HSBC Bank Middle East Limited

Interim Financial Statements 2020

HSBC

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Presentation of information

This document comprises the *Interim Financial Statements 2020* for HSBC Bank Middle East Limited ('the bank') and its subsidiary undertakings (together 'the group'). It contains Condensed Financial Statements, together with the Auditor's review report. References to 'HSBC' or 'the HSBC Group' within this document mean HSBC Holdings plc together with its subsidiaries.

In accordance with IAS 34 the *Interim Report* is intended to provide an update on the *Annual Report and Accounts 2019* and therefore focuses on events during the first six months of 2020 rather than duplicating information previously reported.

Condensed financial statements

Consolidated income statement

		Half-year to	
		30 Jun 2020	30 Jun 2019
	Notes	**US$000**	US$000
Net interest income		**428,894**	498,726
– interest income		**542,629**	643,381
– interest expense		**(113,735)**	(144,655)
Net fee income	3	**211,472**	227,442
– fee income		**252,367**	282,473
– fee expense		**(40,895)**	(55,031)
Net income from financial instruments held for trading or managed on a fair value basis		**112,157**	107,163
Changes in fair value of long-term debt and related derivatives		**40**	(267)
Changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss		**(3,815)**	(236)
Gains less losses from financial investments		**8,742**	(32)
Dividend income		**288**	363
Other operating income, net		**38,290**	25,550
Net operating income before change in expected credit losses and other credit impairment charges		**796,068**	858,709
Change in expected credit losses and other credit impairment charges	9	**(508,129)**	(59,110)
Net operating income		**287,939**	799,599
Employee compensation and benefits		**(261,545)**	(292,198)
General and administrative expenses		**(170,979)**	(153,253)
Depreciation and impairment of property, plant and equipment and right-of-use assets		**(16,950)**	(16,357)
Amortisation and impairment of intangible assets		**(6,795)**	(4,280)
Total operating expenses		**(456,269)**	(466,088)
Operating profit/(loss)		**(168,330)**	333,511
Share of profit in associates		**(110)**	407
Profit/(loss) before tax		**(168,440)**	333,918
Taxation		**13,134**	(45,646)
Profit/(loss) for the period		**(155,306)**	288,272
Attributable to:			
– shareholders of the parent company		**(155,330)**	288,224
– non-controlling interests		**24**	48
Profit/(loss) for the period		**(155,306)**	288,272

The accompanying notes on pages 7 to 19 form an integral part of these financial statements.

Consolidated statement of comprehensive income

	Half-year to	
	30 Jun 2020	30 Jun 2019
	US$000	US$000
Profit/(loss) for the period	**(155,306)**	288,272
Other comprehensive income/(expense)		
Items that will be reclassified subsequently to profit or loss when specific conditions are met:		
Debt instruments at fair value though other comprehensive income	**11,906**	11,294
– fair value gains	**3,328**	12,669
– fair value gains/(losses) transferred to the income statement on disposal	**8,305**	(756)
– expected credit losses recognised in income statement	**1,926**	162
– income taxes	**(1,653)**	(781)
Cash flow hedges	**26,070**	44,718
– fair value gains	**29,037**	49,584
– income taxes	**(2,967)**	(4,866)
Exchange differences	**(21,073)**	(2,327)
Items that will not be reclassified subsequently to profit or loss:		
Remeasurement of defined benefit asset/liability	**(2,544)**	(3,064)
– before income taxes	**(2,544)**	(3,064)
Changes in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	**11,994**	(5,570)
– before income taxes	**11,994**	(5,570)
Equity instruments designated at fair value through other comprehensive income	**(3,630)**	1,835
– fair value (losses)/gains	**(3,630)**	1,835
Other comprehensive income for the period, net of tax	**22,723**	46,886
Total comprehensive income/(expense) for the period	**(132,583)**	335,158
Attributable to:		
– shareholders of the parent company	**(132,607)**	335,110
– non-controlling interests	**24**	48
Total comprehensive income/(expense) for the period	**(132,583)**	335,158

The accompanying notes on pages 7 to 19 form an integral part of these financial statements.

Consolidated statement of financial position

		At	
		30 Jun 2020	31 Dec 2019
	Notes	**US$000**	US$000
Assets			
Cash and balances at central banks		**2,787,910**	896,608
Items in the course of collection from other banks		**59,697**	78,992
Trading assets	10	**799,082**	194,800
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	10	**36,458**	40,731
Derivatives	10	**1,770,542**	1,176,296
Loans and advances to banks		**5,536,988**	5,797,423
Loans and advances to customers	9	**20,475,371**	19,661,235
Reverse repurchase agreements – non-trading		**1,600,271**	741,633
Financial investments	10	**9,978,399**	10,483,891
Prepayments, accrued income and other assets		**1,781,541**	1,566,770
Current tax assets		**10**	10
Interests in associates		**2,964**	3,074
Intangible assets		**77,368**	62,997
Deferred tax assets		**213,559**	170,979
Total assets		**45,120,160**	40,875,439
Liabilities and equity			
Liabilities			
Deposits by banks		**3,201,189**	3,806,270
Customer accounts		**27,149,948**	23,726,514
Repurchase agreements – non-trading		**869,252**	—
Items in the course of transmission to other banks		**159,829**	186,234
Trading liabilities	10	**80,850**	47,989
Financial liabilities designated at fair value	7,10	**3,123,863**	2,514,102
Derivatives	10	**1,684,651**	1,091,651
Debt securities in issue	8	**1,588,745**	1,788,486
Accruals, deferred income and other liabilities		**2,196,803**	2,550,378
Current tax liabilities		**77,331**	99,126
Provisions		**127,362**	71,201
Total liabilities		**40,259,823**	35,881,951
Equity			
Called up share capital		**931,055**	931,055
Share premium account		**61,346**	61,346
Other reserves		**(98,919)**	(112,172)
Retained earnings		**3,962,437**	4,108,865
Total shareholders' equity		**4,855,919**	4,989,094
Non-controlling interests		**4,418**	4,394
Total equity		**4,860,337**	4,993,488
Total liabilities and equity		**45,120,160**	40,875,439

The accompanying notes on pages 7 to 19 form an integral part of these financial statements.

Neslihan Erkazanci

Chief Financial Officer / Director

Consolidated statement of cash flows

	Half-year to	
	30 Jun 2020	30 Jun 2019
	US$000	US$000
Profit/(loss) before tax	**(168,440)**	333,918
Cash flows from operating activities		
Adjustments for:		
Net gain from investing activities	**(8,564)**	—
Share of profits in associates	**(110)**	(407)
Other non-cash items included in profit before tax	**547,703**	46,520
Change in operating assets	**(1,024,690)**	637,691
Change in operating liabilities	**3,112,639**	2,706,303
Elimination of exchange differences[1]	**7,154**	(30,540)
Tax paid	**(8,661)**	(62,741)
Net cash from operating activities	**2,457,031**	3,630,744
Cash flows from investing activities		
Net cash flows from purchase and sale/maturity of financial investments	**312,520**	(1,720,459)
Net cash flows from the purchase and sale of property, plant and equipment	**(3,031)**	(17,180)
Net investment in intangible assets	**(21,852)**	(15,551)
Net cash from/(used) in investing activities	**287,637**	(1,753,190)
Cash flows from financing activities		
Dividends paid to shareholders of the parent company	**—**	(200,000)
Net cash used in financing activities	**—**	(200,000)
Net increase in cash and cash equivalents	**2,744,668**	1,677,554
Cash and cash equivalents at 1 Jan	**6,145,574**	4,328,007
Exchange differences in respect of cash and cash equivalents	**(18,214)**	33,127
Cash and cash equivalents at 30 Jun[2]	**8,872,028**	6,038,688

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

2 At 31 December 2019, HSBC re-presented cash and cash equivalents to reflect a consistent global approach to these amounts. The net effect of these changes increased cash and cash equivalents by US$1.5bn at 30 June 2019.

The accompanying notes on pages 7 to 19 form an integral part of these financial statements.

Consolidated statement of changes in equity

			Other reserves						
	Called up share capital and share premium	Retained earnings	Financial assets at FVOCI reserves	Cash flow hedging reserve	Foreign exchange reserve	Merger and other reserves	Total share-holders' equity	Non-controlling interests	Total equity
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
At 1 Jan 2020	**992,401**	**4,108,865**	**7,192**	**20,570**	**(124,613)**	**(15,321)**	**4,989,094**	**4,394**	**4,993,488**
Loss for the period	**—**	**(155,330)**	**—**	**—**	**—**	**—**	**(155,330)**	**24**	**(155,306)**
Other comprehensive income (net of tax)	**—**	**9,450**	**8,216**	**26,070**	**(21,013)**	**—**	**22,723**	**—**	**22,723**
– debt instruments at fair value through other comprehensive income	**—**	**—**	**11,906**	**—**	**—**	**—**	**11,906**	**—**	**11,906**
– equity instruments designated at fair value through other comprehensive income	**—**	**—**	**(3,630)**	**—**	**—**	**—**	**(3,630)**	**—**	**(3,630)**
– cash flow hedges	**—**	**—**	**—**	**26,070**	**—**	**—**	**26,070**	**—**	**26,070**
– changes in fair value of financial liabilities designated at fair value arising from changes in own credit risk	**—**	**11,994**	**—**	**—**	**—**	**—**	**11,994**	**—**	**11,994**
– remeasurement of defined benefit asset/liability	**—**	**(2,544)**	**—**	**—**	**—**	**—**	**(2,544)**	**—**	**(2,544)**
– exchange differences	**—**	**—**	**(60)**	**—**	**(21,013)**	**—**	**(21,073)**	**—**	**(21,073)**
Total comprehensive expense for the period	**—**	**(145,880)**	**8,216**	**26,070**	**(21,013)**	**—**	**(132,607)**	**24**	**(132,583)**
Dividends to shareholders	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Other movements	**—**	**(548)**	**(20)**	**—**	**—**	**—**	**(568)**	**—**	**(568)**
At 30 Jun 2020	**992,401**	**3,962,437**	**15,388**	**46,640**	**(145,626)**	**(15,321)**	**4,855,919**	**4,418**	**4,860,337**
At 1 Jan 2019	992,401	3,742,607	(32,143)	(19,396)	(123,344)	(15,321)	4,544,804	4,296	4,549,100
Profit for the period	—	288,224	—	—	—	—	288,224	48	288,272
Other comprehensive income (net of tax)	—	(10,280)	13,133	44,717	(684)	—	46,886	—	46,886
– debt instruments at fair value through other comprehensive income	—	—	11,294	—	—	—	11,294	—	11,294
– equity instruments designated at fair value through other comprehensive income	—	—	1,835	—	—	—	1,835	—	1,835
– cash flow hedges	—	—	—	44,718	—	—	44,718	—	44,718
– changes in fair value of financial liabilities designated at fair value arising from changes in own credit risk	—	(5,570)	—	—	—	—	(5,570)	—	(5,570)
– remeasurement of defined benefit asset/liability	—	(3,064)	—	—	—	—	(3,064)	—	(3,064)
– exchange differences	—	(1,646)	4	(1)	(684)	—	(2,327)	—	(2,327)
Total comprehensive income for the period	—	277,944	13,133	44,717	(684)	—	335,110	48	335,158
Dividends to shareholders	—	(200,000)	—	—	—	—	(200,000)	—	(200,000)
Other movements	—	735	2,080	—	—	—	2,815	—	2,815
At 30 Jun 2019	992,401	3,821,286	(16,930)	25,321	(124,028)	(15,321)	4,682,729	4,344	4,687,073

The accompanying notes on pages 7 to 19 form an integral part of these financial statements.

Notes on the Condensed financial statements

1 Legal status and principal activities

The group has its place of incorporation and head office in Dubai International Financial Centre ('DIFC'), in the United Arab Emirates, under a category 1 licence issued by the Dubai Financial Services Authority ('DFSA').

The group's registered office is Level 1, Gate Village Building 8, Dubai International Financial Centre, Dubai, United Arab Emirates.

The group through its branch network and subsidiary undertakings provides a range of banking and related financial services in the Middle East and North Africa.

The immediate parent company of the group is HSBC Middle East Holdings B.V. and the ultimate parent company of the group is HSBC Holdings plc, which is incorporated in England.

2 Basis of preparation and significant accounting policies

(a) Compliance with International Financial Reporting Standards

The interim condensed consolidated financial statements of the group have been prepared in accordance with IAS 34 'Interim Financial Reporting' ('IAS 34') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the European Union ('EU'). Therefore they include an explanation of events and transactions that are significant to an understanding of the changes in the financial position and performance of the group since the end of 2019. These interim condensed consolidated financial statements should be read in conjunction with the *Annual Report and Accounts 2019*.

At 30 June 2020, there were no unendorsed standards effective for the half-year to 30 June 2020 affecting these interim condensed consolidated financial statements, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group.

Standards applied during the half-year to 30 June 2020

Amendments to standards that became effective during the period, had no effect on these interim condensed consolidated financial statements.

(b) Use of estimates and judgements

Management believes that the group's critical accounting estimates and judgements are those which relate to impairment of amortised cost and FVOCI financial assets, the valuation of financial instruments, deferred tax assets and provisions. There was no change in the current period to the critical accounting estimates and judgements applied in 2019, which are stated in the *Annual Report and Accounts 2019*.

(c) Composition of the group

There were no changes in the composition of the group in the half-year to 30 June 2020.

(d) Future accounting developments

IFRS 17 'Insurance Contracts' was issued in May 2017, with amendments to the standard issued in June 2020. It has not been endorsed for use in the EU. The standard sets out the requirements that an entity should apply in accounting for insurance contracts it issues and reinsurance contracts it holds. Following the amendments, IFRS 17 is effective from 1 January 2023. The group has assessed the impact of IFRS 17 and expects that the standard will have no significant effect, when applied, on the consolidated financial statements of the group.

(e) Accounting policies

The accounting policies applied by the group for these interim condensed consolidated financial statements are consistent with those described in the *Annual Report and Accounts 2019*, as are the methods of computation.

3 Net fee income

	30 Jun 2020	30 Jun 2019
	US$000	US$000
Credit facilities	**24,306**	27,875
Remittances	**17,022**	18,657
Cards	**58,300**	73,112
Global custody	**18,919**	18,481
Account services	**13,704**	20,350
Trade finance	**65,798**	58,883
Insurance agency	**5,706**	7,657
Corporate/project finance	**9,003**	9,853
Others	**39,609**	47,605
Total Fee Income	**252,367**	282,473
Fee Expense	**(40,895)**	(55,031)
Net Fee Income	**211,472**	227,442

4 Dividends

Dividends paid to shareholders of the parent company

	Half-year to			
	30 Jun 2020		30 Jun 2019	
	Per share	Total	Per share	Total
	US$	US$000	US$	US$000
Dividends paid on ordinary shares				
In respect of previous year:				
– second interim dividend	–	–	0.1074	100,000
– third interim dividend	–	–	0.1074	100,000
Total	–	–	0.2148	200,000

5 Segment analysis

Change in reportable segments

Effective from 2Q20, we made the following realignments within our internal reporting to Chief Operating Decision Maker ('CODM'):

- Simplification of our matrix organisational structure by merging Global Private Banking ('GPB') and Retail Banking and Wealth Management ('RBWM') to form Wealth and Personal Banking ('WPB').
- Reallocation of Balance Sheet Management from Corporate Centre to the global businesses.

Comparative data have been re-presented accordingly.

Our global businesses

We provide a comprehensive range of banking and related financial services to our customers in our three global businesses. The products and services offered to customers are organised by these global businesses:

- WPB provides a full range of retail banking and wealth products to our customers from personal banking to ultra-high net worth individuals. Typically, customer offerings include retail banking products, such as current and savings accounts, mortgages and personal loans, credit cards, debit cards and local and international payment services. We also provide wealth management services, including insurance and investment products, global asset management services, investment management and Private Wealth Solutions for customers with more sophisticated and international requirements.
- Commercial Banking ('CMB') offers a broad range of products and services to serve the needs of our commercial customers, including small- and medium-sized enterprises, mid-market enterprises and corporates. These include credit and lending, international trade and receivables finance, treasury management and liquidity solutions (payments and cash management and commercial cards), commercial insurance and investments. CMB also offers customers access to products and services offered by other global businesses, such as GBM, which include foreign exchange products, raising capital on debt and equity markets and advisory services.
- Global Banking and Markets ('GBM') provides tailored financial solutions to major government, corporate and institutional clients and private investors worldwide. The client-focused business lines deliver a full range of banking capabilities including financing, advisory and transaction services, a markets business that provides services in credit, rates, foreign exchange, equities, money markets and securities services, and principal investment activities.

Profit/(loss) for the period

	2020				
	Wealth and Personal Banking	Commercial Banking	Global Banking and Markets	Corporate Centre*	Total
Half-year to 30 Jun	US$000	US$000	US$000	US$000	US$000
Net interest income	176,413	103,889	152,686	(4,094)	428,894
Net fee income/(expense)	47,880	69,737	96,195	(2,340)	211,472
Net income from financial instruments held for trading or managed on a fair value basis	26,196	16,154	69,129	678	112,157
Other income	10,081	7,819	11,475	14,170	43,545
Net operating income before change in expected credit losses and other credit impairment charges	260,570	197,599	329,485	8,414	796,068
Change in expected credit losses and other credit impairment charges	(130,852)	(239,818)	(137,459)	–	(508,129)
Net operating income	129,718	(42,219)	192,026	8,414	287,939
Total operating expenses	(180,178)	(115,941)	(132,153)	(27,997)	(456,269)
Operating profit/(loss)	(50,460)	(158,160)	59,873	(19,583)	(168,330)
Share of profit in associates	–	–	–	(110)	(110)
Profit/(loss) before tax	(50,460)	(158,160)	59,873	(19,693)	(168,440)
By geographical region					
U.A.E.	(39,858)	(158,300)	22,330	(22,097)	(197,925)
Qatar	598	6,338	24,546	937	32,419
Rest of Middle East	(11,200)	(6,198)	12,997	1,467	(2,934)
Profit/(loss) before tax	(50,460)	(158,160)	59,873	(19,693)	(168,440)

** inter-segment eliminations are booked under Corporate Centre*

Profit/(loss) for the period (continued)

	2019				
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Corporate Centre	Total
Half-year to 30 Jun	US$000	US$000	US$000	US$000	US$000
Net interest income	208,315	127,884	168,691	(6,164)	498,726
Net fee income/(expense)	58,820	69,258	101,177	(1,813)	227,442
Net income from financial instruments held for trading or managed on a fair value basis	23,673	16,931	62,987	3,572	107,163
Other income	3,326	4,415	3,287	14,350	25,378
Net operating income before change in expected credit losses and other credit impairment charges	294,134	218,488	336,142	9,945	858,709
Change in expected credit losses and other credit impairment charges	(25,995)	(31,526)	(1,589)	—	(59,110)
Net operating income	268,139	186,962	334,553	9,945	799,599
Total operating expenses	(171,018)	(106,030)	(131,800)	(57,240)	(466,088)
Operating profit/(loss)	97,121	80,932	202,753	(47,295)	333,511
Share of profit in associates	—	—	—	407	407
Profit/(loss) before tax	97,121	80,932	202,753	(46,888)	333,918
By geographical region					
U.A.E.	83,672	46,113	120,556	(43,377)	206,964
Qatar	5,462	20,378	40,808	(2,451)	64,197
Rest of Middle East	7,987	14,441	41,389	(1,060)	62,757
Profit/(loss) before tax	97,121	80,932	202,753	(46,888)	333,918

Balance sheet information

	2020				
	Wealth and Personal Banking	**Commercial Banking**	**Global Banking and Markets**	**Corporate Centre**	**Total**
At 30 Jun	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**
Loans and advances to customers (net)	**3,303,903**	**7,275,149**	**9,896,319**	**—**	**20,475,371**
Total assets	**11,171,897**	**10,911,576**	**21,187,048**	**1,849,639**	**45,120,160**
Customer accounts	**12,401,372**	**5,453,624**	**9,294,952**	**—**	**27,149,948**
Total liabilities	**13,700,237**	**7,276,525**	**16,831,395**	**2,451,666**	**40,259,823**
At 31 Dec	2019				
Loans and advances to customers (net)	3,635,259	6,794,851	9,231,125	—	19,661,235
Total assets	11,446,122	10,282,651	17,536,463	1,610,203	40,875,439
Customer accounts	11,484,691	4,694,234	7,547,577	12	23,726,514
Total liabilities	13,169,498	6,737,883	12,836,999	3,137,571	35,881,951

Other financial information

Net operating income by global business

		2020				
		Wealth and Personal Banking	**Commercial Banking**	**Global Banking and Markets**	**Corporate Centre**	**Total**
Half-year to 30 Jun	*Footnotes*	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**
Net operating income	1	**260,570**	**197,599**	**329,485**	**8,414**	**796,068**
– external		**223,969**	**241,369**	**358,757**	**(28,027)**	**796,068**
– internal		**36,601**	**(43,770)**	**(29,272)**	**36,441**	**—**
Half-year to 30 Jun		2019				
Net operating income	1	294,134	218,488	336,142	9,945	858,709
– external		243,206	281,107	408,404	(74,008)	858,709
– internal		50,928	(62,619)	(72,262)	83,953	—

1 *Net operating income before change in expected credit losses and other credit impairment charges, also referred to as revenue.*

6 Fair values of financial instruments not carried at fair value

The bases for measuring the fair values of loans and advances to banks and customers, financial investments, deposits by banks, customer accounts, debt securities in issue, subordinated liabilities and non-trading repurchase and reverse repurchase agreements are explained in the *Annual Report and Accounts 2019*.

Fair values of financial instruments not carried at fair value

	At 30 Jun 2020		At 31 Dec 2019	
	Carrying amount	**Fair value**	Carrying amount	Fair value
	US$000	**US$000**	US$000	US$000
Assets				
Loans and advances to banks	**5,536,988**	**5,542,793**	5,797,423	5,793,326
Loans and advances to customers	**20,475,371**	**20,352,543**	19,661,235	19,535,146
Reverse repurchase agreements – non-trading	**1,600,271**	**1,607,141**	741,633	741,633
Liabilities				
Deposits by banks	**3,201,189**	**3,203,899**	3,806,270	3,808,351
Customer accounts	**27,149,948**	**27,295,475**	23,726,514	23,846,077
Repurchase agreements – non-trading	**869,252**	**872,542**	—	—
Debt securities in issue	**1,588,745**	**1,491,449**	1,788,486	1,765,206

7 Financial liabilities designated at fair value

	At	
	30 Jun 2020	31 Dec 2019
	US$000	US$000
Deposits by bank and customer accounts	**860,968**	778,684
Debt securities in issue	**2,262,895**	1,735,418
Total	**3,123,863**	2,514,102

At 30 June 2020, the accumulated amount of change in fair value attributable to changes in credit risk was a gain of US$1.2m (30 June 2019: US$9.9m loss).

8 Debt securities in issue

	30 Jun 2020	31 Dec 2019
	Carrying amount	Carrying amount
	US$000	US$000
Medium-term notes	**2,901,640**	2,573,904
Non-equity preference shares	**950,000**	950,000
Total debt securities in issue	**3,851,640**	3,523,904
Included within:		
– financial liabilities designated at fair value (Note 7)	**(2,262,895)**	(1,735,418)
Total	**1,588,745**	1,788,486

Movement in medium-term notes at amortised cost

	30 Jun 2020	31 Dec 2019
	US$000	US$000
Balance as at 1 Jan	**838,486**	1,540,371
New issues	**—**	83,000
Repayments	**(200,250)**	(786,892)
Other movements	**509**	2,007
Closing balance	**638,745**	838,486

9 Risk management

The group's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk.

The interim condensed consolidated financial statements do not include all risk management information and disclosures required in the annual financial statements, they should be read in conjunction with the *Annual Report and Accounts 2019.*

There have been no material changes to our policies and practices regarding risk management and governance as described in the *Annual Report and Accounts 2019* except for certain enhancements in the criteria to assess significant increase in credit risk for retail portfolio to ensure that relevant indicators relating to unlikeliness to pay are captured in the current situation.

Summary of credit risk

Summary of financial instruments to which the impairment requirements in IFRS 9 are applied

	Footnotes	At 30 Jun 2020		At 31 Dec 2019	
		Gross carrying/ nominal amount	**Allowance for ECL[1]**	Gross carrying/ nominal amount	Allowance for ECL[1]
		US$000	**US$000**	US$000	US$000
Loans and advances to customers at amortised cost		**21,751,078**	**(1,275,707)**	20,616,496	(955,261)
Loans and advances to banks at amortised cost		**5,540,602**	**(3,614)**	5,798,901	(1,478)
Other financial assets measured at amortised cost		**5,837,685**	**(14,494)**	2,892,317	(7,342)
– cash and balances at central banks		**2,789,695**	**(1,785)**	896,922	(314)
– items in the course of collection from other banks		**59,697**	**—**	78,992	—
– reverse repurchase agreements – non-trading		**1,600,295**	**(24)**	741,661	(28)
– prepayments, accrued income and other assets	2	**1,387,998**	**(12,685)**	1,174,742	(7,000)
Total gross carrying amount on balance sheet		**33,129,365**	**(1,293,815)**	29,307,714	(964,081)
Loans and other credit-related commitments		**6,606,098**	**(18,692)**	6,319,523	(15,939)
Financial guarantee and similar contract		**1,380,124**	**(17,438)**	1,553,668	(6,037)
Total nominal amount off balance sheet	3	**7,986,222**	**(36,130)**	7,873,191	(21,976)

	Fair value	**Memorandum allowance for ECL**	Fair value	Memorandum allowance for ECL
	US$000	**US$000**	US$000	US$000
Debt instruments measured at Fair Value through Other Comprehensive Income ('FVOCI')	**9,936,860**	**(3,394)**	10,438,722	(1,485)

1 *The total ECL is recognised in the loss allowance for the financial asset unless the total ECL exceeds the gross carrying amount of the financial asset, in which case the ECL is recognised as a provision.*
2 *Includes only those financial instruments which are subject to the impairment requirements of IFRS 9. 'Prepayments, accrued income and other assets' as presented within the consolidated statement of financial position includes both financial and non-financial assets.*
3 *Represents the maximum amount at risk should the contracts be fully drawn upon and clients default.*

Reconciliation of allowances for ECL

	2020	2019
	Allowance for ECL	Allowance for ECL
	US$000	US$000
At 1 Jan	**(986,057)**	(1,094,463)
Net remeasurement of ECL arising from transfer of stage	**(49,718)**	(6,019)
Net new lending and changes to risk parameters	**(406,537)**	(67,564)
Assets written off	**126,743**	98,467
Foreign exchange	**494**	(216)
Others	**(14,870)**	(22,993)
At 30 Jun	**(1,329,945)**	(1,092,788)
ECL income statement charge for the period	**(456,255)**	(73,583)
Recoveries	**8,332**	18,561
Others	**(60,206)**	(4,088)
Total ECL income statement charge for the period	**(508,129)**	(59,110)

The following table provides an overview of the group's credit risk by stage, and the associated ECL coverage. The financial assets recorded in each stage have the following characteristics:

Stage 1: Unimpaired and without significant increase in credit risk on which a 12-month allowance for ECL is recognised.

Stage 2: A significant increase in credit risk has been experienced since initial recognition on which a lifetime ECL is recognised.

Stage 3: Objective evidence of impairment, and are therefore considered to be in default or otherwise credit impaired on which a lifetime ECL is recognised.

POCI: Purchased or originated at a deep discount that reflects the incurred credit losses on which a lifetime ECL is recognised.

Summary of credit risk (excluding debt instruments measured at FVOCI) by stage distribution and ECL coverage at 30 June 2020

	Gross carrying/nominal amount					**Allowance for ECL**				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
	US$000	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**
Loans and advances to customers at amortised cost	**16,099,825**	**4,269,308**	**1,380,447**	**1,498**	**21,751,078**	**(99,488)**	**(245,990)**	**(928,731)**	**(1,498)**	**(1,275,707)**
Loans and advances to banks at amortised cost	**5,317,645**	**222,957**	**—**	**—**	**5,540,602**	**(1,695)**	**(1,919)**	**—**	**—**	**(3,614)**
Other financial assets measured at amortised cost	**5,594,038**	**234,919**	**8,728**	**—**	**5,837,685**	**(3,242)**	**(2,524)**	**(8,728)**	**—**	**(14,494)**
Loans and other credit-related commitments	**5,869,332**	**736,625**	**141**	**—**	**6,606,098**	**(6,651)**	**(11,924)**	**(117)**	**—**	**(18,692)**
Financial guarantee and similar contracts	**1,140,869**	**233,827**	**5,428**	**—**	**1,380,124**	**(2,948)**	**(14,488)**	**(2)**	**—**	**(17,438)**
At 30 Jun 2020	**34,021,709**	**5,697,636**	**1,394,744**	**1,498**	**41,115,587**	**(114,024)**	**(276,845)**	**(937,578)**	**(1,498)**	**(1,329,945)**

Summary of credit risk (excluding debt instruments measured at FVOCI) by stage distribution and ECL coverage at 31 December 2019

	Gross carrying/nominal amount					Allowance for ECL				
	Stage 1	Stage 2	Stage 3	POCI	Total	Stage 1	Stage 2	Stage 3	POCI	Total
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Loans and advances to customers at amortised cost	17,507,463	1,907,875	1,198,711	2,447	20,616,496	(68,462)	(87,128)	(798,178)	(1,493)	(955,261)
Loans and advances to banks at amortised cost	5,788,598	10,303	—	—	5,798,901	(1,420)	(58)	—	—	(1,478)
Other financial assets measured at amortised cost	2,801,122	85,307	5,888	—	2,892,317	(1,159)	(295)	(5,888)	—	(7,342)
Loans and other credit-related commitments	5,921,696	391,018	6,809	—	6,319,523	(8,839)	(7,100)	—	—	(15,939)
Financial guarantee and similar contracts	1,432,963	111,318	9,387	—	1,553,668	(2,023)	(3,994)	(20)	—	(6,037)
At 31 Dec 2019	33,451,842	2,505,821	1,220,795	2,447	37,180,905	(81,903)	(98,575)	(804,086)	(1,493)	(986,057)
Net movement[1]	**569,867**	**3,191,815**	**173,949**	**(949)**	**3,934,682**	**(32,121)**	**(178,270)**	**(133,492)**	**(5)**	**(343,888)**

1 This represents net movement of gross carrying/nominal amount and allowance for ECL during the period.

The Stage 2 gross carrying/nominal amount and allowance for ECL increased mainly as a result of movement from Stage 1 and is due to the application of macroeconomic forecast and the probability of a more adverse economic scenario. The increase in Stage 3 gross carrying/nominal amount and allowance for ECL is a result of movements from Stage 1 and Stage 2 due to new Wholesale impairments partially off-set by write-offs.

Gross loans and advances to customers by industry sector

	Gross loans and advances to customers	
	Total	As a % of total gross loans
At 30 Jun 2020	**US$000**	**%**
Personal		
– residential mortgages	**1,926,295**	**8.86**
– other personal	**1,666,260**	**7.66**
	3,592,555	**16.52**
Corporate and commercial		
– commercial, industrial and international trade	**9,948,939**	**45.74**
– commercial real estate and other property-related	**2,884,244**	**13.26**
– government	**1,397,858**	**6.43**
– other commercial	**3,732,902**	**17.16**
	17,963,943	**82.59**
Financial		
– non-bank financial institutions	**194,580**	**0.89**
Total gross loans and advances to customers	**21,751,078**	**100.00**
Impaired loans		
– as a percentage of gross loans and advances to customers	**6.35%**	
Total impairment allowances		
– as a percentage of gross loans and advances to customers	**5.87%**	
At 31 Dec 2019		
Personal		
– residential mortgages	1,949,021	9.50
– other personal	1,885,944	9.10
	3,834,965	18.60
Corporate and commercial		
– commercial, industrial and international trade	9,522,586	46.20
– commercial real estate and other property-related	2,805,084	13.60
– government	1,468,378	7.10
– other commercial	2,859,850	13.90
	16,655,898	80.80
Financial		
– non-bank financial institutions	125,633	0.60
Total gross loans and advances to customers	20,616,496	100.00
Impaired loans		
– as a percentage of gross loans and advances to customers	5.83%	
Total impairment allowances		
– as a percentage of gross loans and advances to customers	4.63%	

Areas of special interest

Covid-19 and Expected Credit Loss ('ECL')

In March 2020, the World Health Organization officially declared Covid-19 a global pandemic. In light of the rapid spread of Covid-19 across the globe, various economies and sectors have faced significant disruptions and uncertainty. Restrictions on mobility implemented by governments the world over to limit the spread of the coronavirus resulted in a sharp contraction in global economic activity in the first half of this year. Economic activity is expected to recover in the second half of the year but there is significant uncertainty associated with the pace and scale of resumption.

The outbreak has led to a weakening in GDP, a key input used for calculating ECL, and the probability of a more adverse economic scenario for at least the short term is substantially higher than at 31 December 2019. The impact will vary by sectors of the economy, with heightened risk to the oil and gas, transport and discretionary consumer sectors being observed in the first stages of the outbreak. The probability of a more adverse economic scenario has contributed to the majority of the increase in Stage 1 and 2 ECL from 31 December 2019. The majority of the increase in Stage 3 ECL is due to new Wholesale impairments partially off-set by write-offs.

In line with other global regulators, the Central Bank of UAE, under the Targeted Economic Support Scheme ('TESS'), has facilitated the provision of temporary relief from the payments of principal and/or interest on outstanding loans for all affected private sector corporates, SMEs and individuals with specific conditions ('Customer deferrals'). We are also working closely with Central Bank of UAE and supporting schemes that focus on the parts of the economy most impacted by Covid-19. Similar schemes have been initiated by regulators in other HBME countries to provide relief to the impacted customers.

UAE Joint Guidance

The UAE Banking Regulators have issued Joint Guidance on the treatment of expected credit loss provisions in the context of the Covid-19 crisis (the 'Joint Guidance'). Based on the Joint Guidance, we have grouped customers that have received payment deferrals within and outside the TESS as follows:

i. those that are temporarily and mildly impacted by Covid-19 ('Group 1'). Group 1 clients are not expected to face substantial changes in their creditworthiness, beyond liquidity issues, caused by the Covid-19 crisis.

ii. those that are significantly impacted by Covid-19 ("Group 2"). Group 2 clients are expected to face substantial changes in their creditworthiness, in addition to liquidity issues that will be addressed by payment deferrals.

Gross loans and advances and deferral amounts to customers by industry sector – UAE

	Loans and advances to customers			ECL on loans and advances to customers		Customer deferral			
						Group 1		Group 2	
	Total gross loans	Deferral amount[1]	% of gross loans[2]	Total ECL[3]	Of which: ECL adjustments[4]	Deferral amount	ECL[5]	Deferral amount	ECL[5]
At 30 Jun 2020	US$000	US$000		US$000	US$000	US$000	US$000	US$000	US$000
Personal									
– residential mortgages	1,899,528	3,435	0.18	(65,960)	(6,723)	2,133	(4)	1,302	(163)
– other personal	1,281,901	8,622	0.67	(189,340)	(10,921)	5,497	(287)	3,125	(1,629)
	3,181,429	12,057	0.38	(255,300)	(17,644)	7,630	(291)	4,427	(1,792)
Corporate and commercial									
– commercial, industrial and international trade	7,049,116	193,494	2.74	(312,138)	38,375	174,406	(507)	19,088	(410)
– commercial real estate and other property-related	2,227,081	76,029	3.41	(325,209)	16,855	40,403	(347)	35,626	(4,515)
– government	1,397,858	–	–	(1,254)	1,068	–	–	–	–
– other commercial	2,573,694	21,033	0.82	(247,547)	650	19,943	(283)	1,090	(30)
	13,247,749	290,556	2.19	(886,148)	56,948	234,752	(1,137)	55,804	(4,955)
Financial									
– non-bank financial institutions	190,094	–	–	(10,068)	1,314	–	–	–	–
Total	16,619,272	302,613	1.82	(1,151,516)	40,618	242,382	(1,428)	60,231	(6,747)

1 *This is the deferral amount provided to customers in the UAE in accordance with the Joint Guidance and represented an Exposure at Default of US$983m. The total amount of gross loans subject to deferral were US$978m. As of 30 June 2020, HBME UAE has availed US$0.3b out of the total TESS facility of US$0.46b provided by the UAE Central Bank.*
2 *This is calculated as a percentage of deferral amount to total gross loans.*
3 *Total ECL includes Stage 1 and 2 ECL of US$286m and Stage 3 ECL of US$866m.*
4 *These are expert credit adjustments made to the model output and have been necessary to reflect management's best estimate of ECL in accordance with IFRS 9 and the Joint Guidance.*
5 *The ECL amount relates to the deferred instalments and has been computed on a pro-rata basis based on the ECL on the total outstanding facility amount.*

Change in gross loans and advances and ECL to customers by industry sector – UAE

	Gross carrying value			Expected credit losses		
	30 Jun 2020	31 Dec 2019	% change	30 Jun 2020	31 Dec 2019	% change
At 30 Jun 2020	US$000	US$000		US$000	US$000	
Personal						
– residential mortgages	1,899,528	1,921,168	(1.13)	(65,960)	(59,024)	11.75
– other personal	1,281,901	1,462,067	(12.32)	(189,340)	(120,758)	56.79
	3,181,429	3,383,235	(5.96)	(255,300)	(179,782)	42.01
Corporate and commercial						
– commercial, industrial and international trade	7,049,116	6,474,342	8.88	(312,138)	(267,928)	16.50
– commercial real estate and other property-related	2,227,081	2,226,576	0.02	(325,209)	(293,684)	10.73
– government	1,397,858	1,468,378	(4.80)	(1,254)	(428)	192.99
– other commercial	2,573,694	1,950,204	31.97	(247,547)	(92,831)	166.66
	13,247,749	12,119,500	9.31	(886,148)	(654,871)	35.32
Financial						
– non-bank financial institutions	190,094	122,172	55.60	(10,068)	(7,208)	39.68
Total	16,619,272	15,624,907	6.36	(1,151,516)	(841,861)	36.78
Exposure at default	15,909,947	15,104,025	5.34	N/A	N/A	N/A

Gross loans and advances to customers benefiting from payment deferrals – stage transfer during the period – UAE[1]

	Transfers between Stage 1 and Stage 2		Transfers between Stage 2 and Stage 3		Transfers between Stage 1 and Stage 3	
	To Stage 2 from Stage 1	To Stage 1 from Stage 2	To Stage 3 from Stage 2	To Stage 2 from Stage 3	To Stage 3 from Stage 1	To Stage 1 from Stage 3
At 30 Jun 2020	US$000	US$000	US$000	US$000	US$000	US$000
Transfer during the period	123,843	4,494	3,892	–	–	–
Personal	18,570	–	3,892	–	–	–
Corporate and commercial	105,273	4,494	–	–	–	–

1 *The stage transfer represents the amount of gross loans subject to deferrals which have moved between stages during the period.*

Macro-economic forecast, probability weights and management overlays

Expected credit loss impairment allowances recognised in the financial statements reflect the effect of a range of possible economic outcomes, calculated on a probability-weighted basis, based on the economic scenarios. The recognition and measurement of ECL involves the use of significant judgement and estimation. It is necessary to formulate multiple macroeconomic forecasts and incorporate them into the ECL estimates. The group uses a standard framework to form economic scenarios to reflect assumptions about future economic conditions, supplemented with the use of management judgement, which may result in using alternative or additional economic scenarios and/or management adjustments. The framework is based on a probability-weight approach assigned to three macroeconomic outcomes (Upside/Central/Downside) which are based on external consensus forecasts.

In light of the current uncertain economic environment, an alternative Downside scenario ('Downside 1') has been included and the scenario weighting has been re-assessed to reflect management's view of extreme risks. This 'U-shaped' scenario assumes that a number of the group's top risks crystallise simultaneously and results in an extremely severe and prolonged recession. These scenarios have been applied for key macroeconomic variables and the highest weight has been assigned to the 'Central scenario'.

Scenarios ranges (2020-21)

The following table describes key macroeconomic variables and the probabilities assigned in the each scenario.

	UAE			
Factors	**Upside**	**Central**	**Downside**	**Downside 1**
2020				
GDP growth rate (%)	**(2.3)**	**(2.7)**	**(3.1)**	**(6.0)**
House price growth (%)	**(11.2)**	**(13.0)**	**(14.3)**	**(13.4)**
Global oil prices ($)	**46.5**	**34.2**	**29.0**	**29.8**
2021				
GDP growth rate (%)	**5.3**	**3.1**	**0.8**	**(9.7)**
House price growth (%)	**(3.5)**	**(10.2)**	**(18.6)**	**(22.7)**
Global oil prices ($)	**76.4**	**37.0**	**22.3**	**14.9**
Probability (%)	**—**	**65.0**	**35.0**	**5.0**

In the context of IFRS 9, post-model adjustments are short-term increases or decreases to the ECL at either a customer or portfolio level to account for late breaking events, model deficiencies and expert credit judgement applied following management review and challenge. The group has an internal governance in place to regularly monitor post-model adjustments and, where possible, to reduce the reliance on these through model recalibration or redevelopment in the medium- to long-term, as appropriate. Depending on the path of the Covid-19 outbreak and the shape of the economic recovery, it is anticipated that the composition of modelled ECLs and post-model adjustments may be revised significantly over 2020, particularly when the economy resumes positive GDP growth.

How economic scenarios are reflected in the wholesale calculation of ECL

HSBC has developed a globally consistent methodology for the application of economic scenarios into the calculation of ECL by incorporating those scenarios into the estimation of the term structure of probability of default ('PD') and loss given default ('LGD'). For PDs, we consider the correlation of economic guidance to default rates for a particular industry in a country. For LGD calculations we consider the correlation of economic guidance to collateral values and realisation rates for a particular country and industry. PDs and LGDs are estimated for the entire term structure of each instrument.

For impaired loans, LGD estimates take into account independent recovery valuations provided by external consultants where available, or internal forecasts corresponding to anticipated economic conditions and individual company conditions. In estimating the ECL on impaired loans that are individually considered not to be significant, HSBC incorporates economic scenarios proportionate to the probability-weighted outcome and the Central scenario outcome for non-Stage 3 populations.

Wholesale - ECL based exposures at 30 June[1]

	UAE	
	2020	2019
Reported ECL (US$m)[2]	**227**	97
Gross carrying/nominal amount (US$m)[3]	**45,614**	42,304
Consensus Central scenario[4]	**186**	97
Consensus Upside scenario[4]	**126**	89
Consensus Downside scenario[4]	**262**	108
Downside 1 scenario[4]	**711**	N/A

1 *Excludes ECL and financial instruments relating to defaulted obligors because the measurement of ECL is relatively more sensitive to credit factors specific to the obligor than future economic scenarios.*
2 *ECL sensitivities exclude portfolios utilising less complex modelling approaches.*
2 *ECL sensitivity includes only on-balance sheet financial instruments to which IFRS 9 impairment requirements are applied.*
3 *Includes low credit-risk financial instruments such as debt instruments at FVOCI, which have high carrying amounts but low ECL under all the above scenarios.*
4 *The sensitivity analysis is stated inclusive of post-model adjustments as appropriate to each scenario.*

How economic scenarios are reflected in the retail calculation of ECL

HSBC has developed and implemented a globally consistent methodology for incorporating forecasts of economic conditions into ECL estimates. The impact of economic scenarios on PD is modelled at a portfolio level. Historic relationships between observed default rates and macroeconomic variables are integrated into estimates by leveraging economic response models. The impact of these scenarios on PD is modelled over a period equal to the remaining maturity of underlying asset or assets. The impact on ('LGD') is modelled for mortgage portfolios by forecasting future loan-to-value ('LTV') profiles for the remaining maturity of the asset by leveraging national level forecasts of the house price index and applying the corresponding LGD expectation.

Retail - ECL based exposures at 30 June[1]

	UAE	
	2020	2019
Reported ECL (US$m)[2]	**256**	174
Gross carrying amount (US$m)	**3,188**	3.391
Consensus Central scenario[3]	**237**	173
Consensus Upside scenario[3]	**210**	158
Consensus Downside scenario[3]	**265**	193
Downside 1 scenario[3]	**310**	N/A

1 *ECL sensitivities exclude portfolios utilising less complex modelling approaches.*
2 *ECL sensitivity includes only on-balance sheet financial instruments to which IFRS 9 impairment requirements are applied. In the retail portfolio.*
3 *The sensitivity analysis is stated inclusive of post-model adjustments as appropriate to each scenario.*

Interbank Offered Rates ('IBOR') transition

During the first half of 2020 group's IBOR transition has developed as follows:

Develop RFR product capabilities

Our businesses continue to develop their capabilities to offer Risk-free rates ('RFR') based products and the supporting processes and systems. Covid-19 has impacted the speed with which we are able to develop these capabilities and many of our customers' readiness to adopt RFR-based products. Consequently, the sale of IBOR contracts with maturities beyond 2021 (legacy contracts) will continue for longer than initially anticipated and is likely to increase the volume of legacy contracts that will need to be transitioned.

Transition legacy contracts

The programme is also continuing to develop the capability to transition legacy IBOR contracts at scale. Covid-19 has likely affected the pace with which many of our customers will have been preparing to adopt RFR-based products and therefore also to transition their legacy contracts to RFRs. Consequently, we expect legacy contract transition to occur over a shortened time period. In combination with the greater number of legacy contracts requiring transition, this increases the overall level of execution risk on the transition process, thus potentially increasing the level of conduct and operational risks. Our plans are being adjusted to reflect both the greater effort required and associated risks.

In addition to the heightened conduct and operational risks, the process of adopting new reference rates may expose the group to an increased level of financial risk, such as potential earnings volatility resulting from contract modifications and changes in hedge accounting relationships. Furthermore, the transition to alternative reference rates could have a range of adverse impacts on our business, including legal proceedings or other actions regarding the interpretation and enforceability of provisions in IBOR-based contracts and regulatory investigations or reviews in respect of our preparation and readiness for the replacement of IBOR with alternative reference rates. 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.

10 Fair values of financial instruments

The accounting policies, control framework and the hierarchy used to determine fair values at 30 June 2020 are consistent with those applied in the *Annual Report and Accounts 2019*.

Financial instruments carried at fair value and bases of valuation

	30 Jun 2020				31 Dec 2019			
	Level 1	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total
	Quoted market price	**Using observable inputs**	**With significant unobservable inputs**		Quoted market price	Using observable inputs	With significant unobservable inputs	
	US$000	**US$000**	**US$000**	**US$000**	US$000	US$000	US$000	US$000
Recurring fair value measurements								
Assets								
Trading assets	**117,466**	**603,330**	**78,286**	**799,082**	3,413	111,427	79,960	194,800
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	**—**	**—**	**36,458**	**36,458**	—	—	40,731	40,731
Derivatives	**—**	**1,765,225**	**5,317**	**1,770,542**	—	1,170,654	5,642	1,176,296
Financial investments	**5,346,776**	**4,590,086**	**41,537**	**9,978,399**	4,513,159	5,925,563	45,169	10,483,891
Liabilities								
Trading liabilities	**78,361**	**2,489**	**—**	**80,850**	—	47,989	—	47,989
Financial liabilities designated at fair value	**—**	**3,123,863**	**—**	**3,123,863**	—	2,514,102	—	2,514,102
Derivatives	**—**	**1,679,774**	**4,877**	**1,684,651**	—	1,091,209	442	1,091,651

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

During 2020 there was nil (2019: nil) transfer from Level 2 to Level 1 Financial Investments. The transfers from Level 2 to Level 3 during the year are shown in 'Movement in Level 3 financial instruments' on page 17.

Fair value valuation bases

Financial instruments measured at fair value using a valuation technique with significant unobservable inputs – Level 3

	Assets					Liabilities	
	Financial investments	Trading Assets	Designated and otherwise mandatorily measured at fair value through profit or loss	Derivatives	Total	Derivatives	Total
	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Private equity including strategic investments	**41,537**	**—**	**36,458**	**—**	**77,995**	**—**	**—**
Other derivatives	**—**	**—**	**—**	**5,317**	**5,317**	**4,877**	**4,877**
Other portfolios	**—**	**78,286**	**—**	**—**	**78,286**	—	—
At 30 Jun 2020	**41,537**	**78,286**	**36,458**	**5,317**	**161,598**	**4,877**	**4,877**
Private equity including strategic investments	45,169	—	40,731	—	85,900	—	—
Other derivatives	—	—	—	5,642	5,642	442	442
Other portfolios	—	79,960	—	—	79,960	—	—
At 31 Dec 2019	45,169	79,960	40,731	5,642	171,502	442	442

The basis for determining the fair value of the financial instruments in the table above is explained in the *Annual Report and Accounts 2019.*

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

Movement in Level 3 financial instruments

	Assets				Liabilities
	Financial investments	Trading Assets	Designated and otherwise mandatorily measured at fair value through profit or loss	Derivatives	Derivatives
	US$000	US$000	US$000	US$000	US$000
At 1 Jan 2020	**45,169**	**79,960**	**40,731**	**5,642**	**442**
Total losses recognised in profit or loss	**—**	**(1,674)**	**(4,273)**	**44**	**—**
– net income from financial instruments held for trading or managed on a fair value basis	**—**	**(1,674)**	**—**	**—**	**—**
– changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss	**—**	**—**	**(4,273)**	**44**	**—**
Total gains recognised in other comprehensive income	**(3,632)**	**—**	**—**	**—**	**—**
– financial investments: fair value losses	**(3,632)**	**—**	**—**	**—**	**—**
Purchases	**—**	**—**	**—**	**4,419**	**4,435**
Sales	**—**	**—**	**—**	**—**	**—**
Settlements	**—**	**—**	**—**	**(4,788)**	**—**
Transfers in	**—**	**—**	**—**	**—**	**—**
At 30 Jun 2020	**41,537**	**78,286**	**36,458**	**5,317**	**4,877**
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 30 Jun 2020	**—**	**(1,674)**	**(4,273)**	**—**	**—**
– net income from financial instruments held for trading or managed on a fair value basis	**—**	**(1,674)**	**—**	**—**	**—**
– changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss	**—**	**—**	**(4,273)**	**—**	**—**
At 1 Jan 2019	256,832	79,955	47,839	—	—
Total gains/(losses) recognised in profit or loss	—	5	(5,853)	(1,856)	—
– net income from financial instruments held for trading or managed on a fair value basis	—	5	—	—	—
– changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss	—	—	(5,853)	(1,856)	—
Total losses recognised in other comprehensive income	8,731	—	—	—	—
– financial investments: fair value losses	8,731	—	—	—	—
Purchases	—	—	—	8,651	442
Sales	—	—	—	—	—
Settlements	—	—	(1,255)	(1,153)	—
Transfers in	(220,394)	—			
At 31 Dec 2019	45,169	79,960	40,731	5,642	442
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 30 Jun 2019	—	23	(1,909)	—	—
– net income from financial instruments held for trading or managed on a fair value basis	—	23	—	—	—
– changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss	—	—	(1,909)	—	—

11 Contingent liabilities, contractual commitments and guarantees

	30 Jun 2020 US$000	31 Dec 2019 US$000
Guarantees and other contingent liabilities		
Guarantees	**16,071,491**	16,136,763
Commitments		
Documentary credits and short-term trade-related transactions	**711,848**	716,233
Standby facilities, credit lines and other commitments to lend	**15,917,946**	16,718,873
Total	**16,629,794**	17,435,106

The above table discloses the nominal principal amounts, which represent the maximum amounts at risk should the contracts be fully drawn upon and clients default. As a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the nominal principal amounts is not indicative of future liquidity requirements.

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 group considers that none of the other matters are material. The recognition of provisions is determined in accordance with the accounting policies set out in Note 1 of HSBC's *Annual Report and Accounts 2019*. While the outcomes of legal proceedings and regulatory matters are 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 2020. Where an individual provision is material, the fact that a provision has been made is stated and quantified, except to the extent that doing so would be seriously prejudicial. 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 relevant to the group as a subsidiary of HSBC operating in the Middle East)

In December 2012, among other agreements, HSBC Holdings plc ('HSBC Holdings' agreed to an undertaking with the UK Financial Services Authority, which was replaced by a Direction issued by the UK Financial Conduct Authority ('FCA') in 2013, and again in July 2020, 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. HSBC Holdings also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions. HSBC's engagement with the Skilled Person appointed pursuant to the 2013 Direction was terminated in February 2020 and a new Skilled Person with a narrower mandate has been appointed to assess the remaining areas that require further work in order for HSBC to transition fully to business-as-usual financial crime risk management. The Independent Consultant will continue. to carry out an annual OFAC compliance review at the FRB's discretion. The role of the Skilled Person/Independent Consultant is discussed on page 145 of HSBC's *Annual Report and Accounts 2019.*

Through the Skilled Person/Independent Consultant's prior 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. The FCA is also conducting an investigation into HSBC Bank's and HSBC UK's compliance with UK money laundering regulations and financial crime systems and controls requirements HSBC is cooperating with all of these investigations.

Since November 2014, a number of lawsuits have been filed in federal court in New York and Illinois, against various HSBC companies and others, on behalf of plaintiffs who are, or are related to, victims of terrorist attacks in the Middle East. In each case, it is alleged that the defendants aided and abetted the unlawful conduct of various sanctioned parties in violation of the US Anti-Terrorism Act. Currently, 10 actions remain pending in federal courts in New York or the District of Columbia against HSBC Group companies, of which the bank is involved in eight actions. One of the cases is presently being appealed to the Second Circuit, following the Bank's Motion to Dismiss being granted by the Eastern District of New York in September 2020. The bank has filed Motions to Dismiss in another three of these cases. In June 2020, two of these Motions to Dismiss were granted with the third pending before the courts. The four remaining actions are at a very early stage.

Based on the facts currently known, it is not practicable at this time for the group to predict the resolution of the above anti-money laundering and sanctions related matters, including the timing or any possible impact on the group, which could be significant.

Foreign exchange rate investigations and litigation

(Matters relevant to the group as a subsidiary of HSBC operating in the Middle East)

Various regulators and competition authorities around the world, including in the EU, Switzerland, Brazil and South Africa, are conducting investigations and reviews into trading by HSBC and others on the foreign exchange markets. HSBC is cooperating with these investigations and reviews.

In January 2018, HSBC Holdings entered into a three-year deferred prosecution agreement with the Criminal Division of the 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.

13 Related party transactions

There were no changes in the related party transactions described in the *Annual Report and Accounts 2019* that have had a significant effect on the financial position or performance of the group in the half-year to 30 June 2020. All related party transactions that took place in the half-year to 30 June 2020 were similar in nature to those disclosed in the *Annual Report and Accounts 2019.*

14 Events after the balance sheet date

These accounts were approved by the Board of Directors on 3 August 2020 and authorised for issue.

Independent Review Report to HSBC Bank Middle East Limited

Review report on condensed consolidated interim financial information to the board of directors of HSBC Bank Middle East Limited

Introduction

We have reviewed the accompanying condensed consolidated interim statement of financial position of HSBC Bank Middle East Limited and its subsidiaries (the 'Group') as at 30 June 2020 and the related condensed consolidated income statement, statement of comprehensive income, statement of cash flows and statement of changes in equity for the six month period then ended and notes, comprising a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and presentation of this condensed consolidated interim financial information in accordance with International Accounting Standard 34 - 'Interim Financial Reporting' as issued by the International Accounting Standards Board ('IASB') and adopted by the European Union. Our responsibility is to express a conclusion on this condensed consolidated interim financial information based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, 'Review of interim financial information performed by the independent auditor of the entity'. 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 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 accompanying condensed consolidated interim financial information is not prepared, in all material respects, in accordance with International Accounting Standard 34 – 'Interim Financial Reporting' as issued by the IASB and adopted by the European Union.

PricewaterhouseCoopers Limited

Place: Dubai, United Arab Emirates

Date: 3 August 2020

Audit Principal: Stuart Scoular

PricewaterhouseCoopers Limited, License no. CL0215
Al Fattan Currency House, Tower 1, Level 8, Unit 801, DIFC, PO Box 11987, Dubai - United Arab Emirates
T: +971 (0)4 304 3100, F: +971 (0)4 346 9150, www.pwc.com/me
PricewaterhouseCoopers Limited is registered with the Dubai Financial Services Authority.

HSBC BANK MIDDLE EAST LIMITED
Incorporated in the Dubai International Financial Centre number – 2199
Regulated by the Dubai Financial Services Authority.

REGISTERED OFFICE
Level 1, Building No. 8, Gate Village, Dubai International Financial Centre, Dubai, United Arab Emirates.

HSBC Bank Middle East Limited

Level 1, Building No. 8, Gate Village,
Dubai International Financial Centre,
P.O. Box 30444, Dubai, United Arab Emirates.
Telephone: 971 456 23465
www.hsbc.ae