

19 February 2019

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
2018 CONSOLIDATED RESULTS – HIGHLIGHTS

- Profit before tax up 16% to HK\$134,583m (HK\$115,619m in 2017)
- Attributable profit up 16% to HK\$103,013m (HK\$88,530m in 2017)
- Return on average ordinary shareholders' equity of 14.8% (13.7% in 2017)
- Total assets up 4% to HK\$8,263bn (HK\$7,943bn at 31 December 2017)
- Common equity tier 1 ratio of 16.5%, total capital ratio of 19.8% (15.9% and 18.9% at 31 December 2017)
- Cost efficiency ratio of 41.5% (43.5% in 2017)

This document is issued by The Hongkong and Shanghai Banking Corporation Limited ('the Bank') and its subsidiaries (together 'the group'). References to 'HSBC', 'the Group' or 'the HSBC Group' within this document mean HSBC Holdings plc together with its subsidiaries. Within this document the Hong Kong Special Administrative Region of the People's Republic of China is referred to as 'Hong Kong'. The abbreviations 'HK\$m' and 'HK\$bn' represent millions and billions (thousands of millions) of Hong Kong dollars respectively.



Comment by John Flint, Chairman

The Hongkong and Shanghai Banking Corporation Limited had another successful year in service of our shareholders and customers.

We have accelerated growth in Asia and from our international network. Our investment in technology continues to improve the service we offer to customers. A majority of customer stock trades are now completed via digital channels, and usage of our mobile banking apps continues to grow among both our retail and business customers. We have also launched new products and made strategic hires in mainland China and Hong Kong that are improving our ability to serve both international and domestic clients.

These achievements, and the work that preceded them, were important factors in delivering a strong financial performance. Profit before tax of HK\$134,583m in 2018 was up HK\$18,964m, or 16%, compared with the previous year. Net operating income before credit charges increased by 13% on the back of strong performances across our global businesses.

We grew loans and advances to customers by 6%, largely in Hong Kong, India and Australia, with growth in all global businesses. Customer deposits increased by 1%, and our advances-to-deposits ratio stood at 67.8% at the end of December 2018.

Business performance

Retail Banking and Wealth Management ('RBWM') had a very good year. Improved deposit spreads and good growth in our wealth distribution business were the main factors behind the 13% increase in net operating income before credit charges. We grew market share in the Hong Kong mortgage market, further cementing our leadership position. We also won new business in insurance. Our investment in technology continued to improve the service we offer to customers. The number of customers using our mobile banking app and PayMe, our social payments app, continued to grow, with PayMe now processing more than 3 million payments per month. We also launched HSBC Reward+, a dedicated mobile app for our credit card holders to discover promotional offers and manage their card transactions. These are important initiatives to help maintain our competitive market position.

Commercial Banking ('CMB') had an excellent 2018, delivering an 18% increase in net operating income before credit charges. We generated good growth in our scale markets and from our international network, particularly in Hong Kong, mainland China, Singapore, Australia and Malaysia. Despite the challenging environment for global trade, we grew market share in trade finance in Hong Kong and Singapore, and were rated 'Best Trade Finance Bank' in the *Euromoney Trade Finance Survey* in a number of markets. We also developed and deployed new technology to make our services faster, safer and simpler to use. Our new mobile app, 'Business Express', uses biometric log-in and allows customers to access a suite of new tools. In trade finance, we successfully completed the first batch of live pilot trade finance transactions on the eTradeConnect platform, which uses blockchain technology to digitise and automate trade finance processes and significantly reduce application-to-approval times. We also launched a new business internet banking platform, drawing on big data analytics to help business customers make better decisions. A new payments app, 'PayMe for Business', will be launched in early 2019, enabling small businesses to collect customer payments instantly via mobile.

In Global Banking and Markets ('GB&M'), we grew net operating income before credit charges by 13%, driven by strong growth in Global Liquidity and Cash Management and Securities Services. We continued to build our new majority-owned securities joint venture in mainland China, HSBC Qianhai Securities Limited, during its first full year of operation. We also consolidated our position as a leader in sustainable financing, playing an important role in the issuance of the Republic of Indonesia's first Sukuk green bond and winning the award for 'Asia's Best Bank for Sustainable Finance' at the *Euromoney Awards For Excellence*. We were ranked as the 'Best Belt and Road Bank' at the *Finance Asia Achievement Awards*, and 'Best Overall for RMB Products and Services' in *Asiamoney's* Global RMB Poll for 2018.

Our Global Private Banking business increased net operating income before credit charges by 30%, mainly driven by an increase in net interest income on the back of interest rate rises. We were voted 'Best Private Bank in Hong Kong' by both *FinanceAsia* and *Professional Wealth Management*.

Operating expenses increased by 8% as we continued to invest in staff, infrastructure and marketing to support business growth. Our 2018 cost efficiency ratio improved from 43.5% in 2017 to 41.5% in spite of this extra investment.

Change in expected credit losses and other impairment charges remained low in relation to customer advances, amounting to HK \$4,720m, compared with loan impairment charges of HK\$4,437m in 2017. The increase of 6% was broadly in line with the rate of growth in customer advances.

Our capital position remains strong, with a common equity tier 1 ratio of 16.5% at the end of the year.

2019

Despite more challenging market conditions at the end of 2018 and a weaker global outlook for 2019, we are optimistic about Asian growth.

The structural and financial reforms being pursued across the region should continue to support growth and development, while the region remains at the vanguard of efforts to liberalise trade at a time when barriers are increasing in other parts of the world. Despite weaker economic data at the start of the year, we expect China to maintain strong growth and accelerate the pace of structural and financial reform in response to changing external conditions. This will benefit both domestic and international investors. The region is also home to some of world's largest growth initiatives, in particular the growth of the ASEAN region, economic integration in the Guangdong-Hong Kong-Macau Greater Bay Area, the internationalisation of the renminbi, and the provision of sustainable finance.

HSBC's international network and access to high-growth markets put us in a unique position to capitalise on these developments in the service of our customers. Our focus is on helping them capture the many growth opportunities that exist, while also navigating the risks and uncertainty inherent in today's world.

We look forward to continuing to do that in 2019 and beyond.

Consolidated income statement by global business

	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Corporate Centre ¹	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Year ended 31 Dec 2018						
Net interest income	62,829	39,004	22,590	2,683	(643)	126,463
Net fee income	21,087	10,598	9,794	2,650	102	44,231
Net income/(expense) from financial instruments measured at fair value	(3,731)	2,694	18,283	800	7,919	25,965
Gains less losses from financial investments	109	(34)	104	—	322	501
Dividend income	—	—	—	—	164	164
Net insurance premium income/(expense)	57,301	3,441	—	—	(64)	60,678
Other operating income	5,851	508	737	110	3,100	10,306
Total operating income	143,446	56,211	51,508	6,243	10,900	268,308
Net insurance claims and benefits paid and movement in liabilities to policyholders	(54,539)	(3,300)	—	—	—	(57,839)
Net operating income before change in expected credit losses and other credit impairment charges	88,907	52,911	51,508	6,243	10,900	210,469
Change in expected credit losses and other credit impairment charges	(2,019)	(2,315)	(394)	(13)	21	(4,720)
Net operating income	86,888	50,596	51,114	6,230	10,921	205,749
Operating expenses	(38,946)	(17,878)	(21,807)	(3,479)	(5,314)	(87,424)
Operating profit	47,942	32,718	29,307	2,751	5,607	118,325
Share of profit in associates and joint ventures	247	—	—	—	16,011	16,258
Profit before tax	48,189	32,718	29,307	2,751	21,618	134,583
Balance at 31 Dec 2018						
Net loans and advances to customers	1,146,689	1,223,999	1,035,629	120,985	1,400	3,528,702
Customer accounts	2,750,104	1,306,775	949,812	196,413	4,562	5,207,666
Year ended 31 Dec 2017						
Net interest income	50,789	31,237	19,147	1,868	7,196	110,237
Net fee income	20,695	10,443	9,936	1,916	160	43,150
Net income/(expense) from financial instruments measured at fair value	17,959	2,560	16,180	963	928	38,590
Gains less losses from financial investments	149	64	1	—	1,894	2,108
Dividend income	36	1	—	—	195	232
Net insurance premium income/(expense)	53,275	2,933	—	—	(32)	56,176
Other operating income	1,488	336	189	51	2,676	4,740
Total operating income	144,391	47,574	45,453	4,798	13,017	255,233
Net insurance claims and benefits paid and movement in liabilities to policyholders	(65,941)	(2,849)	—	—	—	(68,790)
Net operating income before loan impairment charges and other credit risk provisions	78,450	44,725	45,453	4,798	13,017	186,443
Loan impairment (charges)/releases and other credit risk provisions	(1,907)	(2,157)	(451)	(2)	80	(4,437)
Net operating income	76,543	42,568	45,002	4,796	13,097	182,006
Operating expenses	(34,807)	(16,115)	(20,653)	(2,679)	(6,813)	(81,067)
Operating profit	41,736	26,453	24,349	2,117	6,284	100,939
Share of profit in associates and joint ventures	86	—	—	—	14,594	14,680
Profit before tax	41,822	26,453	24,349	2,117	20,878	115,619
Balance at 31 Dec 2017						
Net loans and advances to customers	1,049,006	1,143,241	1,004,350	115,064	17,319	3,328,980
Customer accounts	2,701,399	1,311,873	905,991	187,825	31,184	5,138,272

¹ Includes inter-segment elimination.

Results Commentary

The group reported profit before tax of HK\$134,583m, an increase of 16% compared with 2017, driven by higher net interest income.

Net interest income increased by HK\$16,226m, or 15%, compared with 2017, driven by Hong Kong from improved deposit spreads, mainly in RBWM and CMB, which benefited from interest rate rises, coupled with balance sheet growth, primarily in loans and advances to customers, partly offset by compressed lending spreads. Net interest income also increased in mainland China mainly from growth in loans to customers and improved yields.

Net fee income increased by HK\$1,081m, or 3%, compared with 2017, mainly in Hong Kong from securities brokerage, unit trust and global custody due to higher turnover, coupled with higher mandatory provident fund and credit cards fee income, partly offset by lower underwriting and remittance fees. Fee income in mainland China also increased, mainly from unit trust, underwriting, trade-related fees, credit facilities and credit cards.

Net income from financial instruments measured at fair value decreased by HK\$12,625m, or 33%, compared with 2017, driven by lower insurance income, mainly in Hong Kong due to revaluation losses on the equity portfolio from the unfavourable equity market performance in 2018, as compared to revaluation gains in 2017. To the extent that revaluation is attributable to policyholders, there is an offsetting movement reported under 'Net insurance claims and benefits paid and movement in liabilities to policyholders'. The decrease was partly offset by higher trading income in Hong Kong, mainly from increased holdings of trading debt securities, higher structured equities revenue and revaluation gains on funding swaps. Trading income in mainland China also increased due to a favourable effect from translation of balance sheet exposures and higher income from debt securities trading.

Gains less losses from financial investments decreased by HK\$1,607m, or 76%, compared with 2017, mainly in Hong Kong from the non-recurrence of the gain on disposal of our investment in Vietnam Technological and Commercial Joint Stock Bank ('TechCom Bank') in 2017.

Net insurance premium income increased by HK\$4,502m, or 8%, compared with 2017, driven by the non-recurrence of a major reinsurance arrangement in 2017, coupled with higher premium from new business sales and higher renewals. This was largely offset by a corresponding movement in 'Net insurance claims and benefits paid and movement in liabilities to policyholders'.

Other operating income increased by HK\$5,566m, or 117%, compared with 2017, primarily driven by the favourable movement in the present value of in-force long-term insurance business ('PVIF'), mainly in Hong Kong from higher new business sales, the future sharing of lower investment returns with policyholders, and favourable actuarial and interest rate assumption updates in 2018. In addition, the non-recurrence of regulatory driven changes in actuarial assumptions in Singapore in 2017 also contributed to the overall favourable movement in PVIF in the year. The change in PVIF was partly offset by a corresponding movement in 'Net insurance claims and benefits paid and movement in liabilities to policyholders'.

Net insurance claims and benefits paid and movement in liabilities to policyholders decreased by HK\$10,951m, or 16%, compared with 2017, reflecting lower investment returns to policyholders due to the unfavourable equity market performance in 2018 as compared with the favourable equity market performance in 2017, partly offset by the non-recurrence of the large reinsurance arrangement in prior year, coupled with higher premium income and the favourable movement in PVIF in 2018.

Change in expected credit losses and other credit impairment charges (under HKFRS 9) amounted to HK\$4,720m for the year ended 2018, mainly from Hong Kong and mainland China in CMB and RBWM, and to a lesser extent Indonesia in CMB and Malaysia in GB&M.

Loan impairment charges and other credit risk provisions in 2017 (under HKAS 39) amounted to HK\$4,437m, mainly from Hong Kong in CMB and RBWM, and to a lesser extent Indonesia and mainland China mainly in CMB.

Total operating expenses increased by HK\$6,357m, or 8%, compared with 2017, driven by higher IT-related and staff costs from investments to support digital and business growth initiatives.

Share of profit in associates and joint ventures increased by HK\$1,578m, or 11%, compared with 2017, mainly from our share of higher profits from Bank of Communications Co., Limited, coupled with a favourable effect of foreign exchange translation.

Consolidated income statement
for the year ended 31 December

	2018 HK\$m	2017 HK\$m
Net interest income	126,463	110,237
– interest income	170,065	138,081
– interest expense	(43,602)	(27,844)
Net fee income	44,231	43,150
– fee income	54,585	52,312
– fee expense	(10,354)	(9,162)
Net income from financial instruments held for trading or managed on a fair value basis	31,723	23,098
Net income/(expense) from assets and liabilities of insurance businesses, including related derivatives, measured at fair value through profit or loss	(5,561)	15,607
Changes in fair value of long-term debt issued and related derivatives	20	(115)
Changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss	(217)	N/A
Gains less losses from financial investments	501	2,108
Dividend income	164	232
Net insurance premium income	60,678	56,176
Other operating income	10,306	4,740
Total operating income	268,308	255,233
Net insurance claims and benefits paid and movement in liabilities to policyholders	(57,839)	(68,790)
Net operating income before change in expected credit losses and other credit impairment charges	210,469	186,443
Change in expected credit losses and other credit impairment charges	(4,720)	N/A
Loan impairment charges and other credit risk provisions	N/A	(4,437)
Net operating income	205,749	182,006
Employee compensation and benefits	(40,793)	(40,095)
General and administrative expenses	(39,989)	(34,786)
Depreciation and impairment of property, plant and equipment	(4,686)	(4,650)
Amortisation and impairment of intangible assets	(1,956)	(1,536)
Total operating expenses	(87,424)	(81,067)
Operating profit	118,325	100,939
Share of profit in associates and joint ventures	16,258	14,680
Profit before tax	134,583	115,619
Tax expense	(22,467)	(19,601)
Profit for the year	112,116	96,018
Profit attributable to shareholders of the parent company	103,013	88,530
Profit attributable to non-controlling interests	9,103	7,488

Consolidated statement of comprehensive income

for the year ended 31 December

	2018 HK\$m	2017 HK\$m
Profit for the year	112,116	96,018
Other comprehensive income/(expense)		
Items that will be reclassified subsequently to profit or loss when specific conditions are met:		
Available-for-sale investments	N/A	1,609
– fair value gains	N/A	3,346
– fair value gains reclassified to the income statement	N/A	(1,667)
– amounts reclassified to the income statement in respect of impairment losses	N/A	5
– income taxes	N/A	(75)
Debt instruments at fair value through other comprehensive income	826	N/A
– fair value gains	908	N/A
– fair value losses transferred to the income statement on disposal	142	N/A
– expected credit losses recognised in the income statement	(9)	N/A
– income taxes	(215)	N/A
Cash flow hedges	131	607
– fair value gains/(losses)	1,264	(6,780)
– fair value (gains)/losses reclassified to the income statement	(1,125)	7,506
– income taxes	(8)	(119)
Share of other comprehensive expense of associates and joint ventures	(146)	(852)
Exchange differences	(18,098)	25,387
Items that will not be reclassified subsequently to profit or loss:		
Property revaluation	8,826	8,864
– fair value gains	10,626	10,442
– income taxes	(1,800)	(1,578)
Equity instruments measured at fair value through other comprehensive income	(581)	N/A
– fair value losses	(576)	N/A
– income taxes	(5)	N/A
Changes in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	(199)	(209)
– before income taxes	(241)	(250)
– income taxes	42	41
Remeasurement of defined benefit asset/liability	(910)	1,371
– before income taxes	(1,091)	1,640
– income taxes	181	(269)
Other comprehensive income for the year, net of tax	(10,151)	36,777
Total comprehensive income for the year	101,965	132,795
Attributable to:		
– shareholders of the parent company	92,796	123,739
– non-controlling interests	9,169	9,056
Total comprehensive income for the year	101,965	132,795

Consolidated balance sheet

at 31 December

	2018 HK\$m	2017 HK\$m
Assets		
Cash and sight balances at central banks	205,660	208,073
Items in the course of collection from other banks	25,380	25,714
Hong Kong Government certificates of indebtedness	280,854	267,174
Trading assets	558,838	496,434
Derivatives	292,869	300,243
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	132,859	N/A
Financial assets designated at fair value	N/A	122,646
Reverse repurchase agreements – non-trading	406,327	330,890
Placings with and advances to banks	338,151	433,005
Loans and advances to customers	3,528,702	3,328,980
Financial investments	1,871,026	1,720,873
Amounts due from Group companies	70,455	227,729
Interests in associates and joint ventures	142,885	144,717
Goodwill and intangible assets	65,104	59,865
Property, plant and equipment	112,080	116,336
Deferred tax assets	2,315	2,156
Prepayments, accrued income and other assets	229,949	158,511
Total assets	8,263,454	7,943,346
Liabilities		
Hong Kong currency notes in circulation	280,854	267,174
Items in the course of transmission to other banks	33,806	38,283
Repurchase agreements – non-trading	70,279	47,170
Deposits by banks	164,664	201,697
Customer accounts	5,207,666	5,138,272
Trading liabilities	81,194	231,365
Derivatives	295,553	309,353
Financial liabilities designated at fair value	161,143	49,278
Debt securities in issue	58,236	38,394
Retirement benefit liabilities	3,369	2,222
Amounts due to Group companies	396,487	265,688
Accruals and deferred income, other liabilities and provisions	196,665	110,687
Liabilities under insurance contracts	468,589	438,017
Current tax liabilities	3,337	3,242
Deferred tax liabilities	24,513	24,391
Subordinated liabilities	4,081	4,090
Preference shares	98	21,037
Total liabilities	7,450,534	7,190,360
Equity		
Share capital	172,335	151,360
Other equity instruments	35,879	14,737
Other reserves	114,949	123,417
Retained earnings	429,595	406,966
Total shareholders' equity	752,758	696,480
Non-controlling interests	60,162	56,506
Total equity	812,920	752,986
Total equity and liabilities	8,263,454	7,943,346

Consolidated statement of changes in equity

for the year ended 31 December

	Other reserves										
	Share capital	Other equity instruments	Retained earnings	Property revaluation reserve	Financial assets at FVOCI reserve ⁷	Cash flow hedge reserve	Foreign exchange reserve	Other ¹	Total shareholders' equity	Non-controlling interests	Total equity
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
At 31 Dec 2017	151,360	14,737	406,966	58,381	6,825	(197)	(6,948)	65,356	696,480	56,506	752,986
Impact on transition to HKFRS 9	–	–	(7,478)	–	(4,512)	–	–	–	(11,990)	(323)	(12,313)
At 1 Jan 2018	151,360	14,737	399,488	58,381	2,313	(197)	(6,948)	65,356	684,490	56,183	740,673
Profit for the year	–	–	103,013	–	–	–	–	–	103,013	9,103	112,116
Other comprehensive income/(expense) (net of tax)	–	–	(890)	8,050	228	98	(17,701)	(2)	(10,217)	66	(10,151)
– debt instruments at fair value through other comprehensive income	–	–	–	–	734	–	–	–	734	92	826
– equity instruments designated at fair value through other comprehensive income	–	–	–	–	(367)	–	–	–	(367)	(214)	(581)
– cash flow hedges	–	–	–	–	–	98	–	–	98	33	131
– changes in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	–	–	(197)	–	–	–	–	–	(197)	(2)	(199)
– property revaluation	–	–	–	8,050	–	–	–	–	8,050	776	8,826
– remeasurement of defined benefit asset/liability	–	–	(688)	–	–	–	–	–	(688)	(222)	(910)
– share of other comprehensive expense of associates and joint ventures	–	–	(5)	–	(139)	–	–	(2)	(146)	–	(146)
– exchange differences	–	–	–	–	–	–	(17,701)	–	(17,701)	(397)	(18,098)
Total comprehensive income/(expense) for the year	–	–	102,123	8,050	228	98	(17,701)	(2)	92,796	9,169	101,965
Other equity instruments issued ²	–	21,142	–	–	–	–	–	–	21,142	–	21,142
Dividends paid ³	–	–	(47,440)	–	–	–	–	–	(47,440)	(5,068)	(52,508)
Movement in respect of share-based payment arrangements	–	–	(234)	–	–	–	–	246	12	10	22
Transfers and other movements ^{4,5,6}	20,975	–	(24,342)	(8,517)	412	–	–	13,230	1,758	(132)	1,626
At 31 Dec 2018	172,335	35,879	429,595	57,914	2,953	(99)	(24,649)	78,830	752,758	60,162	812,920
At 1 Jan 2017	114,359	14,737	413,024	53,763	6,189	(793)	(31,861)	58,588	628,006	51,130	679,136
Profit for the year	–	–	88,530	–	–	–	–	–	88,530	7,488	96,018
Other comprehensive income/(expense) (net of tax)	–	–	976	8,144	636	596	24,913	(56)	35,209	1,568	36,777
– available-for-sale investments	–	–	–	–	1,422	–	–	–	1,422	187	1,609
– cash flow hedges	–	–	–	–	–	596	–	–	596	11	607
– changes in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	–	–	(207)	–	–	–	–	–	(207)	(2)	(209)
– property revaluation	–	–	–	8,144	–	–	–	–	8,144	720	8,864
– remeasurement of defined benefit asset/liability	–	–	1,193	–	–	–	–	–	1,193	178	1,371
– share of other comprehensive expense of associates and joint ventures	–	–	(10)	–	(786)	–	–	(56)	(852)	–	(852)
– exchange differences	–	–	–	–	–	–	24,913	–	24,913	474	25,387
Total comprehensive income/(expense) for the year	–	–	89,506	8,144	636	596	24,913	(56)	123,739	9,056	132,795
Shares issued	1,744	–	–	–	–	–	–	–	1,744	–	1,744
Dividends paid ³	–	–	(56,260)	–	–	–	–	–	(56,260)	(4,632)	(60,892)
Movement in respect of share-based payment arrangements	–	–	(73)	–	–	–	–	(324)	(397)	(9)	(406)
Transfers and other movements ^{4,5,6}	35,257	–	(39,231)	(3,526)	–	–	–	7,148	(352)	961	609
At 31 Dec 2017	151,360	14,737	406,966	58,381	6,825	(197)	(6,948)	65,356	696,480	56,506	752,986

¹ The other reserves mainly comprise share of associates' other reserves, purchase premium arising from transfer of business from fellow subsidiaries, property revaluation reserve relating to transfer of properties to a fellow subsidiary and the share-based payment reserve. The share-based payment reserve is used to record the amount relating to share awards and options granted to employees of the group directly by HSBC Holdings plc.

² In 2018, there were US\$2,700m additional tier 1 capital instruments issued.

³ Including distributions paid on perpetual subordinated loans classified as equity under HKFRS.

⁴ Ordinary share capital includes preference shares which have been redeemed or bought back via a payment out of distributable profits. In 2018, the Bank redeemed HK\$20,975m (2017: HK\$35,257m) of preference shares.

⁵ The movement from retained earnings to other reserves includes the relevant transfers in associates according to local regulatory requirements.

⁶ The movement from property revaluation reserve to other reserves in 2018 included HK\$7,169m (2017: HK\$2,100m) relating to transfer of properties to a fellow subsidiary as part of the Recovery and Resolution Plan as set out in the Report of Directors in the Annual Report and Accounts 2018.

⁷ The balance at 31 December 2017 represents the HKAS 39 Available-for-sale fair value reserve as at 31 December 2017.

1 Net interest income

	2018 HK\$m	2017 HK\$m
Net interest income	126,463	110,237
Average interest-earning assets	6,151,920	5,850,010
	%	%
Net interest spread	1.93	1.80
Contribution from net free funds	0.13	0.08
Net interest margin	2.06	1.88

Net interest income ('NII') increased by HK\$16,226m, or 15% compared with 2017, driven by Hong Kong from improved customer deposit spreads and balance sheet growth mainly in loans and advances to customers, coupled with higher yields on financial investments which benefited from interest rate rises. These increases were partly offset by compressed lending spreads, increases in financial liabilities to meet the 'Total Loss Absorbing Capacity' regulatory requirement, coupled with the impact of re-pricing on these financial liabilities as market interest rates increased. NII also increased in mainland China from balance sheet growth and improved yields, partly offset by higher cost of funds on debt securities issued to support business growth. To a lesser extent, NII also increased in Singapore and Malaysia from improved yields and balance sheet growth.

Average interest-earning assets increased by HK\$302bn, or 5%, compared with 2017, driven by Hong Kong primarily due to an increase in loans and advances to customers, notably in corporate term lending and mortgages. To a lesser extent, increases were also noted in mainland China, Australia, Singapore, Taiwan and Malaysia, mainly from growth in loans and advances to customers.

Net interest margin increased by 18 basis points compared with 2017, driven by Hong Kong and mainland China.

In **Hong Kong**, the net interest margin for the Bank increased by 25 basis points, mainly due to improved customer deposit spreads and a change in asset portfolio mix due to growth in customer lending, coupled with higher re-investment yields on financial investments following interest rate increases. These increases were partly offset by compressed lending spreads and increases in financial liabilities to meet the 'Total Loss Absorbing Capacity' regulatory requirement, coupled with the impact of re-pricing on these financial liabilities as market interest rates increased.

At **Hang Seng Bank**, the net interest margin increased by 25 basis points, mainly from improved customer deposit spreads and a change in asset portfolio mix due to growth in customer lending, coupled with higher re-investment yields on financial investments following interest rate increases, partly offset by compressed lending spreads.

In mainland China, the increase in net interest margin was driven by higher yield from portfolio mix changes due to growth in customer lending, improved lending spreads and customer deposit spreads, coupled with an increase in contribution from net free funds, partly offset by higher cost of funds from increased funding to support business growth.

2 Net fee income

	2018 HK\$m	2017 HK\$m
Account services	2,808	2,863
Funds under management	7,506	7,000
Cards	8,414	7,622
Credit facilities	3,180	2,886
Broking income	4,679	4,386
Imports/exports	3,632	3,627
Unit trusts	7,107	6,987
Underwriting	1,112	1,477
Remittances	3,138	3,316
Global custody	3,866	3,626
Insurance agency commission ¹	1,741	1,528
Other	7,402	6,994
Fee income	54,585	52,312
Fee expense	(10,354)	(9,162)
Net fee income	44,231	43,150

¹ Re-insurance fees (previously reported under 'insurance agency commission') were reclassified under 'Other' to align with the Group's presentation. Comparatives have been represented to conform to the current year's presentation.

3 Net income from financial instruments measured at fair value

	2018 HK\$m	2017 HK\$m
Net income/(expense) arising on:		
Trading activities	32,567	23,432
Gain on termination of hedges	–	38
Other trading income - hedging ineffectiveness	(122)	(14)
– on cash flow hedges	–	1
– on fair value hedges	(122)	(15)
Fair value movement on non-qualifying hedges	(209)	(246)
Other instruments designated at fair value and related derivatives ¹	(513)	(112)
Net income from financial instruments held for trading or managed on a fair value basis	31,723	23,098
Financial assets held to meet liabilities under insurance and investment contracts	(6,104)	18,162
Liabilities to customers under investment contracts	543	(2,555)
Net income/(expense) from assets and liabilities of insurance businesses, including related derivatives, measured at fair value through profit or loss¹	(5,561)	15,607
Changes in fair value of long-term debt issued and related derivatives	20	(115)
Changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss	(217)	N/A
Year ended 31 Dec	25,965	38,590

¹ The presentation has been updated to show the net income/(expense) from assets and liabilities backing insurance and investment contracts separately. Comparatives have been represented to conform to the current year's presentation.

4 Gains less losses from financial investments

	2018 HK\$m	2017 HK\$m
Gains on disposal of debt instruments measured at fair value through other comprehensive income	501	N/A
Gains on disposal of available-for-sale securities	N/A	2,113
Impairment of available-for-sale equity investments	N/A	(5)
Year ended 31 Dec	501	2,108

The decrease in gains on disposal of financial investments was mainly due to the non-recurrence of disposal of the investment in TechCom Bank in 2017.

5 Other operating income

	2018 HK\$m	2017 HK\$m
Movement in present value of in-force insurance business	4,629	305
Gains on investment properties	639	416
Gains/(losses) on disposal of property, plant and equipment and assets held for sale	(69)	77
Gains/(losses) on disposal of subsidiaries, associates and business portfolios	38	(186)
Rental income from investment properties	416	426
Other	4,653	3,702
Year ended 31 Dec	10,306	4,740

6 Insurance business

Summary income statement of insurance manufacturing operations

	2018 HK\$m	2017 HK\$m
Insurance manufacturing operations		
Net interest income	13,650	12,571
Net fee expense	(3,162)	(2,487)
Net income/(expense) from financial instruments measured at fair value	(6,279)	15,475
Net insurance premium income	60,713	56,176
Change in present value of in-force long-term insurance business	4,629	305
Other operating income	529	470
Total operating income	70,080	82,510
Net insurance claims and benefits paid and movement in liabilities to policyholders	(57,839)	(68,790)
Net operating income before change in expected credit losses and other credit impairment charges	12,241	13,720
Change in expected credit losses and other credit impairment charges	1	—
Net operating income	12,242	13,720
Total operating expenses	(2,217)	(1,967)
Operating profit	10,025	11,753
Share of profit in associates and joint ventures	246	86
Profit before tax	10,271	11,839
Distribution income earned by banking operations ¹	5,726	5,301

¹ Distribution income earned by banking operations are presented separately. Comparatives have been represented accordingly.

Profit before tax from the insurance manufacturing business decreased by HK\$1,568m, or 13%, driven by the unfavourable equity market performance in 2018 compared to the favourable equity market performance in 2017.

Net interest income increased by 9% from growth in insurance fund size, reflecting net inflows from new and renewal of life insurance premiums.

Net income from financial instruments measured at fair value decreased due to revaluation losses on the equity portfolio supporting insurance contracts from unfavourable equity market performance in 2018, compared to revaluation gains in 2017.

Net insurance premium income increased, mainly in Hong Kong due to the non-recurrence of a major reinsurance arrangement entered into in 2017, coupled with higher new business sales and renewals.

The favourable movement in the present value of in-force long-term insurance business ('PVIF') was driven by Hong Kong, from the future sharing of lower investment returns with policyholders, higher new business sales, and favourable actuarial and interest rate assumption updates in 2018. In addition, the non-recurrence of regulatory driven changes in actuarial assumptions in Singapore in 2017 also contributed to the overall favourable movement in PVIF in the year, although this was partly offset by the impact from higher lapse rate experience in 2018.

To the extent that the above gains or losses are attributable to policyholders, there is an offsetting movement reported under 'Net insurance claims and benefits paid and movement in liabilities to policyholders.'

7 Change in expected credit losses and other credit impairment charges

	2018 HK\$m	2017 HK\$m
Change in expected credit losses/Loan impairment charges		
Loans and advances to banks and customers	4,611	4,330
– new allowances net of allowance releases	5,551	5,224
– recoveries of amounts previously written off	(940)	(894)
Loan commitments and guarantees	123	107
Other financial assets	(14)	—
Year ended 31 Dec	4,720	4,437

Change in expected credit losses as a percentage of average gross customer advances was 0.13% for 2018 (2017: 0.14%)

8 Employee compensation and benefits

	2018 HK\$m	2017 HK\$m
Wages and salaries	36,972	36,485
Social security costs	1,249	1,110
Retirement benefit costs	2,572	2,500
Year ended 31 Dec	40,793	40,095

Employee compensation and benefits increased by HK\$698m mainly due to wage inflation, higher performance-related pay and increase in average headcount, notably in Hong Kong and mainland China to support business growth.

9 General and administrative expenses

	2018 HK\$m	2017 HK\$m
Premises and equipment	8,208	7,814
– rental expenses	4,134	3,717
– other premises and equipment expenses	4,074	4,097
Marketing and advertising expenses	2,940	2,785
Other administrative expenses	28,841	24,187
Year ended 31 Dec	39,989	34,786

Other administrative expenses increased by HK\$4,654m compared with 2017, driven by higher IT-related costs and investment to support digital and business growth initiatives.

10 Associates and joint ventures

At 31 December 2018, we performed an impairment review of our investment in Bank of Communications Co., Ltd ('BoCom') and concluded that it was not impaired, based on our value-in-use calculation (see note on 'Associates and Joint Ventures' in the *Annual Report and Accounts 2018* for further details). As discussed in that note, in future periods the value in use may increase or decrease depending on the effect of changes to model inputs. It is expected that the carrying amount will increase due to retained profits earned by BoCom. At the point where the carrying amount exceeds the value in use, impairment would be recognised. The group would continue to recognise its share of BoCom's profit or loss, but the carrying amount would be reduced to equal the value in use, with a corresponding reduction in income. An impairment review would continue to be performed at each subsequent reporting period, with the carrying amount and income adjusted accordingly.

11 Tax expense

	2018 HK\$m	2017 HK\$m
Current tax		
– Hong Kong taxation	12,144	10,486
– overseas taxation	8,269	8,315
Deferred tax	2,054	800
Year ended 31 Dec	22,467	19,601
Effective tax rate	16.7%	16.9%

12 Dividends

Dividends to ordinary shareholders of the parent company

	2018		2017	
	HK\$ per share	HK\$m	HK\$ per share	HK\$m
Dividends paid on ordinary shares				
In respect of previous year:				
– fourth interim dividend in respect of the previous financial year approved and paid during the year	0.36	16,559	0.56	25,438
In respect of current year:				
– first interim dividend paid	0.22	10,000	0.22	10,000
– second interim dividend paid	0.22	10,000	0.22	10,000
– third interim dividend paid	0.22	10,000	0.22	10,000
Total	1.02	46,559	1.22	55,438

The Directors have declared a fourth interim dividend in respect of the financial year ended 31 December 2018 of HK\$0.47 per ordinary share (HK\$21,958m) (2017: HK\$0.36 per ordinary share (HK\$16,559m)).

Distributions on other equity instruments

	2018 HK\$m	2017 HK\$m
Floating rate perpetual subordinated loans (interest rate at one year US dollar LIBOR plus 3.84%)	881	822

13 Loans and advances to customers

The following table provides an analysis of loans and advances to customers by industry sector.

Analysis of gross loans and advances to customers

	2018 HK\$m	2017 HK\$m
Residential mortgages	937,666	855,788
Credit card advances	93,200	89,368
Other personal	236,133	230,119
Total personal	1,266,999	1,175,275
Real estate	626,120	563,921
Wholesale and retail trade	433,734	460,347
Manufacturing	424,813	411,225
Transportation and storage	95,773	95,834
Other	484,186	429,800
Total corporate and commercial¹	2,064,626	1,961,127
Non-bank financial institutions	213,633	205,623
Gross loans and advances to customers	3,545,258	3,342,025
Expected credit loss allowances / impairment allowances	(16,556)	(13,045)
Net loans and advances to customers	3,528,702	3,328,980
Gross loans and advances to customers by geography²:		
Hong Kong	2,282,909	2,107,700
Rest of Asia Pacific	1,262,349	1,234,325

1 With effect from 2018, the industry sector is based on Statistical Classification of economic activities in the European Community ('NACE'). Comparatives figures have been represented to conform to the current year presentation.

2 The geographical information shown above has been classified by the location of the principal operations of the subsidiary and by the location of the branch responsible for advancing the funds.

Gross loans and advances to customers increased by HK\$203bn, or 6%, including adverse foreign currency translation effects of HK\$53bn. Excluding this, the underlying increase of HK\$256bn was driven by corporate and commercial lending of HK\$133bn and residential mortgages of HK\$98bn, mainly in Hong Kong and Australia.

14 Financial investments

	2018 HK\$m	2017 HK\$m
Financial investments measured at fair value through other comprehensive income	1,503,625	N/A
– treasury and other eligible bills	660,871	N/A
– debt securities	836,896	N/A
– equity shares	5,858	N/A
Debt instruments measured at amortised cost	367,401	N/A
– treasury and other eligible bills	3,624	N/A
– debt securities	363,777	N/A
Available-for-sale securities at fair value	N/A	1,419,930
– treasury and other eligible bills	N/A	539,014
– debt securities	N/A	871,641
– equity shares	N/A	9,275
Held-to-maturity securities at amortised cost	N/A	300,943
– treasury and other eligible bills	N/A	699
– debt securities	N/A	300,244
At 31 Dec	1,871,026	1,720,873

15 Prepayments, accrued income and other assets

	2018 HK\$m	2017 HK\$m
Prepayments and accrued income	27,897	24,541
Bullion	50,058	44,555
Acceptances and endorsements	44,401	36,720
Reinsurers' share of liabilities under insurance contracts	17,792	15,734
Current tax assets	1,517	2,485
Settlement accounts ^{1,2}	23,683	N/A
Cash collateral and margin receivables ^{1,2}	30,378	N/A
Other assets	34,223	34,476
At 31 Dec^{1,2}	229,949	158,511

¹ Settlement accounts were reclassified from 'Trading assets' to 'Other assets' on 1 January 2018 in accordance with HKFRS 9. Comparatives have not been restated.

² Settlement accounts, cash collateral and margin receivables were reclassified from 'Placings with and advances to Banks' and 'Loans and advances to customers' to 'Other assets' on 1 January 2018. This reclassification is to better reflect the nature of these balances and ensure consistency of presentation. Comparatives have not been restated.

16 Customer accounts

Customer accounts by country

	2018 HK\$m	2017 HK\$m
Hong Kong	3,797,807	3,728,687
Mainland China	358,026	359,428
Singapore	331,479	321,548
Australia	161,726	157,959
India	111,297	103,264
Malaysia	108,899	109,626
Taiwan	106,537	105,189
Indonesia	29,843	32,907
Other	202,052	219,664
At 31 Dec¹	5,207,666	5,138,272

¹ Settlement accounts, cash collateral and margin payables were reclassified from 'Customer accounts' to 'Other liabilities' on 1 January 2018. This reclassification is to better reflect the nature of these balances and ensure consistency of presentation. Comparatives have not been restated.

17 Accruals and deferred income, other liabilities and provisions

	2018 HK\$m	2017 HK\$m
Accruals and deferred income	26,932	25,880
Acceptances and endorsements	44,438	36,720
Settlement accounts ¹	37,833	N/A
Cash collateral and margin payables ¹	36,613	N/A
Share-based payment liability to HSBC Holdings plc	1,923	2,268
Other liabilities	47,521	45,193
Provisions for liabilities and charges	1,405	626
At 31 Dec¹	196,665	110,687

¹ Settlement accounts, cash collateral and margin payables were reclassified from 'Trading liabilities', 'Deposits by banks' and 'Customer accounts' to 'Other liabilities' on 1 January 2018. This reclassification is to better reflect the nature of these balances and ensure consistency of presentation. Comparatives have not been restated.

18 Contingent liabilities, contractual commitments and guarantees

	2018 HK\$m	2017 HK\$m
Guarantees and contingent liabilities	295,645	289,892
Commitments	2,563,208	2,481,711
At 31 Dec	2,858,853	2,771,603

The above table discloses the nominal principal amounts of commitments (excluding capital commitments), guarantees and other contingent liabilities, which represents the amounts at risk should contracts be fully drawn upon and clients default. The amount of commitments shown above reflects, where relevant, the expected level of take-up of pre-approved facilities. As a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not indicative of future liquidity requirements.

19 Capital overview

The following tables show the capital ratios, risk-weighted assets ('RWAs') and capital base on a consolidated basis, in accordance with the Banking (Capital) Rules.

Capital ratios

	2018	2017
	%	%
Common equity tier 1 ('CET1') capital ratio	16.5	15.9
Tier 1 capital ratio	17.8	17.0
Total capital ratio	19.8	18.9

Total regulatory capital and RWAs

	2018	2017
	HK\$m	HK\$m
Common equity tier 1 capital	463,774	438,693
Additional tier 1 capital	37,729	29,328
Tier 2 capital	55,677	54,223
Total regulatory capital	557,180	522,244
RWAs	2,813,912	2,758,609

20 Accounting policies

The accounting policies and methods of computation adopted by the group for this document are consistent with those set out in note 1 on the Financial Statements in the *Annual Report and Accounts 2018*.

Standards adopted during the year ended 31 December 2018

The group has adopted the requirements of HKFRS 9 'Financial Instruments' from 1 January 2018, with the exception of the provisions relating to the presentation of gains and losses on financial liabilities designated at fair value, which were adopted from 1 January 2017. This includes the adoption of 'Prepayment Features with Negative Compensation (Amendments to HKFRS 9)' which is effective for annual periods beginning on or after 1 January 2019 with early adoption permitted. The effect of adopting the amendments to HKFRS 9 is not considered to be significant. HKFRS 9 includes an accounting policy choice to remain with HKAS 39 hedge accounting, which the group has exercised. The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application. As permitted by HKFRS 9, the group has not restated comparatives. Adoption reduced net assets at 1 January 2018 by HK\$12,313m as set out in note 2 on the Financial Statements in the *Annual Report and Accounts 2018*.

In addition, the group has adopted the requirements of HKFRS 15 'Revenue from Contracts with Customers' and a number of interpretations and amendments to standards which have had an insignificant effect on the group's consolidated financial statements.

Transitional impact of HKFRS 16 'Leases'

HKFRS 16 'Leases' has an effective date for annual periods beginning on or after 1 January 2019. HKFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under HKAS 17 'Leases'. Lessees will recognise a right of use ('ROU') asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease, and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as under HKAS 17. At 1 January 2019, the group expects to adopt the standard using a modified retrospective approach where the cumulative effect of initially applying the standard is recognised as an adjustment to the opening balance of retained earnings and comparatives are not restated. The implementation is expected to increase assets by approximately HK\$9.2bn and increase financial liabilities by the same amount, with no effect on net assets or retained earnings.

As a consequence of HKFRS 16, properties currently reported under 'Prepayments, accrued income and other assets' as operating leases and held at cost will be reclassified to 'Property, plant and equipment' and be measured at fair value. The implementation is expected to increase 'Property, plant and equipment' by HK\$16.3bn and increase deferred tax liabilities by HK\$2.7bn, with the net impact taken to the 'Property Revaluation Reserve'.

21 Statutory accounts

The information in this document is not audited and does not constitute the Bank's statutory accounts.

Certain financial information in this document is extracted from the financial statements for the year ended 31 December 2018, which were approved by the Board of Directors on 19 February 2019 and will be delivered to the Registrar of Companies and the Hong Kong Monetary Authority. The Auditor's Report was unqualified; did not include a reference to any matters to which the auditor drew any attention by way of emphasis without qualifying their report; and did not contain a statement under sections 406(2), 407(2) or (3) of the Hong Kong Companies Ordinance (Cap.622). The *Annual Report and Accounts 2018*, which include the financial statements, will be published on the Bank's website: www.hsbc.com.hk. A press release will be issued to announce the availability of this information.

22 Ultimate holding company

The Hongkong and Shanghai Banking Corporation Limited is an indirectly-held, wholly-owned subsidiary of HSBC Holdings plc, which is incorporated in England.

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