

**HSBC Bank Middle East Limited**

Interim Financial Statements

30 June 2014

## Interim Financial Statements 2014

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### Presentation of Information

This document comprises the Interim Financial Statements 2014 for HSBC Bank Middle East Limited ('the bank') and its subsidiary undertakings (together 'the group'). It contains Condensed Financial Statements, together with the Auditor's review report. References to 'HSBC' or 'the HSBC Group' within this document mean HSBC Holdings plc together with its subsidiaries.

## Condensed Financial Statements (unaudited)

### Consolidated income statement for the half-year to 30 June 2014

	Half-year to	
	30 June 2014 US\$000	30 June 2013 US\$000
Interest income .....	643,866	685,471
Interest expense .....	(93,715)	(137,941)
Net interest income .....	550,151	547,530
Fee income .....	328,216	303,735
Fee expense .....	(38,471)	(38,476)
Net fee income .....	289,745	265,259
Trading income excluding net interest income .....	185,968	189,139
Net interest expense on trading activities .....	(7,899)	(2,020)
Net trading income .....	178,069	187,119
Net expense from financial instruments designated at fair value .....	(4,809)	(944)
Gains less losses from financial investments .....	1,762	3,821
Dividend income .....	8,746	4,129
Other operating income .....	26,137	18,348
<b>Net operating income before loan impairment charges and other credit risk provisions</b> .....	<b>1,049,801</b>	<b>1,025,262</b>
Loan impairment recoveries and other credit risk provisions .....	50,031	27,507
<b>Net operating income</b> .....	<b>1,099,832</b>	<b>1,052,769</b>
Employee compensation and benefits .....	(303,326)	(269,252)
General and administrative expenses .....	(215,803)	(224,361)
Depreciation and impairment of property, plant and equipment .....	(9,776)	(12,440)
Amortisation and impairment of intangible assets .....	(6,075)	(6,628)
<b>Total operating expenses</b> .....	<b>(534,980)</b>	<b>(512,681)</b>
<b>Operating profit</b> .....	<b>564,852</b>	<b>540,088</b>
Share of profit in associates .....	1,261	242
<b>Profit before tax</b> .....	<b>566,113</b>	<b>540,330</b>
Tax expense .....	(90,694)	(80,298)
<b>Profit for the period</b> .....	<b>475,419</b>	<b>460,032</b>
Profit attributable to shareholders of the parent company .....	467,368	447,706
Profit attributable to non-controlling interests .....	8,051	12,326

The accompanying notes on pages 8 to 22 form an integral part of these condensed financial statements.

**Condensed Financial Statements (unaudited)** (continued)**Consolidated statement of comprehensive income for the half-year to 30 June 2014**

	Half-year to	
	30 June 2014 US\$000	30 June 2013 US\$000
Profit for the period .....	475,419	460,032
<b>Other comprehensive income</b>		
<b>Items that will be reclassified subsequently to profit or loss when specific conditions are met</b>		
Available for sale investments:	8,273	10,184
– fair value gains .....	8,495	13,836
– fair value gains transferred to income statement on disposal .....	(642)	(3,391)
– income taxes .....	420	(261)
Cash flow hedges:	(2,614)	(2,730)
– fair value losses .....	(3,408)	(3,470)
– income taxes .....	794	740
Exchange differences and other .....	9,318	(8,978)
<b>Items that will not be reclassified subsequently to profit or loss</b>		
Remeasurement of defined benefit asset/liability:	(8,364)	–
– before income taxes .....	(10,537)	–
– income taxes .....	2,173	–
Other comprehensive income/(expense) for the period, net of tax .....	6,613	(1,524)
Total comprehensive income for the period .....	<b>482,032</b>	<b>458,508</b>
Total comprehensive income for the period attributable to:		
– shareholders of the parent company .....	473,665	442,979
– non-controlling interests .....	8,367	15,529
	<b>482,032</b>	<b>458,508</b>

The accompanying notes on pages 8 to 22 form an integral part of these condensed financial statements.

**Condensed Financial Statements (unaudited)** (continued)**Consolidated statement of financial position at 30 June 2014**

	Notes	30 June 2014 US\$000	31 December 2013 US\$000
<b>ASSETS</b>			
Cash and balances at central banks .....		1,020,530	1,573,701
Items in the course of collection from other banks .....		83,763	67,483
Trading assets .....	9	665,343	515,374
Derivatives .....	9	951,900	1,135,352
Loans and advances to banks .....		8,890,093	7,592,322
Loans and advances to customers .....		25,691,279	23,629,718
Reverse repurchase agreements – non-trading .....		19,974	24,455
Financial investments .....	9	10,818,057	11,267,242
Assets held for sale .....		-	901,032
Other assets .....		999,359	1,133,222
Current tax assets .....		9,909	6,289
Prepayments and accrued income .....		136,216	137,574
Interests in associates .....		53,803	30,642
Intangible assets .....		51,811	56,284
Property, plant and equipment .....		145,661	153,048
Deferred tax assets .....		196,393	203,934
Total assets .....		<b>49,734,091</b>	<b>48,427,672</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Liabilities</b>			
Deposits by banks .....		1,752,344	1,379,473
Customer accounts .....		33,154,758	31,315,682
Items in the course of transmission to other banks .....		717,141	561,153
Trading liabilities .....	9	1,410,931	1,235,000
Financial liabilities designated at fair value .....	7,9	505,371	503,448
Derivatives .....	9	887,607	1,132,836
Debt securities in issue .....	8	3,147,076	3,206,249
Liabilities of disposal groups held for sale .....		-	1,004,983
Other liabilities .....		1,786,942	1,936,508
Current tax liabilities .....		120,561	151,475
Accruals and deferred income .....		132,385	135,492
Provisions .....		56,658	64,008
Deferred tax liabilities .....		6,971	7,781
Retirement benefit liabilities .....		106,287	95,473
Total liabilities .....		<b>43,785,032</b>	<b>42,729,561</b>
<b>Equity</b>			
Called up share capital .....		931,055	931,055
Other reserves .....		59,774	43,498
Retained earnings .....		4,556,164	4,319,879
Total equity attributable to the shareholders of the parent company .....		<b>5,546,993</b>	<b>5,294,432</b>
Non-controlling interests .....		402,066	403,679
Total equity .....		<b>5,949,059</b>	<b>5,698,111</b>
Total equity and liabilities .....		<b>49,734,091</b>	<b>48,427,672</b>

The accompanying notes on pages 8 to 22 form an integral part of these condensed financial statements.

M M Al Tuwaijri, Chief Executive Officer and Deputy Chairman

**Condensed Financial Statements (unaudited)** (continued)**Consolidated statement of cash flows for the half-year to 30 June 2014**

	Half-year to	
	30 June 2014 US\$000	30 June 2013 US\$000
<b>Cash flows from operating activities</b>		
Profit before tax .....	566,113	540,330
Adjustments for:		
– non-cash items included in profit before tax .....	(10,759)	15,293
– change in operating assets .....	(796,526)	598,351
– change in operating liabilities .....	986,058	767,605
– elimination of exchange differences <sup>1</sup> .....	(22,798)	(5,628)
– net loss from investing activities .....	(5,944)	(4,772)
– share of profit in associates .....	(1,261)	(242)
– dividends received from associates .....	–	547
– contributions paid to defined benefit pension plans .....	(692)	–
– tax paid .....	(116,878)	(81,412)
Net cash generated from operating activities .....	<u>597,313</u>	<u>1,830,072</u>
<b>Cash flows from investing activities</b>		
Purchase of financial investments .....	(6,869,746)	(6,247,114)
Proceeds from the sale and maturity of financial investments .....	7,065,144	5,597,917
Purchase of property, plant and equipment .....	(5,187)	(11,394)
Proceeds from the sale of property, plant and equipment .....	6,064	685
Purchase of intangible assets .....	(1,618)	(1,973)
Proceeds from the sale of intangible assets .....	13	180
Net cash generated from/(used in) investing activities .....	<u>194,670</u>	<u>(661,699)</u>
<b>Cash flows from financing activities</b>		
Non equity preference share capital redeemed .....	–	(100,000)
Dividends paid to ordinary shareholders of the parent company .....	(220,000)	(65,000)
Dividends paid to non-controlling interests .....	(9,678)	(2,545)
Net cash used in financing activities .....	<u>(229,678)</u>	<u>(167,545)</u>
<b>Net increase in cash and cash equivalents</b> .....	<b>562,305</b>	<b>1,000,828</b>
Cash and cash equivalents at 1 January .....	7,888,015	9,160,192
Effect of exchange rate changes on cash and cash equivalents .....	14,354	(13,076)
Cash and cash equivalents at 30 June .....	<u>8,464,674</u>	<u>10,147,944</u>

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

The accompanying notes on pages 8 to 22 form an integral part of these condensed financial statements.

## Consolidated statement of changes in equity for the half-year to 30 June 2014

	Half-year to 30 June 2014										
			Other reserves						Total share- holders' equity US\$000	Non- controlling interests US\$000	Total equity US\$000
	Called up share capital US\$000	Retained earnings US\$000	Available- for-sale fair value reserve US\$000	Cash flow hedging reserve US\$000	Foreign exchange reserve US\$000	Other reserve US\$000	Merger reserve US\$000				
At 1 January 2014 .....	931,055	4,319,879	74,797	4,629	(22,121)	1,545	(15,352)	5,294,432	403,679	5,698,111	
Profit for the period .....	-	467,368	-	-	-	-	-	467,368	8,051	475,419	
Other comprehensive income (net of tax) .....	-	(8,053)	8,305	(2,614)	8,603	56	-	6,297	316	6,613	
Available-for-sale investments .....	-	-	8,302	-	-	-	-	8,302	(29)	8,273	
Cash flow hedges .....	-	-	-	(2,614)	-	-	-	(2,614)	-	(2,614)	
Remeasurement of defined benefit asset/liability .....	-	(8,364)	-	-	-	-	-	(8,364)	-	(8,364)	
Exchange differences and other .....	-	311	3	-	8,603	56	-	8,973	345	9,318	
Total comprehensive income for the period .....	-	459,315	8,305	(2,614)	8,603	56	-	473,665	8,367	482,032	
Dividends to shareholders .....	-	(220,000)	-	-	-	-	-	(220,000)	(9,678)	(229,678)	
Cost of share-based payment arrangements .....	-	125	-	-	-	-	-	125	-	125	
Other movements .....	-	(3,155)	362	125	-	1,439	-	(1,229)	(302)	(1,531)	
At 30 June 2014 .....	931,055	4,556,164	83,464	2,140	(13,518)	3,040	(15,352)	5,546,993	402,066	5,949,059	

The accompanying notes on pages 8 to 22 form an integral part of these condensed financial statements.

	Half-year to 30 June 2013									
	Other reserves									Total equity
	Called up share capital	Retained earnings	Available-for-sale fair value reserve	Cash flow hedging reserve	Foreign exchange reserve	Other reserve	Merger reserve	Total share-holders' equity	Non-controlling interests	
US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	
At 1 January 2013 .....	931,055	3,664,579	62,596	6,688	(17,576)	633	(15,352)	4,632,623	387,664	5,020,287
Profit for the period .....	–	447,706	–	–	–	–	–	447,706	12,326	460,032
Other comprehensive income (net of tax) .....	–	(25)	6,985	(2,730)	(8,957)	–	–	(4,727)	3,203	(1,524)
Available-for-sale investments .....	–	–	6,989	–	–	–	–	6,989	3,195	10,184
Cash flow hedges .....	–	–	–	(2,730)	–	–	–	(2,730)	–	(2,730)
Exchange differences and other .....	–	(25)	(4)	–	(8,957)	–	–	(8,986)	8	(8,978)
Total comprehensive income for the period .....	–	447,681	6,985	(2,730)	(8,957)	–	–	442,979	15,529	458,508
Dividends to shareholders .....	–	(65,000)	–	–	–	–	–	(65,000)	(2,545)	(67,545)
Cost of share-based payment arrangements .....	–	284	–	–	–	–	–	284	–	284
Other movements .....	–	(5,034)	(254)	–	–	992	–	(4,296)	1,162	(3,134)
At 30 June 2013 .....	931,055	4,042,510	69,327	3,958	(26,533)	1,625	(15,352)	5,006,590	401,810	5,408,400

The accompanying notes on pages 8 to 22 form an integral part of these condensed financial statements.



## Notes on the Condensed Financial Statements (unaudited)

### 1 Basis of preparation

#### (a) Compliance with International Financial Reporting Standards

The interim consolidated condensed financial statements of the group have been prepared in accordance with IAS 34 'Interim Financial Reporting' ('IAS 34') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the European Union ('EU').

The consolidated financial statements of the group at 31 December 2013 were prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the IASB and as endorsed by the EU. EU-endorsed IFRSs may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2013, there were no unendorsed standards effective for the year ended 31 December 2013 affecting the consolidated financial statements at that date, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group. Accordingly, the group's financial statements for the year ended 31 December 2013 were prepared in accordance with IFRSs as issued by the IASB.

IFRSs comprise accounting standards issued by the IASB and its predecessor body as well as interpretations issued by the IFRS Interpretations Committee ('IFRIC') and its predecessor body.

At 30 June 2014, there were no unendorsed standards effective for the period ended 30 June 2014 affecting these interim consolidated condensed financial statements, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group.

#### *Standards adopted during the period ended 30 June 2014*

On 1 January 2014, the group adopted amendments to IAS 32 'Offsetting Financial Assets and Financial Liabilities' which clarified the requirements for offsetting financial instruments and addressed inconsistencies in current practice when applying the offsetting criteria in IAS 32 'Financial Instruments: Presentation'. The amendments have been applied retrospectively and have not had a material effect on the group's consolidated condensed financial statements.

There were no new standards adopted during the period ended 30 June 2014.

During the period ended 30 June 2014, the group also adopted interpretations and amendments to standards which have had an insignificant effect on these interim consolidated condensed financial statements.

#### (b) Presentation of information

The functional currency of the bank is US dollars, which is also the presentation currency of the consolidated financial statements of the group.

#### (c) Comparative information

These interim consolidated condensed financial statements include comparative information as required by IAS 34.

#### (d) Use of estimates and assumptions

The preparation of financial information requires the use of estimates and assumptions about future conditions. The use of available information and the application of judgement are inherent in the formation of estimates; actual results in the future may differ from those reported. Management believes that the group's critical accounting policies where judgement is necessarily applied are those which relate to impairment of loans and advances, the valuation of financial instruments, the impairment of available-for-sale financial assets and the valuation of intangible assets recognised in business combinations. These critical accounting policies are described in the *Annual Report and Accounts 2013*.

#### (e) Consolidation

The interim consolidated condensed financial statements of the group comprise the condensed financial statements of HSBC Bank Middle East Limited and its subsidiaries. The method adopted by the group to consolidate its subsidiaries is described in the *Annual Report and Accounts 2013*.

## Notes on the Condensed Financial Statements (unaudited) (continued)

### (f) Future accounting developments

In addition to the projects to complete financial instrument accounting, discussed below, the IASB is continuing to work on projects on insurance and lease accounting which could represent significant changes to accounting requirements in the future.

#### **Amendments issued by the IASB but not endorsed by the EU**

In May 2014, the IASB issued IFRS 15 'Revenue from Contracts with Customers'. The standard is effective for annual periods beginning on or after 1 January 2017 with early adoption permitted. IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied. The standard should be applied retrospectively, with certain practical expedients available. The group is currently assessing the impact of this standard but it is not practicable to quantify the effect as at the date of the publication of these interim consolidated condensed financial statements.

In July 2014, the IASB issued IFRS 9 'Financial Instruments', which is the comprehensive standard to replace IAS 39 'Financial Instruments: Recognition and Measurement' and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

#### *Classification and measurement*

The classification and measurement of financial assets will depend on the entity's business model for their management and their contractual cash flow characteristics and result in financial assets being at amortised cost, fair value through OCI ('FVOCI') or fair value through profit or loss. In many instances, the classification and measurement outcomes will be similar to IAS 39, although differences will arise, for example, since IFRS 9 does not apply embedded derivative accounting to financial assets and equity securities will be measured at fair value through profit or loss or, in limited circumstances, at FVOCI. The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of financial assets measured at amortised cost or fair value compared to IAS 39. The classification of financial liabilities is essentially unchanged, except that, for certain liabilities measured at fair value, gains or losses relating to changes in the entity's own credit rating are to be included in OCI.

#### *Impairment*

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, lease receivables and certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of commitments and guarantees) is required for expected credit losses ('ECL') resulting from default events that are possible within the next 12 months ('12 month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL').

The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the probability of default occurring over the remaining life of the financial instrument, rather than by considering an increase in ECL.

The assessment of credit risk, as well as the estimation of ECL, are required to be unbiased, probability-weighted and should incorporate all available information which is relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward looking than IAS 39 and will tend to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

#### *Hedge accounting*

The general hedge accounting requirements aim to simplify hedge accounting creating a stronger link between it and risk management strategy and permitting the former to be applied to a greater variety of hedging instruments and risks. The standard does not explicitly address macro hedge accounting strategies, which will be addressed in a separate project. To remove the risk of any conflict between existing macro hedge accounting practice and

**Notes on the Condensed Financial Statements (unaudited)** (continued)

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the new general hedge accounting requirements, IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting.

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at 1 January 2018, with no requirement to restate comparative periods. Hedge accounting is applied prospectively from that date.

The mandatory application date for IFRS 9 as a whole is 1 January 2018, but it is possible to apply the revised presentation for certain liabilities measured at fair value from an earlier date. The group is currently assessing the impact IFRS 9 will have on the financial statements through a group-wide project which has been in place since 2010, but due to the complexity of the classification and measurement, impairment, and hedge accounting requirements and their inter-relationship, it is not possible at this stage to quantify the potential impact.

**(g) Changes in composition of the group**

On 19 June 2014, the group completed the sale of its banking operations in Jordan to Arab Jordan Investment Bank. Further explanation is provided in Note 10.

**(h) Changes in presentation**

From 1 January 2014, the group has chosen to present non-trading reverse repurchase agreements separately on the face of the balance sheet. These items are measured at amortised cost and classified for accounting purposes as loans and receivables. Previously they were presented on an aggregate basis together with other loans measured at amortised cost. The separate presentation aligns disclosure of reverse repurchase agreements with market practice and provides more meaningful information in relation to loans and advances.

Comparative periods have been presented accordingly. There is no other effect of this change in presentation.

**2 Accounting policies**

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The accounting policies adopted by the group for these interim consolidated condensed financial statements are consistent with those described in the *Annual Report and Accounts 2013*, except as disclosed in Note 1. The methods of computation applied by the group for these interim consolidated condensed financial statements are consistent with those applied for the *Annual Report and Accounts 2013*.

**3 Dividends**

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A first interim dividend for the financial year ending 31 December 2014 of US\$150 million was declared on 1 May 2014 and paid on 12 May 2014 with a second interim dividend of US\$305 million declared on 23 July 2014 and paid on 31 July 2014. No liability is recorded in the consolidated condensed financial statements in respect of the second dividend.

**Notes on the Condensed Financial Statements (unaudited)** (continued)**4 Concentration of loans and advances**

Loans and advances to banks were widely distributed across major institutions

*Gross loans and advances to customers by industry sector*

	Gross loans and advances to customers			
	30 June 2014		31 December 2013	
	Total	As	Total	As
At 30 June 2014	US\$000	a % of total gross loans %	US\$000	a % of total gross loans %
<b>Personal</b>				
Residential mortgages .....	2,541,699	9.41	2,449,671	9.78
Other personal .....	3,516,393	13.01	3,555,414	14.19
	<b>6,058,092</b>	<b>22.42</b>	<b>6,005,085</b>	<b>23.97</b>
<b>Corporate and commercial</b>				
Manufacturing .....	1,723,700	6.38	1,838,418	7.34
International trade and services .....	9,096,425	33.67	8,030,618	32.07
Commercial real estate .....	429,193	1.59	533,333	2.13
Other property related.....	1,494,296	5.53	1,293,203	5.16
Government .....	1,547,542	5.73	1,288,546	5.14
Other commercial.....	3,924,091	14.52	3,622,074	14.46
	<b>18,215,247</b>	<b>67.42</b>	<b>16,606,192</b>	<b>66.30</b>
<b>Financial</b>				
Non-bank financial institutions .....	2,744,495	10.16	2,437,047	9.73
Total gross loans and advances to customers .....	<b>27,017,834</b>	<b>100.00</b>	<b>25,048,324</b>	<b>100.00</b>
Impaired loans				
- as a percentage of gross loans and advances to customers .....	7.05%		7.95%	
Total impairment allowances				
- as a percentage of gross loans and advances to customers .....	4.91%		5.66%	

**5 Loan impairment charges/recoveries and other credit risk provisions**

	Half-year to	
	30 June 2014	30 June 2013
	US\$000	US\$000
Total loans and advances		
- new allowances net of allowance releases .....	(31,312)	3,667
- recoveries of amounts previously written off.....	(24,012)	(33,771)
	<b>(55,324)</b>	<b>(30,104)</b>
Impairment charges on debt securities and other credit risk provisions.....	5,293	2,597
	<b>(50,031)</b>	<b>(27,507)</b>

**Notes on the Condensed Financial Statements (unaudited)** (continued)

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

	Banks	Customers		Total US\$000
	Individually assessed US\$000	Individually assessed US\$000	Collectively assessed US\$000	
At 1 January 2014.....	18,317	1,053,515	365,091	1,436,923
Amounts written off .....	–	(31,040)	(41,022)	(72,062)
Recoveries of amounts previously written off .....	–	5,329	18,683	24,012
Recoveries to income statement.....	–	(48,547)	(6,777)	(55,324)
Foreign exchange and other movements.....	(3)	16,542	(5,219)	11,320
<b>At 30 June 2014</b>	<b>18,314</b>	<b>995,799</b>	<b>330,756</b>	<b>1,344,869</b>
At 1 January 2013 .....	17,388	1,224,574	407,639	1,649,601
Amounts written off .....	–	(36,323)	(48,819)	(85,142)
Recoveries of amounts previously written off .....	–	13,790	19,981	33,771
(Recoveries)/charge to income statement .....	(78)	(37,196)	7,170	(30,104)
Foreign exchange and other movements.....	(5)	(2,897)	(123)	(3,025)
At 30 June 2013.....	17,305	1,161,948	385,848	1,565,101

## Notes on the Condensed Financial Statements (unaudited) (continued)

## 6 Credit quality of financial instruments

The five credit quality classifications set out and defined in the *Annual Report and Accounts 2013* describe the credit quality of the group's lending, debt securities portfolios and derivatives. These classifications each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending businesses, as well as the external ratings attributed by external agencies to debt securities. There is no direct correlation between internal and external ratings at granular level, except to the extent each falls within a single quality classification.

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

	30 June 2014							
	Neither past due nor impaired				Past due but not impaired	Impaired	Impairment allowances	Total
	Strong US\$000	Good US\$000	Satisfactory US\$000	Sub-standard US\$000	US\$000	US\$000	US\$000	US\$000
Cash and balances at central banks .....	908,294	78,024	5,116	29,096	-	-	-	1,020,530
Items in the course of collection from other banks .....	3,307	-	80,456	-	-	-	-	83,763
Trading assets .....	379,318	58,108	221,297	6,620	-	-	-	665,343
- treasury and other eligible bills .....	171,273	21,645	19,411	-	-	-	-	212,329
- debt securities .....	56,767	36,463	105,178	6,620	-	-	-	205,028
- loans and advances to banks .....	137,701	-	75,299	-	-	-	-	213,000
- loans and advances to customers .....	13,577	-	21,409	-	-	-	-	34,986
Derivatives .....	89,194	127,456	709,689	25,561	-	-	-	951,900
Loans and advances held at amortised cost .....	17,498,408	9,255,952	5,344,299	1,225,219	680,092	1,922,271	(1,344,869)	34,581,372
- loans and advances to banks .....	7,062,049	1,545,497	141,325	140,999	-	18,537	(18,314)	8,890,093
- loans and advances to customers .....	10,436,359	7,710,455	5,202,974	1,084,220	680,092	1,903,734	(1,326,555)	25,691,279
Reverse repurchase agreements non-trading .....	-	-	19,974	-	-	-	-	19,974
Financial investments .....	3,581,061	711,395	6,056,500	271,914	-	-	-	10,620,870
- treasury and other similar bills .....	920,622	549,105	-	120,787	-	-	-	1,590,514
- debt securities .....	2,660,439	162,290	6,056,500	151,127	-	-	-	9,030,356
Other assets .....	75,245	226,300	707,204	63,746	22,233	-	-	1,094,728
- endorsements and acceptances .....	74,334	225,268	543,157	63,746	21,599	-	-	928,104
- accrued income and other .....	911	1,032	164,047	-	634	-	-	166,624
Total financial instruments .....	22,534,827	10,457,235	13,144,535	1,622,156	702,325	1,922,271	(1,344,869)	49,038,480

**Notes on the Condensed Financial Statements (unaudited)** (continued)

	31 December 2013							
	Neither past due nor impaired				Past due but not impaired	Impaired	Impairment allowances	Total
	Strong US\$000	Good US\$000	Satisfactory US\$000	Sub-standard US\$000	US\$000	US\$000	US\$000	US\$000
Cash and balances at central banks .....	1,436,301	105,058	-	32,342	-	-	-	1,573,701
Items in the course of collection from other banks .....	2,374	-	65,109	-	-	-	-	67,483
Trading assets .....	413,509	28,896	68,436	4,533	-	-	-	515,374
– treasury and other eligible bills .....	109,046	-	-	-	-	-	-	109,046
– debt securities .....	202,648	28,896	67,044	4,533	-	-	-	303,121
– loans and advances to banks .....	87,049	-	-	-	-	-	-	87,049
– loans and advances to customers .....	14,766	-	1,392	-	-	-	-	16,158
Derivatives .....	82,822	83,978	864,881	103,671	-	-	-	1,135,352
Loans and advances held at amortised cost .....	15,553,270	7,688,206	5,299,628	1,377,567	729,318	2,010,976	(1,436,925)	31,222,040
– loans and advances to banks .....	5,944,289	1,294,579	189,440	161,926	-	20,405	(18,317)	7,592,322
– loans and advances to customers .....	9,608,981	6,393,627	5,110,188	1,215,641	729,318	1,990,571	(1,418,608)	23,629,718
Reverse repurchase agreements non-trading.....	-	24,455	-	-	-	-	-	24,455
Financial investments .....	4,310,424	531,679	6,030,592	175,568	-	-	-	11,048,263
– treasury and other similar bills .....	1,195,713	368,402	-	48,621	-	-	-	1,612,736
– debt securities .....	3,114,711	163,277	6,030,592	126,947	-	-	-	9,435,527
Other assets.....	203,208	192,410	787,049	36,709	19,473	-	-	1,238,849
– endorsements and acceptances .....	200,053	191,967	596,571	36,709	15,922	-	-	1,041,222
– accrued income and other .....	3,155	443	190,478	-	3,551	-	-	197,627
Total financial instruments ...	22,001,908	8,654,682	13,115,695	1,730,390	748,791	2,010,976	(1,436,925)	46,825,517

**7 Financial liabilities designated at fair value**

	30 June 2014 US\$000	31 December 2013 US\$000
Debt securities in issue .....	505,371	503,448

At 30 June 2014, the accumulated amount of change in fair value attributable to changes in credit risk was a loss of US\$8.5 million (30 June 2013: US\$0.5 million gain).

**Notes on the Condensed Financial Statements (unaudited)** (continued)**8 Debt securities in issue**

	30 June 2014		31 December 2013	
	Carrying amount US\$000	Fair value US\$000	Carrying amount US\$000	Fair value US\$000
Medium term notes .....	3,933,334	3,932,639	3,925,589	3,925,925
Non-equity preference shares .....	950,000	916,287	950,000	925,415
	<b>4,883,334</b>	<b>4,848,926</b>	4,875,589	4,851,340
Of which debt securities in issue reported as				
trading liabilities .....	(1,230,887)	(1,230,887)	(1,165,892)	(1,165,892)
financial liabilities designated at fair value (Note 7) .....	(505,371)	(505,371)	(503,448)	(503,448)
	<b>3,147,076</b>	<b>3,112,668</b>	3,206,249	3,182,000

**9 Fair values of financial instruments**

The accounting policies which determine the classification of financial instruments and the use of assumptions and estimation in valuing them are described in the *Annual Report and Accounts 2013*.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

*Financial instruments carried at fair value and bases of valuation*

	Quoted market price Level 1 US\$000	Valuation techniques		Total US\$000
		Using observable inputs Level 2 US\$000	With significant unobservable inputs Level 3 US\$000	
<b>At 30 June 2014</b>				
<b>Recurring fair value measurements</b>				
<b>Assets</b>				
Trading assets .....	–	665,343	–	665,343
Derivatives .....	–	947,495	4,405	951,900
Financial investments: available-for-sale .....	–	10,679,787	138,270	10,818,057
<b>Liabilities</b>				
Trading liabilities .....	–	1,410,931	–	1,410,931
Financial liabilities designated at fair value .....	505,371	–	–	505,371
Derivatives .....	–	880,502	7,105	887,607
<b>At 31 December 2013</b>				
<b>Recurring fair value measurements</b>				
<b>Assets</b>				
Trading assets .....	–	515,374	–	515,374
Derivatives .....	–	1,133,958	1,394	1,135,352
Financial investments: available-for-sale .....	10	11,107,870	159,362	11,267,242
<b>Liabilities</b>				
Trading liabilities .....	–	1,235,000	–	1,235,000
Financial liabilities designated at fair value .....	503,448	–	–	503,448
Derivatives .....	–	1,130,156	2,680	1,132,836

**Control framework**

Fair values are subject to a control framework designed to ensure that they are either determined, or validated, by a function independent of the risk-taker. Finance establishes the accounting policies and procedures governing valuation, and is responsible for ensuring that they comply with all relevant accounting standards.

Further details of the control framework are included in the *Annual Report and Accounts 2013*.



**Notes on the Condensed Financial Statements (unaudited)** (continued)**Determination of fair value**

Fair values are determined according to the following hierarchy:

- Level 1 – *quoted market price*: financial instruments with quoted prices for identical instruments in active markets.
- Level 2 – *valuation technique using observable inputs*: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
- Level 3 – *valuation technique with significant unobservable inputs*: financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

The 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. Further details on fair values determined using valuation techniques are included in the *Annual Report and Accounts 2013*.

*Movement in Level 3 financial instruments*

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

	Assets			Liabilities
	Available-for-sale US\$000	Held for Trading US\$000	Derivatives US\$000	Derivatives US\$000
<b>2014</b>				
At 1 January.....	159,362	–	1,394	2,680
Total gains or losses recognised in profit or loss.....	–	–	3,100	4,425
Total gains or losses recognised in other comprehensive income.....	(452)	–	(89)	–
Purchases.....	–	–	–	–
Sales.....	(20,640)	–	–	–
Transfers out.....	–	–	–	–
Transfers in.....	–	–	–	–
At 30 June.....	138,270	–	4,405	7,105
Total gains/(losses) recognised in profit or loss relating to those assets and liabilities held on 30 June 2014.....	–	–	3,100	(3,131)
<b>2013</b>				
At 1 January.....	554,163	85,305	3,608	401
Total gains/(losses) recognised in profit or loss.....	(525)	(2,559)	(2,180)	2,279
Total gains/(losses) recognised in other comprehensive income.....	14,081	–	–	–
Purchases.....	180,502	–	–	–
Sales.....	(498)	–	–	–
Transfers out.....	(741,585)	(82,746)	(380)	–
Transfers in.....	153,224	–	346	–
At 31 December.....	159,362	–	1,394	2,680
Total gains/(losses) recognised in profit or loss relating to those assets and liabilities held on 31 December 2013.....	(525)	–	1,394	(2,274)

For assets and liabilities classified as held for trading, realised and unrealised gains and losses are presented in the income statement under ‘Trading income excluding net interest income’.

Realised gains and losses from available-for-sale securities are presented under ‘Gains less losses from financial investments’ in the income statement while unrealised gains and losses are presented in ‘Fair value gains/(losses) taken to equity’ within ‘Available-for-sale investments’ in other comprehensive income.

**Notes on the Condensed Financial Statements (unaudited)** (continued)**Effects of changes in significant unobservable assumptions to reasonably possible alternatives**

The fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data. The following table shows the sensitivity of fair values to reasonably possible alternative assumptions:

*Sensitivity of fair values to reasonably possible alternative assumptions*

	Reflected in profit/(loss)		Reflected in equity	
	Favourable changes US\$000	Unfavourable changes US\$000	Favourable changes US\$000	Unfavourable changes US\$000
<b>At 30 June 2014</b>				
Derivatives/trading assets/trading liabilities <sup>1</sup> .....	–	–	–	–
Financial investments: available-for-sale .....	–	–	6,902	(20,705)
<b>At 31 December 2013</b>				
Derivatives/trading assets/trading liabilities <sup>1</sup> .....	–	–	–	–
Financial investments: available-for-sale .....	–	–	5,548	(18,553)

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

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

	Reflected in profit or loss		Reflected in equity	
	Favourable changes US\$000	Unfavourable changes US\$000	Favourable changes US\$000	Unfavourable changes US\$000
<b>At 30 June 2014</b>				
Private equity investments .....	–	–	6,902	(20,705)
Other derivatives .....	–	–	–	–
Other portfolio .....	–	–	–	–
<b>At 31 December 2013</b>				
Private equity investments .....	–	–	3,484	(16,469)
Other derivatives .....	–	–	–	–
Other portfolio .....	–	–	2,064	(2,064)

Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable parameters using statistical techniques. When parameters are not amenable to statistical analysis, quantification of uncertainty is judgmental.

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

In respect of private equity investments, in many of the methodologies, the principal assumption is the valuation multiple to be applied to the main financial indicators. This may be determined with reference to multiples for comparable listed companies and includes discounts for marketability.

For other derivatives, principal assumptions concern the value to be attributed to future volatility of asset values and the future correlation between asset values.

**10 Discontinued operations***Sale of the group's banking operations in Jordan*

On 20 January 2014, the group announced an agreement to sell the group's banking operations in Jordan at the net asset value of the business on the completion date. On 19 June 2014 the group completed the disposal for total cash consideration of JOD1.8 million (approximately US\$2.6 million) which resulted in no gain or loss on disposal.

**Notes on the Condensed Financial Statements (unaudited)** (continued)**11 Contingent liabilities, contractual commitments and guarantees**

	At 30 June 2014 US\$000	At 31 December 2013 US\$000
<b>Guarantees and other contingent liabilities</b>		
Guarantees and irrevocable letters of credit pledged as collateral security .....	<b>12,461,483</b>	11,787,834
	<b>12,461,483</b>	11,787,834
<b>Commitments</b>		
Documentary credits and short-term trade-related transactions .....	<b>1,217,337</b>	1,385,937
Undrawn formal standby facilities, credit lines and other commitments to lend .....	<b>18,264,640</b>	18,079,162
	<b>19,481,977</b>	19,465,099

The above table discloses the nominal principal amounts of contingent liabilities, commitments and guarantees. They are mainly credit-related instruments which include both financial and non financial guarantees and commitments to extend credit. Nominal principal amounts represent the amounts at risk should contracts be fully drawn upon and clients default. As a significant proportion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not representative of future liquidity requirements.

**Guarantees and other commitments**

The principal types of guarantees generally provided in the normal course of the group's banking business, and other contractual commitments, are consistent with those detailed in the *Annual Report and Accounts 2013*.

**12 Segment analysis**

The factors used to identify the group's reporting segments are discussed in the *Annual Report and Accounts 2013*.

**Products and services**

The group provides a comprehensive range of banking and related financial services to its customers in its geographical regions. The products and services offered to customers are organised by customer group and global business.

- Retail Banking and Wealth Management ('RBWM') offers a broad range of products and services to meet the personal banking, consumer finance and wealth management needs of individual customers. Typical customer offerings include personal banking products (including current and savings accounts, mortgages and personal loans, credit cards, debit cards and insurance, wealth management and local and international payment services) and wealth management services (insurance and investment products and financial planning services).
- Commercial Banking ('CMB') product offerings include the provision of receivables, financing services, payments and cash management, international trade finance, treasury and capital markets, commercial cards, insurance, cash and derivatives in foreign exchange and rates, and online and direct banking offerings.
- Global Banking and Markets ('GB&M') provide tailored financial solutions to government, corporate and institutional clients. The client focused business lines deliver a full range of banking capabilities including investment banking and financing solutions; a markets business that provides services in credit, rates, foreign exchange, money markets and securities services and principal investment activities.
- Private Banking provides a range of services to high net worth individuals and families with complex and international needs.

**Notes on the Condensed Financial Statements (unaudited)** (continued)*Reconciliation of reportable segment profit for the period*

	For the half-year to 30 June 2014					
	UAE US\$000	Oman US\$000	Qatar US\$000	Rest of Middle East US\$000	Intra-group items US\$000	Total US\$000
Net interest income .....	344,293	60,123	46,356	99,379	–	550,151
Net fee income .....	186,063	16,006	34,704	52,972	–	289,745
Net trading income .....	129,969	8,918	20,706	18,476	–	178,069
Net expense from financial instruments designated at fair value .....	(4,809)	–	–	–	–	(4,809)
Gains less losses from financial investments <sup>1</sup> .....	1,539	–	–	223	–	1,762
Dividend income .....	6,494	2,150	–	102	–	8,746
Other operating income .....	55,716	1,424	2,054	2,766	(35,823)	26,137
<b>Net operating income before loan impairment charges and other credit risk provisions .....</b>	<b>719,265</b>	<b>88,621</b>	<b>103,820</b>	<b>173,918</b>	<b>(35,823)</b>	<b>1,049,801</b>
Loan impairment (charges)/recoveries and other credit risk provisions <sup>1</sup> .....	24,077	(2,224)	6,235	21,943	–	50,031
<b>Net operating income .....</b>	<b>743,342</b>	<b>86,397</b>	<b>110,055</b>	<b>195,861</b>	<b>(35,823)</b>	<b>1,099,832</b>
Employee compensation and benefits .....	(217,683)	(31,011)	(19,420)	(35,212)	–	(303,326)
General and administrative expenses .....	(142,743)	(32,062)	(23,610)	(53,211)	35,823	(215,803)
Depreciation and impairment of property, plant and equipment <sup>1</sup> .....	(4,191)	(2,626)	(1,081)	(1,878)	–	(9,776)
Amortisation of intangible assets <sup>1</sup> .....	(2,773)	(3,063)	(89)	(150)	–	(6,075)
<b>Total operating expenses .....</b>	<b>(367,390)</b>	<b>(68,762)</b>	<b>(44,200)</b>	<b>(90,451)</b>	<b>35,823</b>	<b>(534,980)</b>
<b>Operating profit .....</b>	<b>375,952</b>	<b>17,635</b>	<b>65,855</b>	<b>105,410</b>	<b>–</b>	<b>564,852</b>
Share of profit in associates .....	1,261	–	–	–	–	1,261
<b>Profit before tax .....</b>	<b>377,213</b>	<b>17,635</b>	<b>65,855</b>	<b>105,410</b>	<b>–</b>	<b>566,113</b>

<sup>1</sup> Significant non-cash item.

**Notes on the Condensed Financial Statements (unaudited)** (continued)*Reconciliation of reportable segment profit for the period (continued)*

	For the half-year to 30 June 2013					
	UAE US\$000	Oman US\$000	Qatar US\$000	Rest of Middle East US\$000	Intra- group items US\$000	Total US\$000
Net interest income .....	337,835	62,692	46,283	100,720	–	547,530
Net fee income .....	164,092	15,005	32,240	53,922	–	265,259
Net trading income .....	122,262	10,165	23,279	31,413	–	187,119
Net expense from financial instruments designated at fair value .....	(944)	–	–	–	–	(944)
Gains less losses from financial investments <sup>1</sup> .....	3,821	–	–	–	–	3,821
Dividend income .....	3,617	426	–	86	–	4,129
Other operating income .....	56,896	(2,117)	1,945	1,634	(40,010)	18,348
<b>Net operating income before loan impairment charges and other credit risk provisions .....</b>	<b>687,579</b>	<b>86,171</b>	<b>103,747</b>	<b>187,775</b>	<b>(40,010)</b>	<b>1,025,262</b>
Loan impairment (charges)/recoveries and other credit risk provisions <sup>1</sup> .....	3,760	8,913	(3,627)	18,461	–	27,507
<b>Net operating income .....</b>	<b>691,339</b>	<b>95,084</b>	<b>100,120</b>	<b>206,236</b>	<b>(40,010)</b>	<b>1,052,769</b>
Employee compensation and benefits .....	(194,656)	(26,774)	(16,739)	(31,083)	–	(269,252)
General and administrative expenses .....	(156,669)	(34,258)	(22,430)	(51,014)	40,010	(224,361)
Depreciation and impairment of property, plant and equipment <sup>1</sup> .....	(6,122)	(3,374)	(1,137)	(1,807)	–	(12,440)
Amortisation of intangible assets <sup>1</sup> .....	(3,371)	(3,044)	(84)	(129)	–	(6,628)
<b>Total operating expenses .....</b>	<b>(360,818)</b>	<b>(67,450)</b>	<b>(40,390)</b>	<b>(84,033)</b>	<b>40,010</b>	<b>(512,681)</b>
<b>Operating profit .....</b>	<b>330,521</b>	<b>27,634</b>	<b>59,730</b>	<b>122,203</b>	<b>–</b>	<b>540,088</b>
Share of profit in associates .....	242	–	–	–	–	242
<b>Profit before tax .....</b>	<b>330,763</b>	<b>27,634</b>	<b>59,730</b>	<b>122,203</b>	<b>–</b>	<b>540,330</b>

<sup>1</sup> Significant non-cash item.

**Notes on the Condensed Financial Statements (unaudited)** (continued)*Statement of financial position information*

	UAE US\$000	Oman US\$000	Qatar US\$000	Rest of Middle East US\$000	Intra-group items US\$000	Total US\$000
<b>Half-year ended 30 June 2014</b>						
Loans and advances to customers (net).....	17,378,169	2,959,400	1,915,486	3,438,224	–	25,691,279
Interest in associates .....	53,803	–	–	–	–	53,803
Total assets .....	33,161,591	6,254,806	4,981,527	7,827,358	(2,491,191)	49,734,091
Customer accounts.....	19,875,156	5,080,382	3,237,657	4,961,563	–	33,154,758
Total liabilities.....	28,048,692	5,442,350	4,966,648	7,818,533	(2,491,191)	43,785,032
<b>Year ended 31 December 2013</b>						
Loans and advances to customers (net).....	15,876,105	2,553,124	1,779,065	3,421,424	–	23,629,718
Interest in associates .....	30,642	–	–	–	–	30,642
Total assets .....	31,335,868	5,852,729	4,815,929	9,092,281	(2,669,135)	48,427,672
Customer accounts.....	18,486,377	4,638,588	2,860,983	5,329,734	–	31,315,682
Total liabilities.....	26,471,826	5,036,254	4,804,938	9,085,678	(2,669,135)	42,729,561

*Net operating income and profit before tax by global business*

	Retail Banking and Wealth Management US\$000	Commercial Banking US\$000	Global Banking and Markets US\$000	Private Banking US\$000	Other <sup>2</sup> US\$000	Inter Segment US\$000	Total US\$000
<b>Half-year ended 30 June 2014</b>							
Net operating income <sup>1</sup> .....	343,488	342,085	372,373	706	26,972	(35,823)	1,049,801
Profit before tax .....	93,797	216,259	292,731	279	(36,953)	–	566,113
<b>Half-year ended 30 June 2013</b>							
Net operating income <sup>1</sup> .....	344,574	360,199	327,142	354	33,003	(40,010)	1,025,262
Profit before tax .....	109,999	237,283	220,269	923	(28,144)	–	540,330

<sup>1</sup> Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue.

<sup>2</sup> The main items reported in the 'Other' category are certain property activities, unallocated investment activities, centrally held investment companies movements in fair value of own debt and the head office company and financing operations.

**13 Legal proceedings and regulatory matters**

The group is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions arising out of its normal business operations.

No material adverse impact on the financial position of the group is expected to arise from these proceedings.

**Regulatory and law enforcement investigations**

In October 2010, HSBC Bank USA entered into a consent cease-and-desist order with the OCC, and HNAH entered into a consent cease-and-desist order with the FRB (the 'Orders'). These Orders required improvements to establish an effective compliance risk management programme across HSBC's US businesses, including risk management related to US Bank Secrecy Act ('BSA') and anti-money laundering ('AML') compliance. Steps continue to be taken to address the requirements of the Orders to ensure compliance, and that effective policies and procedures are maintained.

## Notes on the Condensed Financial Statements (unaudited) (continued)

In addition, in December 2012, HSBC Holdings, HNAH and HSBC Bank USA entered into agreements with US and UK government agencies regarding past inadequate compliance with the BSA and AML and sanctions laws. Among those agreements, HSBC Holdings and HSBC Bank USA entered into a five-year deferred prosecution agreement with the DoJ, the US Attorney's Office for the Eastern District of New York, and the US Attorney's Office for the Northern District of West Virginia (the 'US DPA'); HSBC Holdings entered into a two-year deferred prosecution agreement with the New York County District Attorney (the 'DANY DPA'); and HSBC Holdings consented to a cease-and-desist order and HSBC Holdings and HNAH consented to a civil money penalty order with the FRB. In addition, HSBC Bank USA entered into a civil money penalty order with FinCEN and a separate civil money penalty order with the OCC. HSBC Holdings also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions and an undertaking with the UK Financial Conduct Authority ('FCA'), to comply with certain forward-looking AML- and sanctions-related obligations.

Under these agreements, HSBC Holdings and HSBC Bank USA made payments totalling US\$1.9 billion to US authorities and are continuing to comply with ongoing obligations. On 1 July 2013, the US District Court for the Eastern District of New York approved the US DPA and retained authority to oversee implementation of that agreement. Under the agreements with the DoJ, FCA, and FRB, an independent monitor (who is, for FCA purposes, a 'skilled person' under Section 166 of the Financial Services and Markets Act) will evaluate and regularly assess the effectiveness of HSBC's AML and sanctions compliance function and HSBC's progress in implementing its remedial obligations under the agreements. The monitorship, which began on 22 July 2013, is proceeding as anticipated.

If HSBC Holdings and HSBC Bank USA fulfil all of the requirements imposed by the US DPA, the DoJ charges against those entities will be dismissed at the end of the five-year period of that agreement. Similarly, if HSBC Holdings fulfils all of the requirements imposed by the DANY DPA, DANY's charges against it will be dismissed at the end of the two-year period of that agreement. The DoJ may prosecute HSBC Holdings or HSBC Bank USA in relation to the matters that are the subject of the US DPA if HSBC Holdings or HSBC Bank USA breaches the terms of the US DPA, and DANY may prosecute HSBC Holdings in relation to the matters which are subject of the DANY DPA if HSBC Holdings violates the terms of the DANY DPA.

HSBC Bank USA also entered into a separate consent order with the OCC requiring it to correct the circumstances and conditions as noted in the OCC's then most recent report of examination, and imposing certain restrictions on HSBC Bank USA directly or indirectly acquiring control of, or holding an interest in, any new financial subsidiary, or commencing a new activity in its existing financial subsidiary, unless it receives prior approval from the OCC. HSBC Bank USA also entered into a separate consent order with the OCC requiring it to adopt an enterprise-wide compliance programme.

The settlement with US and UK authorities does not preclude private litigation relating to, among other things, HSBC's compliance with applicable AML, BSA and sanctions laws or other regulatory or law enforcement actions for AML, BSA or sanctions matters not covered by the various agreements.

The bank is currently co-operating with the Jersey Financial Services Commission (the "Commission") and the appointed Reporting Professional in respect of its enquiry into the bank's adherence to Jersey anti-money laundering requirements and international sanctions legislation.

### **14 Interim Report 2014 and statutory accounts**

The information in this Interim Report 2014 is unaudited and does not constitute statutory accounts within the meaning of Article 105(1) of the Companies (Jersey) 1991, as amended. The Interim Report 2014 was approved by the Board of Directors on 4 August 2014. The statutory accounts for the year ended 31 December 2013 have been delivered to the Registrar of Companies in Jersey in accordance with Article 108 of the Companies (Jersey) 1991, as amended. The auditor has reported on those accounts. Its report was (i) unqualified; (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report; (iii) and did not contain a statement under Article 113B(3) of the Companies (Jersey) 1991, as amended.

## **Independent Review Report by KPMG Channel Islands Limited to HSBC Bank Middle East Limited**

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### **Introduction**

We have been engaged by the company to review the unaudited condensed consolidated financial statements for the six months ended 30 June 2014 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of financial position, the consolidated statement of cash flows, the consolidated statement of changes in equity and the related explanatory notes. We have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the unaudited condensed consolidated financial statements.

This report is made solely to the company in accordance with the terms of our engagement. Our review has been undertaken so that we might state to the company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company for our review work, for this report, or for the conclusions we have reached.

### **Directors' responsibilities**

The interim report is the responsibility of, and has been approved by, the directors. As disclosed in note 1, the annual consolidated financial statements of the group are prepared in accordance with International Financial Reporting Standards as endorsed by the EU. The unaudited condensed consolidated set of interim financial statements has been prepared in accordance with IAS 34 Interim Financial Reporting as endorsed by the EU.

### **Our responsibility**

Our responsibility is to express to the company a conclusion on the unaudited condensed consolidated set of financial statements in the interim report based on our review.

### **Scope of review**

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### **Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the unaudited condensed consolidated set of financial statements in the interim report for the six months ended 30 June 2014 is not prepared, in all material respects, in accordance with IAS 34 Interim Financial Reporting as endorsed by the EU.

Eric Bertrand  
for and on behalf of KPMG Channel Islands Limited  
*Chartered Accountants*  
37 Esplanade  
St Helier  
Jersey  
JE4 8WQ

4 August 2014



## **Independent Review Report by KPMG Channel Islands Limited to HSBC Bank Middle East Limited** (continued)

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Notes:

- The maintenance and integrity of the HSBC Bank Middle East Limited website is the responsibility of the directors, the work carried out by KPMG Channel Islands Limited does not involve consideration of these matters and, accordingly, KPMG Channel Islands Limited accept no responsibility for any changes that may have occurred to the condensed consolidated set of financial statements or review report since the 4 August 2014. KPMG Channel Islands Limited has carried out no procedures of any nature subsequent to 4 August 2014 which in any way extends this date.
- Legislation in Jersey governing the preparation and dissemination of condensed consolidated financial statements may differ from legislation in other jurisdictions. The directors shall remain responsible for establishing and controlling the process for doing so, and for ensuring that the condensed consolidated financial statements are complete and unaltered in any way.