The Hongkong and Shanghai Banking Corporation Limited

Interim Report 2019

HSBC

Contents

Certain defined terms

This document comprises the *Interim Report 2019* for 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.

Cautionary statement regarding forward-looking statements

This *Interim Report 2019* contains certain forward-looking statements with respect to the financial condition, results of operations and business of the group.

Statements that are not historical facts, including statements about the group's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential' and 'reasonably possible', variations of these words and similar expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made. The Hongkong and Shanghai Banking Corporation Limited makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statement.

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward-looking statement.

Chinese translation

A Chinese translation of the *Interim Report 2019* is available upon request from: Communications (Asia), Level 32, HSBC Main Building, 1 Queen's Road Central, Hong Kong. The report is also available, in English and Chinese, on the Bank's website at www.hsbc.com.hk.

本《*2019年中期業績報告*》備有中譯本，如有需要可向下列部門索取：
香港皇后大道中1號滙豐總行大廈32樓企業傳訊部（亞太區）。
本年報之中英文本亦載於本行之網站 www.hsbc.com.hk。

Additional information

The *Banking Disclosure Statement at 30 June 2019*, which is prepared in accordance with the Banking (Disclosure) Rules made under section 60A of the Banking Ordinance, will be published on our website at www.hsbc.com.hk.

Highlights

Financial highlights

- Profit before tax up 3% to HK$72,867m (HK$71,013m in the first half of 2018).
- Attributable profit up 3% to HK$55,489m (HK$53,759m in the first half of 2018).
- Return on average ordinary shareholders' equity of 14.8% (15.8% in the first half of 2018).
- Total assets up 5% to HK$8,673bn (HK$8,263bn at the end of 2018).
- Common equity tier 1 ratio of 16.6% (16.5% at the end of 2018), total capital ratio of 20.3% (19.8% at the end of 2018).
- Cost efficiency ratio of 40.7% (40.4% for the first half of 2018).

Chairman

On 5 August 2019, John Flint stepped down as Chairman of The Hongkong and Shanghai Banking Corporation Limited and as a Director of the Bank.

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Financial review

Consolidated income statement by global business[1]

	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Corporate Centre[2]	Total
	HK$m	HK$m	HK$m	HK$m	HK$m	HK$m
Half-year to 30 Jun 2019						
Net interest income	**33,236**	**21,438**	**12,582**	**1,458**	**(4,125)**	**64,589**
Net fee income	**9,824**	**5,404**	**4,927**	**1,392**	**42**	**21,589**
Net income from financial instruments held for trading or managed on a fair value basis	**664**	**1,339**	**8,836**	**624**	**6,986**	**18,449**
Net income/(expense) from assets and liabilities of insurance businesses, including related derivatives, measured at fair value through profit or loss	**8,812**	**(65)**	**–**	**–**	**(17)**	**8,730**
Changes in fair value of other financial instruments measured at fair value	**12**	**15**	**75**	**(55)**	**53**	**100**
Gains less losses from financial investments	**22**	**2**	**–**	**–**	**335**	**359**
Dividend income	**–**	**–**	**8**	**–**	**135**	**143**
Net insurance premium income/(expense)	**32,975**	**3,224**	**–**	**–**	**(13)**	**36,186**
Other operating income	**7,115**	**302**	**393**	**54**	**314**	**8,178**
Total operating income	**92,660**	**31,659**	**26,821**	**3,473**	**3,710**	**158,323**
Net insurance claims and benefits paid and movement in liabilities to policyholders	**(43,011)**	**(3,125)**	**–**	**–**	**–**	**(46,136)**
Net operating income before change in expected credit losses and other credit impairment charges	**49,649**	**28,534**	**26,821**	**3,473**	**3,710**	**112,187**
Change in expected credit losses and other credit impairment charges	**(857)**	**(975)**	**(201)**	**8**	**(14)**	**(2,039)**
Net operating income	**48,792**	**27,559**	**26,620**	**3,481**	**3,696**	**110,148**
Operating expenses	**(20,442)**	**(9,205)**	**(11,620)**	**(1,959)**	**(2,458)**	**(45,684)**
Operating profit	**28,350**	**18,354**	**15,000**	**1,522**	**1,238**	**64,464**
Share of profit in associates and joint ventures	**282**	**–**	**–**	**–**	**8,121**	**8,403**
Profit before tax	**28,632**	**18,354**	**15,000**	**1,522**	**9,359**	**72,867**
Balance at 30 Jun 2019						
Loans and advances to customers (net)	**1,209,577**	**1,275,924**	**1,048,439**	**163,016**	**1,533**	**3,698,489**
Customer accounts	**2,818,644**	**1,290,543**	**987,427**	**189,607**	**3,352**	**5,289,573**
Half-year to 30 Jun 2018						
Net interest income	29,795	18,445	10,518	1,304	1,289	61,351
Net fee income	11,945	5,702	5,316	1,405	54	24,422
Net income from financial instruments held for trading or managed on a fair value basis	952	1,492	10,291	515	2,119	15,369
Net income/(expense) from assets and liabilities of insurance businesses, including related derivatives, measured at fair value through profit or loss	(751)	(92)	–	–	220	(623)
Changes in fair value of other financial instruments measured at fair value	9	7	(19)	(14)	(31)	(48)
Gains less losses from financial investments	–	(5)	70	–	225	290
Dividend income	–	–	–	–	8	8
Net insurance premium income/(expense)	30,288	2,621	–	–	(51)	32,858
Other operating income	3,102	429	470	37	1,132	5,170
Total operating income	75,340	28,599	26,646	3,247	4,965	138,797
Net insurance claims and benefits paid and movement in liabilities to policyholders	(30,263)	(2,307)	–	–	–	(32,570)
Net operating income before change in expected credit losses and other credit impairment charges	45,077	26,292	26,646	3,247	4,965	106,227
Change in expected credit losses and other credit impairment charges	(1,083)	36	119	–	19	(909)
Net operating income	43,994	26,328	26,765	3,247	4,984	105,318
Operating expenses	(19,065)	(8,964)	(11,100)	(1,717)	(2,036)	(42,882)
Operating profit	24,929	17,364	15,665	1,530	2,948	62,436
Share of profit in associates and joint ventures	131	–	–	–	8,446	8,577
Profit before tax	25,060	17,364	15,665	1,530	11,394	71,013
Balance at 30 Jun 2018						
Loans and advances to customers (net)	1,101,006	1,218,349	1,046,631	129,083	1,848	3,496,917
Customer accounts	2,711,008	1,314,607	914,346	177,065	35,498	5,152,524

1 *The financial information included in this table forms part of the Interim condensed consolidated financial statements, which have been reviewed by PricewaterhouseCoopers.*
2 *Includes inter-segment elimination.*

Financial review

All commentary in this financial review compares the first half of 2019 results with the first half of 2018 unless otherwise stated.

Result commentary

The group reported profit before tax of HK$72,867m, an increase of HK$1,854m, or 3%.

Net interest income increased by HK$3,238m, or 5%, with increases across all global businesses and mainly in Hong Kong, primarily from growth in loans and advances to customers and from improved deposit spreads. The increase was dampened by the impact of higher funding costs as market interest rates increased, and a change in customer deposit mix in the higher interest rate environment.

Net fee income decreased by HK$2,833m, or 12%, with decreases across all global businesses but mainly in RBWM from lower securities brokerage, unit trust, and funds under management fees due to lower turnover from equity market activities in Hong Kong in the first half of 2019.

Net income from financial instruments held for trading or managed on a fair value basis increased by HK$3,080m, or 20%, driven by higher income from Rates and Credit trading, revaluation gains on funding swaps and subordinated liabilities raised to meet the 'Total Loss-absorbing Capacity' requirements. These were partly offset by the unfavourable valuation adjustment on derivative contracts, coupled with lower income from equities and foreign exchange trading.

Net income from assets and liabilities of insurance business, including related derivatives, measured at fair value through profit or loss increased by HK$9,353m, driven by revaluation gains in Hong Kong on equities held to back insurance liabilities from favourable equity market performance in the first half of 2019. To the extent that these gains are attributable to policyholders, the gains are offset by a corresponding movement in 'Net insurance claims and benefits paid and movement in liabilities to policyholders'.

Net insurance premium income increased by HK$3,328m, or 10%, driven by higher new business sales and 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$3,008m, or 58%, driven by the favourable movement in the present value of in-force insurance business, mainly in Hong Kong. This was partly offset by a corresponding movement in 'Net insurance claims and benefits paid and movement in liabilities to policyholders'. Recoveries from fellow group companies decreased due to a change in the cost recharge mechanism following the transfer of shared services and operations to HSBC Global Services (Hong Kong) Limited ('ServCo'), with a corresponding decrease in operating expenses.

Net insurance claims and benefits paid and movement in liabilities to policyholders increased by HK$13,566m, or 42%, reflecting higher investment returns to policyholders from the favourable equity market performance in the first half of 2019, higher claims from business growth and the favourable movement in the present value of in-force insurance business.

Change in expected credit losses and other credit risk provisions increased by HK$1,130m, or 124%, mainly driven by CMB in Hong Kong and mainland China across various industry sectors, reflecting portfolio growth as well as increased provision in light of the increasingly complex economic outlook.

Total operating expenses increased by HK$2,802m, or 7%, with increases across all global businesses. The increase was driven by higher IT and staff costs to support growth initiatives, wage inflation and higher management charges from ServCo following the transfer of over 8,300 employees to ServCo in the first half of this year. Depreciation charge also increased due to a change in valuation base of certain properties from cost to fair value following the implementation of HKFRS 16. These increases were partly offset by the non-recurrence of customer remediation in the prior year, release of a provision in relation to a tax matter in Indonesia, and from a change in the cost recharge mechanism from fellow group companies as mentioned above.

Share of profit in associates and joint ventures decreased by HK$174m, or 2%, driven by an unfavourable foreign exchange impact. Excluding this impact, share of profit in associates and joint ventures increased by HK$341m, mainly from Bank of Communications Co., Limited, and Canara HSBC Oriental Life Insurance.

Net interest income

	Half-year to	
	30 Jun 2019	30 Jun 2018
	HK$m	HK$m
Net interest income	**64,589**	61,351
Average interest-earning assets	**6,437,120**	6,082,122
	%	%
Net interest spread	**1.86**	1.93
Contribution from net free funds	**0.16**	0.10
Net interest margin	**2.02**	2.03

Net interest income ('NII') increased by HK$3,238m, or 5%, driven by Hong Kong from growth in loans and advances to customers, coupled with improved deposit spreads. The increase was dampened by the impact of higher funding costs as market interest rates increased, and a change in customer deposit mix in the higher interest rate environment. The increase in Hong Kong was partly offset by decreases in mainland China, Australia and Taiwan.

Average interest-earning assets increased by HK$355bn, or 6%, driven by Hong Kong mainly from an increase in loans and advances to customers, notably in corporate term lending and residential mortgages. Increases were also noted in Singapore and Australia, driven by growth in customer advances.

Net interest margin decreased by one basis point, driven collectively by mainland China, Australia and Taiwan, largely offset by Hong Kong.

In **Hong Kong**, the net interest margin for the Bank increased by four basis points, primarily from improved customer deposit spreads and higher reinvestment yields on financial investments as interest rates increased. These increases were partly offset by reduced lending spreads and an increase in financial liabilities to meet the 'Total Loss-absorbing Capacity' requirements.

At **Hang Seng Bank**, the net interest margin increased by five basis points, mainly from improved customer deposit spreads and higher contribution from net free funds as market interest rates increased, partly offset by reduced lending spreads, notably in corporate and commercial term lending.

In mainland China, the decrease in net interest margin was driven by higher cost of funds on customer deposits and more debt securities issued to support business growth, coupled with lower reinvestment yields from financial investments due to ample liquidity in the market.

In Australia and Taiwan, the drop in net interest margin was mainly due to higher cost of funds following interest rate increases in the prior year.

Net fee income

	Half-year to	
	30 Jun 2019	30 Jun 2018
	HK$m	HK$m
Account services	**1,374**	1,447
Funds under management	**3,526**	3,871
Cards	**4,218**	4,087
Credit facilities	**1,842**	1,804
Broking income	**1,926**	2,915
Imports/exports	**1,656**	1,855
Unit trusts	**3,812**	4,279
Underwriting	**803**	659
Remittances	**1,435**	1,592
Global custody	**1,870**	2,010
Insurance agency commission[1]	**959**	1,014
Other	**3,810**	4,023
Fee income	**27,231**	29,556
Fee expense	**(5,642)**	(5,134)
Net fee income	**21,589**	24,422

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

Net income from financial instruments measured at fair value

	Half-year to	
	30 Jun 2019 HK$m	30 Jun 2018 HK$m
Net income/(expense) arising on:		
Trading activities	**21,716**	16,150
Other trading income – hedging ineffectiveness on fair value hedges	**3**	(113)
Fair value movement on non-qualifying hedges	**(86)**	(128)
Other instruments designated at fair value and related derivatives	**(3,184)**	(540)
Net income from financial instruments held for trading or managed on a fair value basis[1]	**18,449**	15,369
Financial assets held to meet liabilities under insurance and investment contracts	**10,081**	(769)
Liabilities to customers under investment contracts	**(1,351)**	146
Net income/(expense) from assets and liabilities of insurance businesses, including related derivatives, measured at fair value through profit or loss	**8,730**	(623)
Changes in fair value of other financial instruments measured at fair value[2]	**100**	(48)
Net income from financial instruments measured at fair value	**27,279**	14,698

1 *The presentation has been updated to align with the presentation in the* Annual Report and Accounts 2018*. Comparatives have been re-presented to conform to the current year's presentation.*

2 *Changes in fair value of other financial instruments measured at fair value included change in fair value of long-term debt issued and related derivatives, and changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss.*

Other operating income

	Half-year to	
	30 Jun 2019 HK$m	30 Jun 2018 HK$m
Movement in present value of in-force long-term insurance business	**6,610**	2,745
Gains on investment properties	**308**	182
Gains/(losses) on disposal of property, plant and equipment, and assets held for sale	**6**	(20)
Other	**1,254**	2,263
Other operating income	**8,178**	5,170

In 2019, the group transferred shared services and operations to ServCo which provides functional support services to the group. As a result of the transfer, costs incurred relating to services provided to fellow companies are reflected in the financial statements of ServCo instead of the group, and so are recoveries on these costs. This resulted in lower other operating income as well as lower operating expenses for the group.

Insurance business

Summary income statement of insurance manufacturing operations

	Half-year to	
	30 Jun 2019	30 Jun 2018
	HK$m	HK$m
Insurance manufacturing operations		
Net interest income	**7,122**	6,645
Net fee expense	**(2,606)**	(1,798)
Net income/(expense) from financial instruments measured at fair value	**8,339**	(1,204)
Net insurance premium income	**36,212**	32,893
Change in present value of in-force long-term insurance business	**6,610**	2,745
Other operating income	**227**	128
Total operating income	**55,904**	39,409
Net insurance claims and benefits paid and movement in liabilities to policyholders	**(46,136)**	(32,570)
Net operating income before change in expected credit losses and other credit impairment charges	**9,768**	6,839
Change in expected credit losses and other credit impairment charges	**(19)**	19
Net operating income	**9,749**	6,858
Total operating expenses	**(1,018)**	(1,016)
Operating profit	**8,731**	5,842
Share of profit in associates and joint ventures	**282**	131
Profit before tax	**9,013**	5,973
Distribution income earned by banking operations[1]	**3,394**	3,306

1 *Distribution income earned by banking operations are presented separately. Comparatives have been re-presented accordingly.*

Profit before tax from the insurance manufacturing business increased by HK$3,040m, or 51%, driven by the favourable equity market performance in the first half of 2019.

Net interest income increased by 7% as net premium inflows from new business and renewals increased fixed income assets held to back insurance liabilities.

Net income from financial instruments measured at fair value increased significantly, driven by revaluation gains in Hong Kong on equities held to back insurance liabilities.

Net insurance premium income increased, mainly in Hong Kong due to 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 update of the valuation interest rates applied to insurance liabilities and the value of new business written in the period increased.

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.

Change in expected credit losses and other credit impairment charges

	Half-year to	
	30 Jun 2019	30 Jun 2018
	HK$m	HK$m
Change in expected credit losses		
Loans and advances to banks and customers	**1,923**	845
– new allowances net of allowance releases	**2,381**	1,313
– recoveries of amounts previously written off	**(458)**	(469)
– modification losses and other movements	**–**	1
Loan commitments and guarantees	**45**	90
Other financial assets	**71**	(26)
Change in expected credit losses and other credit impairment charges	**2,039**	909

Change in expected credit losses as a percentage of average gross customer advances was 0.11% for the first half of 2019 (first half of 2018: 0.05%).

Operating expenses

	Half-year to	
	30 Jun 2019	30 Jun 2018
	HK$m	HK$m
Employee compensation and benefits	**19,615**	20,858
General and administrative expenses	**20,859**	18,840
Depreciation of property, plant and equipment	**4,040**	2,336
Amortisation and impairment of intangible assets	**1,170**	848
Operating expenses	**45,684**	42,882

In the first half of 2019, over 8,300 employees performing shared services and operations in Hong Kong were transferred from the group to ServCo as part of recovery and resolution planning to provide services to the group. The transfer resulted in a decrease in 'employee compensation and benefits' and an increase in 'general and administrative expenses', reflecting the management charge for the services provided which included a mark-up on the expenses incurred. Excluding the impact from the employee transfers, employee compensation and benefits increased, reflecting wage inflation as well as new hires, mainly in Hong Kong, mainland China and Singapore, to support business growth.

General and administrative expenses increased by HK$2,019m, or 11%, compared with the first half of 2018, largely due to the management charge on services and operations provided by ServCo as mentioned above, coupled with higher spend to support growth initiatives. These increases were partly offset by lower rental expenses on premises and equipment following the implementation of HKFRS 16 'Leases' (with a corresponding increase in amortisation of right-of-use ('ROU') of assets), the non-recurrence of customer remediation in the prior year, release of a provision in relation to a tax matter in Indonesia, and from a change in the cost recharge mechanism from fellow group companies as mentioned previously.

Depreciation charges on property, plant and equipment increased by HK$1,704m, or 73%, compared with the first half of 2018, driven by ROU of assets following the implementation of HKFRS 16 as mentioned above, and from a change in valuation base of certain properties which were previously reported as operating leases and held at cost, now reclassified to 'Property, plant and equipment' and measured at fair value.

Share of profit in associates and joint ventures

At 30 June 2019, an impairment review on the group's investment in Bank of Communications Co., Limited ('BoCom') was carried out and it was concluded that the investment was not impaired based on our value-in-use calculation (see note 5 on the Financial Statements 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.

Risk

Principal risks and uncertainties

The group continuously monitors and identifies risks. Our principal risks are credit risk, liquidity and funding risk, market risk, operational risk, regulatory compliance risk, financial crime risk, reputational risk, pension risk, sustainability risk and insurance risk. There is no material change expected in the principal risks for the remaining six months of the financial year despite increased uncertainties arising from the tensions between the US and China, which has dampened investor and business confidence and may continue to impact global trade sentiment. A description of principal risks and a summary of our current policies and practices regarding the management of risk is set out in the 'Risk' section of the Annual Report and Accounts 2018.

Key developments in the first half of 2019

There were no material changes to the policies and practices for the management of risk, as described in the *Annual Report and Accounts 2018*, in the first half of 2019 except for the following:

- We continued to strengthen our approach to managing operational risk, as set out in the Operational Risk Management Framework. The framework sets out our governance and appetite. It provides a single view of non-financial risks that matter the most and associated controls. It incorporates a risk management system to enable active risk management.
- We continued to strengthen our management of conduct and embed conduct considerations as a key part of risk management across the group. We continued to promote and encourage good conduct through our people's behaviour and decision making to deliver fair outcomes for customers and preserve market integrity.
- The Global Standards programme continued to integrate the final elements of our capabilities for anti-money laundering and sanctions into our day-to-day operations throughout the first half of 2019. We continue to enhance our financial crime risk management capabilities and the effectiveness of our financial crime controls. We are maintaining our investment in the next generation of tools to fight financial crime through the application of advanced analytics and artificial intelligence.

Update on the nature of our Ibor risks

The impact of the replacement of interbank offered rates ('Ibors') with alternative risk-free rates on our products and services remains a key area of focus. The programme to coordinate our transition activities is significant in terms of scale and complexity and will impact all global businesses and jurisdictions as well as multiple products, currencies, systems and processes. In addition to the consequent execution risks, the process of adopting new reference rates exposes the group to a wide range of material conduct, operational and financial risks. We continue to engage with industry participants, the official sector and our clients to support an orderly transition and the mitigation of the risks resulting from the transition.

Capital

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 and RWAs

	At	
	30 Jun 2019	31 Dec 2018
	%	%
Capital ratios		
Common equity tier 1 ('CET1') ratio	**16.6**	16.5
Tier 1 ratio	**18.2**	17.8
Total capital ratio	**20.3**	19.8
	HK$m	HK$m
RWAs	**2,897,902**	2,813,912

The following table sets out the composition of the group's capital base under Basel III at 30 June 2019. The position at 30 June 2019 benefits from transitional arrangements which will be phased out.

Capital base

	At	
	30 Jun 2019	31 Dec 2018
	HK$m	HK$m
Common equity tier 1 ('CET1') capital		
Shareholders' equity	**675,729**	645,810
– shareholders' equity per balance sheet	**796,737**	752,758
– revaluation reserve capitalisation issue	**(1,454)**	(1,454)
– other equity instruments	**(44,615)**	(35,879)
– unconsolidated subsidiaries	**(74,939)**	(69,615)
Non-controlling interests	**27,309**	26,034
– non-controlling interests per balance sheet	**62,321**	60,162
– non-controlling interests in unconsolidated subsidiaries	**(9,816)**	(9,316)
– surplus non-controlling interests disallowed in CET1	**(25,196)**	(24,812)
Regulatory deductions to CET1 capital	**(222,428)**	(208,070)
– valuation adjustments	**(1,646)**	(1,599)
– goodwill and intangible assets	**(18,109)**	(17,215)
– deferred tax assets net of deferred tax liabilities	**(2,030)**	(2,378)
– cash flow hedging reserve	**55**	63
– changes in own credit risk on fair valued liabilities	**779**	(198)
– defined benefit pension fund assets	**(29)**	(24)
– significant Loss-absorbing capacity ('LAC') investments in unconsolidated financial sector entities	**(101,179)**	(99,407)
– property revaluation reserves[1]	**(75,717)**	(60,429)
– regulatory reserve	**(24,552)**	(26,883)
Total CET1 capital	**480,610**	463,774
Additional tier 1 ('AT1') capital		
Total AT1 capital before regulatory deductions	**45,694**	37,729
– perpetual subordinated loans	**44,615**	35,879
– allowable non-controlling interests in AT1 capital	**1,079**	1,850
Regulatory deductions to AT1 capital	**(7)**	–
– significant LAC investments in unconsolidated financial sector entities	**(7)**	–
Total AT1 capital	**45,687**	37,729
Total tier 1 capital	**526,297**	501,503
Tier 2 capital		
Total tier 2 capital before regulatory deductions	**69,210**	61,178
– perpetual subordinated debt	**3,123**	3,133
– term subordinated debt	**14,596**	13,944
– property revaluation reserves[1]	**34,727**	27,847
– impairment allowances and regulatory reserve eligible for inclusion in tier 2 capital	**16,764**	16,254
Regulatory deductions to tier 2 capital	**(6,158)**	(5,501)
– significant LAC investments in unconsolidated financial sector entities	**(6,158)**	(5,501)
Total tier 2 capital	**63,052**	55,677
Total capital	**589,349**	557,180

1 *Includes the revaluation surplus on investment properties which is reported as part of retained earnings and adjustments made in accordance with the Banking (Capital) Rules issued by the HKMA.*

The following table shows the pro-forma Basel III end point basis position once all transitional arrangements have been phased out. It should be noted that the pro-forma Basel III end point basis position takes no account of, for example, any future profits or management actions. In addition, the current regulations or their application may change before full implementation.

Reconciliation of regulatory capital from transitional basis to a pro-forma Basel III end point basis

	At	
	30 Jun 2019	31 Dec 2018
	HK$m	HK$m
CET1 capital on a transitional and end point basis	**480,610**	463,774
AT1 capital on a transitional and end point basis	**45,687**	37,729
Tier 2 capital on a transitional basis	**63,052**	55,677
Grandfathered instruments:	**(3,123)**	(3,133)
– perpetual subordinated debt	**(3,123)**	(3,133)
Tier 2 capital end point basis	**59,929**	52,544

We closely monitor and consider future regulatory change and continue to evaluate the impact upon our capital requirements of regulatory developments. This includes the Basel III reforms package, over which there remains a significant degree of uncertainty due to the number of national discretions within Basel's reforms. It remains premature to provide details of an impact although we currently anticipate the potential for an increase in RWAs.

Statement of Directors' responsibilities

The Directors, the names of whom are set out below, confirm to the best of their knowledge that:

- the Interim condensed consolidated financial statements have been prepared in accordance with Hong Kong Accounting Standard ('HKAS') 34 'Interim Financial Reporting'; and
- the Interim Report includes a fair review of the information required by DTR 4.2.7R of the Disclosure Guidance and Transparency Rules sourcebook issued by the UK Financial Conduct Authority, being an indication of important events that have occurred during the first six months of the financial year ending 31 December 2019 and their impact on the Interim condensed consolidated financial statements and a description of the principal risks and uncertainties for the remaining six months of the financial year.

Peter Tung Shun Wong (Deputy Chairman & Chief Executive)
Laura May Lung Cha*, GBM (Deputy Chairman)
Zia Mody* (Deputy Chairman)
Graham John Bradley*
Louisa Wai Wan Cheang
Dr Christopher Wai Chee Cheng*, GBS, OBE
Dr Raymond Kuo Fung Ch'ien*, GBS, CBE
Yiu Kwan Choi*
Irene Yun-lien Lee*
Jennifer Xinzhe Li*
Victor Tzar Kuoi Li#
Bin Hwee Quek (née Chua)*, PBM, BBM, JP
Kevin Anthony Westley*, BBS
Tan Sri Dr Francis Sock Ping Yeoh*, CBE

* independent non-executive Director
\# non-executive Director

On behalf of the Board
Peter Wong
Deputy Chairman
5 August 2019

Independent review report by PricewaterhouseCoopers

Report on the Interim condensed consolidated financial statements to the Board of Directors of The Hongkong and Shanghai Banking Corporation Limited

Introduction

We have reviewed the Interim condensed consolidated financial statements set out on pages 14 to 29, which comprise the consolidated balance sheet of The Hongkong and Shanghai Banking Corporation Limited (the 'Bank') and its subsidiaries (together, the 'group') as at 30 June 2019 and the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes[1]. The directors of the Bank are responsible for the preparation and presentation of the Interim condensed consolidated financial statements in accordance with Hong Kong Accounting Standard 34 'Interim Financial Reporting' issued by the Hong Kong Institute of Certified Public Accountants and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority. Our responsibility is to express a conclusion on the Interim condensed consolidated financial statements based on our review and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

1 *As described in Note 10 on the Interim condensed consolidated financial statements, required disclosure of the table 'Consolidated income statement by global business' has been presented elsewhere in the Interim Report 2019 rather than in the notes on the Interim condensed consolidated financial statements. This is cross-referenced from the Interim condensed consolidated financial statements and is identified as reviewed.*

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 United Kingdom's Auditing Practices Board. A review of Interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) 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 Interim condensed consolidated financial statements of the group are not prepared, in all material respects, in accordance with Hong Kong Accounting Standard 34 'Interim Financial Reporting' and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

PricewaterhouseCoopers

Certified Public Accountants

Hong Kong

5 August 2019

Interim condensed consolidated financial statements

Consolidated income statement

	Half-year to	
	30 Jun 2019	30 Jun 2018
	HK$m	HK$m
Net interest income	**64,589**	61,351
– interest income	**95,534**	79,476
– interest expense	**(30,945)**	(18,125)
Net fee income	**21,589**	24,422
– fee income	**27,231**	29,556
– fee expense	**(5,642)**	(5,134)
Net income from financial instruments held for trading or managed on a fair value basis	**18,449**	15,369
Net income/(expense) from assets and liabilities of insurance businesses, including related derivatives, measured at fair value through profit or loss	**8,730**	(623)
Changes in fair value of other financial instruments measured at fair value	**100**	(48)
Gains less losses from financial investments	**359**	290
Dividend income	**143**	8
Net insurance premium income	**36,186**	32,858
Other operating income	**8,178**	5,170
Total operating income	**158,323**	138,797
Net insurance claims and benefits paid and movement in liabilities to policyholders	**(46,136)**	(32,570)
Net operating income before change in expected credit losses and other credit impairment charges	**112,187**	106,227
Change in expected credit losses and other credit impairment charges	**(2,039)**	(909)
Net operating income	**110,148**	105,318
Employee compensation and benefits	**(19,615)**	(20,858)
General and administrative expenses	**(20,859)**	(18,840)
Depreciation of property, plant and equipment	**(4,040)**	(2,336)
Amortisation and impairment of intangible assets	**(1,170)**	(848)
Total operating expenses	**(45,684)**	(42,882)
Operating profit	**64,464**	62,436
Share of profit in associates and joint ventures	**8,403**	8,577
Profit before tax	**72,867**	71,013
Tax expense	**(12,266)**	(12,495)
Profit for the period	**60,601**	58,518
Profit attributable to shareholders of the parent company	**55,489**	53,759
Profit attributable to non-controlling interests	**5,112**	4,759

Consolidated statement of comprehensive income

	Half-year to	
	30 Jun 2019 HK$m	30 Jun 2018 HK$m
Profit for the period	**60,601**	58,518
Other comprehensive income/(expense)		
Items that will be reclassified subsequently to profit or loss when specific conditions are met:		
Debt instruments at fair value through other comprehensive income	**1,485**	80
– fair value gains/(losses)	**6,864**	(2,455)
– fair value (gains)/losses transferred to the income statement on disposal	**(4,965)**	2,440
– expected credit recoveries/(losses) recognised in the income statement	**23**	(4)
– income taxes	**(437)**	99
Cash flow hedges	**(10)**	(273)
– fair value gains/(losses)	**192**	(632)
– fair value (gains)/losses reclassified to the income statement	**(206)**	293
– income taxes	**4**	66
Share of other comprehensive income/(expense) of associates and joint venture	**207**	(571)
Exchange differences	**(725)**	(8,233)
Items that will not be reclassified subsequently to profit or loss:		
Property revaluation	**3,307**	3,492
– fair value gains	**3,972**	4,162
– income taxes	**(665)**	(670)
Equity instruments designated at fair value through other comprehensive income	**2,059**	(324)
– fair value gains/(losses)	**2,063**	(319)
– income taxes	**(4)**	(5)
Changes in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	**(809)**	(820)
– before income taxes	**(969)**	(978)
– income taxes	**160**	158
Remeasurement of defined benefit asset/liability	**(295)**	105
– before income taxes	**(351)**	134
– income taxes	**56**	(29)
Other comprehensive income/(expense) for the period, net of tax	**5,219**	(6,544)
Total comprehensive income for the period	**65,820**	51,974
Attributable to:		
– shareholders of the parent company	**59,880**	47,169
– non-controlling interests	**5,940**	4,805
Total comprehensive income for the period	**65,820**	51,974

Consolidated balance sheet

		At	
		30 Jun	31 Dec
		2019	2018
	Notes	**HK$m**	HK$m
Assets			
Cash and sight balances at central banks		**232,828**	205,660
Items in the course of collection from other banks		**44,311**	25,380
Hong Kong Government certificates of indebtedness		**284,964**	280,854
Trading assets		**614,685**	558,838
Derivatives		**298,197**	292,869
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss		**148,061**	132,859
Reverse repurchase agreements – non-trading		**393,760**	406,327
Placings with and advances to banks		**418,935**	338,151
Loans and advances to customers	3	**3,698,489**	3,528,702
Financial investments	4	**1,783,190**	1,871,026
Amounts due from Group companies		**96,905**	70,455
Interests in associates and joint ventures	5	**145,933**	142,885
Goodwill and intangible assets		**72,898**	65,104
Property, plant and equipment		**138,485**	112,080
Deferred tax assets		**1,969**	2,315
Prepayments, accrued income and other assets		**299,183**	229,949
Total assets		**8,672,793**	8,263,454
Liabilities			
Hong Kong currency notes in circulation		**284,964**	280,854
Items in the course of transmission to other banks		**52,386**	33,806
Repurchase agreements – non-trading		**141,685**	70,279
Deposits by banks		**220,156**	164,664
Customer accounts	6	**5,289,573**	5,207,666
Trading liabilities		**81,600**	81,194
Derivatives		**308,835**	295,553
Financial liabilities designated at fair value		**173,152**	161,143
Debt securities in issue		**90,959**	58,236
Retirement benefit liabilities		**3,173**	3,369
Amounts due to Group companies		**365,506**	396,487
Accruals and deferred income, other liabilities and provisions		**257,330**	196,665
Liabilities under insurance contracts		**502,127**	468,589
Current tax liabilities		**9,044**	3,337
Deferred tax liabilities		**29,079**	24,513
Subordinated liabilities		**4,068**	4,081
Preference shares		**98**	98
Total liabilities		**7,813,735**	7,450,534
Equity			
Share capital		**172,335**	172,335
Other equity instruments		**44,615**	35,879
Other reserves		**135,287**	114,949
Retained earnings		**444,500**	429,595
Total shareholders' equity		**796,737**	752,758
Non-controlling interests		**62,321**	60,162
Total equity		**859,058**	812,920
Total liabilities and equity		**8,672,793**	8,263,454

Consolidated statement of cash flows

	Half-year to	
	30 Jun 2019	30 Jun 2018 *Restated*[3]
	HK$m	HK$m
Profit before tax	**72,867**	71,013
Adjustments for non-cash items:		
Depreciation and amortisation	**5,210**	3,191
Net gain from investing activities	**(673)**	(452)
Share of profits in associates and joint ventures	**(8,403)**	(8,577)
Loss on disposal of subsidiaries, businesses, associates and joint ventures	**13**	2
Change in expected credit losses gross of recoveries and other credit impairment charges	**2,039**	909
Provisions	**19**	116
Share-based payment expense	**409**	562
Other non-cash items included in profit before tax	**(6,314)**	(2,366)
Change in operating assets	**(293,035)**	(213,391)
Change in operating liabilities	**325,976**	243,292
Elimination of exchange differences	**953**	5,984
Dividends received from associates	**84**	84
Contributions paid to defined benefit plans	**(176)**	(272)
Tax paid	**(4,922)**	(3,597)
Net cash from operating activities	**94,047**	96,498
Purchase of financial investments	**(457,815)**	(481,624)
Proceeds from the sale and maturity of financial investments	**372,990**	437,335
Purchase of property, plant and equipment	**(1,421)**	(1,167)
Proceeds from sale of property, plant and equipment and assets held for sale	**1,824**	17
Proceeds from disposal of customer loan portfolios	**1,066**	798
Net investment in intangible assets	**(2,321)**	(1,944)
Net cash inflow on sale of subsidiaries	**299**	—
Net cash from investing activities	**(85,378)**	(46,585)
Issue of other equity instruments	**8,617**	—
Subordinated loan capital issued[1]	**—**	67,052
Subordinated loan capital repaid[1]	**—**	(39,118)
Dividends paid to shareholders of the parent company and non-controlling interests	**(41,802)**	(29,745)
Net cash from financing activities	**(33,185)**	(1,811)
Net increase/(decrease) in cash and cash equivalents	**(24,516)**	48,102
Cash and cash equivalents at 1 Jan	**721,609**	718,038
Exchange differences in respect of cash and cash equivalents	**2,798**	(1,938)
Cash and cash equivalents at 30 Jun[2]	**699,891**	764,202

Interest received in the first half of 2019 was HK$94,234m (first half of 2018: HK$78,572m), interest paid in the first half of 2019 was HK$29,218m (first half of 2018: HK$17,384m) and dividends received in the first half of 2019 were HK$135m (first half of 2018: HK$20m).

1 *Changes in subordinated liabilities (including those issued to Group companies) during the period included amounts from repayment and re-issuance with no cash movement, and non-cash changes from foreign exchange loss (HK$359m) and fair value loss after hedging (HK$120m).*
2 *The amount of cash and cash equivalents that are subject to exchange control and regulatory restrictions amounted to HK$102,325m at 30 June 2019 (at 30 June 2018: HK$127,961m).*
3 *The comparatives for cash and cash equivalents are restated due to certain cash and cash equivalents balances not being previously identified for disclosure. The impact of the restatement is to increase 'cash and cash equivalents' by HK$74.3bn, with an increase in 'net cash from operating activities' by HK$79.5bn and a reduction in 'net cash from investing activities' by HK$5.2bn.*

Consolidated statement of changes in equity

	Share capital	Other equity instru-ments	Retained earnings	Property revaluation reserve	Financial assets at FVOCI reserve	Cash flow hedge reserve	Foreign exchange reserve	Other[1]	Total share-holders' equity	Non-controlling interests	Total equity
	Half-year to 30 Jun 2019										
				Other reserves							
	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 2018	**172,335**	**35,879**	**429,595**	**57,914**	**2,953**	**(99)**	**(24,649)**	**78,830**	**752,758**	**60,162**	**812,920**
Impact on transition to HKFRS 16	**–**	**–**	**–**	**13,483**	**–**	**–**	**–**	**–**	**13,483**	**–**	**13,483**
At 1 Jan 2019	**172,335**	**35,879**	**429,595**	**71,397**	**2,953**	**(99)**	**(24,649)**	**78,830**	**766,241**	**60,162**	**826,403**
Profit for the period	**–**	**–**	**55,489**	**–**	**–**	**–**	**–**	**–**	**55,489**	**5,112**	**60,601**
Other comprehensive income/(expense) (net of tax)	**–**	**–**	**(1,079)**	**3,014**	**3,213**	**(36)**	**(713)**	**(8)**	**4,391**	**828**	**5,219**
– debt instruments at fair value through other comprehensive income	**–**	**–**	**–**	**–**	**1,462**	**–**	**–**	**–**	**1,462**	**23**	**1,485**
– equity instruments designated at fair value through other comprehensive income	**–**	**–**	**–**	**–**	**1,536**	**–**	**–**	**–**	**1,536**	**523**	**2,059**
– cash flow hedges	**–**	**–**	**–**	**–**	**–**	**(36)**	**–**	**–**	**(36)**	**26**	**(10)**
– changes in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	**–**	**–**	**(810)**	**–**	**–**	**–**	**–**	**–**	**(810)**	**1**	**(809)**
– property revaluation	**–**	**–**	**–**	**3,014**	**–**	**–**	**–**	**–**	**3,014**	**293**	**3,307**
– remeasurement of defined benefit asset/liability	**–**	**–**	**(269)**	**–**	**–**	**–**	**–**	**–**	**(269)**	**(26)**	**(295)**
– share of other comprehensive income/(expense) of associates and joint ventures	**–**	**–**	**–**	**–**	**215**	**–**	**–**	**(8)**	**207**	**–**	**207**
– exchange differences	**–**	**–**	**–**	**–**	**–**	**–**	**(713)**	**–**	**(713)**	**(12)**	**(725)**
Total comprehensive income/(expense) for the period	**–**	**–**	**54,410**	**3,014**	**3,213**	**(36)**	**(713)**	**(8)**	**59,880**	**5,940**	**65,820**
Other equity instruments issued[2]	**–**	**44,615**	**–**	**–**	**–**	**–**	**–**	**–**	**44,615**	**–**	**44,615**
Other equity instruments repaid[2]	**–**	**(35,879)**	**–**	**–**	**–**	**–**	**–**	**–**	**(35,879)**	**–**	**(35,879)**
Dividends paid[3]	**–**	**–**	**(38,183)**	**–**	**–**	**–**	**–**	**–**	**(38,183)**	**(3,619)**	**(41,802)**
Movement in respect of share-based payment arrangements	**–**	**–**	**(75)**	**–**	**–**	**–**	**–**	**68**	**(7)**	**–**	**(7)**
Transfers and other movements[5]	**–**	**–**	**(1,247)**	**(1,355)**	**–**	**–**	**–**	**2,672**	**70**	**(162)**	**(92)**
At 30 Jun 2019	**172,335**	**44,615**	**444,500**	**73,056**	**6,166**	**(135)**	**(25,362)**	**81,562**	**796,737**	**62,321**	**859,058**
	Half-year to 30 Jun 2018										
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 period	–	–	53,759	–	–	–	–	–	53,759	4,759	58,518
Other comprehensive income/(expense) (net of tax)	–	–	(680)	3,142	(675)	(250)	(8,117)	(10)	(6,590)	46	(6,544)
– debt instruments at fair value through other comprehensive income	–	–	–	–	34	–	–	–	34	46	80
– equity instruments designated at fair value through other comprehensive income	–	–	–	–	(151)	–	–	–	(151)	(173)	(324)
– cash flow hedges	–	–	–	–	–	(250)	–	–	(250)	(23)	(273)
– changes in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	–	–	(816)	–	–	–	–	–	(816)	(4)	(820)
– property revaluation	–	–	–	3,142	–	–	–	–	3,142	350	3,492
– remeasurement of defined benefit asset/liability	–	–	139	–	–	–	–	–	139	(34)	105
– share of other comprehensive expense of associates and joint ventures	–	–	(3)	–	(558)	–	–	(10)	(571)	–	(571)
– exchange differences	–	–	–	–	–	–	(8,117)	–	(8,117)	(116)	(8,233)
Total comprehensive income/(expense) for the period	–	–	53,079	3,142	(675)	(250)	(8,117)	(10)	47,169	4,805	51,974
Dividends paid	–	–	(26,559)	–	–	–	–	–	(26,559)	(3,186)	(29,745)
Movement in respect of share-based payment arrangements	–	–	(146)	–	–	–	–	69	(77)	–	(77)
Transfers and other movements[5]	–	–	(1,892)	(664)	–	–	–	2,633	77	–	77
At 30 Jun 2018	151,360	14,737	423,970	60,859	1,638	(447)	(15,065)	68,048	705,100	57,802	762,902

Consolidated statement of changes in equity (continued)

	Half-year to 31 Dec 2018										
				Other reserves							
	Share capital	Other equity instruments	Retained earnings	Property revaluation reserve	Financial assets at FVOCI reserve	Cash flow hedge reserve	Foreign exchange reserve	Other[1]	Total share-holders' 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 1 Jul 2018	151,360	14,737	423,970	60,859	1,638	(447)	(15,065)	68,048	705,100	57,802	762,902
Profit for the period	—	—	49,254	—	—	—	—	—	49,254	4,344	53,598
Other comprehensive income/ (expense) (net of tax)	—	—	(210)	4,908	903	348	(9,584)	8	(3,627)	20	(3,607)
– debt instruments at fair value through other comprehensive income	—	—	—	—	700	—	—	—	700	46	746
– equity instruments designated at fair value through other comprehensive income	—	—	—	—	(216)	—	—	—	(216)	(41)	(257)
– cash flow hedges	—	—	—	—	—	348	—	—	348	56	404
– changes in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	—	—	619	—	—	—	—	—	619	2	621
– property revaluation	—	—	—	4,908	—	—	—	—	4,908	426	5,334
– remeasurement of defined benefit asset/liability	—	—	(827)	—	—	—	—	—	(827)	(188)	(1,015)
– share of other comprehensive expense of associates and joint ventures	—	—	(2)	—	419	—	—	8	425	—	425
– exchange differences	—	—	—	—	—	—	(9,584)	—	(9,584)	(281)	(9,865)
Total comprehensive income/ (expense) for the period	—	—	49,044	4,908	903	348	(9,584)	8	45,627	4,364	49,991
Other equity instruments issued[2]	—	21,142	—	—	—	—	—	—	21,142	—	21,142
Dividends paid[3]	—	—	(20,881)	—	—	—	—	—	(20,881)	(1,882)	(22,763)
Movement in respect of share-based payment arrangements	—	—	(88)	—	—	—	—	177	89	10	99
Transfers and other movements[4,5,6]	20,975	—	(22,450)	(7,853)	412	—	—	10,597	1,681	(132)	1,549
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

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 the first half of 2019, there were US$1,100m additional tier 1 capital instruments issued (2018: US$2,700m). In addition, US$4,600m of additional tier 1 capital instruments were repaid and re-issued in the first half of 2019 with no actual cash movement (nil in 2018).*

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 payment out of distributable profits in previous years.*

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 the second half of 2018 included HK$7,169m relating to transfer of properties to a fellow subsidiary of the Group as part of the Recovery and Resolution Plan as set out in the Report of Directors in the* Annual Report and Accounts 2018*.*

Notes on the Interim condensed consolidated financial statements

1 Basis of preparation and significant accounting policies

(a) Compliance with Hong Kong Financial Reporting Standards

The Interim condensed consolidated financial statements of the group have been prepared in accordance with HKAS 34 'Interim Financial Reporting' as issued by the Hong Kong Institute of Certified Public Accountants ('HKICPA'). These financial statements should be read in conjunction with the *Annual Report and Accounts 2018*.

Standards applied during the half-year to 30 June 2019

HKFRS 16

On 1 January 2019, the group adopted the requirements of HKFRS 16 and recognised lease liabilities in relation to leases which had previously been classified as 'operating leases' in accordance with HKAS 17 'Leases'. These liabilities were measured at the present value of the remaining lease payments, discounted at the lessee's incremental borrowing rate as at 1 January 2019. The associated right-of-use ('ROU') assets were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments or provisions for onerous leases recognised on balance sheet at 31 December 2018. In addition, the following practical expedients permitted by the standard were applied:

- Reliance was placed on previous assessments on whether leases were onerous;
- Operating leases with a remaining lease term of less than 12 months as at 1 January 2019 were treated as short-term leases; and
- Initial direct costs were not included in the measurement of ROU assets for leases previously accounted for as operating leases.

The differences between HKAS 17 and HKFRS 16 are summarised in the table below:

HKAS 17	HKFRS 16
Leases were classified as either finance or operating leases. Payments made under operating leases were charged to profit or loss on a straight-line basis over the period of the lease.	Leases are recognised as an ROU asset and a corresponding liability at the date at which the leased asset is made available for use. Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease term so as to produce a constant period rate of interest on the remaining balance of the liability. The ROU asset is depreciated over the shorter of the ROU asset's useful economic life and the lease term on a straight-line basis. In determining lease term, the group considers all facts and circumstances that create an economic incentive to exercise an extension option or not exercise a termination option over the planning horizon of five years. In general, it is not expected that the discount rate implicit in the lease is available so the lessee's incremental borrowing rate is used. This is the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of a similar value in a similar economic environment with similar terms and conditions. The rates are determined for each economic environment in which the group operates by adjusting swap rates with funding spreads (own credit spread) and cross-currency basis where appropriate.

The group adopted the requirements of HKFRS 16 retrospectively, with the cumulative effect of initially applying the standard recognised as an adjustment to the opening balance of retained earnings at that date. Comparatives were not restated. In relation to the operating leases that were under HKAS 17 'Leases', the adoption of the standard increased assets by HK$9.2bn reported under 'Property, plant and equipment' and increased lease liabilities by the same amount reported under 'Accruals and deferred income, other liabilities and provisions' with no effect on net assets or retained earnings.

In addition, as a consequence of HKFRS 16, properties previously reported under 'Prepayments, accrued income and other assets' as operating leases and held at cost were reclassified to 'Property, plant and equipment' and measured at fair value. The implementation increased 'Property, plant and equipment' by HK$16.3bn and increased deferred tax liabilities by HK$2.7bn, with the net impact taken to the 'Property Revaluation Reserve'.

The overall impact of the above is to increase 'Property, plant and equipment' by HK$25.5bn, increase 'Accruals and deferred income, other liabilities and provisions' by HK$9.2bn, increase 'Deferred tax liabilities' by HK$2.7bn, increase 'Property Revaluation Reserve' by HK$13.5bn and decrease 'Prepayments, accrued income and other assets' by HK$136m.

(b) Use of estimates and judgements

Management believes that the group's critical accounting estimates and judgements are those which relate to impairment of financial instruments, the valuation of financial instruments, deferred tax assets, provisions for liabilities and interests in associates. There were no other changes in the current period to the critical accounting estimates and judgements applied in 2019, which are stated in note 1 of the *Annual Report and Accounts 2018.*

(c) Composition of group

There were no material changes in the composition of the group in the half-year to 30 June 2019.

(d) Future accounting developments

HKFRS 17 'Insurance Contracts' was issued in January 2018 and sets out the requirements that an entity should apply in accounting for insurance contracts it issues and reinsurance contracts it holds. HKFRS 17 is currently effective from 1 January 2021. However, the HKICPA is consulting on delaying the mandatory implementation date by one year and may make additional changes to the standard. The group is in the process of implementing HKFRS 17. Industry practice and interpretation of the standard is still developing and there may be changes to implementation decisions as practice evolves, therefore the likely impact of its implementation remains uncertain.

(e) Going concern

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the group and parent company have the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows, capital requirements and capital resources.

(f) Accounting policies

Except as described above, the accounting policies applied by the group for the Interim condensed consolidated financial statements are consistent with those described in note 1 of the *Annual Report and Accounts 2018*, as are the methods of computation.

2 Dividends

	Half-year to			
	30 Jun 2019		30 Jun 2018	
	HK$ per share	**HK$m**	HK$ per share	HK$m
Ordinary dividends paid				
– fourth interim dividend in respect of the previous financial year approved and paid during the half-year	**0.47**	**21,958**	0.36	16,559
– first interim dividend paid	**0.32**	**14,963**	0.22	10,000
Total	**0.79**	**36,921**	0.58	26,559

On 22 July 2019, the Directors declared a second interim dividend in respect of the half-year ended 30 June 2019 of HK$0.32 per ordinary share (HK$14,963m) (half-year ended 30 June 2018 of HK$0.22 per ordinary share (HK$10,000m)). This distribution was paid on 30 July 2019. No liability is recognised in the Interim condensed consolidated financial statements in respect of this dividend.

Distributions on other equity instruments

		Half-year to	
		30 Jun 2019	30 Jun 2018
		HK$m	HK$m
US$1,900m	Floating rate perpetual subordinated loans (interest rate at one year US dollar LIBOR plus 3.84%)[1]	**497**	–
US$1,400m	Floating rate perpetual subordinated loans (interest rate at three months US dollar LIBOR plus 3.51%)[1,2]	**373**	–
US$600m	Floating rate perpetual subordinated loan (interest rate at three months US dollar LIBOR plus 3.62%)[1,2]	**178**	–
US$700m	Floating rate perpetual subordinated loan (interest rate at three months US dollar LIBOR plus 4.98%)[1,2]	**214**	–
Total		**1,262**	–

1 *These subordinated loans were early repaid in the first half of 2019 and distributions were made on repayment.*
2 *These subordinated loans were issued in the second half of 2018.*

3 Loans and advances to customers

	At	
	30 Jun 2019	31 Dec 2018
	HK$m	HK$m
Gross loans and advances to customers	**3,714,568**	3,545,258
Expected credit loss allowances	**(16,079)**	(16,556)
	3,698,489	3,528,702

The following table provides an analysis of loans and advances to customers by industry sector based on the Statistical Classification of economic activities in the European Community ('NACE') codes.

Analysis of gross loans and advances to customers

	At	
	30 Jun 2019	31 Dec 2018
	HK$m	HK$m
Residential mortgages	**998,656**	937,666
Credit card advances	**89,887**	93,200
Other personal	**281,320**	236,133
Total personal	**1,369,863**	1,266,999
Real estate	**663,912**	626,120
Wholesale and retail trade	**438,585**	433,734
Manufacturing	**439,884**	424,813
Transportation and storage	**85,985**	95,773
Other	**475,216**	484,186
Total corporate and commercial	**2,103,582**	2,064,626
Non-bank financial institutions	**241,123**	213,633
	3,714,568	3,545,258
By geography[1]		
Hong Kong	**2,384,808**	2,282,909
Rest of Asia Pacific	**1,329,760**	1,262,349

1 *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$169bn, or 5%, which included unfavourable foreign exchange translation effects of HK$2bn. Excluding this impact, the underlying increase of HK$171bn was driven by an increase in residential mortgages of HK$63bn, mainly in Hong Kong and Australia, coupled with an increase in other personal lending of HK$45bn mainly in Hong Kong and Singapore. Corporate and commercial lending also increased by HK$39bn, mainly in mainland China and Singapore.

4 Financial investments

	At	
	30 Jun 2019	31 Dec 2018
	HK$m	HK$m
Financial investments measured at fair value through other comprehensive income	**1,359,254**	1,503,625
– treasury and other eligible bills	**480,497**	660,871
– debt securities	**870,856**	836,896
– equity securities	**7,901**	5,858
Debt instruments measured at amortised cost	**423,936**	367,401
– treasury and other eligible bills	**2,395**	3,624
– debt securities	**421,541**	363,777
	1,783,190	1,871,026

5 Interests in associates and joint ventures

Bank of Communications Co., Limited ('BoCom')

The group's investment in BoCom is classified as an associate. Significant influence in BoCom was established via representation on BoCom's Board of Directors and participation in a Technical Cooperation and Exchange Programme ('TCEP'). Under the TCEP, a number of HSBC staff have been seconded to assist in the maintenance of BoCom's financial and operating policies. Investments in associates are recognised using the equity method of accounting in accordance with HKAS 28 whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the group's share of BoCom's net assets. An impairment test is required if there is any indication of impairment.

Impairment testing

At 30 June 2019, the fair value of the group's investment in BoCom had been below the carrying amount for approximately 86 months. As a result, the group performed an impairment test on the carrying amount, which confirmed that there was no impairment at 30 June 2019 as the recoverable amount as determined by a value-in-use ('VIU') calculation was higher than the carrying value.

	At					
	30 Jun 2019			31 Dec 2018		
	VIU	**Carrying value**	**Fair value**	VIU	Carrying value	Fair value
	HK$bn	**HK$bn**	**HK$bn**	HK$bn	HK$bn	HK$bn
BoCom	**158.0**	**142.4**	**83.8**	141.3	139.6	86.1

The increase in VIU for the first half of 2019 was principally driven by BoCom's actual performance exceeding earlier forecasts and upward revisions to management's best estimates of BoCom's future earnings.

In future periods, the VIU may increase or decrease depending on the effect of changes to model inputs. The main model inputs are described below and are based on factors observed at period-end. The factors that could result in a change in the VIU and an impairment include a short-term under-performance by BoCom, a change in regulatory capital requirements, or an increase in uncertainty regarding the future performance of BoCom resulting in a downgrade of the future asset growth or profitability. An increase in the discount rate as a result of an increase in the risk premium or risk-free rates could also result in a reduction of VIU and an impairment. At the point where the carrying value exceeds the VIU, impairment would be recognised.

If the group did not have significant influence in BoCom, the investment would be carried at fair value rather than the current carrying value.

Basis of recoverable amount

The impairment test was performed by comparing the recoverable amount of BoCom, determined by a VIU calculation, with its carrying amount. The VIU calculation uses discounted cash flow projections based on management's best estimates of future earnings available to ordinary shareholders prepared in accordance with HKAS 36. Significant management judgement is required in arriving at the best estimate. There are two main components to the VIU calculation. The first component is management's best estimate of BoCom's earnings which is based on explicit forecasts over the short to medium term. This results in forecast earnings growth that is lower than recent historical actual growth and also reflects the uncertainty arising from the current economic outlook. Earnings beyond the short to medium term are then extrapolated in perpetuity using a long-term growth rate to derive a terminal value, which comprises the majority of the VIU. The second component is the capital maintenance charge ('CMC') which is management's forecast of the earnings that need to be withheld in order for BoCom to meet regulatory capital requirements over the forecast period (i.e. CMC is deducted when arriving at management's estimate of future earnings available to ordinary shareholders). The principal inputs to the CMC calculation include estimates of asset growth, the ratio of risk-weighted assets to total assets, and the expected minimum regulatory capital requirements. An increase in the CMC as a result of a change to these principal inputs would reduce VIU. Additionally, management considers other factors (including qualitative factors) to ensure that the inputs to the VIU calculation remain appropriate.

Key assumptions in value-in-use calculation

We used a number of assumptions in our VIU calculation, in accordance with the requirements of HKAS 36:

- Long-term profit growth rate: 3% (31 December 2018: 3%) for periods after 2022, which does not exceed forecast GDP growth in mainland China and is consistent with forecasts by external analysts.
- Long-term asset growth rate: 3% (31 December 2018: 3%) for periods after 2022, which is the rate that assets are expected to grow to achieve long-term profit growth of 3%.
- Discount rate: 11.82% (31 December 2018: 11.82%) which is based on a Capital Asset Pricing Model ('CAPM') calculation for BoCom, using market data. Management also compares the rate derived from the CAPM with discount rates from external sources. The discount rate used is within the range of 10.3% to 14.3% (31 December 2018: 10.4% to 15.0%) indicated by external sources.
- Expected credit losses as a percentage of customer advances: ranges from 0.88% to 0.94% (31 December 2018: 0.73% to 0.79%) in the short to medium term and reflect increases due to the US-China trade tensions. For periods after 2022, the ratio is 0.70% (31 December 2018: 0.70%) which is slightly higher than the historical average.
- Risk-weighted assets as a percentage of total assets: 61% (31 December 2018: 62%) for all forecast periods. This is slightly higher than BoCom's actual results and the forecasts disclosed by external analysts.
- Cost-income ratio: ranges from 38.1% to 38.9% (31 December 2018: 38.7% to 39.0%) in the short to medium term. This is slightly higher than the forecasts disclosed by external analysts.
- Effective tax rate: ranges from 13.9% to 22.0% (31 December 2018: 13.8% to 22.3%) in the short to medium term reflecting an expected increase towards the long-term assumption. For periods after 2022, the rate is 22.5% (31 December 2018: 22.5%) which is slightly higher than the historical average.
- Capital requirements: Capital adequacy ratio: 11.5% (31 December 2018: 11.5%) and Tier 1 capital adequacy ratio: 9.5% (31 December 2018: 9.5%), based on the minimum regulatory requirements.

The following table shows the change to each key assumption in the VIU calculation that on its own would reduce the headroom to nil:

Key assumption	Changes to key assumption to reduce headroom to nil
• Long-term profit growth rate	• Decrease by 83 basis points
• Long-term asset growth rate	• Increase by 71 basis points
• Discount rate	• Increase by 102 basis points
• Expected credit losses as a percentage of customer advances	• Increase by 14 basis points
• Risk-weighted assets as a percentage of total assets	• Increase by 499 basis points
• Cost-income ratio	• Increase by 315 basis points
• Long-term effective tax rate	• Increase by 727 basis points
• Capital requirements – capital adequacy ratio	• Increase by 94 basis points
• Capital requirements – tier 1 capital adequacy ratio	• Increase by 169 basis points

The following table further illustrates the impact on VIU of reasonably possible changes to key assumptions. This reflects the sensitivity of the VIU to each key assumption on its own and it is possible that more than one favourable and/or unfavourable change may occur at the same time. The selected rates of reasonably possible changes to key assumptions are largely based on external analysts' forecasts which can change period to period.

	Favourable change			Unfavourable change		
		Increase in VIU	VIU		Decrease in VIU	VIU
	bps	HK$bn	HK$bn	bps	HK$bn	HK$bn
At 30 June 2019						
Long-term profit growth rate	**—**	**—**	**158.0**	**-50**	**(9.7)**	**148.3**
Long-term asset growth rate	**-50**	**9.5**	**167.5**	**—**	**—**	**158.0**
Discount rate	**-72**	**13.4**	**171.4**	**+38**	**(6.2)**	**151.8**
Expected credit losses as a percentage of customer advances	**2019 to 2022: 0.90% 2023 onwards: 0.69%**	**1.2**	**159.2**	**2019 to 2022: 0.95% 2023 onwards: 0.79%**	**(8.9)**	**149.1**
Risk-weighted assets as a percentage of total assets	**-125**	**3.6**	**161.6**	**+150**	**(4.6)**	**153.4**
Cost-income ratio	**-190**	**10.3**	**168.3**	**—**	**—**	**158.0**
Long-term effective tax rate	**-345**	**7.4**	**165.4**	**+250**	**(5.4)**	**152.6**
Earnings in short to medium term – compound annual growth rate[1]	**+102**	**7.5**	**165.5**	**-272**	**(13.7)**	**144.3**
Capital requirements – capital adequacy ratio	**—**	**—**	**158.0**	**+273**	**(48.8)**	**109.2**
Capital requirements – tier 1 capital adequacy ratio	**—**	**—**	**158.0**	**+273**	**(35.3)**	**122.7**
At 31 December 2018						
Long-term profit growth rate	+100	20.2	161.5	-10	(1.7)	139.6
Long-term asset growth rate	-10	2.0	143.3	+100	(21.7)	119.6
Discount rate	-142	25.4	166.7	+28	(4.0)	137.3
Expected credit losses as a percentage of customer advances	2018 to 2022: 0.70% 2023 onwards: 0.65%	7.0	148.3	2018 to 2022: 0.83% 2023 onwards: 0.77%	(7.9)	133.4
Risk-weighted assets as a percentage of total assets	-140	4.1	145.4	+80	(2.3)	139.0
Cost-income ratio	-160	8.8	150.1	+200	(10.9)	130.4
Long-term effective tax rate	-280	5.3	146.6	+250	(4.6)	136.7
Earnings in short to medium term – compound annual growth rate[1,2]	+204	8.1	149.4	-366	(14.2)	127.1
Capital requirements – capital adequacy ratio	—	—	141.3	+258	(39.4)	101.9
Capital requirements – tier 1 capital adequacy ratio	—	—	141.3	+243	(25.2)	116.1

1 *Based on management's explicit forecasts over the short to medium term.*
2 *Comparatives on 31 December 2018 have been updated to align with the 2019 approach to describe the impact of the change in isolation.*

Considering the interrelationship of the changes set out in the table above, management estimates that the reasonably possible range of VIU is HK$136.7bn to HK$166.4bn (31 December 2018: HK$121.4bn to HK$153.5bn). The range is based on the favourable/unfavourable change in the earnings in the short-to medium-term and long-term expected credit losses as a percentage of customer advances as set out in the table above. All other long-term assumptions, the discount rate and the basis of the CMC have been kept unchanged when determining the reasonably possible range of the VIU.

6 Customer accounts

Customer accounts by country

	At	
	30 Jun 2019	31 Dec 2018
	HK$m	HK$m
Hong Kong	**3,810,364**	3,797,807
Singapore	**360,998**	331,479
Mainland China	**354,599**	358,026
Australia	**173,022**	161,726
India	**122,290**	111,297
Malaysia	**109,202**	108,899
Taiwan	**106,803**	106,537
Indonesia	**34,953**	29,843
Other	**217,342**	202,052
	5,289,573	5,207,666

7 Fair values of financial instruments carried at fair value

The accounting policies, control framework and hierarchy used to determine fair values at 30 June 2019 are consistent with those applied for the *Annual Report and Accounts 2018.*

The following table provides an analysis of financial instruments carried at fair value and bases of valuation.

	Fair value hierarchy					
	Level 1	Level 2	Level 3	Third-party total	Inter-company[2]	Total
	HK$m	HK$m	HK$m	HK$m	HK$m	HK$m
At 30 Jun 2019						
Assets						
Trading assets[1]	**431,245**	**183,398**	**42**	**614,685**	**–**	**614,685**
Derivatives	**2,344**	**223,039**	**538**	**225,921**	**72,276**	**298,197**
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	**86,251**	**35,598**	**26,212**	**148,061**	**–**	**148,061**
Financial investments	**1,005,154**	**349,221**	**4,879**	**1,359,254**	**–**	**1,359,254**
Liabilities						
Trading liabilities[1]	**70,695**	**10,905**	**–**	**81,600**	**–**	**81,600**
Derivatives	**2,756**	**226,084**	**1,652**	**230,492**	**78,343**	**308,835**
Financial liabilities designated at fair value[1]	**–**	**151,108**	**22,044**	**173,152**	**–**	**173,152**
At 31 Dec 2018						
Assets						
Trading assets[1]	395,769	162,841	228	558,838	–	558,838
Derivatives	3,219	209,450	1,206	213,875	78,994	292,869
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	75,105	36,599	21,155	132,859	–	132,859
Financial investments	1,146,426	352,490	4,709	1,503,625	–	1,503,625
Liabilities						
Trading liabilities[1]	74,376	6,818	–	81,194	–	81,194
Derivatives	3,348	220,043	1,842	225,233	70,320	295,553
Financial liabilities designated at fair value[1]	–	139,782	21,361	161,143	–	161,143

1 *Amounts with HSBC Group entities are not reflected here.*
2 *Derivatives balances with HSBC Group entities are largely under 'Level 2'.*

Transfers between Level 1 and Level 2 fair values

	Assets				Liabilities		
	Financial investments	Trading assets	Designated and otherwise mandatorily measured at fair value	Derivatives	Trading liabilities	Designated at fair value	Derivatives
	HK$m	HK$m	HK$m	HK$m	HK$m	HK$m	HK$m
At 30 Jun 2019							
Transfers from Level 1 to Level 2	**4,673**	**1,410**	**–**	**–**	**126**	**–**	**–**
Transfers from Level 2 to Level 1	**14,348**	**7,570**	**1,268**	**–**	**532**	**–**	**–**
At 31 Dec 2018							
Transfers from Level 1 to Level 2	9,955	1,389	–	–	349	–	–
Transfers from Level 2 to Level 1	121,667	18,109	–	–	376	–	–

Transfers between levels of the fair value hierarchy are deemed to occur at the end of each quarterly reporting period. Transfers into and out of Levels of the fair value hierarchy are primarily attributable to changes in observability of valuation inputs and price transparency.

Movements in Level 3 financial instruments

There were no material transfers from/to Levels 1 and 2 as a result of change in observability of valuation inputs, settlement, nor gains/loss recognised in the income statement/other comprehensive income during the first half of 2019 in relation to financial instruments carried at fair value in Level 3 (1H 2018: immaterial). The increase in Level 3 assets was mainly due to the purchase of financial assets of HK$5,252m (1H 2018: HK$7,428m) to support growth in insurance business.

8 Fair values of financial instruments not carried at fair value

Fair values of financial instruments not carried at fair value and bases of valuation

	At			
	30 Jun 2019		31 Dec 2018	
	Carrying amount	**Fair value**	Carrying amount	Fair value
	HK$m	**HK$m**	HK$m	HK$m
Assets				
Reverse repurchase agreements – non-trading	**393,760**	**394,215**	406,327	406,784
Placings with and advances to banks	**418,935**	**418,875**	338,151	337,974
Loans and advances to customers	**3,698,489**	**3,697,003**	3,528,702	3,525,759
Financial investments – at amortised cost	**423,936**	**444,915**	367,401	365,379
Liabilities				
Repurchase agreements – non-trading	**141,685**	**141,671**	70,279	70,282
Deposits by banks	**220,156**	**220,130**	164,664	164,662
Customer accounts	**5,289,573**	**5,289,715**	5,207,666	5,207,871
Debt securities in issue	**90,959**	**91,605**	58,236	58,808
Subordinated liabilities	**4,068**	**3,908**	4,081	3,879
Preference shares	**98**	**98**	98	98

Other financial instruments not carried at fair value are typically short-term in nature or re-priced to current market rates frequently. Accordingly, their carrying amount is a reasonable approximation of fair value. Details of how the fair values of financial instruments that are not carried at fair value on the balance sheet are calculated can be found in note 36 of the *Annual Report and Accounts 2018.*

9 Contingent liabilities, contractual commitments and guarantees

	At	
	30 Jun 2019	31 Dec 2018
	HK$m	HK$m
Contingent liabilities and financial guarantee contracts	**307,523**	295,645
Commitments	**2,638,858**	2,563,208
	2,946,381	2,858,853

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.

Contingent liabilities at 30 June 2019 included amounts in relation to legal and regulatory matters as set out in note 12.

10 Segmental analysis

The global businesses are considered our reportable segments under HKFRS 8. The basis of identifying segments and measuring segmental results is set out in note 33 'Segmental Analysis' of the *Annual Report and Accounts 2018.* There have been no material changes to the reportable segments since 31 December 2018.

Financial performance by global business is set out in the Financial Review on page 3, which forms part of the Interim condensed consolidated financial statements.

Geographical regions

	Hong Kong	Rest of Asia-Pacific	Intra-segment elimination	Total
	HK$m	HK$m	HK$m	HK$m
Half-year to 30 Jun 2019				
Total operating income	**116,843**	**41,728**	**(248)**	**158,323**
Profit before tax	**47,964**	**24,903**	**—**	**72,867**
Total assets	**6,203,675**	**3,125,360**	**(656,242)**	**8,672,793**
Total liabilities	**5,716,131**	**2,753,846**	**(656,242)**	**7,813,735**
Half-year to 30 Jun 2018				
Total operating income	101,609	38,532	(1,344)	138,797
Profit before tax	45,916	25,097	—	71,013
Total assets	5,967,744	2,990,353	(719,230)	8,238,867
Total liabilities	5,576,965	2,618,230	(719,230)	7,475,965

11 Related party transactions

During the first half of 2019, over 8,300 employees performing shared services in Hong Kong have been transferred from the group to a separate service company, HSBC Global Services (Hong Kong) Limited (the 'ServCo'), which is a fellow subsidiary of the Group set up in Hong Kong as part of recovery and resolution planning to provide functional support services to the group. There were no changes to employment terms and conditions or pension benefits as a result of these transfers. The group recognises a management charge for the services provided by ServCo, which is reported under 'General and administrative expenses'. In the first half of 2019, ServCo has recharged HK$7,382m (first half of 2018 : HK$495m) to the group in relation to the remuneration and other costs associated with the transfer of relevant employees and assets to ServCo.

As at 30 June 2019, the group has completed the restructuring of its internal regulatory capital and loss-absorbing capacity ('LAC')-eligible debt and equity instruments such that they are all held by its immediate parent, HSBC Asia Holdings Limited, in order to comply with the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules which came into operation on 14 December 2018.

Except for the above, all related party transactions that took place in the half-year to 30 June 2019 were similar in nature to those disclosed in the *Annual Report and Accounts 2018*. There were no changes in the related party transactions as described in the *Annual Report and Accounts 2018* that have had a material effect on the financial position or performance of the group in the half-year to 30 June 2019.

12 Legal proceedings and regulatory matters

The group is party to legal proceedings and regulatory matters in a number of jurisdictions arising out of its normal business operations. Apart from the matters described below, the Bank considers that none of these matters are material. The recognition of provisions is determined in accordance with the accounting policies set out in note 1.2(n) of the *Annual Report and Accounts 2018*. While the outcome of legal proceedings and regulatory matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of these matters as at 30 June 2019. Any provision recognised does not constitute an admission of wrongdoing or legal liability. It is not practicable to provide an aggregate estimate of potential liability for our legal proceedings and regulatory matters as a class of contingent liabilities.

Anti-money laundering and sanctions-related matters

In December 2012, among other agreements, HSBC Holdings plc agreed to an undertaking with the UK Financial Conduct Authority ('FCA') and consented to a cease-and-desist order with the US Federal Reserve Board ('FRB'), both of which contained certain forward-looking anti-money laundering ('AML') and sanctions-related obligations. HSBC also agreed to retain an independent compliance monitor (who is, for FCA purposes, a 'Skilled Person' under section 166 of the Financial Services and Markets Act and, for FRB purposes, an 'Independent Consultant') to produce periodic assessments of the Group's AML and sanctions compliance programme (the 'Skilled Person/Independent Consultant'). In December 2012, HSBC Holdings plc also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions. The Skilled Person/Independent Consultant will continue to conduct country reviews and provide periodic reports for a period of time at the FCA's and FRB's discretion.

Through the Skilled Person/Independent Consultant's country-level reviews, as well as internal reviews conducted by HSBC, certain potential AML and sanctions compliance issues have been identified that HSBC is reviewing further with the FRB, FCA and/or OFAC. The Financial Crimes Enforcement Network of the US Treasury Department as well as the Civil Division of the US Attorney's Office for the Southern District of New York are investigating the collection and transmittal of third-party originator information in certain payments instructed over HSBC's proprietary payment systems. HSBC is cooperating with all of these investigations.

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

Tax investigations

The Bank continues to cooperate with the relevant US and other authorities, including with respect to clients of the Bank in India who may have had US tax reporting obligations.

In addition, various tax administration, regulatory and law enforcement authorities around the world, including in India, are conducting investigations and reviews of HSBC Private Bank (Suisse) SA and other HSBC companies in connection with allegations of tax evasion or tax fraud, money laundering and unlawful cross-border banking solicitation. In February 2015, the Indian tax authority issued a summons and request for information to the Bank in India.

The Bank and other HSBC companies are cooperating with these ongoing investigation. There are many factors that may affect the range of outcomes, and the resulting financial impact, of these investigations and reviews, which could be significant.

In light of the media attention regarding these matters, it is possible that other tax administration, regulatory or law enforcement authorities will also initiate or enlarge similar investigations or regulatory proceedings.

Singapore Interbank Offered Rate ('Sibor'), Singapore Swap Offer Rate ('SOR') and Australia Bank Bill Swap Rate ('BBSW')

In July and August 2016, HSBC and other panel banks were named as defendants in two putative class actions filed in the New York District Court on behalf of persons who transacted in products related to the Sibor, SOR and BBSW benchmark rates. The complaints allege, among other things, misconduct related to these benchmark rates in violation of US antitrust, commodities and racketeering laws, and state law.

In the Sibor/SOR litigation, following a decision on the defendants' motion to dismiss in October 2018, the claims against a number of HSBC entities were dismissed, and the Bank remains the only HSBC defendant in this action. In October 2018, the Bank filed a motion for reconsideration of the decision based on the issue of personal jurisdiction; this motion was denied in April 2019. Also in October 2018, the plaintiff filed a third amended complaint, naming only the Sibor panel members, including the Bank, as defendants; the court dismissed the third amended complaint in its entirety in July 2019.

In the BBSW litigation, in November 2018, the court dismissed all foreign defendants including all the HSBC entities, on personal jurisdiction grounds. In April 2019, the plaintiff filed an amended complaint, which the defendants have moved to dismiss.

There are many factors that may affect the range of outcomes, and the resulting financial impact, of these matters, which could be significant.

United States Bankruptcy Court for the Southern District of New York litigation

In June 2018, a claim was issued against the Bank in the United States Bankruptcy Court for the Southern District of New York by the Chapter 11 Trustee of CFG Peru Investments Pte. Ltd. (Singapore) (the 'Trustee Complaint'). The Trustee Complaint makes allegations under the Peruvian Civil Code, Hong Kong and U.S. common law and the Bankruptcy Code concerning the Bank's alleged conduct in commencing the winding-up proceedings and pursuing the appointment of joint provisional liquidators for affiliates of CFG Peru Investments Pte. Ltd. The Trustee is seeking damages and equitable subordination or disallowance of the Bank's Chapter 11 claims in a related bankruptcy proceeding.

The Bank is seeking to dismiss the Trustee Complaint. Based on the facts currently known, it is not practicable at this time to predict the resolution of this matter, including the timing or any possible impact, which could be significant.

Foreign exchange rate investigations

In January 2018, HSBC Holdings plc entered into a three-year deferred prosecution agreement with the Criminal Division of the US Department of Justice ('DoJ') (the 'FX DPA'), regarding fraudulent conduct in connection with two particular transactions in 2010 and 2011. This concluded the DoJ's investigation into HSBC's historical foreign exchange activities. Under the terms of the FX DPA, HSBC has a number of ongoing obligations, including implementing enhancements to its internal controls and procedures in its Global Markets business, which will be the subject of annual reports to the DoJ. In addition, HSBC agreed to pay a financial penalty and restitution.

There are many factors that may affect the range of outcomes and the resulting financial impact of this matter, which could be significant.

13 Interim Report 2019 and statutory accounts

The information in this *Interim Report 2019* is unaudited and does not constitute statutory accounts. The *Interim Report 2019* was approved by the Board of Directors on 5 August 2019. The Bank's statutory annual consolidated accounts for the year ended 31 December 2018 have been delivered to the Registrar of Companies and the Hong Kong Monetary Authority. The auditor has reported on those financial statements in their report dated 19 February 2019. The auditor's report was unqualified; did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying its report; and did not contain a statement under sections 406(2), 407(2) or (3) of the Hong Kong Companies Ordinance (Cap. 622).

14 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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