash profit-sharing and other bonuses	2,735,609	3,510,521	2,735,609	3,510,521
Non-monetary benefits	663,012	743,625	663,012	743,625
Other short-term employee benefits	955,616	1,380,989	955,616	1,380,989
	9,865,090	10,614,982	9,865,090	10,614,982
Post employment benefits				
Pension and superannuation benefits	491,976	445,404	491,976	445,404
Other post-employment benefits	29,539	31,032	29,539	31,032
	521,515	476,436	521,515	476,436
	10,386,605	11,091,418	10,386,605	11,091,418
Share based payments granted during the year	1,416,003	2,152,366	1,416,003	2,152,366

Other transactions with key management personnel

In addition to their salaries, the consolidated entity also provides non-cash benefits to its key management personnel, and contributes to a post-employment defined contribution plan on their behalf.

Executive officers are eligible to participate in the ultimate chief entity's share option programme (see note 22).

Apart from the details disclosed in this note, no director has entered into a material contract with the company or the consolidated entity since the end of the previous financial year and there were no material contracts involving Directors' interests existing at year-end.

Loans to key management personnel and their related parties

	Consolidated 2012 $	Consolidated 2011 $	Company 2012 $	Company 2011 $
The aggregate amount of loans to key management personnel of any entity in the consolidated entity*	5,882,245	4,614,747	5,882,245	4,614,747
Loan repayments received	683,627	859,424	683,627	859,424

* These amounts are included in loans and advances to customers to the accounts.
Fringe Benefits Tax ("FBT") is paid on all subsidised interest loans to Directors and this, together with the FBT benchmark interest rate, is included as part of those Directors' remuneration.

Notes to the Consolidated Financial Statements

35. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The following is an analysis, by remaining contractual maturities at balance date, of selected asset and liability accounts and represents the actual obligation date expected for the asset or liability to be recovered or settled within one year, and greater than one year.

Consolidated	2012 Due within one year $'m	2012 Due after one year $'m	2012 Total $'m	2011 Due within one year $'m	2011 Due after one year $'m	2011 Total $'m
Assets						
Cash and balances at central bank	430.5	-	430.5	398.0	-	398.0
Items in the course of collection from other banks	1.1	-	1.1	1.6	-	1.6
Loan and advances to banks	24.2	192.6	216.8	1,905.6	74.0	1,979.6
Loans and advances to customers	5,727.1	10,292.5	16,019.6	6,064.0	9,705.8	15,769.8
Financial investments	3,297.0	2,356.2	5,653.2	3,021.3	1,564.9	4,586.2
Other assets	1,867.1	171.5	2,038.6	809.6	160.8	970.4
Liabilities						
Deposits by banks	655.2	-	655.2	644.5	-	644.5
Customer accounts	18,524.2	22.8	18,547.0	17,752.5	37.8	17,790.3
Items in the course of transmission to other banks	26.3	-	26.3	22.1	-	22.1
Debt securities on issue	331.8	825.4	1,157.2	448.9	938.1	1,387.0
Financial liabilities designated at fair value	-	39.7	39.7	-	-	-
Other liabilities	1,971.3	7.1	1,978.4	2,149.4	-	2,149.4
Employee benefits	29.7	2.7	32.4	26.0	4.0	30.0
Subordinated liabilities	42.0	200.0	242.0	-	242.0	242.0

36. SUBSEQUENT EVENTS

There has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity, in future financial years.

Directors Declaration

In the opinion of the Directors of HSBC Bank Australia Limited:

(a) the financial statements and notes set out on pages 4 to 80 are in accordance with the Corporations Act 2001, including:

(i) giving a true and fair view of the financial position of the Company and the consolidated entity as at 31 December 2012, and of their performance, as represented by the results of their operations and their cash flows, for the year ended on that date; and

(ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and

(b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable; and

(c) the financial report also complies with International Financial Reporting Standards as disclosed in Note2(a).

Dated at Sydney this 14th day of February 2013.

Signed in accordance with a resolution of the Directors:

Graham J Bradley
Chairman

Anthony W Cripps
Director

Independent auditor's report to the members of HSBC Bank Australia Ltd

Report on the financial report

We have audited the accompanying financial report of HSBC Bank Australia Ltd (the Company), which comprises the statements of financial position as at 31 December 2012, and income statements and statements of comprehensive income, statements of changes in equity and statements of cash flows for the year ended on that date, notes 1 to 36 comprising a summary of significant accounting policies and other explanatory information and the directors' declaration of the Company and the Group comprising the Company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement whether due to fraud or error. In note 2(a), the directors also state, in accordance with Australian Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements of the Group comply with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We performed the procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001* and Australian Accounting Standards, a true and fair view which is consistent with our understanding of the Company's and the Group's financial position and of their performance.

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

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*.

Auditor's opinion

In our opinion:

(a) the financial report of HSBC Bank Australia Ltd is in accordance with the *Corporations Act 2001*, including:

  (i) giving a true and fair view of the Company's and the Group's financial position as at 31 December 2012 and of their performance for the year ended on that date; and

  (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001.

(b) the financial report also complies with International Financial Reporting Standards as disclosed in note 2(a).

KPMG

Peter Russell
Partner

Sydney

14 February 2013

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To: the directors of HSBC Bank Australia Ltd

I declare that, to the best of my knowledge and belief, in relation to the audit for the financial year ended 31 December 2012 there have been:

(i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and

(ii) no contraventions of any applicable code of professional conduct in relation to the audit.

KPMG

Peter Russell
Partner

Sydney

14 February 2013