HSBC Bank Middle East Limited

Annual Report and Accounts 2021

HSBC

Contents

Presentation of Information

This document comprises the *Annual Report and Accounts 2021* for HSBC Bank Middle East Limited ('the bank') and its subsidiary undertakings (together 'the group'). It contains the Report of the Directors, Financial Statements together with the Auditor's report and Additional information. References to 'HSBC' or 'the HSBC Group 'or 'the Group' within this document mean HSBC Holdings plc together with its subsidiaries.

Board of Directors

Samir Assaf, Chairman
Amina Alrustamani, Deputy Chairman
Muna Al Gurg
David Dew
John Raine
Neslihan Erkazanci
John Bartlett
Christopher Spooner
Stephen Moss

Change in Directors

- Samir Assaf appointed as a Director on 15 April 2021.
- Martin Tricaud resigned as a Director on 3 April 2021.
- David Eldon resigned as a Director on 1 May 2021.

Principal activities

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

Attributable profit and dividends

The profit attributable to the shareholders of the parent company amounted to US$505m (loss in 2020: US$86m) as set out in the consolidated income statement on page 7.

During the year, a final dividend of US$277m for 2019 (2020: nil) was declared on 25 October 2021.

Going concern statement

The Board, having made appropriate enquiries, is satisfied that the group as a whole has adequate resources to continue operations for a period of at least twelve months from the date of this report, and it therefore continues to adopt the going concern basis in preparing the financial statements.

In making their going concern assessment, the Directors have considered a range of detailed information relating to present and potential conditions, including projections for profitability, cash flows, capital requirements, capital resources and the impact of stressed scenarios on group's operations.

Registered office

The bank is registered by continuation as a company limited by shares in the Dubai International Financial Centre ('DIFC') under the Companies Law, DIFC Law No. 2 of 2009, on 30 June 2016 with registered number 2199. Its head office and registered office is located at Level 1, Gate Village Building 8, Dubai International Financial Centre, Dubai, United Arab Emirates.

Auditor

PricewaterhouseCoopers Limited has expressed its willingness to continue in office and the Board recommends that it be reappointed. A resolution proposing the reappointment of PricewaterhouseCoopers Limited as auditor of the group and giving authority to the Directors to determine its remuneration will be submitted to the forthcoming Annual General Meeting.

On behalf of the Board

J A Tothill

Secretary

Report on the audit of the consolidated financial statements

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of HSBC Bank Middle East Limited (the 'Company') and its subsidiaries (together the 'group') as at 31 December 2021, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board ('IASB') and as adopted by the United Kingdom.

What we have audited

The group's consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2021;
- the consolidated income statement for the year then ended;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of cash flows for the year then ended;
- the consolidated statement of changes in equity for the year then ended; and
- the notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing ('ISAs'). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report.

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

Independence

We are independent of the group in accordance with the International Code of Ethics for Professional Accountants (including International Independence Standards) issued by the International Ethics Standards Board for Accountants ('IESBA Code') and the requirements of the Dubai Financial Services Authority (the 'DFSA'). We have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Our audit approach

Overview

Group scoping	The scope of our audit and the nature, timing and extent of audit procedures performed were determined by our risk assessment, the financial significance of the components and other qualitative factors.
Materiality	Overall group materiality: US$21.8m, which represents 5% of the average of the absolute value of profit or loss of the current year and the prior two financial years as a benchmark for calculating our overall group materiality.
Key audit matters	The key audit matter identified during the year is Expected credit losses – Impairment on loans and advances to customers.

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where the directors made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

How we tailored our group audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the group, the accounting processes and controls, and the industry in which the group operates.

Given the geographically dispersed nature of the group's operations in the Middle East and North Africa and the diversity of its banking activities, our approach was designed to cover each of the significant locations, being the United Arab Emirates ('UAE') and Qatar. We audited the operations of the group in the UAE and instructed a PwC member firm to perform work and issue an audit opinion to us in respect of the group's operations in Qatar. Each location that was not individually significant was assessed for any significant risks or material balances and, where appropriate, we instructed PwC member firms in those locations to perform and report on specific procedures relating to matters which were judgmental in nature and/or material to the overall group. The work in these locations was carried out by applying standard benchmarks on materiality and reflected the size and complexity of the operations in those locations.

A significant amount of the group's operational processes which are critical to financial reporting are undertaken in shared service centres run by Digital Business Services ('DBS') across 11 individual locations. The audit work over the shared service centre processes and controls was performed by PwC member firms in each of the global shared service centre locations and coordinated by the PwC member firm in the UK, with oversight from us. This work enabled us to evaluate the effectiveness of the controls over key processes that supported material balances, classes of transactions and disclosures within the group consolidated financial statements, and to consider the implications on our audit work. In aggregate, the audit work performed across the locations above provided us with the audit evidence required to form an opinion on the group consolidated financial statements.

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.

Our audit approach (continued)

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall group materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the consolidated financial statements as a whole.

Overall group materiality	US$21.8m
How we determined it	We have used the average of the absolute value of profit or loss of the current year and the prior two financial years as a benchmark for calculating our overall group materiality.
Rationale for the materiality benchmark applied	We used profit before tax as the benchmark because, in our view, it is the benchmark against which the performance of the group is most commonly measured by users and is a generally accepted benchmark. We chose 5% which is within the range of acceptable quantitative materiality thresholds in auditing standards.

We agreed with those charged with governance that we would report to them misstatements identified during our audit above US$1m as well as misstatements that, in our view, warranted reporting for qualitative reasons.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current year. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	How our audit addressed the key audit matter
Expected credit losses – Impairment on loans and advances to customers	
We focused on the Expected Credit Losses (‘ECL’) for loans and advances to customers due to the materiality of the loan balances and the associated allowances for ECL. In addition, the compliance with IFRS in this area involves management judgement and is subject to a high degree of estimation uncertainty. The level of judgment and estimation uncertainty remain elevated as a result of Covid-19. As disclosed in note 31, the allowance for ECL for loans and advances to customers as at 31 December 2021, is US$995m. The largest loan portfolios and significant ECL allowances are in the UAE, Qatar and Bahrain. Management makes various assumptions when estimating ECL. The significant assumptions that we focused on in our audit included those with greater levels of management judgement and for which variations had the most significant impact on ECL. These included assumptions made in: • the application and determination of forward looking economic scenarios and their probability weights; • the recoverability of credit impaired wholesale exposures; and • estimating material management judgemental adjustments. The impact of Covid-19, including the nature and extent of government support, and more recent factors including supply chain constraints have resulted in unprecedented economic conditions that vary between countries and industries leading to uncertainty around judgements made in determining the severity and probability weighting of macroeconomic variable (‘MEV’) forecasts across the different economic scenarios used in ECL models.	We assessed the design and operating effectiveness of governance and controls over the estimation of ECLs. We observed management’s review and challenge at governance forums where we observed assessment of ECL for Retail and Wholesale portfolios, including the assessment of model limitations and any resulting management judgemental adjustments. We also tested the controls over: • Credit reviews that determine customer risk ratings for wholesale customers; • the input of critical data into source systems, and the flow and transformation of critical data from source systems to the impairment calculation engine and management judgemental adjustments; and • The calculation and approval of management judgemental adjustments to modelled outcomes We involved our modelling experts in assessing the appropriateness of modelling methodologies that were enhanced during the year. We also assessed the appropriateness of modelling methodologies that did not change during the year and whether post model adjustments were needed. In addition, we performed substantive testing over: • a sample of critical data used in the year end ECL calculation and management judgemental adjustments; • a sample of credit reviews to determine that Credit Risk Ratings were appropriately applied to wholesale exposures; • appropriateness and application of the quantitative and qualitative criteria used to assess significant increases in credit risk; • critical data, assumptions and discounted cash flows for a sample of credit impaired wholesale exposures.

Our audit approach (continued)

Key audit matters (continued)

Key audit matter	How our audit addressed the key audit matter
Expected credit losses – Impairment on loans and advances to customers (continued)	
The modelling methodologies used to estimate ECL are developed using historical experience. The impact of the unprecedented economic conditions has resulted in certain limitations in the reliability of these methodologies to forecast the extent and timing of future customer defaults and therefore estimate ECL. In addition, modelling methodologies do not incorporate all factors that are relevant to estimating ECL, such as differentiating the impact on industry sectors of economic conditions. These limitations are addressed with management adjustments, the measurement of which is inherently judgemental and subject to a high level of estimation uncertainty. The nature and extent of these limitations and the resulting changes to ECL varies across retail and wholesale portfolios. The uncertainty caused by Covid-19 also increases judgement involved in estimating expected cash flows and collateral valuations for specific impairments on credit impaired wholesale exposures. Management makes other assumptions which are less judgemental or for which variations have a less significant impact on ECL. These assumptions include: • The methodologies used in quantitative scorecards for determining customer risk ratings (CRRs); • Model methodologies themselves; and • Quantitative and qualitative criteria used to assess significant increases in credit risk.	Further, we obtained reporting from our PwC member firm in the UK containing the results of certain centralised audit procedures in respect of ECL. We reviewed the reporting received in the context of the appropriateness of the nature, timing and extent of the work performed for the purpose of our audit. Their work included the following procedures: • the compliance of ECL methodologies and assumptions with the requirements of IFRS 9; • testing of model validation and monitoring controls; • observing the review and challenge governance forum's discussions around the determination of MEV forecasts and their likelihood for different economic scenarios; • testing of the calculation and approval of management judgemental adjustments to modelled outcomes; and • assessment of the significant assumptions made in determining the severity and probability weighting of MEV forecasts using the PwC UK member firm's economic experts. We assessed the disclosures included in the consolidated financial statements and assessed their compliance with the requirements of IFRS.

Other information

The directors are responsible for the other information. The other information comprises the Report of the Directors and Additional Information on page 73-80 (but does not include the consolidated financial statements and our auditor's report thereon).

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement on the other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of directors and those charged with governance for the consolidated financial statements

The directors are responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS as issued by the IASB and their preparation in accordance with the applicable regulatory requirements of the DFSA, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors are responsible for assessing the group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or to cease operations, or have no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;

Auditor's responsibilities for the audit of the consolidated financial statements (continued)

- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the group's internal control;
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;
- conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the group to cease to continue as a going concern;
- evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation;
- obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, actions taken to eliminate threats or safeguards applied.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on legal and other regulatory requirements

As required by the applicable provisions of the DFSA Rulebook, we report that the consolidated financial statements have been properly prepared in accordance with the applicable requirements of the DFSA.

PricewaterhouseCoopers Limited

22 February 2022

Tamsin King

Audit Principal, Reference Number I009875

Dubai, United Arab Emirates

Consolidated income statement

for the year ended 31 December

	Notes	2021 US$000	2020 US$000
Net interest income		**633,247**	777,595
– interest income		**727,942**	961,697
– interest expense		**(94,695)**	(184,102)
Net fee income	3	**444,727**	421,050
– fee income		**535,662**	503,098
– fee expense		**(90,935)**	(82,048)
Net income from financial instruments held for trading or managed on a fair value basis		**275,376**	237,139
Changes in fair value of designated debt and related derivatives	4	**(4,743)**	(6,346)
Changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss		**(2,540)**	(96)
Gains less losses from financial investments		**11,293**	9,538
Dividend income		**58**	288
Other operating income		**50,241**	56,881
Net operating income before change in expected credit losses and other credit impairment charges		**1,407,659**	1,496,049
Change in expected credit losses and other credit impairment charges	5	**145,432**	(638,271)
Net operating income		**1,553,091**	857,778
Employee compensation and benefits	6	**(518,697)**	(540,881)
General and administrative expenses		**(378,659)**	(339,633)
Depreciation and impairment of property, plant and equipment and right-of-use assets		**(34,309)**	(34,430)
Amortisation and impairment of intangible assets		**(26,198)**	(18,145)
Total operating expenses		**(957,863)**	(933,089)
Operating profit/(loss)	5	**595,228**	(75,311)
Share of profit/(loss) in associates	17	**(208)**	(207)
Profit/(loss) before tax		**595,020**	(75,518)
Tax expense	8	**(89,535)**	(10,541)
Profit/(loss) for the year		**505,485**	(86,059)
Attributable to:			
– shareholders of the parent company		**505,485**	(86,083)
– non-controlling interests		**–**	24
Profit/(loss) for the year		**505,485**	(86,059)

The accompanying notes on pages 12 to 72 form an integral part of these financial statements.

Consolidated statement of comprehensive income

for the year ended 31 December

	2021	2020
	US$000	US$000
Profit/(loss) for the year	505,485	(86,059)
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	(24,821)	15,494
– fair value gains/(losses)	(37,609)	7,204
– fair value (gains)/losses transferred to the income statement on disposal	11,039	9,066
– expected credit losses recognised in income statement	(1,194)	1,292
– income taxes	2,943	(2,068)
Cash flow hedges	(21,062)	3,722
– fair value gains/(losses)	(23,756)	4,544
– fair value (gains)/losses reclassified to the income statement	(244)	(257)
– income taxes	2,938	(565)
Exchange differences	(1,430)	(23,022)
Items that will not be reclassified subsequently to profit or loss:		
Remeasurement of defined benefit asset/liability	(31,430)	7,070
– before income taxes	(31,430)	11,481
– income taxes	—	(4,411)
Equity instruments designated at fair value through other comprehensive income	(11,459)	(7,480)
– fair value gains/(losses)	(11,459)	(7,480)
– income taxes	—	—
Changes in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	5,613	(3,639)
– fair value gains/(losses)	5,613	(3,639)
– income taxes	—	—
Other comprehensive income/(expense) for the year, net of tax	(84,589)	(7,855)
Total comprehensive income/(expense) for the year	420,896	(93,914)
Attributable to:		
– shareholders of the parent company	420,896	(93,938)
– non-controlling interests	—	24
Total comprehensive income/(expense) for the year	420,896	(93,914)

The accompanying notes on pages 12 to 72 form an integral part of these financial statements.

Consolidated statement of financial position

at 31 December

	Notes	2021 US$000	2020 US$000
Assets			
Cash and balances at central banks		**848,471**	1,240,991
Items in the course of collection from other banks		**53,900**	69,569
Trading assets	*11*	**1,106,182**	741,594
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss		**25,315**	38,813
Derivatives	*14*	**1,070,156**	1,879,242
Loans and advances to banks	*26*	**7,807,302**	7,742,424
Loans and advances to customers	*26*	**18,623,781**	19,350,716
Reverse repurchase agreements – non-trading	*26*	**4,900,749**	1,828,851
Financial investments	*15*	**10,928,961**	10,103,834
Prepayments, accrued income and other assets	*19*	**1,051,496**	1,271,857
Current tax assets		**10**	11
Interests in associates	*17*	**2,659**	2,867
Intangible assets	*20*	**154,091**	110,870
Deferred tax assets	*8*	**198,649**	219,664
Total assets		**46,771,722**	44,601,303
Liabilities and equity			
Liabilities			
Deposits by banks	*26*	**4,575,102**	3,468,222
Customer accounts	*26*	**27,010,549**	26,834,947
Repurchase agreements – non-trading		**2,366,542**	506,475
Items in the course of transmission to other banks		**670,767**	111,462
Trading liabilities	*21*	**618,099**	299,546
Financial liabilities designated at fair value	*22*	**1,563,998**	2,823,792
Derivatives	*14*	**1,014,392**	1,799,144
Debt securities in issue	*23*	**1,874,830**	2,000,594
Accruals, deferred income and other liabilities	*24*	**1,630,882**	1,641,852
Current tax liabilities		**82,944**	85,740
Provisions	*25*	**100,046**	129,583
Total liabilities		**41,508,151**	39,701,357
Equity			
Called up share capital	*29*	**931,055**	931,055
Share premium account	*29*	**61,346**	61,346
Other equity instrument[1]	*29*	**225,000**	—
Other reserves		**(181,815)**	(119,765)
Retained earnings		**4,227,985**	4,022,892
Total shareholders' equity		**5,263,571**	4,895,528
Non-controlling interests		**—**	4,418
Total equity		**5,263,571**	4,899,946
Total liabilities and equity		**46,771,722**	44,601,303

1 *The accounting treatment for undated preference shares has been reassessed during the current year and, accordingly, these instruments have been reclassified from debt securities in issue to other equity instruments.*

The accompanying notes on pages 12 to 72 form an integral part of these financial statements.

Neslihan Erkazanci

Chief Financial Officer / Director

Consolidated statement of cash flows

for the year ended 31 December

	Notes	2021 US$000	2020 US$000
Cash flows from operating activities			
Profit/(loss) before tax		**595,020**	(75,518)
Adjustments for:			
Net (gain)/loss from investing activities		**(11,158)**	(9,199)
Share of profit/(loss) in associates		**208**	207
Other non-cash items included in profit before tax	30	**(12,549)**	759,511
Change in operating assets	30	**146,046**	(1,486,626)
Change in operating liabilities	30	**2,213,108**	2,436,671
Elimination of exchange differences[1]		**(1,954)**	(16,477)
Tax paid		**(65,599)**	(81,120)
Net cash generated from/(used in) operating activities		**2,863,122**	1,527,449
Cash flows from investing activities			
Net cash flows from purchase and sale/maturity of financial investments		**(584,990)**	89,309
Net cash flows from the purchase and sale of property, plant and equipment		**(2,796)**	(6,892)
Net investment in intangible assets		**(69,438)**	(53,412)
Net cash generated from/(used) in investing activities		**(657,224)**	29,005
Cash flows from financing activities			
Redemption of non-equity preference shares		**(250,000)**	—
Dividends paid		**(279,193)**	—
Net cash generated from/(used in) financing activities		**(529,193)**	—
Net increase in cash and cash equivalents		**1,676,705**	1,556,454
Cash and cash equivalents at 1 Jan[2]		**7,702,023**	6,145,574
Exchange differences in respect of cash and cash equivalents		**66**	(5)
Cash and cash equivalents at 31 Dec	30	**9,378,794**	7,702,023

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 *Cash and cash equivalents include mandatory deposits amounting to US$699m (2020: US$385m) at central banks which are not available for use by the group.*

The accompanying notes on pages 12 to 72 form an integral part of these financial statements.

Consolidated statement of changes in equity

for the year ended 31 December

				Other reserves						
	Called up share capital and share premium	Other equity instru-ments[1]	Retained earnings	Financial assets at FVOCI reserves	Cash flow hedging reserve	Foreign exchange reserve	Merger and other reserves[2]	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	US$000
At 1 Jan 2021	**992,401**	**—**	**4,022,892**	**15,110**	**24,292**	**(143,846)**	**(15,321)**	**4,895,528**	**4,418**	**4,899,946**
Profit/(loss) for the year	**—**	**—**	**505,485**	**—**	**—**	**—**	**—**	**505,485**	**—**	**505,485**
Other comprehensive income/(expense)-net of tax	**—**	**—**	**(22,547)**	**(36,291)**	**(21,062)**	**(4,689)**	**—**	**(84,589)**	**—**	**(84,589)**
– debt instruments at fair value through other comprehensive income	**—**	**—**	**—**	**(24,821)**	**—**	**—**	**—**	**(24,821)**	**—**	**(24,821)**
– equity instruments designated at fair value through other comprehensive income	**—**	**—**	**—**	**(11,459)**	**—**	**—**	**—**	**(11,459)**	**—**	**(11,459)**
– cash flow hedges	**—**	**—**	**—**	**—**	**(21,062)**	**—**	**—**	**(21,062)**	**—**	**(21,062)**
– changes in fair value of financial liabilities designated at fair value arising from changes in own credit risk	**—**	**—**	**5,613**	**—**	**—**	**—**	**—**	**5,613**	**—**	**5,613**
– remeasurement of defined benefit asset/liability	**—**	**—**	**(31,430)**	**—**	**—**	**—**	**—**	**(31,430)**	**—**	**(31,430)**
– exchange differences	**—**	**—**	**3,270**	**(11)**	**—**	**(4,689)**	**—**	**(1,430)**	**—**	**(1,430)**
Total comprehensive income for the year	**—**	**—**	**482,938**	**(36,291)**	**(21,062)**	**(4,689)**	**—**	**420,896**	**—**	**420,896**
Reclassification of undated preference shares[1]	**—**	**225,000**	**—**	**—**	**—**	**—**	**—**	**225,000**	**—**	**225,000**
Dividends	**—**	**—**	**(279,193)**	**—**	**—**	**—**	**—**	**(279,193)**	**—**	**(279,193)**
Other movements	**—**	**—**	**1,348**	**(8)**	**—**	**—**	**—**	**1,340**	**(4,418)**	**(3,078)**
At 31 Dec 2021	**992,401**	**225,000**	**4,227,985**	**(21,189)**	**3,230**	**(148,535)**	**(15,321)**	**5,263,571**	**—**	**5,263,571**
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
Profit/(loss) for the year	—	—	(86,083)	—	—	—	—	(86,083)	24	(86,059)
Other comprehensive income/(expense) – net of tax	—	—	(276)	7,932	3,722	(19,233)	—	(7,855)	—	(7,855)
– debt instruments at fair value through other comprehensive income	—	—	—	15,494	—	—	—	15,494	—	15,494
– equity instruments designated at fair value through other comprehensive income	—	—	—	(7,480)	—	—	—	(7,480)	—	(7,480)
– cash flow hedges	—	—	—	—	3,722	—	—	3,722	—	3,722
– changes in fair value of financial liabilities designated at fair value arising from changes in own credit risk	—	—	(3,639)	—	—	—	—	(3,639)	—	(3,639)
– remeasurement of defined benefit asset/liability	—	—	7,070	—	—	—	—	7,070	—	7,070
– exchange differences	—	—	(3,707)	(82)	—	(19,233)	—	(23,022)	—	(23,022)
Total comprehensive loss for the year	—	—	(86,359)	7,932	3,722	(19,233)	—	(93,938)	24	(93,914)
Dividends	—	—	—	—	—	—	—	—	—	—
Other movements	—	—	386	(14)	—	—	—	372	—	372
At 31 Dec 2020	992,401	—	4,022,892	15,110	24,292	(143,846)	(15,321)	4,895,528	4,418	4,899,946

1 *The accounting treatment for undated preference shares has been reassessed during the current year and, accordingly, these instruments have been reclassified from debt securities in issue to other equity instruments.*
2 *The merger reserve pertains to the acquisition of HBME Algeria in 2009.*

The accompanying notes on pages 12 to 72 form an integral part of these financial statements.

Notes on the 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

2.1 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The consolidated financial statements of the group have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB'), including interpretations issued by the IFRS Interpretations Committee. These financial statements are also compliant with IFRSs adopted by the United Kingdom (UK) as there are no applicable differences from IFRSs as issued by the IASB for the periods presented. At 31 December 2021, there were no unendorsed standards effective for the year ended 31 December 2021 affecting these consolidated financial statements. For the periods presented, there was no difference between IFRSs adopted by the UK, IFRSs as endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group.

Standards adopted during the year ended 31 December 2021

There were no new accounting standards or interpretations that had a significant effect on HSBC in 2021. Accounting policies have been consistently applied.

(b) Future accounting developments

Minor amendments to IFRSs

The IASB has not published any minor amendments effective from 1 January 2022 that are applicable to the group. However, the IASB has published a number of minor amendments to IFRSs that are effective from 1 January 2023 and 1 January 2024. The management expects they will have an insignificant effect, when adopted, on the consolidated financial statements of the group.

Major new IFRSs

IFRS 17 'Insurance Contracts'

IFRS 17 'Insurance contracts' was issued in May 2017, and sets out the requirements that an entity should apply in accounting for insurance contracts it issues and reinsurance contracts it holds. IFRS 17 is effective from 1 January 2023. The management 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.

(c) Going concern

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

(d) Foreign currencies

The group's consolidated financial statements are presented in US dollars because the US dollar and currencies linked to it form the major currency bloc in which the group transacts and funds its business. The US dollar is also the HSBC Bank Middle East Limited's functional currency because the US dollar and currencies linked to it are the most significant currencies relevant to the underlying transactions, events and conditions of its subsidiaries, as well as representing a significant proportion of its funds generated from financing activities.

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange at the balance sheet date. Any resulting exchange differences are included in the income statement. Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Any exchange component of a gain or loss on a non-monetary item is recognised either in other comprehensive income or in the income statement depending where the gain or loss on the underlying non-monetary item is recognised.

In the consolidated financial statements, the assets and liabilities of branches, subsidiaries, joint ventures and associates whose functional currency is not US dollars, are translated into the group's presentation currency at the rate of exchange at the balance sheet date, while their results are translated into US dollars at the average rates of exchange for the reporting period. Exchange differences arising from the retranslation of opening foreign currency net assets, and exchange differences arising from retranslation of the result for the reporting period from the average rate to the exchange rate at the period end, are recognised in other comprehensive income. Exchange differences on a monetary item that is part of a net investment in a foreign operation are recognised in the income statement of the separate financial statements and in other comprehensive income in consolidated accounts. On disposal of a foreign operation, exchange differences previously recognised in other comprehensive income are reclassified to the income statement as a reclassification adjustment.

(e) Critical accounting estimates and judgements

The preparation of financial information requires the use of estimates and judgements about future conditions. In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of items highlighted as the critical accounting estimates and judgements in section 2.2 below, it is possible that the outcomes in the next financial year could differ from those on which management's estimates are based, resulting in materially different conclusions from those reached by management for the purposes of these financial statements. Management's selection of the group's accounting policies which contain critical estimates and judgements reflects the materiality of the items to which the policies are applied and the high degree of judgement and estimation uncertainty involved.

(f) Segmental analysis

The group's chief operating decision-maker is the Board. Operating segments are reported in a manner consistent with the internal reporting provided to the Board.

Measurement of segmental assets, liabilities, income and expenses is in accordance with the group's accounting policies. Segmental income and expenses include transfers between segments, and these transfers are conducted at arm's length. Shared costs are included in segments on the basis of the actual recharges made.

In 2021, the operating segment of Global Banking & Markets ('GB&M') has been re-segmented into Global Banking ('GB') and Markets and Securities Services ('MSS') as it aligns with the changes in the management structure and internal reporting to the Board. GB and MSS are separate reportable segments. MSS includes revenues for products and services sold to GB clients that are not necessarily reflected on a shared basis in the GB segment. MSS and GB comprise certain costs and cost allocations that are split for internal reporting purposes but are shared in nature and not wholly directly attributable to any one segment. The new reporting structure does not change the Group's management of its global GBM strategy. Comparatives have been re-presented to conform with the current year's presentation.

Products and services

The group manages products and services to its customers in the region through global businesses.

- Wealth and Personal Banking ('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 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) 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 ('GB') provides tailored financial solutions to major government, corporate and institutional clients worldwide. The client-focused business line delivers a full range of banking capabilities including structured financing, advisory, capital markets, liquidity and cash management services.
- Markets and Securities Services ('MSS') enables our corporate and institutional clients to access financial markets and liquidity, unlock investment opportunities, manage risk and transact seamlessly. Bringing together financing solutions; sales, trading and distribution across multiple asset classes; research; clearing and settlement; global and direct custody; and asset servicing.
- Corporate Centre comprises interests in associates and central stewardship costs that support our businesses.

2.2 Summary of significant accounting policies

(a) Consolidation and related policies

Investments in subsidiaries

The group controls and consequently consolidates an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Control is initially assessed based on consideration of all facts and circumstances, and is subsequently reassessed when there are significant changes to the initial setup.

Where an entity is governed by voting rights, the group would consolidate when it holds, directly or indirectly, the necessary voting rights to pass resolutions by the governing body. In all other cases, the assessment of control is more complex and requires judgement of other factors, including having exposure to variability of returns, power over the relevant activities or holding the power as agent or principal.

Business combinations are accounted for using the acquisition method. The amount of non-controlling interest is measured at the non-controlling interest's proportionate share of the acquiree's identifiable net assets.

The group has adopted the policy of 'predecessor accounting' for the transfer of business combinations under common control within the HSBC Group. Under IFRS where both HSBC Group entities adopt the same method for accounting for common control transactions the excess of the cost of the purchased group entity over the carrying value is recorded as a merger reserve on consolidation.

Changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are treated as transactions between equity holders and are reported in equity.

Entities that are controlled by the group are consolidated from the date the group gains control and cease to be consolidated on the date the group loses control of the entities.

The group performs a re-assessment of consolidation whenever there is a change in the facts and circumstances of determining the control of all entities.

All intra-group transactions are eliminated on consolidation.

Interests in associates and joint arrangements

Joint arrangements are investments in which the group, together with one or more parties, has joint control. Depending on the group's rights and obligations, the joint arrangement is classified as either a joint operation or a joint venture. The group classifies investments in entities over which it has significant influence, and that are neither subsidiaries nor joint arrangements, as associates.

The group recognises its share of the assets, liabilities and results in a joint operation. Investments in associates are recognised using the equity method. The attributable share of the results and reserves of associates are included in the consolidated financial statements of group based on either financial statements made up to 31 December or pro-rated amounts adjusted for any material transactions or events occurring between the date of financial statements available and 31 December. Investments in associates are assessed at each reporting date and tested for impairment when there is an indication that the investment may be impaired.

(b) Income and expenses

Operating income

Interest income and expense

Interest income and expense for all financial instruments except for those classified as held for trading or designated at fair value (except for debt securities issued by the group and derivatives managed in conjunction with those debt securities) are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

Non-interest income and expense

The group generates fee income from services provided at a fixed price over time, such as account service and card fees, or when the group delivers a specific transaction at the point in time such as broking services and import/export services. With the exception of certain fund management and performance fees, all other fees are generated at a fixed price. Fund management and performance fees can be variable depending on the size of the customer portfolio and the group's performance as fund manager. Variable fees are recognised when all uncertainties are resolved. Fee income is generally earned from short-term contracts with payment terms that do not include a significant financing component.

The group acts as principal in the majority of contracts with customers, with the exception of broking services. For most brokerage trades the group acts as agent in the transaction and recognises broking income net of fees payable to other parties in the arrangement.

The group recognises fees earned on transaction-based arrangements at a point in time when we have fully provided the service to the customer. Where the contract requires services to be provided over time, income is recognised on a systematic basis over the life of the agreement.

Where the group offers a package of services that contains multiple non-distinct performance obligations, such as those included in account service packages, the promised services are treated as a single performance obligation. If a package of services contains distinct performance obligations, such as those including both account and insurance services, the corresponding transaction price is allocated to each performance obligation based on the estimated stand-alone selling prices.

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders approve the dividend for unlisted equity securities.

Net income/(expense) from financial instruments measured at fair value through profit or loss includes the following:

- 'Net income from financial instruments held for trading or managed on a fair value basis'. This element is comprised of the net trading income, which includes all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with the related interest income, expense and dividends; and it also includes all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets and liabilities measured at fair value through profit or loss.
- 'Changes in fair value of designated debt and related derivatives'. Interest on the external long-term debt and interest cash flows on related derivatives is presented in interest expense.
- 'Changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss'. This includes interest on instruments which fail the SPPI test.

(c) Valuation of financial instruments

All financial instruments are recognised initially at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, if there is a difference between the transaction price and the fair value of financial instruments whose fair value is based on a quoted price in an active market or a valuation technique that uses only data from observable markets, the group recognises the difference as a trading gain or loss at inception (a 'day 1 gain or loss'). In all other cases, the entire day 1 gain or loss is deferred and recognised in the income statement over the life of the transaction either until the transaction matures or is closed out, the valuation inputs become observable or the group enters into an offsetting transaction.

The fair value of financial instruments is generally measured on an individual basis. However, in cases where the group manages a group of financial assets and liabilities according to its net market or credit risk exposure, the group measures the fair value of the group of financial instruments on a net basis but presents the underlying financial assets and liabilities separately in the financial statements, unless they satisfy the IFRS offsetting criteria.

Critical accounting estimates and judgements

The majority of valuation techniques employ only observable market data. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them the measurement of fair value is more judgemental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's inception profit or greater than 5% of the instrument's valuation is driven by unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

(d) Financial instruments measured at amortised cost

Financial assets that are held to collect the contractual cash flows and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest, such as most loans and advances to banks and customers and some debt securities, are measured at amortised cost. In addition, most financial liabilities are measured at amortised cost. The group accounts for regular way amortised cost financial instruments using trade date accounting. The carrying value of these financial assets at initial recognition includes any directly attributable transactions costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some leveraged finance and syndicated lending activities, the difference is deferred and recognised over the life of the loan through the recognition of interest income.

The group may commit to underwriting loans on fixed contractual terms for specified periods of time. When the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative. When the group intends to hold the loan, the loan commitment is included in the impairment calculations.

Non-trading reverse repurchase, repurchase and similar agreements

When debt securities are sold subject to a commitment to repurchase them at a predetermined price ('repos'), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to resell ('reverse repos') are not recognised on the balance sheet and an asset is recorded in respect of the initial consideration paid. Non-trading repos and reverse repos are measured at amortised cost. The difference between the sale and repurchase price or between the purchase and resale price is treated as interest and recognised in net interest income over the life of the agreement.

Contracts that are economically equivalent to reverse repurchase or repurchase agreements (such as sales or purchases of debt securities entered into together with total return swaps with the same counterparty) are accounted for similarly to, and presented together with, reverse repurchase or repurchase agreements.

(e) Financial assets measured at fair value through other comprehensive income ('FVOCI')

Financial assets that are held for a business model achieved by collecting contractual cash flows and selling and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest are measured at FVOCI. These comprise primarily debt securities. They are recognised on the trade date when the group enters into contractual arrangements to purchase and are normally derecognised when they are either sold or redeemed. They are subsequently remeasured at fair value and changes therein (except for those relating to impairment, interest income and foreign currency exchange gains and losses) are recognised in other comprehensive income until the assets are sold. Upon disposal, the cumulative gains or losses in other comprehensive income are recognised in the income statement as 'Gains less losses from financial instruments'. Financial assets measured at FVOCI are included in the impairment calculations and impairment is recognised in profit or loss.

(f) Equity securities measured at fair value with fair value movements presented in other comprehensive income ('OCI')

The equity securities for which fair value movements are shown in OCI are business facilitation and other similar investments where the group holds the investments other than to generate a capital return. Gains or losses on the derecognition of these equity securities are not transferred to profit or loss. Otherwise equity securities are measured at fair value through profit or loss (except for dividend income which is recognised in profit or loss).

(g) Financial instruments designated at fair value through profit or loss

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below and are so designated irrevocably at inception:

- the use of the designation removes or significantly reduces an accounting mismatch;
- when a group of financial assets or a group of financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; and
- where the financial liability contains one or more non-closely related embedded derivatives.

Designated financial assets are recognised when the group enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when the rights to the cash flows expire or are transferred. Designated financial liabilities are recognised when the group enters into contracts with counterparties, which is generally on settlement date, and are normally derecognised when extinguished. Subsequent changes in fair values are recognised in the income statement in 'Net income from financial instruments held for trading or managed on a fair value basis' except for the effect of changes in the liabilities' credit risk, which is presented in 'Other comprehensive income', unless that treatment would create or enlarge an accounting mismatch in profit or loss.

Under the above criterion, the main classes of financial instruments designated by the group are:

- Long-term debt issues.

The interest and/or foreign exchange exposure on certain fixed rate debt securities issued has been matched with the interest and/or foreign exchange exposure on certain swaps as part of a documented risk management strategy.

(h) Derivatives

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, interest rates or other indices. Derivatives are recognised initially and are subsequently measured at fair value through profit and loss. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative. This includes embedded derivatives in financial liabilities which are bifurcated from the host contract when they meet the definition of a derivative on a stand-alone basis.

Where the derivatives are managed with debt securities issued by the group that are designated at fair value, the contractual interest is shown in 'Interest expense' together with the interest payable on the issued debt.

Hedge accounting

When derivatives are not part of fair value designated relationships, if held for risk management purposes they are designated in hedge accounting relationships where the required criteria for documentation and hedge effectiveness are met. Group uses these derivatives or, where allowed, other non-derivative hedging instruments in fair value hedges, cash flow hedges or hedges of net investments in foreign operations as appropriate to the risk being hedged.

Fair value hedge

Fair value hedge accounting does not change the recording of gains and losses on derivatives and other hedging instruments, but results in recognising changes in the fair value of the hedged assets or liabilities attributable to the hedged risk that would not otherwise be recognised in the income statement. If a hedge relationship no longer meets the criteria for hedge accounting, hedge accounting is discontinued; the cumulative adjustment to the carrying amount of the hedged item is amortised to the income statement on a recalculated effective interest rate, unless the hedged item has been derecognised, in which case it is recognised in the income statement immediately.

Cash flow hedge

The effective portion of gains and losses on hedging instruments is recognised in other comprehensive income; the ineffective portion of the change in fair value of derivative hedging instruments that are part of a cash flow hedge relationship is recognised immediately in the income statement within 'Net income from financial instruments held for trading or managed on a fair value basis'. The accumulated gains and losses recognised in other comprehensive income are reclassified to the income statement in the same periods in which the hedged item affects profit or loss. In hedges of forecast transactions that result in recognition of a non-financial asset or liability, previous gains and losses recognised in other comprehensive income are included in the initial measurement of the asset or liability. When a hedge relationship is discontinued, or partially discontinued, any cumulative gain or loss recognised in other comprehensive income remains in equity until the forecast transaction is recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss previously recognised in other comprehensive income is immediately reclassified to the income statement.

Net investment hedge

Hedges of net investments in foreign operations are accounted for in a similar way to cash flow hedges. The effective portion of gains and losses on the hedging instrument is recognised in other comprehensive income; other gains and losses are recognised immediately in the income statement. Gains and losses previously recognised in other comprehensive income are reclassified to the income statement on the disposal, or part disposal, of the foreign operation.

Derivatives that do not qualify for hedge accounting

Non-qualifying hedges are derivatives entered into as economic hedges of assets and liabilities for which hedge accounting was not applied.

(i) Impairment of amortised cost and FVOCI financial assets

Expected credit losses are recognised for loans and advances to banks and customers, non-trading reverse repurchase agreements, other financial assets held at amortised cost, debt instruments measured at fair value through other comprehensive income, and certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is required for ECL resulting from default events that are possible within the next 12 months (or less, where the remaining life is less than 12 months) ('12-month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit-impaired are in 'stage 3'. Purchased or originated credit-impaired financial assets ('POCI') are treated differently as set out below.

Credit-impaired (stage 3)

The group determines that a financial instrument is credit-impaired and in stage 3 by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are past due for more than 90 days;
- there are other indications that the borrower is unlikely to pay such as that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and
- the loan is otherwise considered to be in default.

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due, even where regulatory rules permit default to be defined based on 180 days past due. Therefore the definitions of credit-impaired and default are aligned as far as possible so that stage 3 represents all loans which are considered defaulted or otherwise credit-impaired.

Interest income is recognised by applying the effective interest rate to the amortised cost amount, i.e. gross carrying amount less ECL allowance.

Write-off

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

Renegotiation

Loans are identified as renegotiated and classified as credit-impaired when we modify the contractual payment terms due to significant credit distress of the borrower. Renegotiated loans remain classified as credit-impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows and retain the designation of renegotiated until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement is made on substantially different terms or if the terms of an existing agreement are modified such that the renegotiated loan is a substantially different financial instrument. Any new loans that arise following derecognition events in these circumstances are considered to be purchased or originated credit-impaired ('POCI') and will continue to be disclosed as renegotiated loans.

Other than originated credit-impaired loans, all other modified loans could be transferred out of stage 3 if they no longer exhibit any evidence of being credit-impaired and, in the case of renegotiated loans, there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, over the minimum observation period, and there are no other indicators of impairment. These loans could be transferred to stage 1 or 2 based on the mechanism as described below by comparing the risk of a default occurring at the reporting date (based on the modified contractual terms) and the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms). Any amount written off as a result of the modification of contractual terms would not be reversed.

Loan modifications that are not credit-impaired

Loan modifications that are not identified as renegotiated are considered to be commercial restructuring. Where a commercial restructuring results in a modification (whether legalised through an amendment to the existing terms or the issuance of a new loan contract) such that group's rights to the cash flows under the original contract have expired, the old loan is derecognised and the new loan is recognised at fair value. The rights to cash flows are generally considered to have expired if the commercial restructure is at market rates and no payment-related concession has been provided.

Significant increase in credit risk (stage 2)

An assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. The assessment explicitly or implicitly compares the risk of default occurring at the reporting date compared to that at initial recognition, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. The assessment is unbiased, probability-weighted, and to the extent relevant, uses forward-looking information consistent with that used in the measurement of ECL. The analysis of credit risk is multifactor. The determination of whether a specific factor is relevant and its weight compared with other factors depends on the type of product, the characteristics of the financial instrument and the borrower, and the geographical region. Therefore, it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk and these criteria will differ for different types of lending, particularly between retail and wholesale. However, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when 30 days past due. In addition, wholesale loans that are individually assessed, typically corporate and commercial customers, and included on a watch or worry list are included in stage 2.

For wholesale portfolios, the quantitative comparison assesses default risk using a lifetime probability of default which encompasses a wide range of information including the obligor's customer risk rating, macroeconomic condition forecasts and credit transition probabilities. Significant increase in credit risk is measured by comparing the average PD for the remaining term estimated at origination with the equivalent estimation at reporting date (or that the origination PD has doubled in the case of origination CRR greater than 3.3). The significance of changes in PD was informed by expert credit risk judgement, referenced to historical credit migrations and to relative changes in external market rates. The quantitative measure of significance varies depending on the credit quality at origination as follows:

Origination CRR	Significance trigger – PD to increase by
0.1–1.2	15bps
2.1–3.3	30 bps
Greater than 3.3 and not impaired	2x

For loans originated prior to the implementation of IFRS 9, the origination PD does not include adjustments to reflect expectations of future macroeconomic conditions since these are not available without the use of hindsight. In the absence of this data, origination PD must be approximated assuming through-the-cycle PDs and through-the-cycle migration probabilities, consistent with the instrument's underlying modelling approach and the CRR at origination. For these loans, the quantitative comparison is supplemented with additional CRR deterioration based thresholds as set out in the table below:

Origination CRR	Additional significance criteria – Number of CRR grade notches deterioration required to identify as significant credit deterioration (stage 2) (> or equal to)
0.1	5 notches
1.1–4.2	4 notches
4.3–5.1	3 notches
5.2–7.1	2 notches
7.2–8.2	1 notch
8.3	0 notch

Further information about the 23-grade scale used for CRR can be found on page 56.

For certain portfolios of debt securities where external market ratings are available and credit ratings are not used in credit risk management, the debt securities will be in stage 2 if their credit risk increases to the extent they are no longer considered investment grade. Investment grade is where the financial instrument has a low risk of incurring losses, the structure has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil their contractual cash flow obligations.

For retail portfolios, default risk is assessed using a reporting date 12-month PD derived from credit scores which incorporate all available information about the customer. This PD is adjusted for the effect of macroeconomic forecasts for periods longer than 12 months and is considered to be a reasonable approximation of a lifetime PD measure. Retail exposures are first segmented into homogeneous portfolios, generally by country, product and brand. Within each portfolio, the stage 2 accounts are defined as accounts with an adjusted 12-month PD greater than the average 12-month PD of loans in that portfolio 12 months before they become 30 days past due.

The expert credit risk judgement is that no prior increase in credit risk is significant. This portfolio-specific threshold identifies loans with a PD higher than would be expected from loans that are performing as originally expected and higher than that which would have been acceptable at origination. It therefore approximates a comparison of origination to reporting date PDs.

Unimpaired and without significant increase in credit risk – (stage 1)

ECL resulting from default events that are possible within the next 12 months ('12-month ECL') are recognised for financial instruments that remain in stage 1.

Purchased or originated credit-impaired

Financial assets that are purchased or originated at a deep discount that reflects the incurred credit losses are considered to be POCI. This population includes the recognition of a new financial instrument following a renegotiation where concessions have been granted for economic or contractual reasons relating to the borrower's financial difficulty that otherwise would not have been considered. The amount of change-in-lifetime ECL is recognised in profit or loss until the POCI is derecognised, even if the lifetime ECL are less than the amount of ECL included in the estimated cash flows on initial recognition.

Movement between stages

Financial assets can be transferred between the different categories (other than POCI) depending on their relative increase in credit risk since initial recognition. Financial instruments are transferred out of stage 2 if their credit risk is no longer considered to be significantly increased since initial recognition based on the assessments described above. Except for renegotiated loans, financial instruments are transferred out of stage 3 when they no longer exhibit any evidence of credit impairment as described above. Renegotiated loans that are not POCI will continue to be in stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, observed over a minimum one-year period and there are no other indicators of impairment. For loans that are assessed for impairment on a portfolio basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

Measurement of ECL

The assessment of credit risk, and the estimation of ECL, are unbiased and probability-weighted, and incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money.

In general, the group calculates ECL using three main components, a probability of default, a loss given default and the exposure at default ('EAD').

The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated using the lifetime PD instead. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument respectively.

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of committed facilities. The LGD represents expected losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realised and the time value of money.

The group leverages the Basel II IRB framework where possible, with recalibration to meet the differing IFRS 9 requirements as follows:

Model	Regulatory capital	IFRS 9
PD	• Through the cycle (represents long-run average PD throughout a full economic cycle) • The definition of default includes a backstop of 90+ days past due, this has been modified to 180+ days past due for some portfolios	• Point in time (based on current conditions, adjusted to take into account estimates of future conditions that will impact PD) • Default backstop of 90+ days past due for all portfolios
EAD	• Cannot be lower than current balance	• Amortisation captured for term products
LGD	• Downturn LGD (consistent losses expected to be suffered during a severe but plausible economic downturn) • Regulatory floors may apply to mitigate risk of underestimating downturn LGD due to lack of historical data • Discounted using cost of capital • All collection costs included	• Expected LGD (based on estimate of loss given default including the expected impact of future economic conditions such as changes in value of collateral) • No floors • Discounted using the original effective interest rate of the loan • Only costs associated with obtaining/selling collateral included
Other		• Discounted back from point of default to balance sheet date

While 12-month PDs are recalibrated from Basel models where possible, the lifetime PDs are determined by projecting the 12-month PD using a term structure. For the wholesale methodology, the lifetime PD also takes into account credit migration, i.e. a customer migrating through the CRR bands over its life.

The ECL for wholesale stage 3 is determined on an individual basis using a discounted cash flow methodology. The expected future cash flows are based on the credit risk officer's estimates as at the reporting date, reflecting reasonable and supportable assumptions and projections of future recoveries and expected future receipts of interest. Collateral is taken into account if it is likely that the recovery of the outstanding amount will include realisation of collateral based on its estimated fair value of collateral at the time of expected realisation, less costs for obtaining and selling the collateral. The cash flows are discounted at a reasonable approximation of the original effective interest rate. For significant cases, cash flows under four different scenarios are probability-weighted by reference to the three economic scenarios applied more generally by the Group and the judgement of the credit risk officer in relation to the likelihood of the workout strategy succeeding or receivership being required. For less significant cases, the effect of different economic scenarios and work-out strategies is approximated and applied as an adjustment to the most likely outcome.

Period over which ECL is measured

Expected credit loss is measured from the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the group is exposed to credit risk. For wholesale overdrafts, credit risk management actions are taken no less frequently than on an annual basis and therefore this period is to the expected date of the next substantive credit review. The date of the substantive credit review also represents the initial recognition of the new facility. However, where the financial instrument includes both a drawn and undrawn commitment and the contractual ability to demand repayment and cancel the undrawn commitment does not serve to limit group's exposure to credit risk to the contractual notice period, the contractual period does not determine the maximum period considered. Instead, ECL is measured over the period the group remains exposed to credit risk that is not mitigated by credit risk management actions. This applies to retail overdrafts and credit cards, where the period is the average time taken for stage 2 exposures to default or close as performing accounts, determined on a portfolio basis and ranging from between two and six years. In addition, for these facilities it is not possible to identify the ECL on the loan commitment component separately from the financial asset component. As a result, 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.

Forward-looking economic inputs

The group applies multiple forward-looking global economic scenarios determined with reference to external forecast distributions representative of our view of forecast economic conditions, the Consensus Economic Scenario approach. This approach is considered sufficient to calculate unbiased expected loss in most economic environments. They represent a 'most likely outcome' (the Central scenario) and three, less likely, 'Outer' scenarios, referred to as the Upside, Downside scenarios and Additional Downside scenarios. The Central scenario is used by the annual operating planning process and, with regulatory modifications, will also be used in enterprise-wide stress tests. The Upside, Downside and Additional Downside are constructed following a standard process supported by a scenario narrative reflecting the group's current top and emerging risks and by consulting external and internal subject matter experts. The relationship between the Outer scenarios and Central scenario will generally be fixed with the Central scenario, with the difference between the Central and Outer scenarios in terms of economic severity being informed by the spread of external forecast distributions among professional industry forecasts. The Outer scenarios are economically plausible, internally consistent states of the world and will not necessarily be as severe as scenarios used in stress testing. The period of forecast is five years, after which the forecasts will revert to a view based on average past experience. The spread between the central and outer scenarios is grounded on consensus distributions of projected gross domestic product of UAE. The economic factors include, but are not limited to, gross domestic product, unemployment, interest rates, and commercial property prices across all the countries in which the group operates.

In general, the consequences of the assessment of credit risk and the resulting ECL outputs will be probability-weighted using the probability weights which are reviewed on a quarterly basis and changed in line with the current and expected economic environment. The economic forecast for Central and Outer scenarios is updated on quarterly basis.

The group recognises that the Consensus Economic Scenario approach using three scenarios will be insufficient in certain economic environments. Additional analysis may be requested at management's discretion, including the production of extra scenarios. If conditions warrant, this could result in a management overlay for economic uncertainty which is included in the ECL.

Critical accounting estimates and judgements

The calculation of the group's ECL under IFRS 9 requires the group to make a number of judgements, assumptions and estimates. The most significant are set out below:

Judgements	Estimates
• Defining what is considered to be a significant increase in credit risk • Determining the lifetime and point of initial recognition of overdrafts and credit cards • Selecting and calibrating the PD, LGD and EAD models, which support the calculations, including making reasonable and supportable judgements about how models react to current and future economic conditions • Selecting model inputs and economic forecasts, including determining whether sufficient and appropriately weighted economic forecasts are incorporated to calculate unbiased expected loss	• The sections on pages 50 to 52, 'Measurement uncertainty and sensitivity analysis of ECL estimates' set out the assumptions used in determining ECL and provide an indication of the sensitivity of the result to the application of different weightings being applied to different economic assumptions

(j) Employee compensation and benefits

Share-based payments

Shares in HSBC Holdings plc are awarded to employees in certain cases. Equity-settled share-based payment arrangements entitle employees to receive equity instruments of HSBC.

The vesting period for these schemes may commence before the grant date if the employees have started to render services in respect of the award before the grant date. Expenses are recognised when the employee starts to render service to which the award relates.

Cancellations result from the failure to meet a non-vesting condition during the vesting period, and are treated as an acceleration of vesting recognised immediately in the income statement. Failure to meet a vesting condition by the employee is not treated as a cancellation, and the amount of expense recognised for the award is adjusted to reflect the number of awards expected to vest.

Post-employment benefit plans

The group contributes to the Government pension and social security schemes in the countries in which it operates, as per local regulations. Where the group's obligations under the plans are equivalent to a defined contribution plan the payments made are charged as an expense as they fall due. End of service benefits are calculated and paid in accordance with local law. The group's net obligation in respect of such end of service benefits is the amount of future benefits that employees have earned in return for their service in current and prior periods.

Defined benefit pension obligations are calculated using the projected unit credit method. The net charge to the income statement mainly comprises the service cost and the net interest on the net defined benefit asset or liability, and is presented in operating expenses.

Re-measurements of the net defined benefit asset or liability, which comprise actuarial gains and losses, return on plan assets excluding interest and the effect of the asset ceiling (if any, excluding interest), are recognised immediately in other comprehensive income. The net defined benefit asset or liability represents the present value of defined benefit obligations reduced by the fair value of plan assets, after applying the asset ceiling test, where the net defined benefit surplus is limited to the present value of available refunds and reductions in future contributions to the plan.

The cost of obligations arising from other post-employment plans are accounted for on the same basis as defined benefit pension plans.

Critical accounting estimates and judgements

The most significant critical accounting estimates relate to the determination of key assumptions applied in calculating the defined benefit pension obligation for the principal plan.	
Judgements	**Estimates**
	• A range of assumptions could be applied, and different assumptions could significantly alter the defined benefit obligation and the amounts recognised in profit or loss or OCI. • The calculation of the defined benefit pension obligation includes assumptions with regard to the discount rate, inflation rate, pension payments and deferred pensions, pay and mortality. Management determines these assumptions in consultation with the plan's actuaries. • Key assumptions used in calculating the defined benefit pension obligation for the principal plan and the sensitivity of the calculation to different assumptions are described in Note 6.

(k) Tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in the same statement in which the related item appears.

Current tax is the tax expected to be payable on the taxable profit for the year and any adjustment to tax payable in respect of previous years. The group provides for potential current tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled.

Current and deferred tax is calculated based on tax rates and laws enacted, or substantively enacted, by the balance sheet date.

Critical accounting estimates and judgements

Assessing the probability and sufficiency of future taxable profits, taking into account the future reversal of existing taxable temporary differences and tax planning strategies including corporate reorganisations.

(l) Debt securities in issue

Financial liabilities for debt securities issued are recognised when the group enters into contractual arrangements with counterparties and are initially measured at fair value, which is normally the consideration received, net of directly attributable transaction costs incurred. Subsequent measurement of financial liabilities, other than those measured at fair value through profit or loss and financial guarantees, is at amortised cost, using the effective interest method to amortise the difference between proceeds received, net of directly attributable transaction costs incurred, and the redemption amount over the expected life.

(m) Provisions, contingent liabilities and guarantees

Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation which has arisen as a result of past events and for which a reliable estimate can be made.

Critical accounting estimates and judgements

The recognition and measurement of provisions requires the Group to make a number of judgements, assumptions and estimates. The most significant are set out below:	
Judgements	**Estimates**
• Determining whether a present obligation exists. Professional advice is taken on the assessment of litigation and similar obligations. • Provisions for legal proceedings and regulatory matters typically require a higher degree of judgement than other types of provisions. When matters are at an early stage, accounting judgements can be difficult because of the high degree of uncertainty associated with determining whether a present obligation exists, and estimating the probability and amount of any outflows that may arise. As matters progress, management and legal advisers evaluate on an ongoing basis whether provisions should be recognised, revising previous estimates as appropriate. At more advanced stages, it is typically easier to make estimates around a better defined set of possible outcomes.	• Provisions for legal proceedings and regulatory matters remain very sensitive to the assumptions used in the estimate. There could be a wider range of possible outcomes for any pending legal proceedings, investigations or inquiries. As a result it is often not practicable to quantify a range of possible outcomes for individual matters. It is also not practicable to meaningfully quantify ranges of potential outcomes in aggregate for these types of provisions because of the diverse nature and circumstances of such matters and the wide range of uncertainties involved.

Contingent liabilities, contractual commitments and guarantees

Contingent liabilities

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security and contingent liabilities related to legal proceedings or regulatory matters, are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

Financial guarantee contracts

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received or present value of the fee receivable.

(n) Acceptances and endorsements

Acceptances arise when the group is under an obligation to make payments against documents drawn under letters of credit. Acceptances specify the amount of money, the date, and the person to which the payment is due. After acceptance, the instrument becomes an unconditional liability of the group and is therefore recognised as a financial liability with a corresponding contractual right of reimbursement from the customer recognised as a financial asset.

(o) Impairment of non-financial assets

Software under development is tested for impairment at least annually. Other non-financial assets such as property, plant and equipment, intangible assets (excluding goodwill) and right-of-use assets are tested for impairment at the individual asset level when there is indication of impairment at that level, or at the Cash Generating Unit ('CGU') level for assets that do not have a recoverable amount at the individual asset level. In addition, impairment is also tested at the CGU level when there is indication of impairment at that level. For this purpose, CGUs are considered to be the legal entity divided by global business.

Impairment testing compares the carrying amount of the CGU with is recoverable amount, which is the higher of the fair value less costs of disposal or the value in use. The carrying amount of a CGU is its assets and liabilities, including non-financial assets that are directly attributable to it and non-financial assets that can be allocated to it on a reasonable and consistent basis. Non-financial assets that cannot be allocated to an individual CGU are tested for impairment at an appropriate grouping of CGUs. The recoverable amount of the CGU is the higher of the fair value less costs of disposal of the CGU, which is determined by independent and qualified valuers where relevant, and the value in use, which is calculated based on appropriate inputs.

When the recoverable amount of a CGU is less than its carrying amount, an impairment loss is recognised in the income statement to the extent that the impairment can be allocated on a pro-rata basis to the non-financial assets by reducing their carrying amounts to the higher of their respective individual recoverable amount or nil. Impairment is not allocated to the financial assets in a CGU.

Impairment loss recognised in prior periods for non-financial assets is reversed when there has been a change in the estimate used to determine the recoverable amount. The impairment loss is reversed to the extent that the carrying amount of the non-financial assets would not exceed the amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised in prior periods.

Critical accounting estimates and judgements

The review of the non-financial assets for impairment reflects management's best estimate of the future cash flows of the CGUs and the rates used to discount these cash flows, both of which are subject to uncertain factors as described in the Critical accounting estimates and judgements in Note 2.1(e). In 2021, there was no impairment of non-financial assets based on comparing the carrying amount of the group's CGUs with their recoverable amount.

3 Net fee income

	2021	2020
	US$000	US$000
Credit facilities	**38,815**	48,670
Remittances	**34,863**	32,931
Cards	**128,643**	113,881
Global custody	**40,910**	35,107
Account services	**33,590**	23,825
Import/exports	**56,400**	52,188
Insurance agency	**9,210**	12,078
Corporate/project finance	**17,485**	18,306
Performance/tender bonds	**59,240**	58,554
Unit trusts	**19,357**	9,517
Others[1]	**97,149**	98,041
Total Fee Income	**535,662**	503,098
Fee Expense	**(90,935)**	(82,048)
Net Fee Income	**444,727**	421,050

1 *Others include intercompany fee of US$60m (2020: US$60m). Refer Note 35 for further details of Related Party Transactions.*

4 Changes in fair value of designated debt and related derivatives

	2021	2020
	US$000	US$000
Net income/(expense) arising on:		
– other changes in fair value	**(4,743)**	(6,346)
Year ended 31 Dec	**(4,743)**	(6,346)

5 Operating profit/(loss)

Operating profit is stated after the following items:

	2021	2020
	US$000	US$000
Income		
Interest recognised on financial assets measured at amortised cost	**665,440**	860,813
– of which: Interest recognised on impaired financial assets	***4,730***	*9,751*
Interest recognised on financial assets measured at FVOCI	**60,755**	99,654
Fees earned on financial assets that are not at fair value through profit or loss (other than amounts included in determining the effective interest rate)	**368,996**	353,455
Fees earned on trust and other fiduciary activities	**15,998**	18,209
Expense		
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated or otherwise mandatorily measured at fair value	**(46,624)**	(112,750)
Fees payable on financial liabilities that are not at fair value through profit or loss (other than amounts included in determining the effective interest rate)	**(67,573)**	(65,187)
Restructuring provisions	**(12,076)**	(9,412)
Gains/(losses)		
Gains on disposal of property, plant and equipment, intangible assets and non-financial investments	**(135)**	(340)
Change in expected credit loss charges and other credit impairment charges	**145,432**	(638,271)
– loans and advances to banks and customers	**117,676**	(576,798)
– loans commitments and guarantees	**28,477**	(60,065)
– other financial assets	**(1,915)**	(116)
– debt instruments measured at fair value though other comprehensive income	**1,194**	(1,292)

6 Employee compensation and benefits

	2021	2020
	US$000	US$000
Wages and salaries	**490,017**	510,451
Social security costs	**8,064**	7,301
Post-employment benefits	**20,616**	23,129
Year ended 31 Dec	**518,697**	540,881

Share-based payments

'Wages and salaries' include the effect of share-based payments arrangements, all equity settled, as follows:

	2021	2020
	US$000	US$000
Restricted share awards	**10,455**	8,792
Year ended 31 Dec	**10,455**	8,792

Defined benefit pension plans

Net asset/(liability) under defined benefit pension plans[1]

	Present value of defined benefit obligations[2]	Net defined benefit liability
	US$000	US$000
At 1 Jan 2021	**(145,354)**	**(145,354)**
Current service cost	**(17,798)**	**(17,798)**
Net interest cost on the net defined benefit liability	**(1,823)**	**(1,823)**
Re-measurement effects recognised in other comprehensive income – actuarial gains/(losses)	**(31,430)**	**(31,430)**
Exchange differences and other movements	**(792)**	**(792)**
Benefits paid	**19,600**	**19,600**
At 31 Dec 2021	**(177,597)**	**(177,597)**
At 1 Jan 2020	(151,757)	(151,757)
Current service cost	(19,114)	(19,114)
Net interest cost on the net defined benefit liability	(2,656)	(2,656)
Re-measurement effects recognised in other comprehensive income – actuarial gains/(losses)	11,481	11,481
Exchange differences and other movements	(223)	(223)
Benefits paid	16,915	16,915
At 31 Dec 2020	(145,354)	(145,354)

1 *There are no plan assets under defined benefit pension plans as at 31 Dec 2021 (31 Dec 2020: nil) .*
2 *These are payable to employees immediately after resignation.*

Post-employment defined benefit plans' principal actuarial financial assumptions

The principal actuarial financial assumptions used to calculate the group's obligations under its defined benefit pension plans at 31 December for each year, and used as the basis for measuring periodic costs under the plans in the following years, were as follows:

Key actuarial assumptions for the principal plan

	Discount rate	Rate of pay increase	Combined rate of resignation and employment termination
	%	%	%
United Arab Emirates			
At 31 Dec 2021	**1.38**	**3**	**8.90**
At 31 Dec 2020	1.48	0.25	7.00

The group determines discount rates to be applied to its obligations in consultation with the plans' local actuaries, on the basis of current average yields of long term government bonds.

The effect of changes in key assumptions on the principal plan

	United Arab Emirates	
	2021	2020
	US$000	US$000
Discount rate		
Change in scheme obligation at year end from a 25bps increase	**(2,864)**	(2,289)
Change in scheme obligation at year end from a 25bps decrease	**2,477**	2,361
Change in following year scheme cost from a 25bps increase	**(29)**	(499)
Change in following year scheme cost from a 25bps decrease	**(225)**	42
Rate of pay increase		
Change in scheme obligation at year end from a 25bps increase	**4,553**	2,548
Change in scheme obligation at year end from a 25bps decrease	**(2,743)**	(2,480)
Change in following year scheme cost from a 25bps increase	**588**	453
Change in following year scheme cost from a 25bps decrease	**(519)**	(257)

7 Auditors' remuneration

	2021	2020
	US$000	US$000
Audit fees payable to PwC	**1,359**	1,445
Other audit fees payable	**64**	38
Year ended 31 Dec	**1,423**	1,483

Fees payable by the group to PwC

	2021	2020
	US$000	US$000
Fees for HSBC Bank Middle East Limited statutory audit[1]	**1,359**	1,445
– relating to current year	**1,359**	1,445
Fees for other services provided to the group	**1,109**	952
– audit-related assurance services[2]	**799**	743
– other non-audit services	**310**	209
Year ended 31 Dec	**2,468**	2,397

1 *Fees payable to PwC for the statutory audit of the consolidated financial statements of the group.*
2 *Including services for assurance and other services that relate to statutory and regulatory filings, including interim reviews.*

No fees were payable by the group to PwC as principal auditor for internal audit services and services related to litigation, recruitment and remuneration.

8 Tax

Tax expense

	2021	2020
	US$000	US$000
Current tax	**68,662**	63,883
– for this year	**70,252**	68,918
– adjustments in respect of prior years	**(1,590)**	(5,035)
Deferred tax	**20,873**	(53,342)
– origination and reversal of temporary differences	**20,873**	(53,342)
Year ended 31 Dec	**89,535**	10,541

The group provides for taxation at the appropriate rates in the countries in which it operates.

Tax reconciliation

The tax charged to the income statement differs from the tax charge that would apply if all profits had been taxed at the corporate tax rate applicable in UAE:

	2021		2020	
	US$000	%	US$000	%
Profit/(loss) before tax	**595,020**		(75,518)	
Tax expense				
Taxation at UAE corporate tax rate of 20% (2020: 20%)	**119,004**	**20.0**	(15,104)	20.0
Effect of differently taxed overseas profits	**1,421**	**0.2**	10,640	(14.1)
Adjustments in respect of prior period liabilities	**(2,971)**	**(0.5)**	(5,035)	6.7
Non-taxable income and gains	**(21,840)**	**(3.7)**	2,953	(3.9)
Permanent disallowables	**(4,820)**	**(0.8)**	5,464	(7.2)
Deferred tax	**(7,438)**	**(1.3)**	7,438	(9.8)
Local taxes and overseas withholding taxes	**4,621**	**0.8**	4,185	(5.5)
Other items	**1,558**	**0.3**	—	—
Overall tax expense	**89,535**	**15.0**	10,541	(13.8)

Accounting for taxes involves some estimation because the tax law is uncertain and the application requires a degree of judgement, which authorities may dispute. Liabilities are recognised based on best estimates of the probable outcome, taking into account external advice where appropriate. We do not expect significant liabilities to arise in excess of the amounts provided. The group only recognises current and deferred tax assets where recovery is probable.

Movement of deferred tax assets and liabilities

	Retirement benefits	Loan impairment allowances	Other	Total
	US$000	US$000	US$000	US$000
Assets	**—**	**190,087**	**29,577**	**219,664**
Liabilities	**—**	**—**	**—**	**—**
At 1 Jan 2021	**—**	**190,087**	**29,577**	**219,664**
Income statement	**—**	**(17,323)**	**(3,550)**	**(20,873)**
Other comprehensive income	**—**	**—**	**—**	**—**
Foreign exchange and other adjustments	**—**	**—**	**(142)**	**(142)**
At 31 Dec 2021	**—**	**172,764**	**25,885**	**198,649**
Assets	**—**	**172,764**	**25,885**	**198,649**
Liabilities	**—**	**—**	**—**	**—**
Assets	4,411	158,042	8,526	170,979
Liabilities	—	—	—	—
At 1 Jan 2020	4,411	158,042	8,526	170,979
Income statement	—	32,148	21,194	53,342
Other comprehensive income	(4,411)	—	—	(4,411)
Foreign exchange and other adjustments	—	(103)	(143)	(246)
At 31 Dec 2020	—	190,087	29,577	219,664
Assets	—	190,087	29,577	219,664
Liabilities	—	—	—	—

Unrecognised deferred tax

The amount of temporary differences, unused tax losses and tax credits for which no deferred tax asset is recognised in the balance sheet was nil (2020: 7.4m).

Other information

In December 2021, the Organisation for Economic Co-operation and Development ('OECD') published model rules that provide a template for countries to implement a new Global Minimum Tax ('GMT') rate of 15% from 2023. In Jan 2022, the UAE Ministry of Finance ('MoF') announced the introduction of a Federal Corporate Tax ('FCT') in the UAE at 9%. The statutory rate for multinational enterprises, hasn't yet been announced. The impact on the group will depend on the details of UAE's implementation of the FCT and the interaction with the GMT, as well as the profitability and local tax liabilities of the group's operations in the UAE from 2023.

9 Dividends

Dividends to shareholders of the parent company

	2021		2020	
	Per share	Total	Per share	Total
	US$	US$000	US$	US$000
Dividends paid on ordinary shares				
In respect of previous year:				
– final dividend 2019	**0.2975**	**277,000**	—	—
In respect of current year:				
– first interim dividend	**—**	**—**	—	—
Total	**0.2975**	**277,000**	—	—

10 Segment analysis

Profit/(loss) for the period

	2021					
	Wealth and Personal Banking	Commercial Banking	Global Banking[1]	Markets and Securities Services[1]	Corporate Centre	Total
Full year	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**
Net interest income	**235,720**	**171,884**	**181,490**	**46,122**	**(1,969)**	**633,247**
Net fee income	**110,114**	**134,974**	**127,338**	**72,400**	**(99)**	**444,727**
Net income from financial instruments held for trading or managed on a fair value basis	**44,259**	**36,396**	**1,847**	**193,704**	**(830)**	**275,376**
Other income	**13,145**	**16,595**	**2,182**	**1,330**	**21,057**	**54,309**
Net operating income before change in expected credit losses and other credit impairment charges	**403,238**	**359,849**	**312,857**	**313,556**	**18,159**	**1,407,659**
Change in expected credit losses and other credit impairment charges	**39,174**	**(8,145)**	**114,297**	**106**	**—**	**145,432**
Net operating income	**442,412**	**351,704**	**427,154**	**313,662**	**18,159**	**1,553,091**
Total operating expenses	**(345,366)**	**(244,626)**	**(172,818)**	**(111,815)**	**(83,238)**	**(957,863)**
Operating profit/(loss)	**97,046**	**107,078**	**254,336**	**201,847**	**(65,079)**	**595,228**
Share of profit/(loss) in associates	**—**	**—**	**—**		**(208)**	**(208)**
Profit/(loss) before tax	**97,046**	**107,078**	**254,336**	**201,847**	**(65,287)**	**595,020**
By geographical region						
U.A.E.	**92,585**	**5,346**	**192,787**	**147,367**	**(53,002)**	**385,083**
Qatar	**(4,652)**	**53,039**	**38,139**	**35,391**	**(1,512)**	**120,405**
Rest of Middle East	**9,113**	**48,693**	**23,410**	**19,089**	**(10,773)**	**89,532**
Profit/(loss) before tax	**97,046**	**107,078**	**254,336**	**201,847**	**(65,287)**	**595,020**

	2020					
Net interest income	311,370	190,471	208,372	71,908	(4,526)	777,595
Net fee income	92,907	130,282	130,095	71,415	(3,649)	421,050
Net income from financial instruments held for trading or managed on a fair value basis	46,146	30,185	3,383	156,356	1,069	237,139
Other income	14,046	12,617	6,987	(1,584)	28,199	60,265
Net operating income before change in expected credit losses and other credit impairment charges	464,469	363,555	348,837	298,095	21,093	1,496,049
Change in expected credit losses and other credit impairment charges	(128,491)	(327,897)	(181,805)	(78)	—	(638,271)
Net operating income	335,978	35,658	167,032	298,017	21,093	857,778
Total operating expenses	(363,371)	(232,691)	(174,370)	(103,542)	(59,115)	(933,089)
Operating profit/(loss)	(27,393)	(197,033)	(7,338)	194,475	(38,022)	(75,311)
Share of profit in associates	—	—	—	—	(207)	(207)
Profit/(loss) before tax	(27,393)	(197,033)	(7,338)	194,475	(38,229)	(75,518)
By geographical region						
U.A.E.	(20,926)	(210,334)	(42,135)	145,842	(38,658)	(166,211)
Qatar	(741)	14,287	25,739	26,785	(75)	65,995
Rest of Middle East	(5,726)	(986)	9,058	21,848	504	24,698
Profit/(loss) before tax	(27,393)	(197,033)	(7,338)	194,475	(38,229)	(75,518)

1 *During the year, GB&M has been re-segmented into GB and MSS as it aligns with the changes in the management structure and internal reporting to the Board. Comparatives have been re-presented to conform with the current year's presentation.*

Balance sheet information

	2021					
	Wealth and Personal Banking	Commercial Banking	Global Banking	Markets and Securities Services	Corporate Centre	Total
	US$000	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**
Loans and advances to customers (net)	**3,448,764**	**6,072,356**	**9,102,651**	**10**	**—**	**18,623,781**
Interest in associates	**—**	**—**	**—**	—	**2,659**	**2,659**
Total assets	**12,040,353**	**10,158,530**	**16,690,646**	**6,149,985**	**1,732,208**	**46,771,722**
Customer accounts	**13,169,265**	**5,675,239**	**7,437,546**	**728,363**	**136**	**27,010,549**
Total liabilities	**14,742,502**	**7,215,927**	**11,619,599**	**4,775,241**	**3,154,882**	**41,508,151**

	2020					
Loans and advances to customers (net)	3,142,919	6,250,448	9,949,568	7,781	—	19,350,716
Interest in associates	—	—	—	—	2,867	2,867
Total assets	11,435,751	9,749,856	17,070,972	4,573,395	1,771,329	44,601,303
Customer accounts	12,586,110	5,329,063	8,209,742	710,019	13	26,834,947
Total liabilities	13,450,534	6,849,109	10,981,341	5,729,391	2,690,982	39,701,357

Other financial information

Information by country

	2021		2020	
	External net operating income[1]	**Non-current assets[2]**	External net operating income[1]	Non-current assets[2]
	US$000	**US$000**	US$000	US$000
U.A.E.	**1,107,139**	**378,238**	1,168,941	359,341
Qatar	**176,835**	**13,237**	168,614	9,831
Rest of Middle East	**123,685**	**26,859**	158,494	23,001
Total	**1,407,659**	**418,334**	1,496,049	392,173

1 *External net operating income is attributed to countries on the basis of the location of the branch responsible for reporting the results or advancing the funds.*
2 *Non-current assets consist of property, plant and equipment, other intangible assets and certain other assets expected to be recovered more than 12 months after the reporting period.*

Performance ratios

	2021					
	Wealth and Personal Banking	**Commercial Banking**	**Global Banking**	**Markets and Securities Services**	**Corporate Centre**	**Total**
	%	**%**	**%**	**%**	**%**	**%**
Year ended 31 December 2021						
Share of the group's profit before tax	**16.3**	**18.0**	**42.7**	**33.9**	**(10.9)**	**100.0**
Cost efficiency ratio[1]	**85.6**	**68.0**	**55.2**	**35.7**	**458.4**	**68.0**
	2020					
Year ended 31 December 2020						
Share of the group's profit before tax	(36.3)	(260.9)	(9.7)	257.5	(50.6)	(100.0)
Cost efficiency ratio	78.2	64.0	50.0	34.7	280.3	62.4

1 *Cost efficiency ratio is calculated by dividing total operating expenses by net operating income before change in expected credit losses and other credit impairment charges.*

11 Trading assets

	2021	2020
	US$000	US$000
Trading assets:		
– not subject to repledge or resale by counterparties	**1,106,182**	741,594
At 31 Dec	**1,106,182**	741,594
Debt securities	**231,379**	224,795
Treasury and other eligible bills	**158,645**	73,941
Trading securities	**390,024**	298,736
Loans and advances to banks	**–**	132,318
Trading reverse repurchase agreements	**701,322**	275,386
Loans and advances to customers	**14,836**	35,154
At 31 Dec	**1,106,182**	741,594

12 Fair values of financial instruments carried at fair value

Control framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk taker.

Where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is used. For inactive markets, the group sources alternative market information, with greater weight given to information that is considered to be more relevant and reliable. Examples of the factors considered are price observability, instrument comparability, consistency of data sources, underlying data accuracy and timing of prices.

For fair values determined using valuation models, the control framework includes development or validation by independent support functions of the model logic, inputs, model outputs and adjustments. Valuation models are subject to a process of due diligence before becoming operational and are calibrated against external market data on an ongoing basis.

The majority of financial instruments measured at fair value are in GBM. GBM's fair value governance structure comprises its Finance function, Valuation Committee and a Valuation Committee Review Group. Finance is responsible for establishing procedures governing valuation and ensuring fair values are in compliance with accounting standards. The fair values are reviewed by the Valuation Committees, which consist of independent support functions. These Committees are overseen by the Valuation Committee Review Group, which considers all material subjective valuations.

Financial liabilities measured at fair value

In certain circumstances, the group records its own debt in issue at fair value, based on quoted prices in an active market for the specific instrument concerned, where available. An example of this is where own debt in issue is hedged with interest rate derivatives. When quoted market prices are unavailable, the own debt in issue is valued using valuation techniques, the inputs for which are either based upon quoted prices in an inactive market for the instrument, or are estimated by comparison with quoted prices in an active market for similar instruments. In both cases, the fair value includes the effect of applying the credit spread which is appropriate to the group's liabilities. The change in fair value of issued debt securities attributable to the group's own credit spread is computed as follows: for each security at each reporting date, an externally verifiable price is obtained or a price is derived using credit spreads for similar securities for the same issuer. Then, using discounted cash flow, each security is valued using a Libor-based discount curve. The difference in the valuations is attributable to the group's own credit spread. This methodology is applied consistently across all securities.

The credit spread applied to these instruments is derived from the spreads at which the group issues structured notes.

Gains and losses arising from changes in the credit spread of liabilities issued by the group is taken in reserves (OCI), the residual risks (rates, volatility, time effects) are Fair valued through Profits and Losses.

Fair value hierarchy

Fair values of financial assets and liabilities are determined according to the following hierarchy:

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

Financial instruments carried at fair value and bases of valuation

	2021				2020			
	Level 1	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total
	US$000	**US$000**	**US$000**	**US$000**	US$000	US$000	US$000	US$000
Recurring fair value measurements at 31 Dec								
Assets								
Trading assets	**353,181**	**405,101**	**347,900**	**1,106,182**	152,116	394,423	195,055	741,594
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	**—**	**—**	**25,315**	**25,315**	—	—	38,813	38,813
Derivatives	**—**	**1,068,997**	**1,159**	**1,070,156**	—	1,876,664	2,578	1,879,242
Financial investments	**8,264,716**	**2,638,020**	**26,225**	**10,928,961**	5,859,460	4,206,655	37,719	10,103,834
Liabilities								
Trading liabilities	**179,907**	**438,192**	**—**	**618,099**	139,120	160,426	—	299,546
Financial liabilities designated at fair value	**—**	**1,563,998**	**—**	**1,563,998**	—	2,823,792	—	2,823,792
Derivatives	**—**	**1,011,158**	**3,234**	**1,014,392**	—	1,796,424	2,720	1,799,144

The balance as at 31 December 2021 under financial assets mandatorily measured at fair value through profit or loss is US$25.3m (2020: US$38.8m) and financial assets designated at fair value through profit or loss is nil (2020: nil).

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 2021 there was a transfer of nil (2020: nil) 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 29.

Fair value adjustments

Fair value adjustments are adopted when the group considers that there are additional factors that would be considered by a market participant which are not incorporated within the valuation model.

Movements in the level of fair value adjustments do not necessarily result in the recognition of profits or losses within the income statement. For example, as models are enhanced, fair value adjustments may no longer be required.

Bid-offer

IFRS 13 requires use of the price within the bid-offer spread that is most representative of fair value. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the extent to which bid-offer cost would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the position.

Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, there exists a range of possible values that the financial instrument or market parameter may assume and an adjustment may be necessary to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model.

Credit and debit valuation adjustment

The credit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the counterparty may default and that the group may not receive the full market value of the transactions.

The debit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the group may default, and that the group may not pay full market value of the transactions.

The group calculates a separate credit valuation adjustment and debit valuation adjustment for each group legal entity, and within each entity for each counterparty to which the entity has exposure.

The group calculates the credit valuation adjustment by applying the probability of default ('PD') of the counterparty conditional on the non-default of the group to the expected positive exposure to the counterparty and multiplying the result by the loss expected in the event of default. Conversely, the group calculates the debit valuation adjustment by applying the PD of the group, conditional on the non-default of the counterparty, to the expected positive exposure of the counterparty to the group and multiplying by the loss expected in the event of default. Both calculations are performed over the life of the potential exposure.

Funding fair value adjustment

The funding fair value adjustment is calculated by applying future market funding spreads to the expected future funding exposure of any uncollateralised component of the OTC derivative portfolio. This includes the uncollateralised component of collateralised derivatives in addition to derivatives that are fully uncollateralised. The expected future funding exposure is calculated by a simulation methodology, where available. The expected future funding exposure is adjusted for events that may terminate the exposure such as the default of the group or the counterparty.

Model limitation

Models used for portfolio valuation purposes may be based upon a simplified set of assumptions that do not capture all current and future material market characteristics. In these circumstances, model limitation adjustments are adopted.

Inception profit (Day 1 P&L reserves)

Inception profit adjustments are adopted when the fair value estimated by a valuation model is based on one or more significant unobservable inputs.

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	**26,225**	**–**	**25,315**	**–**	**51,540**	**–**	**–**
Other derivatives	**–**	**–**	**–**	**1,159**	**1,159**	**3,234**	**3,234**
Other portfolios	**–**	**347,900**	**–**	**–**	**347,900**	**–**	**–**
At 31 Dec 2021	**26,225**	**347,900**	**25,315**	**1,159**	**400,599**	**3,234**	**3,234**
Private equity including strategic investments	37,719	–	38,813	–	76,532	–	–
Other derivatives	–	–	–	2,578	2,578	2,720	2,720
Other portfolios	–	195,055	–	–	195,055	–	–
At 31 Dec 2020	37,719	195,055	38,813	2,578	274,165	2,720	2,720

Private equity including strategic investments

The investment's fair value is estimated on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors; by reference to market valuations for similar entities quoted in an active market; or the price at which similar companies have changed ownership.

Derivatives

OTC (i.e. non-exchange traded) derivatives are valued using valuation models. Valuation models calculate the present value of expected future cash flows, based upon 'no-arbitrage' principles. For many vanilla derivative products, such as interest rate swaps and European options, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some differences in market practice. Inputs to valuation models are determined from observable market data wherever possible, including prices available from exchanges, dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices via model calibration procedures or estimated from historical data or other sources.

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 2021	**37,719**	**195,055**	**38,813**	**2,578**	**2,720**
Total gain/(losses) recognised in profit or loss	**–**	**5,045**	**(3,244)**	**(548)**	**(780)**
– net income/expense from financial instruments held for trading or managed on a fair value basis	**–**	**5,045**	**–**	**(548)**	**(780)**
– changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss	**–**	**–**	**(3,244)**	**–**	**–**
Total gains/(losses) recognised in other comprehensive income	**(11,494)**	**–**	**–**	**–**	**–**
– financial investments: fair value gains/(losses)	**(11,494)**	**–**	**–**	**–**	**–**
Purchases	**–**	**211,189**	**–**	**–**	**2,165**
Settlements	**–**	**(78,225)**	**(10,254)**	**(871)**	**(871)**
Transfers in	**–**	**14,836**	**–**	**–**	**–**
At 31 Dec 2021	**26,225**	**347,900**	**25,315**	**1,159**	**3,234**
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 31 Dec 2021	**–**	**5,045**	**(3,244)**	**(548)**	**(780)**
– net income/expense from financial instruments held for trading or managed on a fair value basis	**–**	**5,045**	**–**	**(548)**	**(780)**
– changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss	**–**	**–**	**(3,244)**	**–**	**–**
At 1 Jan 2020	45,169	79,960	40,731	5,642	442
Total gain/(losses) recognised in profit or loss	–	(2,135)	(1,889)	(1,293)	–
– net income from financial instruments held for trading or managed on a fair value basis	–	(2,135)	–	(1,293)	–
– changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss	–	–	(1,889)	–	–
Total gains/(losses) recognised in other comprehensive income	(7,450)	–	–	–	–
– financial investments: fair value gains/(losses)	(7,450)	–	–	–	–
Purchases[1]	–	117,230	–	4,419	4,435
Settlements	–	–	(29)	(6,190)	(2,157)
Transfers in	–	–	–	–	–
At 31 Dec 2020	37,719	195,055	38,813	2,578	2,720
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 31 Dec 2020	–	(2,135)	(1,889)	(1,293)	–
– net income/expense from financial instruments held for trading or managed on a fair value basis	–	(2,135)	–	(1,293)	–
– changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss	–	–	(1,889)	–	–

1 *These are trading reverse repurchase agreements originated in prior period and the comparatives have been updated to reflect the correct classification as Level 3.*

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

Sensitivity of Level 3 fair values to reasonably possible alternative assumptions

	At 31 Dec 2021				At 31 Dec 2020			
	Reflected in profit or loss		**Reflected in OCI**		Reflected in profit or loss		Reflected in OCI	
	Favourable changes	**Un-favourable changes**	**Favourable changes**	**Un-favourable changes**	Favourable changes	Un-favourable changes	Favourable changes	Un-favourable changes
	US$000	**US$000**	**US$000**	**US$000**	US$000	US$000	US$000	US$000
Derivatives, trading assets and trading liabilities[1]	**–**	**(27)**	**–**	**–**	–	(2,171)	–	–
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	**1,983**	**(1,983)**	**–**	**–**	1,941	(1,941)	–	–
Financial investments	**–**	**–**	**2,598**	**(1,311)**	–	–	3,747	(1,886)
Total	**1,983**	**(2,010)**	**2,598**	**(1,311)**	1,941	(4,112)	3,747	(1,886)

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

13 Fair values of financial instruments not carried at fair value

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

		Fair value			
	Carrying amount	Quoted market price Level 1	Observable inputs Level 2	Significant unobservable inputs Level 3	Total
	US$000	US$000	US$000	US$000	US$000
At 31 Dec 2021					
Assets					
Loans and advances to banks	**7,807,302**	**—**	**7,916,583**	**—**	**7,916,583**
Loans and advances to customers	**18,623,781**	**—**	**—**	**18,599,743**	**18,599,743**
Reverse repurchase agreements – non-trading	**4,900,749**	**—**	**4,898,648**	**—**	**4,898,648**
Liabilities					
Deposits by banks	**4,575,102**	**—**	**4,662,479**	**—**	**4,662,479**
Customer accounts	**27,010,549**	**—**	**27,014,401**	**—**	**27,014,401**
Repurchase agreements – non-trading	**2,366,542**	**—**	**2,365,875**	**—**	**2,365,875**
Debt securities in issue	**1,874,830**	**—**	**1,879,945**	**—**	**1,879,945**
At 31 Dec 2020					
Assets					
Loans and advances to banks	7,742,424	—	7,831,950	—	7,831,950
Loans and advances to customers	19,350,716	—	—	19,216,687	19,216,687
Reverse repurchase agreements – non-trading	1,828,851	—	1,795,732	—	1,795,732
Liabilities					
Deposits by banks[1]	3,468,222	—	3,544,422	—	3,544,422
Customer accounts	26,834,947	—	26,849,547	—	26,849,547
Repurchase agreements – non-trading	506,475	—	502,950	—	502,950
Debt securities in issue	2,000,594	—	1,962,882	—	1,962,882

1 *We have updated the prior year fair value balance of 'Deposits by banks' to reflect the correct fair value.*

Other financial instruments not carried at fair value are typically short-term in nature and re-priced to current market rates frequently. Accordingly, their carrying amount is a reasonable approximation of fair value.

Valuation

The fair value measurement is the group's estimate of the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It does not reflect the economic benefits and costs that the group expects to flow from the instruments' cash flows over their expected future lives. Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available.

Loans and advances to banks and customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using valuation models that incorporate a range of input assumptions. These assumptions may include forward looking discounted cash flow models using assumptions which the group believes are consistent with those which would be used by market participants in valuing such loans; and trading inputs from other market participants which includes observed primary and secondary trades.

Loans are grouped, as far as possible, into homogeneous groups and stratified by loans with similar characteristics to improve the accuracy of estimated valuation outputs. The stratification of a loan book considers all material factors, including vintage, origination period, estimates of future interest rates, prepayment speeds, delinquency rates, loan-to-value ratios, the quality of collateral, default probability, and internal credit risk ratings.

The fair value of a loan reflects both loan impairments at the balance sheet date and estimates of market participants' expectations of credit losses over the life of the loans, and the fair value effect of repricing between origination and the balance sheet date.

Financial investments

The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that take into consideration the prices and future earnings streams of equivalent quoted securities.

Deposits by banks and customer accounts

Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is approximated by its carrying value.

Debt securities in issue and subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments.

Repurchase and reverse repurchase agreements – non-trading

Fair values approximate carrying amounts as their balances are generally short dated.

14 Derivatives

Notional contract amounts and fair values of derivatives by product contract type held by the group

	Notional contract amount		Fair value – Assets			Fair value – Liabilities		
	Trading	Hedging	Trading	Hedging	Total	Trading	Hedging	Total
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Foreign exchange	**124,359,130**	**812,989**	**505,335**	**2,268**	**507,603**	**483,673**	**91**	**483,764**
Interest rate	**45,535,214**	**2,001,163**	**544,297**	**17,596**	**561,893**	**514,905**	**14,268**	**529,173**
Credit	**133,480**	**—**	**284**	**—**	**284**	**1,079**	**—**	**1,079**
Commodity and other	**127,388**	**—**	**376**	**—**	**376**	**376**	**—**	**376**
At 31 Dec 2021	**170,155,212**	**2,814,152**	**1,050,292**	**19,864**	**1,070,156**	**1,000,033**	**14,359**	**1,014,392**
Foreign exchange	129,218,566	900,963	807,461	2,929	810,390	739,242	—	739,242
Interest rate	54,859,586	6,013,892	986,065	68,702	1,054,767	981,543	63,942	1,045,485
Credit	48,491	—	303	—	303	635	—	635
Commodity and other	472,181	—	13,782	—	13,782	13,782	—	13,782
At 31 Dec 2020	184,598,824	6,914,855	1,807,611	71,631	1,879,242	1,735,202	63,942	1,799,144

The notional contract amounts of derivatives held for trading purposes and derivatives designated in qualifying hedge accounting relationships indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Use of derivatives

The group transacts derivatives for three primary purposes: to create risk management solutions for clients, to manage the portfolio risks arising from client business and to manage and hedge the group's own risks.

The group's derivative activities give rise to significant open positions in portfolios of derivatives. These positions are managed constantly to ensure that they remain within acceptable risk levels. When entering into derivative transactions, the group employs the same credit risk management framework to assess and approve potential credit exposures that it uses for traditional lending.

Trading derivatives

Most of the group's derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities include market-making and risk management. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume. Risk management activity is undertaken to manage the risk arising from client transactions, with the principal purpose of retaining client margin. Other derivatives classified as held for trading include non-qualifying hedging derivatives.

Hedge accounting derivatives

Fair value hedges

The group enters into fixed-for-floating-interest-rate swaps to manage the exposure to changes in fair value due to movements in market interest rates on certain fixed rate financial instruments which are not measured at fair value through profit or loss, including debt securities held and issued.

Hedging instrument by hedged risk

	Hedging Instrument				
		Carrying amount			
	Notional amount[1]	Assets	Liabilities	Balance sheet	Change in fair value[2]
Hedged Risk	US$000	US$000	US$000	presentation	US$000
Interest rate	**1,624,296**	**9,441**	**14,268**	**Derivatives**	**46,643**
At 31 Dec 2021	**1,624,296**	**9,441**	**14,268**		**46,643**
Interest rate	2,933,857	5,697	63,942	Derivatives	(27,976)
At 31 Dec 2020	2,933,857	5,697	63,942		(27,976)

1 *The notional contract amounts of derivatives designated in qualifying hedge accounting relationships indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.*
2 *Used in effectiveness testing; comprising the full fair value change of the hedging instrument.*

Hedged item by hedged risk

	Hedged Item						In-effectiveness	
	Carrying amount		Accumulated fair value hedge adjustments included in carrying amount					
	Assets	Liabilities	Assets	Liabilities	Balance sheet	Change in fair value[1]	Recognised in profit and loss	Profit and loss
Hedged Risk	US$000	US$000	US$000	US$000	presentation	US$000	US$000	presentation
Interest rate	**1,484,524**	**—**	**1,264**	**—**	**Financial investment**	**(47,431)**		
Interest rate	**—**	**—**	**—**	**—**	**L&A to Bank**	**(2,006)**		
Interest rate	**349,496**	**—**	**8,218**	**—**	**L&A to Cust**	**1**	**87**	**Net income from financial instruments held for trading or managed on a fair value basis**
Interest rate	**—**	**40,897**	**—**	**515**	**Debt issued**	**2,880**		
Interest rate	**—**	**43,204**	**—**	**1,316**	**Depo by Bank**	**—**		
At 31 Dec 2021	**1,834,020**	**84,101**	**9,482**	**1,831**		**(46,556)**	**87**	

Hedged item by hedged risk (continued)

	Hedged Item						In-effectiveness	
	Carrying amount		Accumulated fair value hedge adjustments included in carrying amount					
	Assets	Liabilities	Assets	Liabilities	Balance sheet presentation	Change in fair value[1]	Recognised in profit and loss	Profit and loss presentation
Hedged Risk	US$000	US$000	US$000	US$000		US$000	US$000	
Interest rate	2,914,921	—	46,168	—	Financial investment	27,810		Net income from financial instruments held for trading or managed on a fair value basis
Interest rate	—	—	—	—	L&A to Bank	1,834	(1,301)	
Interest rate	385,752	—	23,136	—	L&A to Cust	(890)		
Interest rate	—	69,664	—	1,945	Debt issued	(2,079)		
Interest rate	—	43,204	—	2,765	Depo by Bank	—		
At 31 Dec 2020	3,300,673	112,868	69,304	4,710		26,675	(1,301)	

1 *Used in effectiveness assessment; comprising amount attributable to the designated hedged risk that can be a risk component. The hedged item is either the benchmark interest rate risk portion within the fixed rate of the hedged item or the full fixed rate and it is hedged for changes in fair value due to changes in the benchmark interest rate risk.*

Sources of hedge ineffectiveness may arise from basis risk including but not limited to the discount rates used for calculating the fair value of derivatives, hedges using instruments with a non-zero fair value and notional and timing differences between the hedged items and hedging instruments.

Cash flow hedges

The group's cash flow hedging instruments consist principally of interest rate swaps and cross-currency swaps that are used to manage the variability in future interest cash flows of non-trading financial assets and liabilities, arising due to changes in market interest rates and foreign-currency basis.

The group applies macro cash flow hedging for interest-rate risk exposures on portfolios of replenishing current and forecasted issuances of non-trading assets and liabilities that bear interest at variable rates, including rolling such instruments. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio of financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate cash flows representing both principal balances and interest cash flows across all portfolios are used to determine the effectiveness and ineffectiveness.

The group also hedges the variability in future cash-flows on foreign-denominated financial assets and liabilities arising due to changes in foreign exchange market rates with cross-currency swaps.

Hedging instrument by hedged risk

	Hedging Instrument					Hedged Item	Ineffectiveness	
		Carrying amount						
	Notional amount[1]	Assets	Liabilities	Balance sheet presentation	Change in fair value[2]	Change in fair value[3]	Recognised in profit and loss	Profit and loss presentation
Hedged Risk	US$000	US$000	US$000		US$000	US$000	US$000	
Foreign currency	**812,989**	**2,268**	**91**	**Derivatives**	**59**	**59**	**—**	**Net income from financial instruments held for trading or managed on a fair value basis**
Interest rate	**376,867**	**8,155**	**—**	**Derivatives**	**(24,192)**	**(24,192)**	**—**	
At 31 Dec 2021	**1,189,856**	**10,423**	**91**		**(24,133)**	**(24,133)**	**—**	
Foreign currency	900,963	2,929	—	Derivatives	1,745	1,745	—	Net income from financial instruments held for trading or managed on a fair value basis
Interest rate	3,080,035	63,005	—	Derivatives	2,674	2,674	—	
At 31 Dec 2020	3,980,998	65,934	—		4,419	4,419	—	

1 *The notional contract amounts of derivatives designated in qualifying hedge accounting relationships indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.*
2 *Used in effectiveness testing; comprising the full fair value change of the hedging instrument not excluding any component.*
3 *Used in effectiveness assessment; comprising amount attributable to the designated hedged risk that can be a risk component.*

Interest rate benchmark reform: Amendments to IFRS 9 and IAS 39 'Financial Instruments'

The group has applied both the first set of amendments ('Phase 1') and the second set of amendments ('Phase 2') to IFRS 9 and IAS 39 applicable to hedge accounting.

The most significant Ibor benchmark in which the group continues to have hedging instruments is US dollar Libor. It is expected that the transition out of US dollar Libor hedging derivatives will be largely completed by the end of 2022. These transitions do not necessitate new approaches compared with any of the mechanisms used so far for transition and it will not be necessary to change the transition risk management strategy.

For some of the Ibors included under the 'Other' header, in the table below, judgment has been needed to establish whether a transition is required, since there are Ibor benchmarks which are subject to computation methodology improvements and insertion of fallback provisions without full clarity being provided by their administrators on whether these Ibor benchmarks will be demised.

The notional amounts of interest rate derivatives designated in hedge accounting relationships represent the extent of the risk exposure managed by the group that is expected to be directly affected by market-wide Ibors reform and in scope of Phase 1 and Phase 2 amendments.

Hedging Instrument impacted by Ibor Reform

	Hedging instrument						
	Impacted by Ibor Reform					NOT Impacted by Ibor Reform	Notional Contract Amount[1]
	EUR	GBP	USD	Other	Total		
	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Fair Value Hedges	**—**	**—**	**1,259,727**	**—**	**1,259,727**	**364,569**	**1,624,296**
Cash Flow Hedges	**—**	**—**	**99,985**	**276,882**	**376,867**	**812,989**	**1,189,856**
At 31 Dec 2021	**—**	**—**	**1,359,712**	**276,882**	**1,636,594**	**1,177,558**	**2,814,152**
Fair Value Hedges	12,184	68,282	2,309,609	543,782	2,933,857	—	2,933,857
Cash Flow Hedges	—	—	1,639,890	1,440,145	3,080,035	900,963	3,980,998
At 31 Dec 2020	12,184	68,282	3,949,499	1,983,927	6,013,892	900,963	6,914,855

1 *The notional contract amounts of interest rate derivatives designated in qualifying hedge accounting relationships indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.*

15 Financial investments

Carrying amount of financial investments

	2021	2020
	US$000	US$000
Financial investment measured at fair value through other comprehensive income		
Treasury and other eligible bills	**7,014,648**	3,966,741
Debt securities	**3,888,088**	6,099,374
Equity securities[1]	**26,225**	37,719
At 31 Dec	**10,928,961**	10,103,834

1 *These mainly include investment in HSBC Turkey and dividends recognised on these investments during the year were nil (2020: nil).*

16 Assets charged as security for liabilities, and collateral accepted as security for assets

Assets charged as security for liabilities

The fair value of assets pledged as collateral but that do not qualify for derecognition is US$1,349m (2020: US$50m). These transactions are conducted under terms that are usual and customary to repurchase agreements.

Collateral accepted as security for assets

The fair value of financial assets accepted as collateral that the group is permitted to sell or repledge in the absence of default is US$6,277m (2020: US$2,382m). The fair value of any such collateral sold or repledged is US$1,451m (2020: US$453m). The group is obliged to return equivalent securities. These transactions are conducted under terms that are usual and customary to reverse repurchase agreements.

17 Interests in associates and joint arrangement

Associates of the group

	At 31 Dec 2021			
	Country of incorporation	Principal activity	The group's interest in equity capital	Issued equity capital
MENA Infrastructure Fund (GP) Limited	**Dubai, UAE**	**Private Equity fund management**	**33.33%**	**US$0.99m fully paid**

The above associate is not considered significant to the group and is unlisted.

Movements in interests in associates

	2021	2020
	US$000	US$000
At 1 Jan	**2,867**	3,074
Disposals	**—**	—
Share of results	**(208)**	(207)
At 31 Dec	**2,659**	2,867

Joint arrangement of the group

	At 31 Dec 2021			
	Country of incorporation	**Principal activity**	**The group's interest in equity capital**	**Issued equity capital**
HSBC Middle East Leasing Partnership – (Joint operation)	**Dubai, UAE**	**Leasing**	**15.00%**	**US$621m fully paid**

The results of the joint arrangement have been included on proportionate basis.

18 Investments in subsidiaries

Subsidiary undertakings of the bank

	At 31 Dec 2021	
	Country of incorporation or registration	**Bank's interest in equity capital**
HSBC Middle East Asset Company LLC	**Dubai, UAE**	**100%**
HSBC Middle East Securities LLC[1]	**Dubai, UAE**	**100%**
HSBC Insurance Services (Lebanon) S.A.L. (in liquidation)	**Lebanon**	**100%**
HSBC Bank Middle East Representative Office Morocco S.A.R.L. (in liquidation)	**Morocco**	**100%**

All the above prepare their financial statements up to 31 December and the countries of operation are the same as the countries of incorporation.

The subsidiary undertakings are unlisted, directly owned and are included in the consolidated financial statements of the group. HSBC Financial Services (Middle East) Limited, 100% owned subsidiary of the group was liquidated during the year.

1 In order to comply with local legal requirements, the ownership of the investment in HSBC Middle East Securities LLC is held 49.00% in the name of the bank and 51.00% in the personal name of Mr. Abdul Wahid Al Ulama, as nominee. Under a Memorandum of Understanding, the nominee has transferred his legal and/or beneficial interest in HSBC Middle East Securities LLC to the bank. The total book value of the assets of HSBC Middle East Securities LLC amount to US$3m (2020: US$3.3m).

19 Prepayments, accrued income and other assets

	2021	2020
	US$000	US$000
Prepayments and accrued income	**175,432**	160,791
Endorsements and acceptances	**467,006**	610,748
Other accounts	**147,474**	221,882
Property, plant and equipment[1]	**261,584**	278,436
At 31 Dec	**1,051,496**	1,271,857

1 As at 31 December 2021, net book value of HSBC Tower was US$229m (2020: US$236m) and depreciation charged during the year was US$9m (2020: US$8m).

20 Intangible assets

Included within intangible assets is internally generated software with a net carrying value of US$154m (2020: US$110m).

During the year, capitalisation of internally generated software was US$75m (2020: US$54m), amortisation was US$22m (2020: US$16m).

21 Trading liabilities

	2021	2020
	US$000	US$000
Deposits by banks	**–**	8,055
Trading repurchase agreements	**437,883**	152,371
Other liabilities – net short positions in securities	**180,216**	139,120
At 31 Dec	**618,099**	299,546

22 Financial liabilities designated at fair value

	2021	2020
	US$000	US$000
Deposits by bank and customer accounts	**489,368**	517,228
Debt securities in issue (Note 23)	**1,074,630**	2,306,564
Total	**1,563,998**	2,823,792

At 31 December 2021, the accumulated amount of change in fair value attributable to changes in credit risk was a loss of US$8.8m (2020: US$14.3m loss). As at 31 December 2021, the difference between the carrying amount and the amount contractually required to be paid at maturity was US$24m (2020: US$57m).

23 Debt securities in issue

	2021		2020	
	Carrying amount	**Fair value**	Carrying amount	Fair value
	US$000	**US$000**	US$000	US$000
Medium-term notes	**2,474,460**	**2,470,920**	3,357,158	3,357,183
Non-equity preference shares[1]	**475,000**	**483,655**	950,000	912,263
Total debt securities in issue	**2,949,460**	**2,954,575**	4,307,158	4,269,446
Included within:				
– financial liabilities designated at fair value (Note 22)	**(1,074,630)**	**(1,074,630)**	(2,306,564)	(2,306,564)
At 31 Dec	**1,874,830**	**1,879,945**	2,000,594	1,962,882

1 *During the year, US$250m dated preference shares have been redeemed. In addition, the accounting treatment for US$225m undated preference shares has been reassessed and accordingly, these undated preference shares have been reclassified from debt securities in issue to other equity instruments (refer note 29 for details).*

Movement in medium-term notes at amortised cost

	2021	2020
	US$000	US$000
Balance as at 1 Jan	**1,050,594**	838,486
New issues	**1,170,765**	412,044
Repayments	**(821,529)**	(199,936)
At 31 Dec	**1,399,830**	1,050,594

Non-equity preference share capital

Authorised

The authorised non-equity preference share capital of the bank at 31 December 2021 and 31 December 2020 was 1,125,000 dated preference shares of US$1.00 each and 225,000 undated preference shares of US$1.00 each. The undated preference shares have been reclassified from debt securities in issue to other equity instruments during the year.

Issued

Dated preference shares

Issue number	Issue date	Dated preference shares	Preference dividends	Redeemable at the option of the bank on any date after
		Number	%	Date
11	16 December 2014	250,000	3 month US dollar Libor + 2.70	16 December 2024
12	30 December 2014	225,000	3 month US dollar Libor + 2.70	30 December 2024

1 *The dated preference shares have been issued at a nominal value of US$1 each with a premium of US$999 per share.*
2 *Preference dividends are payable quarterly on the issue price of each dated share.*
3 *Redemption of the dated preference shares, other than at the option of the bank, will be subject to the approval of the ordinary shareholders of the bank. The earliest redemption date is as disclosed in the table above and if not approved by the shareholders will next fall for review at 10 yearly intervals thereafter. However, the shares may be redeemed at the option of the Bank without the approval of the ordinary shareholders of the bank. On redemption, the holders of the shares shall be entitled to receive an amount equal to any accrued but unpaid dividends plus the issue price of each share.*
4 *In the event of a winding up, the preference shareholders would receive, in priority to the ordinary shareholders of the bank, repayment of US$1,000 per share, plus an amount equal to any accrued but unpaid dividends. With the exception of the above, the preference shares do not carry any right to participate in the surplus of assets on a winding up.*

24 Accruals, deferred income and other liabilities

	2021	2020
	US$000	US$000
Accruals and deferred income	**239,514**	211,190
Share-based payments liability to HSBC Holdings plc	**10,829**	10,215
Endorsements and acceptances	**469,610**	614,022
Employee benefit liabilities (Note 6)	**177,597**	145,354
Margin deposits	**369,789**	332,213
Transitory accounts	**18,093**	26,599
Other liabilities	**345,450**	302,259
At 31 Dec	**1,630,882**	1,641,852

25 Provisions

	Restructuring costs	Contractual commitments	Legal proceedings and regulatory matters	Other provisions	Total
	US$000	US$000	US$000	US$000	US$000
At 1 Jan 2021	**7,699**	**113,073**	**3,054**	**5,757**	**129,583**
Additions	**12,076**	**—**	**721**	**2,550**	**15,347**
Amounts utilised	**(11,447)**	**—**	**(101)**	**(234)**	**(11,782)**
Unused amounts reversed	**(4,229)**	**—**	**(594)**	**(328)**	**(5,151)**
Net Change in expected credit loss provision	**—**	**(28,477)**	**—**	**—**	**(28,477)**
Exchange and other movements	**1**	**—**	**530**	**(5)**	**526**
At 31 Dec 2021	**4,100**	**84,596**	**3,610**	**7,740**	**100,046**
At 1 Jan 2020	7,877	53,008	4,638	5,678	71,201
Additions	9,412	—	769	1,119	11,300
Amounts utilised	(7,411)	—	(774)	(1,147)	(9,332)
Unused amounts reversed	(2,179)	—	(1,569)	—	(3,748)
Net Change in expected credit loss provision	—	60,065	—	—	60,065
Exchange and other movements	—	—	(10)	107	97
At 31 Dec 2020	7,699	113,073	3,054	5,757	129,583

26 Maturity analysis of assets, liabilities and off-balance sheet commitments

The following is an analysis by remaining contractual maturities at the balance sheet date, of assets and liability line items that combine amounts expected to be recovered or settled within one year and after more than one year.

Maturity analysis of assets and liabilities

	At 31 Dec 2021				
	Due within 3 months	Due between 3 and 12 months	Due between 1 and 5 years	Due after 5 years	Total
	US$000	US$000	US$000	US$000	US$000
Financial assets					
Trading assets	**715,258**	**274,933**	**115,991**	**—**	**1,106,182**
Derivatives	**1,052,318**	**4,032**	**13,045**	**761**	**1,070,156**
Loans and advances to banks	**6,410,469**	**485,537**	**911,296**	**—**	**7,807,302**
Loans and advances to customers	**5,205,160**	**2,533,957**	**7,811,762**	**3,072,902**	**18,623,781**
Reverse repurchase agreements – non-trading	**3,689,218**	**258,492**	**953,039**	**—**	**4,900,749**
Financial investments	**4,795,285**	**3,258,375**	**2,609,708**	**265,593**	**10,928,961**
Other financial assets	**656,607**	**87,277**	**2,066**	**—**	**745,950**
Total Financial assets	**22,524,315**	**6,902,603**	**12,416,907**	**3,339,256**	**45,183,081**
Non-Financial assets	**—**	**—**	**—**	**660,955**	**660,955**
Financial liabilities					
Deposits by banks	**1,452,404**	**635,865**	**2,486,833**	**—**	**4,575,102**
Customer accounts	**26,156,313**	**731,714**	**122,522**	**—**	**27,010,549**
Repurchase agreements – non-trading	**2,029,269**	**113,248**	**224,025**	**—**	**2,366,542**
Trading liabilities	**352,652**	**—**	**265,447**	**—**	**618,099**
Financial liabilities designated at fair value	**72,970**	**439,646**	**1,051,382**	**—**	**1,563,998**
Derivatives	**1,003,142**	**3,726**	**7,524**		**1,014,392**
Debt securities in issue	**346,643**	**40,897**	**1,012,290**	**475,000**	**1,874,830**
Other financial liabilities	**1,285,951**	**91,789**	**17,899**	**5,540**	**1,401,179**
Total Financial liabilities	**32,699,344**	**2,056,885**	**5,187,922**	**480,540**	**40,424,691**
Non-Financial liabilities	**—**	**—**	**—**	**412,693**	**412,693**
Loan and other credit-related commitments	**18,330,346**	**—**	**—**	**—**	**18,330,346**
Financial guarantees and similar contracts	**17,248,568**	**—**	**—**	**—**	**17,248,568**

Maturity analysis of assets and liabilities (continued)

	At 31 Dec 2020				
	Due within 3 months	Due between 3 and 12 months	Due between 1 and 5 years	Due after 5 years	Total
	US$000	US$000	US$000	US$000	US$000
Financial assets					
Trading assets	624,020	—	117,574	—	741,594
Derivatives	1,821,937	37,910	19,395	—	1,879,242
Loans and advances to banks	6,099,421	585,175	1,057,828	—	7,742,424
Loans and advances to customers	5,242,908	3,671,143	7,675,518	2,761,147	19,350,716
Reverse repurchase agreements – non-trading	1,517,283	54,353	257,215	—	1,828,851
Financial investments	6,046,915	1,326,254	2,540,976	189,689	10,103,834
Other financial assets	779,843	147,759	1,919	—	929,521
Total Financial assets	22,132,327	5,822,594	11,670,425	2,950,836	42,576,182
Non-Financial assets	—	—	—	675,748	675,748
Financial liabilities					
Deposits by banks	611,893	362,684	2,493,645	—	3,468,222
Customer accounts	25,259,178	1,507,774	67,995	—	26,834,947
Repurchase agreements – non-trading	463,508	—	42,967	—	506,475
Trading liabilities	299,546	—	—	—	299,546
Financial liabilities designated at fair value	71,595	1,710,325	1,033,891	7,981	2,823,792
Derivatives	1,742,044	1,271	51,414	4,415	1,799,144
Debt securities in issue	349,937	442,988	507,669	700,000	2,000,594
Other financial liabilities	1,253,784	155,548	17,850	7,523	1,434,705
Total Financial liabilities	30,051,485	4,180,590	4,215,431	719,919	39,167,425
Non-Financial liabilities	—	—	—	422,470	422,470
Loan and other credit-related commitments	17,030,270	—	—	—	17,030,270
Financial guarantees and similar contracts	16,459,976	—	—	—	16,459,976

Cash flows payable by the group under financial liabilities by remaining contractual maturities

	On demand	**Due within 3 months**	**Due between 3 and 12 months**	**Due between 1 and 5 years**	**Due after 5 years**
	US$000	**US$000**	**US$000**	**US$000**	**US$000**
Deposits by banks	**1,302,873**	**150,889**	**638,867**	**2,492,428**	**—**
Customer accounts	**25,247,868**	**909,753**	**732,984**	**122,817**	**—**
Repurchase agreements – non-trading	**1,917,024**	**112,245**	**113,248**	**224,025**	**—**
Trading liabilities	**618,099**	**—**	**—**	**—**	**—**
Financial liabilities designated at fair value	**2,887**	**73,662**	**448,448**	**1,062,857**	**—**
Derivatives	**1,001,313**	**1,829**	**3,726**	**7,523**	**—**
Debt securities in issue	**956**	**352,526**	**58,893**	**1,072,707**	**488,788**
Other financial liabilities	**1,566,460**	**344,153**	**92,267**	**18,935**	**5,882**
	31,657,480	**1,945,057**	**2,088,433**	**5,001,292**	**494,670**
Loan and other credit-related commitments	**18,330,346**	**—**	**—**	**—**	**—**
Financial guarantees and similar contracts	**17,248,568**	**—**	**—**	**—**	**—**
At 31 Dec 2021	**67,236,394**	**1,945,057**	**2,088,433**	**5,001,292**	**494,670**
Deposits by banks	612,777	1,768	363,433	2,509,716	—
Customer accounts	24,141,829	1,124,049	1,512,535	68,567	—
Repurchase agreements – non-trading	353,927	109,581	—	42,967	—
Trading liabilities	299,546	—	—	—	—
Financial liabilities designated at fair value	64,290	23,639	1,727,873	1,056,823	8,172
Derivatives	1,735,202	1,004	7,109	51,414	4,415
Debt securities in issue	—	354,304	450,530	527,778	716,011
Other financial liabilities	1,004,485	301,256	156,680	21,824	9,154
	28,212,056	1,915,601	4,218,160	4,279,089	737,752
Loan and other credit-related commitments	17,030,270	—	—	—	—
Financial guarantees and similar contracts	16,459,976	—	—	—	—
At 31 Dec 2020	61,702,302	1,915,601	4,218,160	4,279,089	737,752

The above table shows, on an undiscounted basis, all cash flows relating to principal and future coupon payments (except for trading liabilities and derivatives not treated as hedging derivatives). For this reason, balances in the above table do not agree directly with those in our consolidated balance sheet. Undiscounted cash flows payable in relation to hedging derivative liabilities are classified according to their contractual maturities. Trading liabilities and derivatives not treated as hedging derivatives are included in the 'Due not more than 1 month' time bucket and not by contractual maturity.

Further discussion of the group's liquidity and funding management can be found in Note 31 'Risk management'.

27 Offsetting of financial assets and financial liabilities

The 'Amounts not set off in the balance sheet' include transactions where:

- the counterparty has an offsetting exposure with the group and a master netting or similar arrangement is in place with a right to set off only in the event of default, insolvency or bankruptcy, or the offset criteria are otherwise not satisfied; and
- in the case of derivatives and reverse repurchase/repurchase, stock borrowing/lending and similar agreements, cash and non-cash collateral has been received/pledged.

For risk management purposes, the net amounts of loans and advances to customers are subject to limits, which are monitored and the relevant customer agreements are subject to review and updated, as necessary, to ensure that the legal right to set off remains appropriate.

	Amounts subject to enforceable netting arrangements						
				Amounts not set off in the balance sheet			
	Gross amounts	Amounts offset	Net amounts in the balance sheet	Financial instruments	Non-cash collateral	Cash collateral	Net amount
	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Financial assets							
Derivatives (Note 14)	**1,070,156**	**–**	**1,070,156**	**(810,874)**	**(7,804)**	**–**	**251,478**
Reverse repos, stock borrowing and similar agreements classified as:	**4,279,788**	**–**	**4,279,788**	**–**	**(4,279,788)**	**–**	**–**
– non-trading assets	**4,279,788**	**–**	**4,279,788**	**–**	**(4,279,788)**	**–**	**–**
Loans and advances to customers excluding reverse repos at amortised cost[1]	**320,897**	**–**	**320,897**	**–**	**–**	**(198,783)**	**122,114**
At 31 Dec 2021	**5,670,841**	**–**	**5,670,841**	**(810,874)**	**(4,287,592)**	**(198,783)**	**373,592**
Derivatives (Note 14)	1,879,242	–	1,879,242	(1,535,679)	(28,549)	–	315,014
Reverse repos, stock borrowing and similar agreements classified as:	1,336,606	–	1,336,606	–	(1,336,606)	–	–
– non-trading assets	1,336,606	–	1,336,606	–	(1,336,606)	–	–
Loans and advances to customers excluding reverse repos at amortised cost[1]	426,874	–	426,874	–	–	(126,143)	300,731
At 31 Dec 2020	3,642,722	–	3,642,722	(1,535,679)	(1,365,155)	(126,143)	615,745

	Amounts subject to enforceable netting arrangements						
				Amounts not set off in the balance sheet			
	Gross amounts	Amounts offset	Net amounts in the balance sheet	Financial instruments	Non-cash collateral	Cash collateral	Net amount
	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Financial liabilities							
Derivatives (Note 14)	**1,014,392**	**–**	**1,014,392**	**(815,672)**	**–**	**–**	**198,720**
Repurchase agreements - non trading	**2,366,542**	**–**	**2,366,542**	**–**	**(2,366,542)**	**–**	**–**
At 31 Dec 2021	**3,380,934**	**–**	**3,380,934**	**(815,672)**	**(2,366,542)**	**–**	**198,720**
Derivatives (Note 14)	1,799,144	–	1,799,144	(1,535,679)	–	–	263,465
Repurchase agreements - non trading	506,475	–	506,475	–	(506,475)	–	–
At 31 Dec 2020	2,305,619	–	2,305,619	(1,535,679)	(506,475)	–	263,465

1 *At 31 December 2021, the total amount of 'Loans and advances to customers' was US$18,623m (2020: US$19,351m), of which US$321m (2020: US$427m) was subject to offsetting.*

28 Foreign exchange exposure

Structural foreign exchange exposures

The group's structural foreign currency exposure is represented by the net asset value of its foreign currency equity and subordinated debt investments in subsidiaries, branches and associates with non-US dollar functional currencies. Gains or losses on structural foreign exchange exposures are recognised in other comprehensive income.

The main operating currencies of the group are UAE dirham and other Gulf currencies that are linked to the US dollar.

The group's management of structural foreign currency exposures is discussed in Note 31 'Risk management'.

Net structural foreign currency exposures

Currency of structural exposure

	2021			2020		
	Structural foreign exchange exposures	**Economic hedges-structural FX hedge[1]**	**Net structural foreign exchange exposures**	Structural foreign exchange exposures	Economic hedges-structural FX hedge[1]	Net structural foreign exchange exposures
	US$000	**US$000**	**US$000**	US$000	US$000	US$000
Algerian dinar	**159,883**	**–**	**159,883**	151,573	–	151,573
Bahraini dinar	**156,820**	**(35,611)**	**121,209**	146,847	(75,000)	71,847
Kuwaiti dinar	**273,481**	**–**	**273,481**	254,686	–	254,686
Lebanese pound	**177**	**–**	**177**	177	–	177
Moroccan dirham	**172**	**–**	**172**	179	–	179
Qatari riyal	**724,789**	**(332,000)**	**392,789**	666,685	(382,000)	284,685
UAE dirham	**4,155,116**	**(1,984,936)**	**2,170,180**	3,867,051	(1,984,936)	1,882,115
Total	**5,470,438**	**(2,352,547)**	**3,117,891**	5,087,198	(2,441,936)	2,645,262

1 *Economic Hedges – Structural FX hedge represent hedges that do not qualify as net investment hedges for accounting purposes.*

29 Called up share capital and share premium

Authorised

The authorised ordinary share capital of the Bank at 31 December 2021 was 1,500,000,000 (2020: 1,500,000,000) ordinary shares[1] of US$1.00 each.

Called up share capital and share premium

Issued and fully paid

	2021		2020	
	Number	**US$000**	Number	US$000
At 1 Jan	**931,055,001**	**931,055**	931,055,001	931,055
At 31 Dec[1]	**931,055,001**	**931,055**	931,055,001	931,055

Share premium

	2021	2020
	US$000	US$000
At 31 Dec	**61,346**	61,346

Total called up share capital and share premium

	2021	2020
	US$000	US$000
At 31 Dec	**992,401**	992,401

1 *All ordinary shares in issue confer identical rights, including in respect of capital, dividends and voting.*

Other equity instruments

Undated preference shares[1]

	2021	2020
	US$000	US$000
At 31 Dec	**225,000**	–

1 *The accounting treatment for undated preference shares has been reassessed during the current year and, accordingly, these instruments have been reclassified from debt securities in issue to other equity instruments.*

Issued

Undated preference shares

	Nominal value	Dividend basis %	Mandatory redemption (maturity date)
Undated preference shares	50,000	12 month US dollar Libor + 0.35	undated
Undated preference shares	25,000	12 month US dollar Libor + 0.70	undated
Undated preference shares	150,000	12 month US dollar Libor + 0.65	undated
At 31 December	225,000		

1 *The undated preference shares have been issued at a nominal value of US$1 each with a premium of US$999 per share.*
2 *Preference dividends are payable annually on the issue price of each undated share at the option of the issuer.*
3 *The undated preference shares are redeemable, however there is no mandatory redemption date. On redemption, the holders of the shares shall be entitled to receive an amount equal to any accrued but unpaid dividends plus the issue price of each share.*
4 *Each share carries one vote at meetings of the shareholders of the bank.*
5 *In the event of a winding up, the preference shareholders would receive, in priority to the ordinary shareholders of the bank, repayment of US$1,000 per share, plus an amount equal to any accrued but unpaid dividends. With the exception of the above, the preference shares do not carry any right to participate in the surplus of assets on a winding up.*

30 Notes on the statement of cash flows

Non-cash items included in profit before tax

	2021	2020
	US$000	US$000
Depreciation, amortisation and impairment	**60,507**	52,575
Share-based payment expense	**10,455**	9,753
Change in expected credit losses and other credit impairment charges	**(117,668)**	662,390
Provisions including pensions	**29,815**	29,322
Other non-cash items included in profit before tax	**4,342**	5,471
	(12,549)	759,511

Change in operating assets

	2021	2020
	US$000	US$000
Change in other assets	**124,239**	618,785
Change in net trading securities and net derivatives	**(45,702)**	(286,403)
Change in loans and advances to banks and customers	**1,255,545**	(1,207,416)
Change in reverse repurchase agreements – non-trading	**(1,201,534)**	(613,510)
Change in financial assets designated at fair value	**13,498**	1,918
	146,046	(1,486,626)

Change in operating liabilities

	2021	2020
	US$000	US$000
Change in other liabilities	**(24,495)**	(1,503,981)
Change in deposits by banks and customer accounts	**1,282,482**	2,770,385
Change in debt securities in issue	**349,236**	212,108
Change in financial liabilities designated at fair value	**(1,254,182)**	451,684
Change in repurchase agreements – non-trading	**1,860,067**	506,475
	2,213,108	2,436,671

Cash and cash equivalents

	2021	2020
	US$000	US$000
Cash and balances at central banks	**848,471**	1,240,991
Items in the course of collection from other banks	**53,900**	69,569
Loans and advances to banks of one month or less	**6,203,905**	5,714,370
Reverse repurchase agreement with banks of one month or less	**2,401,927**	531,563
Net settlement accounts and cash collateral	**68,585**	56,692
Treasury bills, other bills and certificates of deposit less than three months	**472,773**	200,300
Less: items in the course of transmission to other banks	**(670,767)**	(111,462)
Total cash and cash equivalents	**9,378,794**	7,702,023

31 Risk management

Our approach to risk

Our risk management

All the group's activities involve, to varying degrees, the analysis, evaluation, acceptance and active management of risks or combinations of risks. The key financial risks which the group is exposed to are retail and wholesale credit risk (including cross-border country risk), market risk (predominantly foreign exchange and interest rate risks), liquidity and funding risk and strategic risk (including reputational risk). The group is also exposed to non-financial risk in various forms (including Resilience risk, Financial Crime and Fraud Risk, People Risk, Regulatory Compliance Risk, Legal Risk, Financial Reporting and Tax risks and Model Risks). There is a growing focus on the management of Climate Risk and its embedment in to how we do our business, conduct our operation and deal with all our stakeholders.

The implementation of our business strategy, which includes transformation, remains a key focus. As we implement change initiatives, we actively manage the execution risks. We aim to use a comprehensive risk management approach across the organization and across all risk types, underpinned by our culture and values. This is outlined in our risk management framework, including the key principles and practices that we employ in managing material risks, both financial and non-financial. The framework fosters continual monitoring promotes risk awareness and encourages a sound operational and strategic decision making process. It also supports a consistent approach to identifying, assessing, managing and reporting the risks we accept and incur in our activities.

Our risk management framework

The following table and descriptions summarize key aspects of the risk management framework, including governance, structure, our risk management tools and our culture, which together help align employee behaviour with our risk appetite.

Key components of our risk management framework

HSBC Values and risk culture		
Risk governance	Non-executive risk governance	The Board approves the risk appetite, plans and performance targets. It sets the 'tone from the top' and is advised by the Risk Committee and the Audit Committee.
	Executive risk governance	Our executive risk governance structure is responsible for the enterprise-wide management of all risks, including key policies and frameworks for the management of risk across the organization.
Roles and responsibilities	Three Lines Of Defence ('LOD') model	Our 'three lines of defence' model defines roles and responsibilities for risk management. An independent Risk function helps ensure the necessary balance in risk/return decisions.
Processes and tools	Risk appetite	There are processes in place to identify/assess, monitor, manage and report risks to help ensure we remain within our risk appetite.
	Enterprise-wide risk management tools	
	Active risk management: identification/assessment, monitoring, management and reporting	
Internal controls	Policies and procedures	Policies and procedures define the minimum requirements for the controls required to manage our risks.
	Control activities	Operational and resilience risk management defines minimum standards and processes for managing operational risks and internal controls.
	Systems and infrastructure	There are systems and/or processes that support the identification, capture and exchange of information to support risk management activities.

Risk culture

The group's strong risk governance reflects the importance placed by the Board on managing risks effectively. It is supported by a clear policy framework of risk ownership and by the accountability of all staff for identifying, assessing and managing risks within the scope of their assigned responsibilities. This personal accountability, reinforced by the governance structure, experience and mandatory learning, helps to foster a disciplined and constructive culture of risk management and control throughout the group and one that supports and encourages the behaviours of good judgement, speaking-up and accountability.

Risk governance and ownership

An established risk governance and ownership structure ensures oversight of, and accountability for, the effective management of risk across the group and global business level. The risk management framework applies to all the types of risk we face, ensures we define, identify & assess and have sufficient controls in place to manage, aggregate, report and govern the risks consistently across the group. This will help to grow our business safely within our appetite, deliver fair outcomes for customers and maintain the orderly and transparent operation of financial markets.

The Board has ultimate accountability for risk and approves the risk appetite, sets the 'tone from the top' regarding the strong risk culture expected across our organization and delegates responsibility for risk oversight to the Risk Committee and the Audit Committee. The Audit and Risk Committees are responsible for advising the Board on material risk matters and provide non-executive oversight of risks. Under authority delegated by the Board Risk Committee, the separately convened Risk Management Meeting ('RMM') formulates high-level risk management policy and oversees the implementation of risk appetite and controls. The RMM together with the Asset and Liability Committee ('ALCO') monitors all categories of risk, receives reports on actual performance and emerging issues, determines action to be taken and reviews the efficacy of our risk management framework.

The Chief Risk Officer ('CRO') chairs the RMM of the Executive Committee. The CRO, who reports to the Chief Executive Officer ('CEO') and functionally to the Europe and MENAT CRO in the HSBC Group, heads the Risk Function, which is independent from the global businesses and forms part of the second line of defence. The RMM is a formal risk governance committee where members of the Executive Committee make recommendations and provide advice to the CRO to help them carry out their role and responsibilities in relation to enterprise risk oversight over all risks, including compliance. Following the level of maturity achieved by the Financial Crime Risk Management Meeting ('FCRMM') and the financial crime risk governance framework, the FCRMM responsibilities have been assumed by the RMM. The membership of the Executive Committee ensures that the committee oversees risk management matters across the three lines of defence. The CRO is granted authority and accountability by the CEO to take decisions related to matters considered at the RMM, except where decision-making authority is the responsibility of another member of the Executive Committee (e.g. finance-related decisions taken by the CFO).

Day-to-day responsibility for risk management is delegated to senior managers with individual accountability for decision making. All our people have a role to play in identifying and managing risk within the scope of their roles. These roles are defined using the three lines of defence model. The first line of defence has ultimate ownership for risk and controls, including read across assessments of identified issues, events and near misses, and the delivery of good conduct outcomes. The second line of defence review and challenge the first line of defence activities to help ensure that risk management decisions and actions are appropriate, within risk appetite and support the delivery of conduct outcomes. The third line of defence is internal audit.

We define financial risk as the risk of a financial loss as a result of business activities. We actively take these types of risks to maximize shareholder value and profits. Non-financial risk is the risk of loss as a result of failed internal processes, people and systems, or from external events. Responsibility for minimizing both financial and non-financial risk lies with our people. They are required to manage the risk of the business and operational activities for which they are responsible. We maintain adequate oversight of our risks through our various specialist risk stewards and the collective accountability held by our CRO. Sound non-financial risk management is central to achieving good outcome from our customers. We have continued to strengthen the control environment and our approach to the management of non-financial risk, as broadly set out in our risk management framework. The management of non-financial risk focuses on governance and risk appetite, and provides a single view of the non-financial risk that matter the most and the associated controls. It incorporates a risk management system designed to enable the active management of non-financial risks. Our ongoing focus is on simplifying our approach to non-financial risk management, while driving more effective oversight and better end-to-end identification and management of non-financial risks. This is overseen by the Operational and Resilience Risk function.

Risk appetite

Our risk appetite encapsulates the consideration of financial and non-financial risks. Group risk appetite is expressed in both quantitative and qualitative terms and applied at global business level, at the regional level and to material operating entities. Our risk appetite continues to evolve and expand its scope as part of this regular review process. The Board periodically reviews and approves the group's risk appetite statement to ensure it remains fit for purpose. The risk appetite is considered, developed and enhanced through:

a. An alignment with our strategy, purpose, values, customer needs and HSBC Group Risk Appetite;

b. Trends highlighted in other risk reports;

c. Communication with risk stewards on the developing risk landscape;

d. Strength of our capital, liquidity and balance sheet;

e. Compliance with applicable laws and regulations;

f. Effectiveness of the applicable control environment to mitigate risk, informed by risk ratings from risk control assessments;

g. Functionality, capacity and resilience of available systems to manage risk, and

h. The level of available staff with the required competencies to manage risks.

We formally articulate our risk appetite through our Risk Appetite Statements (‘RAS’). Setting out our risk appetite ensures that we agree a suitable level of risk for our strategy. In this way, risk appetite informs our financial planning process and helps senior management to allocate capital to business activities, services and products.

The performance against the RAS is reported to the Risk Management Meeting (‘RMM’) alongside key risk indicators to support targeted insight and discussion on breaches of risk appetite and associated mitigating actions. This reporting allows risk to be promptly identified and mitigated, and informs risk-adjusted remuneration to drive a strong risk culture.

Top and emerging risks

We use a top and emerging risks process to provide a forward-looking view of issues with the potential to threaten the execution of our strategy or operations over the medium to long term. We proactively assess the internal and external risk environment, as well as review the themes identified across the countries and global businesses, for any risks that may require global escalation, updating our top and emerging risks as necessary.

A ‘Top Risk’ is defined as a risk we are currently managing, which if not managed and mitigated has the potential to have a material impact on the Group, Regions or Global Businesses. It may arise across any combination of risk types, regions or global businesses. The impact may be well understood by senior management and some mitigating actions may already be in place.

An ‘Emerging Risk’ is defined as a risk that could have a material impact on the risk profile of the Group, Global Businesses or Regions, but is not under active management and is not immediate. Existing mitigation plans are likely to be minimal, reflecting the uncertain nature of these risks at this stage. Some high-level analysis and/or stress testing may have been carried out to assess the potential impact.

Our current top and emerging risks are described on page 73 of the *Annual Report and Accounts 2021.*

Stress testing and recovery planning

Our stress testing programme assesses our capital and liquidity strength through rigorous examination of our resilience to external shocks. As well as understanding regulatory-driven stress tests. We conduct our own internal stress tests in order to understand the nature and level of all material risks, quantify the impact of such risks and develop plausible business-as-usual mitigating actions.

Internal stress tests

Our internal capital assessment uses a range of stress scenarios that explore risks identified by management. They include potential adverse macroeconomic, geopolitical and operational risk events, as well as other potential events that are specific to the HSBC and the group.

The selection of stress scenarios is based upon the output of our identified top and emerging risks and our risk appetite. Stress testing analysis helps management understand the nature and extent of vulnerabilities to which the region is exposed. Using this information, management decides whether risks can or should be mitigated through management actions or if they were to crystallise, be absorbed through capital and liquidity. This in turn informs decisions about preferred capital and liquidity levels and allocations.

In addition to HSBC Group wide stress testing scenarios, the group conducts regular macroeconomic and event-driven scenario and analyses specific to its region. We also participate, as required, in the regulatory stress testing programmes of the jurisdictions in which the group operate.

We also conduct reverse stress tests each year to understand potential extreme conditions that would make our business model non-viable. Reverse stress testing identifies potential stresses and vulnerabilities we might face, and helps inform early warning triggers, management actions and contingency plans designed to mitigate risks.

Recovery and resolution plan

Recovery and resolution plans form part of the integral framework safeguarding the group’s financial stability. The recovery plan together with stress testing help us understand the likely outcomes of adverse business or economic conditions and in the identification of appropriate risk mitigating action. The group is also committed to further developing its recovery and resolution capabilities in line with applicable local regulatory resolvability assessment framework requirements.

Key developments in 2021

We continued to actively manage the risks resulting from the Covid-19 outbreak and its impacts on our customers and operations during 2021, as well as other key risks described in this section. In addition, we enhanced our risk management in the following areas:

- We accelerated the transformation of our approach to managing financial risks across the businesses and risk functions, including initiatives to enhance portfolio monitoring and analytics, credit risk, and treasury risk management, as well as the models used to manage financial risks.

- We continued to enhance our approach to portfolio and concentration risk management and improved our data and management information reporting capabilities.
- The Climate Risk Oversight Forum continues to shape and oversee our approach to climate risk. A Head of Climate Risk in support of our climate change strategy and to oversee the development of our climate risk management capabilities has been appointed. The climate risk programme continues to drive the delivery of our enhanced climate risk management approach.
- We continued to improve the effectiveness of our financial crime controls with a targeted update of our wholesale lending fraud controls. We refreshed our financial crime policies, ensuring they remained up-to-date and addressed changing and emerging risks, and we continued to meet our regulatory obligations.
- We introduced enhanced governance and oversight around model adjustments and related processes for IFRS 9 models.

Areas of special interest

Covid-19

The Covid-19 outbreak and its effect on the global economy have impacted our customers. The outbreak necessitated governments to respond at unprecedented levels to protect public health, and to support local economies and livelihoods. The resulting government support measures and restrictions have created additional challenges, given the rapid pace of change and significant operational demands. Renewed outbreaks emphasise the ongoing threat of Covid-19 and could result in significant further tightening of government restrictions following recent relaxations. There is a material risk of a renewed decline in economic activity and financial volatility if a new variant was to necessitate the imposition of broad lockdown measures.

Our central scenario used to calculate impairment assumes that economic activity will continue to recover through 2022, surpassing peak pre-pandemic levels of GDP. It is assumed that the private sector expenditure growth accelerates, ensuring strong growth is sustained even as pandemic related central bank support is rolled back. There is a high degree of uncertainty associated with economic forecasts in the current environment and there are significant risks to our central scenario.

Governments and central banks in major economies have deployed extensive measures to support their local populations. Central banks in developed markets are expected to begin raising interest rates in 2022, but to move slowly and to keep monetary policy accommodative overall. Policy tightening in emerging markets has already begun in order to counteract rising inflation and the risk of capital outflows. Government debt has risen in most advanced economies, and is expected to remain high into the medium term. This could eventually pose a dilemma for central banks, as they face the conflicting aims of keeping debt servicing costs contained while preventing a steep rise in inflation.

The impact of the pandemic on the long-term prospects of businesses in the most vulnerable sectors of the economy – such as retail, hospitality, contracting, airlines and commercial real estate – remains uncertain and may lead to significant credit losses on specific exposures, which may not be fully captured in ECL estimates. In addition, in times of stress, fraudulent activity is often more prevalent, leading to potentially significant credit or operational losses.

As economic conditions improve, and government support measures come to an end, there is a risk that the outputs of IFRS 9 models may have a tendency to underestimate loan losses. Model outputs and management adjustments are closely monitored and independently reviewed at the group and country level for reliability and appropriateness prior to inclusion in the financial results. We are continuing to redevelop models used to calculate ECL and drive business decisions.

Central Bank of UAE Targeted Economic Support Scheme ('TESS')

Under the TESS, the Central Bank of UAE 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'). Similar schemes have been initiated by regulators in other HBME countries. The TESS program has expired on 31 December 2021.

In 2020, the UAE Banking Regulators had issued Joint Guidance on the treatment of ECL 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]	Exposure at default	Total ECL[3]	*Of which ECL adjustments*[4]	Deferral amount	ECL[5]	Deferral amount	ECL[5]
At 31 Dec 2021	**US$000**	**US$000**		**US$000**	**US$000**	***US$000***	**US$000**	**US$000**	**US$000**	**US$000**
Personal										
– residential mortgages	**1,923,815**	**—**	**—**	**—**	**(18,049)**	***833***	**—**	**—**	**—**	**—**
– other personal	**1,231,812**	**4**	**—**	**55**	**(91,584)**	***11,640***	**4**	**—**	**—**	**—**
	3,155,627	**4**	**—**	**55**	**(109,633)**	***12,473***	**4**	**—**	**—**	**—**
Corporate and commercial										
– commercial, industrial and international trade	**5,893,852**	**93,026**	**1.58**	**256,798**	**(292,368)**	***37,861***	**32,500**	**95**	**60,526**	**2,469**
– commercial real estate and other property-related	**1,864,228**	**53,029**	**2.84**	**182,768**	**(347,327)**	***41,500***	**33,220**	**236**	**19,809**	**13,436**
– government	**1,701,121**	**—**	**—**	**—**	**(529)**	**—**	**—**	**—**	**—**	**—**
– other commercial	**1,989,368**	**—**	**—**	**—**	**(165,816)**	**—**	**—**	**—**	**—**	**—**
	11,448,569	**146,055**	**1.28**	**439,566**	**(806,040)**	***79,361***	**65,720**	**331**	**80,335**	**15,905**
Financial										
– non-bank financial institutions	**189,334**	**—**	**—**	**—**	**(198)**	**—**	**—**	**—**	**—**	**—**
Total	**14,793,530**	**146,059**	**0.99**	**439,621**	**(915,871)**	***91,834***	**65,724**	**331**	**80,335**	**15,905**
At 31 Dec 2020										
Personal										
– residential mortgages	1,841,053	22	—	2,547	(38,135)	*1,592*	18	—	4	—
– other personal	1,157,609	407	0.04	3,851	(163,013)	*1,021*	257	26	150	82
	2,998,662	429	0.01	6,398	(201,148)	*2,613*	275	26	154	82
Corporate and commercial										
– commercial, industrial and international trade	6,084,514	58,004	0.95	181,386	(374,041)	*(104,638)*	24,612	456	33,392	2,092
– commercial real estate and other property-related	2,073,074	97,573	4.71	500,482	(324,132)	*2,220*	19,061	846	78,512	3,194
– government	1,342,671	—	—	—	(1,772)	—	—	—	—	—
– other commercial	2,412,966	12,522	0.52	169,238	(302,278)	—	11,432	576	1,090	37
	11,913,225	168,099	1.41	851,106	(1,002,223)	*(102,418)*	55,105	1,878	112,994	5,323
Financial										
– non-bank financial institutions	170,427	—	—	—	(2,390)	—	—	—	—	—
Total	15,082,314	168,528	1.12	857,504	(1,205,761)	*(99,805)*	55,380	1,904	113,148	5,405

1 This is the deferral amount provided to customers in the UAE in accordance with the Joint Guidance. The total amount of gross loans subject to deferral were US$455m (31Dec 2020: US$843m), representing an Exposure at Default of US$440m (31 Dec 2020: US$858m). As of 31 December 2021, HBME UAE has repaid all the TESS facility to the UAE Central Bank (31 Dec 2020: HBME UAE had availed US$0.12bn out of the total TESS facility of US$0.46bn 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$141m (31 Dec 2020: US$268m) and Stage 3 ECL of US$775m (31 Dec 2020: US$938m).
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 to customers and ECL by industry sector – UAE

	Gross carrying value			ECL		
	31 Dec 2021	31 Dec 2020		**31 Dec 2021**	31 Dec 2020	
At 31 Dec 2021	**US$000**	US$000	**% change**	**US$000**	US$000	**% change**
Personal						
– residential mortgages	**1,923,815**	1,841,053	**4.50**	**(18,049)**	(38,135)	**(52.67)**
– other personal	**1,231,812**	1,157,609	**6.41**	**(91,584)**	(163,013)	**(43.82)**
	3,155,627	2,998,662	**5.23**	**(109,633)**	(201,148)	**(45.50)**
Corporate and commercial						
– commercial, industrial and international trade	**5,893,852**	6,084,514	**(3.13)**	**(292,368)**	(374,041)	**(21.84)**
– commercial real estate and other property-related	**1,864,228**	2,073,074	**(10.07)**	**(347,327)**	(324,132)	**7.16**
– government	**1,701,121**	1,342,671	**26.70**	**(529)**	(1,772)	**(70.15)**
– other commercial	**1,989,368**	2,412,966	**(17.56)**	**(165,816)**	(302,278)	**(45.14)**
	11,448,569	11,913,225	**(3.90)**	**(806,040)**	(1,002,223)	**(19.57)**
Financial						
– non-bank financial institutions	**189,334**	170,427	**11.09**	**(198)**	(2,390)	**(91.72)**
Total	**14,793,530**	15,082,314	**(1.91)**	**(915,871)**	(1,205,761)	**(24.04)**
Exposure at default	**13,960,540**	14,277,816	**(2.22)**	**N/A**	N/A	**N/A**

Clients benefiting from deferrals – UAE			**Number of clients deferred**	**Payment deferrals**	**Exposure**	**Impairment Allowance**
At 31 Dec 2021				**US$000**	**US$000**	**US$000**
Segment	**Stage**	**Group**				
Retail banking	Stage 1	Group 1	**3**	**4**	**55**	**1**
		Group 2	**—**	**—**	**—**	**—**
	Total Stage 1		**3**	**4**	**55**	**1**
	Stage 2	Group 1	**—**	**—**	**—**	**—**
		Group 2	**—**	**—**	**—**	**—**
	Total Stage 2		**—**	**—**	**—**	**—**
	Stage 3	Group 1	**—**	**—**	**—**	**—**
		Group 2	**—**	**—**	**—**	**—**
	Total Stage 3		**—**	**—**	**—**	**—**
Total retail banking			**3**	**4**	**55**	**1**
Wholesale banking	Stage 1	Group 1	**5**	**42,450**	**89,069**	**157**
		Group 2	**—**	**—**	**—**	**—**
	Total Stage 1		**5**	**42,450**	**89,069**	**157**
	Stage 2	Group 1	**3**	**23,270**	**55,947**	**540**
		Group 2	**3**	**50,270**	**279,724**	**5,110**
	Total Stage 2		**6**	**73,540**	**335,671**	**5,650**
	Stage 3	Group 1	**—**	**—**	**—**	**—**
		Group 2	**5**	**30,065**	**30,065**	**15,235**
	Total Stage 3		**5**	**30,065**	**30,065**	**15,235**
Total wholesale banking			**16**	**146,055**	**454,805**	**21,042**
At 31 Dec 2020						
Segment	Stage	Group				
Retail banking	Stage 1	Group 1	65	228	4,713	52
		Group 2	—	—	—	—
	Total Stage 1		65	228	4,713	52
	Stage 2	Group 1	19	48	272	118
		Group 2	75	147	1,276	620
	Total Stage 2		94	195	1,548	738
	Stage 3	Group 1	—	—	—	—
		Group 2	2	6	181	46
	Total Stage 3		2	6	181	46
Total retail banking			161	429	6,442	836
Wholesale banking	Stage 1	Group 1	4	32,804	113,181	3,998
		Group 2	1	14,746	63,400	667
	Total Stage 1		5	47,550	176,581	4,665
	Stage 2	Group 1	10	22,300	206,491	8,284
		Group 2	17	79,532	434,888	26,902
	Total Stage 2		27	101,832	641,379	35,186
	Stage 3	Group 1	—	—	—	—
		Group 2	5	18,717	18,717	2,675
	Total Stage 3		5	18,717	18,717	2,675
Total wholesale banking			37	168,099	836,677	42,526

ECL movement during the year – UAE

	Not credit impaired		Credit impaired		
	Stage 1	Stage 2	Stage 3	POCI	Total
At 31 Dec 2021	US$000	US$000	US$000	US$000	US$000
Personal					
ECL allowance as of start of year	**23,885**	**93,236**	**84,830**	**—**	**201,951**
– residential mortgages	**(1,111)**	**(2,395)**	**(17,566)**	**—**	**(21,072)**
– other personal	**5,822**	**(64,924)**	**(11,168)**	**—**	**(70,270)**
ECL allowance as of end of year	**28,596**	**25,917**	**56,096**	**—**	**110,609**
Corporate and commercial					
ECL allowance as of start of year	**46,255**	**133,977**	**848,639**	**4,249**	**1,033,120**
– Corporates	**(10,146)**	**(59,839)**	**(130,148)**	**(2,749)**	**(202,882)**
– government	**4,342**	**(5,389)**	**—**	**—**	**(1,047)**
– non-bank financial institutions	**83**	**(2,879)**	**—**	**—**	**(2,796)**
– Banks	**(587)**	**(323)**	**—**	**—**	**(910)**
ECL allowance as of end of year	**39,947**	**65,547**	**718,491**	**1,500**	**825,485**
At 31 Dec 2020					
Personal					
ECL allowance as of start of year	24,307	43,280	112,596	—	180,183
– residential mortgages	630	4,662	(25,396)	—	(20,104)
– other personal	(1,052)	45,294	(2,370)	—	41,872
ECL allowance as of end of year	23,885	93,236	84,830	—	201,951
Corporate and commercial					
ECL allowance as of start of year	38,821	31,851	591,796	7,760	670,228
– Corporates	6,426	93,698	263,913	(3,511)	360,526
– government	1,045	5,389	—	—	6,434
– non-bank financial institutions	(337)	2,835	(7,070)	—	(4,572)
– Banks	300	204	—	—	504
ECL allowance as of end of year	46,255	133,977	848,639	4,249	1,033,120

ECL adjustments1 – UAE	Non-Covid related ECL adjustments	Covid related ECL adjustments	Total ECL adjustments
As at 31 Dec 2021	US$000	US$000	US$000
Retail banking loans:			
– residential mortgages	**—**	**833**	**833**
– other personal	**—**	**11,640**	**11,640**
Total retail banking loans	**—**	**12,473**	**12,473**
Wholesale banking loans:			
– Non-government obligors	**—**	**79,361**	**79,361**
Total wholesale banking loans	**—**	**79,361**	**79,361**
As at 31 Dec 2020			
Retail banking loans:			
– residential mortgages	1,592	—	1,592
– other personal	—	1,021	1,021
Total retail banking loans	1,592	1,021	2,613
Wholesale banking loans:			
– Non-government obligors	—	(102,418)	(102,418)
Total wholesale banking loans	—	(102,418)	(102,418)

1 *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.*

Ibor transition

InterBank Offered Rates (Ibor's) such as the London Interbank Offered Rate (Libor) are interest rates at which banks borrow money on unsecured terms in wholesale markets. These benchmarks have historically been used extensively to set interest rates across 5 major currencies, the Dollar, Sterling, Swiss Franc, Japanese Yen and the Euro across different types of financial transactions and for valuation purposes, risk measurement and performance benchmarking. Following the UK's Financial Conduct Authority ('FCA') announcement in July 2017 that it would no longer continue to persuade, or require panel banks to submit rates for the Libor after 2021, we have been actively working to transition legacy contracts from Ibor's and meet client needs for new replacement rates. For 2021, the focus has been to transition the non-USD Libor-linked portfolio following ICE Benchmark Administration Limited's ('IBA') decision to continue to publish US dollar Libor for its most widely used settings until June 2023.

Through 2021, our Ibor transition programme ('the programme') developed IT and new near risk free replacement rate ('RFR') product capabilities, and implemented operational processes and controls to manage any heightened financial and non-financial risks whilst actively engaging with our clients to discuss options to transition their legacy contracts. HSBC met regulatory milestones to cease issuance of new Libor contracts for the demising benchmarks through 2021, and expects to meet regulatory timelines to complete transition of our US dollar legacy contracts by mid-2023.

Financial reporting risks continue to exist with respect to off-balance sheet exposure reporting and application of accounting reliefs, both of which can be manually intensive. Off-balance sheet exposure is difficult to quantify, in some sites, given that notional facility data is not always held at benchmark level. The application of accounting reliefs relating to amendment of contracts will require detailed review and interpretation of contractual changes to appropriately apply accounting rules. There is a risk that differences in US dollar Libor and the replacement rate, Secured Overnight Funding rate ('SOFR'), create a basis risk that we need to actively manage. Basis risk in the trading book and in the banking book may arise out of the asymmetric adoption of US dollar Libor alternatives across assets and liabilities. At present, derivative hedging solution on offer is 'compounded in-arrear' methodology as HSBC's global term SOFR derivative rollout is dependent on market developments potentially impacting our ability to provide certain types of hedges. Additionally, liquidity risk could potentially be present as the use of SOFR continues to build, or as alternative rates are brought to market. This could also result in delays to transition of legacy US dollar contracts into 2023 and potentially heightened operational risks at that point.

Our approach to transitioning the US dollar legacy contracts will differ by product and business area, but will be based on the lessons learned from the successful transition of those contracts which referenced Ibor's which ceased at the end of 2021. We will continue to communicate with our clients and investors in a structured manner and be client led in the timing and nature of the transition. We continue to carry out extensive training, communication and client engagement to facilitate appropriate selection of rates and products. We continue to actively engage with regulatory and industry bodies to mitigate risks relating to any potential 'tough legacy' contracts.

For derivatives, we anticipate our exposure will continue to reduce through 2022 following the requirement to only transact trades for risk management purposes after 01 January 2022. However, we will continue to look to actively reduce our exposure by transitioning trades.

We will continue to work with our clients to determine their abilities to adhere and support them through the transition as required. Additionally, we are working with market participants to ensure we are able to transition contracts in large quantities as the US dollar Libor cessation date approaches. For the remaining demising Ibors, notably US dollar Libor, our Wholesale bank has begun to engage with clients with upcoming contract maturities with a view to refinancing at an appropriate replacement rate.

For our bond issuance, we have been discussing the ability to support RFR instead of LIBOR linked note issuances. The transition from the US dollar Libor, continues to be the programme's objective, with systems and processes being put in place to achieve this.

Financial instruments impacted by Ibor reform

Amendments to IFRSs issued in August 2020 (Interest Rate Benchmark Reform Phase 2) represents the second phase of the IASB's project on the effects of interest rate benchmark reform, addressing issues affecting financial statements when changes are made to contractual cash flows and hedging relationships as a result of reform.

Under these amendments, changes made to an amortised cost financial instrument that are economically equivalent and required by interest rate benchmark reform do not result in the derecognition or a change in the carrying amount of the financial instrument, but instead require the effective interest rate to be updated to reflect the change in the interest rate benchmark. In addition, hedge accounting will not be discontinued solely because of the replacement of the interest rate benchmark if the hedge meets other hedge accounting criteria.

These amendments applied from 1 January 2021 with early adoption permitted. The group adopted the amendments from 1 January 2020.

	Financial instruments yet to transition to alternative benchmarks, by main benchmark			
	USD Libor	GBP Libor	JPY Libor	Others
At 31 Dec 2021	**US$000**	**US$000**	**US$000**	**US$000**
Non-derivative financial assets				
Loans and advances to customers	**5,146,550**	–	–	–
Other financial assets	**946,790**	–	–	–
Total non-derivative financial assets	**6,093,340**	–	–	–
Non-derivative financial liabilities				
Financial liabilities designated at fair value	–	–	–	–
Debt securities in issue	**1,443,991**	–	–	–
Other financial liabilities	**1,980,000**	–	–	–
Total non-derivative financial liabilities	**3,423,991**	–	–	–
Derivative notional contract amount				
Interest rate	**22,311,157**	–	–	**276,882**
Total derivative notional contract amount	**22,311,157**	–	–	**276,882**
At 31 Dec 2020				
Non-derivative financial assets				
Loans and advances to customers	5,559,494	10,428	–	–
Other financial assets	1,044,160	–	–	–
Total non-derivative financial assets	6,603,654	10,428	–	–
Non-derivative financial liabilities				
Financial liabilities designated at fair value	203,290	–	–	–
Debt securities in issue	1,239,486	–	–	–
Other financial liabilities	2,236,877	–	–	–
Total non-derivative financial liabilities	3,679,653	–	–	–
Derivative notional contract amount				
Interest rate	27,755,353	68,282	–	1,996,111
Total derivative notional contract amount	27,755,353	68,282	–	1,996,111

The amounts in the above table relate to the group's main operating entities and provide an indication of the extent of the group's exposure to the Ibor benchmarks which are due to be replaced. Amounts are in respect of the financial instruments that:

- contractually reference an interest rate benchmark that is planned to transition to an alternative benchmark;
- have a contractual maturity date after 30 June 2023, the date by which Libor is expected to cease;
- are recognised on the group's consolidated balance sheet.

In March 2021, IBA announced that the publication date of most US dollar Libor tenors is extended from 31 December 2021 to 30 June 2023. Publication of one-week and two-month tenors will cease after 31 December 2021.

Credit risk

Credit risk management

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from direct lending, trade finance and leasing business, but also from other products such as guarantees and credit derivatives. Credit risk generates the largest regulatory capital requirement of the risks the group incurs.

We have implemented HSBC Group wide credit risk management and related IFRS9 processes. We continue to assess actively the impact of economic developments in key markets on specific customers, customer segments or portfolios. As credit conditions change, we take mitigating action, including the revision of risk appetites or limits and tenors, as appropriate. In addition, we continue to evaluate the terms under which we provide credit facilities within the context of individual customer requirements, the quality of the relationship, local regulatory requirements, market practices and our local market position.

Credit approval authorities are delegated by the Board to the CEO and with the authority to sub-delegate them. The Credit Risk sub-function reports to the CRO and is responsible for key policies and processes for managing credit risk, which include formulating credit policies and risk rating frameworks, guiding the group's appetite for credit risk exposures, undertaking independent reviews and objective assessment of credit risk, and monitoring performance and management of portfolios.

The principal objectives of our credit risk management are:

- To maintain a strong culture of responsible lending, and robust risk policies and control frameworks
- To both partner and challenge our business in defining, implementing and continually re-evaluating our risk appetite under actual and scenario conditions; and
- To ensure there is independent, expert scrutiny of credit risk, their costs and their mitigation.

IFRS 9 Financial Instruments Process

We have established IFRS9 modelling and data processes which are subject to internal model risk governance including independent review of significant model developments. A centralised impairment engine performs the expected credit loss ('ECL') calculation using data, which is subject to a number of validation checks and enhancements, from a variety of client, finance and risk systems. Where possible, these checks and processes are performed in a globally consistent and centralised manner. A group review forum with representatives from Credit Risk and Finance is established to review and approve the impairment results.

Concentration of exposure

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or such counterparties are engaged in similar activities or operate in the same geographical areas or industry sectors so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. We use a number of controls and measures to minimise undue concentration of exposure in our portfolios across industries, countries and global businesses. These include portfolio and counterparty limits, approval and review controls and stress testing.

Wrong-way risk is an aggravated form of concentration risk and arises when there is a strong correlation between the counterparty's probability of default and the mark-to-market value of the underlying transaction. The group uses a range of procedures to monitor and control wrong-way risk, including requiring entities to obtain prior approval before undertaking wrong-way risk transactions outside pre-agreed guidelines.

Credit quality of financial instruments

The group's credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. In the case of individually significant accounts, risk ratings are reviewed regularly and any amendments are implemented promptly. Within the group's retail business, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

Special attention is paid to problem exposures in order to accelerate remedial action. Where appropriate, the group uses specialist units to provide customers with support in order to help them avoid default wherever possible.

Periodic risk-based audits of the group's credit processes and portfolios are also undertaken by an independent function.

Renegotiated loans and forbearance

'Forbearance' describes concessions made on the contractual terms of a loan in response to an obligor's financial difficulties. A loan is classified as 'renegotiated' when we modify the contractual payment terms on concessionary terms because we have significant concerns about the borrower's ability to meet contractual payments when due. Non-payment-related concessions (e.g.covenant waivers), while potential indicators of impairment, do not trigger identification as renegotiated loans. Loans that have been identified as renegotiated retain this designation until maturity or derecognition. On execution of renegotiation, the loan will also be classified as credit impaired if it is not already so classified. In wholesale lending, all facilities with a customer including loans that have not been modified are considered credit impaired following the identification of a renegotiated loan until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment. Personal renegotiated loans generally remain credit impaired until repayment, write-off or derecognition.

For retail lending, unsecured renegotiated loans are generally segmented from other parts of the loan portfolio. Renegotiated expected credit loss assessments reflect the higher rates of losses typically encountered with renegotiated loans. For wholesale lending, renegotiated loans are typically assessed individually and take into account the higher risk of the future non-payment inherent in renegotiated loans.

Impairment Assessment

It is the group's policy to create allowances for impaired loans promptly and consistently.

For details of impairment policies on loans and advances and financial investments, see Note 2.2(i) on the Financial Statements.

Write-off of loans and advances

Loans are normally written off, either partially or in full, when there is no realistic prospect of further recovery. For secured loans, write-off generally occurs after receipt of any proceeds from the realisation of security.

Unsecured personal facilities, including credit cards, are generally written off at between 150 and 210 days past due, the standard period being the end of the month in which the account becomes 180 days contractually delinquent. Write-off periods may be extended, generally to no more than 360 days past due. However, in exceptional circumstances, they may be extended further, in countries where local regulation or legislation constrain earlier write-off, or where the realisation of collateral for secured real estate lending extends to this time.

In the event of bankruptcy or analogous proceedings, write-off may occur earlier than at the periods stated above. Collections procedures may continue after write-off.

Summary of credit risk

The disclosure below presents the gross carrying/nominal amount of financial instruments to which the impairment requirements in IFRS 9 are applied and the associated allowance for ECL.

The IFRS 9 allowance for ECL has decreased from US$1,411m at 31 December 2020 to US$1,032m at 31 December 2021.

The IFRS 9 allowance for ECL at 31 December 2021 comprises US$1,005m (2020: US$1,358m) in respect of assets held at amortised cost and US$27m (2020: US$53m) in respect of loan commitments and financial guarantees.

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

	31 Dec 2021		31 Dec 2020	
	Gross carrying/nominal amount	**Allowance for ECL**	Gross carrying/nominal amount	Allowance for ECL
	US$000	**US$000**	US$000	US$000
Loans and advances to customers at amortised cost	**19,618,941**	**(995,160)**	20,696,401	(1,345,685)
Loans and advances to banks at amortised cost	**7,810,570**	**(3,268)**	7,746,251	(3,827)
Other financial assets measured at amortised costs	**6,494,761**	**(6,284)**	4,012,810	(8,197)
– cash and balances at central banks	**848,873**	**(402)**	1,241,854	(863)
– items in the course of collection from other banks	**53,900**	**—**	69,569	—
– reverse repurchase agreements – non-trading	**4,900,749**	**—**	1,828,851	—
– prepayments, accrued income and other assets	**691,239**	**(5,882)**	872,536	(7,334)
Total gross carrying amount on-balance sheet	**33,924,272**	**(1,004,712)**	32,455,462	(1,357,709)
Loans and other credit related commitments	**7,555,710**	**(14,167)**	6,639,554	(36,535)
Financial guarantees	**2,342,657**	**(13,102)**	1,217,383	(16,675)
Total nominal amount off-balance sheet	**9,898,367**	**(27,269)**	7,856,937	(53,210)

	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)	**10,904,286**	**(1,550)**	10,068,873	(2,758)

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 31 December 2021

	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	**15,238,549**	**3,218,945**	**1,155,649**	**5,798**	**19,618,941**	**(78,892)**	**(90,052)**	**(824,717)**	**(1,499)**	**(995,160)**
Loans and advances to banks at amortised cost	**7,785,538**	**25,032**	**–**	**–**	**7,810,570**	**(3,093)**	**(175)**	**–**	**–**	**(3,268)**
Other financial assets measured at amortised cost	**6,382,940**	**105,646**	**6,175**	**–**	**6,494,761**	**(976)**	**(495)**	**(4,813)**	**–**	**(6,284)**
Loan and other credit-related commitments	**7,201,601**	**353,028**	**1,081**	**–**	**7,555,710**	**(7,036)**	**(7,044)**	**(87)**	**–**	**(14,167)**
Financial guarantees	**2,116,443**	**217,558**	**8,656**	**–**	**2,342,657**	**(3,069)**	**(10,031)**	**(2)**	**–**	**(13,102)**
At 31 Dec 2021	**38,725,071**	**3,920,209**	**1,171,561**	**5,798**	**43,822,639**	**(93,066)**	**(107,797)**	**(829,619)**	**(1,499)**	**(1,031,981)**

	ECL coverage %				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
	%	**%**	**%**	**%**	**%**
Loans and advances to customers at amortised cost	**0.5**	**2.8**	**71.4**	**25.9**	**5.1**
Loans and advances to banks at amortised cost	**–**	**0.7**	**–**	**–**	**–**
Other financial assets measured at amortised cost	**–**	**0.5**	**77.9**	**–**	**(0.1)**
Loan and other credit-related commitments	**0.1**	**2.0**	**8.0**	**–**	**0.2**
Financial guarantees	**0.1**	**4.6**	**–**	**–**	**0.6**
At 31 Dec 2021	**0.2**	**2.7**	**70.8**	**25.9**	**2.4**

Summary of credit risk (excluding debt instruments measured at FVOCI) by stage distribution and ECL coverage at 31 December 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	13,361,211	5,872,001	1,449,336	13,853	20,696,401	(94,003)	(244,803)	(1,005,380)	(1,499)	(1,345,685)
Loans and advances to banks at amortised cost	7,599,139	147,112	–	–	7,746,251	(2,717)	(1,110)	–	–	(3,827)
Other financial assets measured at amortised cost	3,893,057	114,132	5,621	–	4,012,810	(2,280)	(1,643)	(4,274)	–	(8,197)
Loan and other credit related commitments	5,611,694	977,570	50,290	–	6,639,554	(9,578)	(26,824)	(133)	–	(36,535)
Financial guarantees	947,092	257,612	12,679	–	1,217,383	(3,671)	(13,002)	(2)	–	(16,675)
At 31 Dec 2020	31,412,193	7,368,427	1,517,926	13,853	40,312,399	(112,249)	(287,382)	(1,009,789)	(1,499)	(1,410,919)

	ECL coverage %				
	Stage 1	Stage 2	Stage 3	POCI	Total
	%	%	%	%	%
Loans and advances to customers at amortised cost	0.7	4.2	69.4	10.8	6.5
Loans and advances to banks at amortised cost	–	0.8	–	–	–
Other financial assets measured at amortised cost	0.1	1.4	76.0	–	(0.2)
Loan and other credit related commitments	0.2	2.7	0.3	–	0.6
Financial guarantees	0.4	5.0	–	–	1.4
At 31 Dec 2020	0.4	3.9	66.5	10.8	3.5

Measurement uncertainty and sensitivity analysis of ECL estimates

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 described below. The recognition and measurement of ECL involves the use of significant judgement and estimation. It is necessary to formulate multiple economic scenarios based on economic forecasts, apply these assumptions to credit risk models to estimate future credit losses and probability weight the results to determine an unbiased ECL estimate. 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.

Methodology for Developing Forward Looking Economic Scenarios

The group has adopted the use of multiple economic scenarios to reflect assumptions about future economic conditions. Four economic scenarios are used to capture the current economic environment and to articulate management's view of the range of potential outcomes. Scenarios produced to calculate ECL are aligned to the group's top and emerging risks. In the second quarter of 2020, to ensure that the severe risks associated with the pandemic were appropriately captured, management added a fourth, more severe, scenario to use in the measurement of ECL. Starting in the fourth quarter of 2021, the group's methodology has been adjusted so that the use of four scenarios, of which two are downside scenarios, is the standard approach to ECL calculation. Three of the scenarios are drawn from consensus forecasts and distributional estimates. The central scenario is deemed the 'most likely' scenario, and usually attracts the largest probability weighting, while the outer scenarios represent the tails of the distribution, which are less likely to occur. The central scenario is created using the average of a panel of external forecasters.

For the central scenario, the group sets key economic assumptions such as GDP growth and oil price using either the average of external economist forecasts (commonly referred to as consensus forecasts) for most economies, or market prices helping to ensure that the IFRS 9 scenarios are unbiased and maximise the use of independent information. An external provider's global macro model, conditioned to follow the consensus forecasts, projects the other paths required as inputs to credit models. This external provider is subject to the HSBC Group's risk governance framework, with oversight by a specialist internal unit.

The upside and downside scenarios are designed to be cyclical, in that assumptions such as GDP growth usually revert back to the central scenario after the first three years for major economies. We determine the maximum divergence of GDP growth from the central scenario using the 10th and the 90th percentile of the entire distribution of forecast outcomes for major economies. We use externally available forecast distributions to help ensure independence in scenario construction. While key economic variables are set with reference to external distributional forecasts, we also align the overall narrative of the scenarios to the macroeconomic risks captured in the group's Top and Emerging Risks. This ensures that scenarios remain consistent with the more qualitative assessment of these risks. We project additional variable paths using the external provider's global macro model.

The forecast macro-economic scenarios have continued to show improvement; therefore, during 2021 the group increased the probability weight of the central scenario due to higher confidence in the forecast outcomes. As a result, as at 31 December 2021, the central scenario has been assigned a weighting of 70%, the downside scenario 20% and the upside and additional downside 5% each, according to the decision of the group's senior management.

Description of Consensus Economic Scenarios

The following table describes key macroeconomic variables and the probabilities assigned in the consensus central scenario for the UAE.

Central scenario (2022Q1–2026Q4)

	UAE
Probability (%)	**70**
GDP growth rate (%)	
2022: Annual average growth rate	**4.4**
2023: Annual average growth rate	**3.4**
2024: Annual average growth rate	**3.0**
5-year average	**3.2**
Oil price (US$)	
2022: Average oil price	**69.5**
2023: Average oil price	**66.6**
2024: Average oil price	**65.2**
5-year average	**67.4**
House price growth (%)	
2022: Annual average growth rate	**4.9**
2023: Annual average growth rate	**0**
2024: Annual average growth rate	**2.1**
5-year average	**2.7**

The following table describes the probabilities assigned in the consensus upside scenario, consensus downside scenario and additional downside scenario, the key macroeconomic variables for each scenario and the largest quarterly measure observed for each variable over the forecast period. The additional downside scenario features a global recession and has been created to reflect management's view of severe risks.

Outer scenarios (less likely)

	UAE		
	Consensus upside scenario	Consensus downside scenario	Additional downside scenario
Probability (%)	**5**	**20**	**5**
GDP growth rate (%)	**10.8 (1Q22)**	**(2) (4Q22)**	**(12.5) (4Q22)**
Oil price (US$)	**100.1 (2Q22)**	**34.88 (4Q22)**	**26.45 (1Q23)**
House price growth (%)	**14.4 (2Q22)**	**(6.6) (1Q23)**	**(16.2) (4Q22)**

How economic scenarios are reflected in the wholesale calculation of ECL

HSBC has developed a globally consistent methodology for the application of forward economic guidance into the calculation of ECL by incorporating these 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 forward economic guidance to default rates. For LGD calculations, we consider the correlation of forward economic guidance to collateral values and realisation rates. 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 forward economic guidance proportionate to the probability-weighted outcome and the central scenario outcome for non-stage 3 populations.

ECL based exposures at 31 December 2021[1]

	UAE	
	2021	2020
Reported ECL (US$m)[2]	**158**	250
Gross carrying/nominal amount (US$m)[3]	**44,767**	44,777
Consensus central scenario	**122**	241
Consensus upside scenario	**73**	190
Consensus downside scenario	**214**	330
Additional downside scenario	**711**	536

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 *Includes off-balance sheet financial instruments that are subject to significant measurement uncertainty.*
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.*

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. Historical relationships between observed default rates and macro-economic variables are integrated into IFRS 9 ECL estimates by using 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 using national level forecasts of the house price index and applying the corresponding LGD expectation.

IFRS 9 ECL sensitivity to future economic conditions[1]

	UAE					
US$m	Gross carrying amount	Reported ECL[2]	Central scenario ECL	Upside scenario ECL	Downside scenario ECL	Additional Downside scenario ECL
Mortgages	**1,982**	**45**	**44**	**42**	**46**	**57**
Credit cards	**429**	**43**	**41**	**29**	**54**	**82**
Other	**615**	**19**	**18**	**13**	**21**	**25**
Mortgages	1,889	66	63	53	73	78
Credit cards	426	92	81	62	107	126
Other	683	38	37	33	41	46

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.*

Economic scenarios sensitivity analysis of ECL estimates

The ECL outcome is sensitive to judgement and estimations made with regards to the formulation and incorporation of multiple forward looking economic conditions described above. As a result, management assessed and considered the sensitivity of the ECL outcome against the forward looking economic conditions as part of the ECL governance process by recalculating the ECL under each scenario described above for selected portfolios, applying a 100% weighting to each scenario in turn. The weighting is reflected in both the determination of significant increase in credit risk as well as the measurement of the resulting ECL.

The economic scenarios are generated to capture the group's view of a range of possible forecast economic conditions that is sufficient for the calculation of unbiased and probability-weighted ECL. As a result, the ECL calculated for the upside and downside scenarios should not be taken to represent the upper and lower limits of possible actual ECL outcomes. There are a very wide range of possible combinations of inter-related economic factors that could influence actual credit loss outcomes, accordingly the range of estimates provided by attributing 100% weightings to scenarios are indicative of possible outcomes given the assumptions used. A wider range of possible ECL outcomes reflects uncertainty about the distribution of economic conditions and does not necessarily mean that credit risk on the associated loans is higher than for loans where the distribution of possible future economic conditions is narrower. The recalculated ECLs for each of the scenarios should be read in the context of the sensitivity analysis as a whole and in conjunction with the narrative disclosures.

Credit exposure

Maximum exposure to credit risk

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

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

The offset in the table relate to amounts where there is a legally enforceable right of offset in the event of counterparty default and where, as a result, there is a net exposure for credit risk purposes. However, as there is no intention to settle these balances on a net basis under normal circumstances, they do not qualify for net presentation for accounting purposes.

No offset has been applied to off-balance sheet collateral. In the case of derivatives, the offset column also includes collateral received in cash and other financial assets.

Maximum exposure to credit risk

	2021			2020		
	Maximum exposure	**Offset**	**Net**	Maximum exposure	Offset	Net
	US$000	**US$000**	**US$000**	US$000	US$000	US$000
Loans and advances to customers held at amortised cost	**18,623,781**	**(198,783)**	**18,424,998**	19,350,716	(126,143)	19,224,573
Loans and advances to banks held at amortised cost	**7,807,302**	**—**	**7,807,302**	7,742,424	—	7,742,424
Other financial assets measured at amortised costs	**17,391,213**	**—**	**17,391,213**	14,070,728	—	14,070,728
– cash and balances at central banks	**848,471**	**—**	**848,471**	1,240,991	—	1,240,991
– items in the course of collection from other banks	**53,900**	**—**	**53,900**	69,569	—	69,569
– reverse repurchase agreements – non-trading[1]	**4,900,749**	**—**	**4,900,749**	1,828,851	—	1,828,851
– financial investments	**10,902,736**	**—**	**10,902,736**	10,066,115	—	10,066,115
– prepayments, accrued income and other assets	**685,357**	**—**	**685,357**	865,202	—	865,202
Derivatives	**1,070,156**	**(810,874)**	**259,282**	1,879,242	(1,535,679)	343,563
Total off-balance sheet	**25,056,696**	**—**	**25,056,696**	23,247,532	—	23,247,532
– financial guarantees and similar contracts	**6,726,350**	**—**	**6,726,350**	6,217,262	—	6,217,262
– loan and other credit-related commitments	**18,330,346**	**—**	**18,330,346**	17,030,270	—	17,030,270

1 *The disclosure has been updated to align to the HSBC Group approach.*

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers including loan commitments and financial guarantees

The following disclosure provides a reconciliation by stage of the group's gross carrying/nominal amount and allowances for loans and advances to banks and customers, including loan commitments and financial guarantees. Movements are calculated on a quarterly basis and therefore fully capture stage movements between quarters. If movements were calculated on a year-to-date basis they would only reflect the opening and closing position of the financial instrument. The transfers of financial instruments represents the impact of stage transfers upon the gross carrying/nominal amount and associated allowance for ECL.

The net remeasurement of ECL arising from stage transfers represents the increase or decrease due to these transfers, for example, moving from a 12-month (stage 1) to a lifetime (stage 2) ECL measurement basis. Net remeasurement excludes the underlying customer risk rating ('CRR')/probability of default ('PD') movements of the financial instruments from stage transfers. This is captured, along with other credit quality movements in the 'Net new and further lending/(repayments) and changes in risk parameters' line item. This line also includes changes due to volume movements within the group's lending portfolio.

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers including loan commitments and financial guarantees at 31 December 2021

	Non-credit impaired				**Credit impaired**					
	Stage 1		**Stage 2**		**Stage 3**		**POCI**		**Total**	
	Gross carrying/ nominal amount	**Allowance for ECL**	**Gross carrying/ nominal amount**	**Allowance for ECL**	**Gross carrying/ nominal amount**	**Allowance for ECL**	**Gross carrying/ nominal amount**	**Allowance for ECL**	**Gross carrying/ nominal amount**	**Allowance for ECL**
	US$000	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**
At 1 Jan 2021	**27,519,136**	**(109,969)**	**7,254,294**	**(285,739)**	**1,512,305**	**(1,005,515)**	**13,853**	**(1,499)**	**36,299,588**	**(1,402,722)**
Transfers of financial instruments:	**4,864,805**	**(97,061)**	**(5,005,417)**	**141,678**	**140,612**	**(44,617)**	**—**	**—**	**—**	**—**
– Transfers from Stage 1 to Stage 2	**(3,615,031)**	**21,079**	**3,615,031**	**(21,079)**	**—**	**—**	**—**	**—**	**—**	**—**
– Transfers from Stage 2 to Stage 1	**8,479,836**	**(118,140)**	**(8,479,836)**	**118,140**	**—**	**—**	**—**	**—**	**—**	**—**
– Transfers to Stage 3	**—**	**—**	**(228,823)**	**63,680**	**228,823**	**(63,680)**	**—**	**—**	**—**	**—**
– Transfers from Stage 3	**—**	**—**	**88,211**	**(19,063)**	**(88,211)**	**19,063**	**—**	**—**	**—**	**—**
Net remeasurement of ECL arising from transfer of stage	**—**	**53,305**	**—**	**(18,089)**	**—**	**(121)**	**—**	**—**	**—**	**35,095**
Net new and further lending/(repayments) and changes in risk parameters	**(45,742)**	**61,446**	**1,566,538**	**49,668**	**(218,382)**	**(37,027)**	**(8,651)**	**(167)**	**1,293,763**	**73,920**
Assets written off	**—**	**—**	**—**	**—**	**(268,665)**	**268,665**	**(167)**	**167**	**(268,832)**	**268,832**
Foreign exchange and others	**3,932**	**(25)**	**(852)**	**39**	**(484)**	**(206)**	**763**	**—**	**3,359**	**(192)**
Others	**—**	**214**	**—**	**5,141**	**—**	**(5,985)**	**—**	**—**	**—**	**(630)**
At 31 Dec 2021	**32,342,131**	**(92,090)**	**3,814,563**	**(107,302)**	**1,165,386**	**(824,806)**	**5,798**	**(1,499)**	**37,327,878**	**(1,025,697)**
ECL (charge)/release for the period	**—**	**114,751**	**—**	**31,579**	**—**	**(37,148)**	**—**	**(167)**	**—**	**109,015**
Recoveries	**—**	**—**	**—**	**—**	**—**	**25,644**	**—**	**—**	**—**	**25,644**
Others	**—**	**—**	**—**	**—**	**—**	**(1)**	**—**	**—**	**—**	**(1)**
Total ECL (charge)/ release for the period	**—**	**114,751**	**—**	**31,579**	**—**	**(11,505)**	**—**	**(167)**	**—**	**134,658**

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers including loan commitments and financial guarantees at 31 December 2021 (continued)

	At 31 Dec 2021		Twelve months ended 31 Dec 2021
	Gross carrying/nominal amount	Allowance for ECL	ECL and other credit charges
	US$000	US$000	US$000
As above	**37,327,878**	**(1,025,697)**	**134,658**
Other financial assets measured at amortised cost	**6,494,761**	**(6,284)**	**(1,915)**
Other instruments not within the scope of IFRS 9	**N/A**	**N/A**	**11,495**
Summary of financial instruments to which the impairment requirements in IFRS 9 are applied/ Summary consolidated income statement	**43,822,639**	**(1,031,981)**	**144,238**
Debt instruments measured at FVOCI	**10,904,286**	**(1,550)**	**1,194**
Change in expected credit losses and other credit impairment charges	**N/A**	**(1,033,531)**	**145,432**

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers including loan commitments and financial guarantees at 31 December 2020 (continued)

	Non-credit impaired				Credit impaired					
	Stage 1		Stage 2		Stage 3		POCI		Total	
	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
At 1 Jan 2020	30,650,720	(80,744)	2,420,514	(98,280)	1,214,907	(798,198)	2,447	(1,493)	34,288,588	(978,715)
Transfers of financial instruments:	(7,783,688)	(14,796)	7,174,093	94,873	609,595	(80,077)	—	—	—	—
– Transfers from Stage 1 to Stage 2	(11,841,009)	67,441	11,841,009	(67,441)	—	—	—	—	—	—
– Transfers from Stage 2 to Stage 1	4,367,933	(83,322)	(4,367,933)	83,322	—	—	—	—	—	—
– Transfers to Stage 3	(310,612)	1,085	(342,555)	85,836	653,167	(86,921)	—	—	—	—
– Transfers from Stage 3	—	—	43,572	(6,844)	(43,572)	6,844	—	—	—	—
Net remeasurement of ECL arising from transfer of stage	—	24,828	—	(93,430)	—	(6,246)	—	—	—	(74,848)
Net new and further lending/(repayments) and changes in risk parameters	4,742,554	(37,247)	(2,322,761)	(189,022)	(93,734)	(329,412)	11,759	—	2,337,818	(555,681)
Assets written off	—	—	—	—	(217,718)	217,718	(257)	257	(217,975)	217,975
Foreign exchange and others	(90,450)	81	(17,552)	264	(745)	658	—	—	(108,747)	1,003
Others	—	(2,091)	—	(144)	0	(9,958)	(96)	(263)	(96)	(12,456)
At 31 Dec 2020	27,519,136	(109,969)	7,254,294	(285,739)	1,512,305	(1,005,515)	13,853	(1,499)	36,299,588	(1,402,722)
ECL (charge)/release for the period	—	(12,419)	—	(282,452)	—	(335,658)	—	—	—	(630,529)
Recoveries	—	—	—	—	—	23,320	—	—	—	23,320
Others	—	—	—	—	—	930	—	—	—	930
Total ECL (charge)/release for the period	—	(12,419)	—	(282,452)	—	(311,408)	—	—	—	(606,279)

	At 31 Dec 2020		Twelve months ended 31 Dec 2020
	Gross carrying/nominal amount	Allowance for ECL	ECL and other credit charges
	US$000	US$000	US$000
As above	36,299,588	(1,402,722)	(606,279)
Other financial assets measured at amortised cost	4,012,810	(8,197)	(116)
Other instruments not within the scope of IFRS 9	N/A	N/A	(30,584)
Summary of financial instruments to which the impairment requirements in IFRS 9 are applied/ Summary consolidated income statement	40,312,398	(1,410,919)	(636,979)
Debt instruments measured at FVOCI	10,068,873	(2,758)	(1,292)
Change in expected credit losses and other credit impairment charges	N/A	(1,413,677)	(638,271)

Wholesale lending – Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers including loan commitments and financial guarantees at 31 December 2021

	Non-credit impaired				Credit impaired					
	Stage 1		Stage 2		Stage 3		POCI		Total	
	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
At 1 Jan 2021	**22,712,710**	**(78,788)**	**6,957,601**	**(185,915)**	**1,354,196**	**(909,054)**	**13,853**	**(1,499)**	**31,038,360**	**(1,175,256)**
Transfers of financial instruments	**4,720,649**	**(61,008)**	**(4,794,415)**	**64,570**	**73,766**	**(3,562)**	**—**	**—**	**—**	**—**
Net remeasurement of ECL arising from transfer of stage	**—**	**28,591**	**—**	**(14,584)**	**—**	**—**	**—**	**—**	**—**	**14,007**
Net new and further lending/ (repayments) and changes in risk parameters	**(212,698)**	**53,800**	**1,499,312**	**52,429**	**(183,487)**	**(28,526)**	**(8,651)**	**(167)**	**1,094,476**	**77,536**
Assets written off	**—**	**—**	**—**	**—**	**(188,625)**	**188,625**	**(167)**	**167**	**(188,792)**	**188,792**
Foreign exchange and others	**1,760**	**(18)**	**(850)**	**38**	**(534)**	**(159)**	**763**	**—**	**1,139**	**(139)**
Others	**—**	**214**	**—**	**5,141**	**—**	**(5,928)**	**—**	**—**	**—**	**(573)**
At 31 Dec 2021	**27,222,421**	**(57,209)**	**3,661,648**	**(78,321)**	**1,055,316**	**(758,604)**	**5,798**	**(1,499)**	**31,945,183**	**(895,633)**
ECL (charge)/release for the period	**—**	**82,391**	**—**	**37,845**	**—**	**(28,526)**	**—**	**(167)**	**—**	**91,543**
Recoveries	**—**	**—**	**—**	**—**	**—**	**4,940**	**—**	**—**	**—**	**4,940**
Others	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Total ECL (charge)/release for the period	**—**	**82,391**	**—**	**37,845**	**—**	**(23,586)**	**—**	**(167)**	**—**	**96,483**
At 1 Jan 2020	25,125,914	(52,210)	2,251,660	(50,977)	1,020,812	(673,930)	2,447	(1,493)	28,400,833	(778,610)
Transfers of financial instruments:	(7,434,239)	1,281	6,929,253	22,915	504,986	(24,196)	—	—	—	—
Net remeasurement of ECL arising from transfer of stage	—	12,931	—	(71,392)	—	(5,933)	—	—	—	(64,394)
Net new and further lending/ (repayments) and changes in risk parameters	5,107,903	(38,780)	(2,205,752)	(86,575)	(70,152)	(296,394)	11,759	—	2,843,758	(421,749)
Assets written off	—	—	—	—	(100,795)	100,795	(257)	257	(101,052)	101,052
Foreign exchange and others	(86,868)	79	(17,560)	259	(655)	573	—	—	(105,083)	911
Others	—	(2,089)		(145)	—	(9,969)	(96)	(263)	(96)	(12,466)
At 31 Dec 2020	22,712,710	(78,788)	6,957,601	(185,915)	1,354,196	(909,054)	13,853	(1,499)	31,038,360	(1,175,256)
ECL (charge)/release for the period	—	(25,849)	—	(157,967)	—	(302,327)	—	—	—	(486,143)
Recoveries	—	—	—	—	—	7,263	—	—	—	7,263
Others	—	—	—	—	—	923	—	—	—	923
Total ECL (charge)/release for the period	—	(25,849)	—	(157,967)	—	(294,141)	—	—	—	(477,957)

Personal lending – Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to customers including loan commitments and financial guarantees at 31 December 2021

	Non-credit impaired				Credit impaired			
	Stage 1		Stage 2		Stage 3		Total	
	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
At 1 Jan 2021	**4,806,426**	**(31,181)**	**296,694**	**(99,824)**	**158,109**	**(96,461)**	**5,261,229**	**(227,466)**
Transfers of financial instruments:	**144,156**	**(36,053)**	**(211,002)**	**77,108**	**66,846**	**(41,055)**	**—**	**—**
Net remeasurement of ECL arising from transfer of stage	**—**	**24,714**	**—**	**(3,505)**	**—**	**(121)**	**—**	**21,088**
Net new and further lending/(repayments) and changes in risk parameters	**166,956**	**7,646**	**67,226**	**(2,761)**	**(34,895)**	**(8,501)**	**199,287**	**(3,616)**
Assets written off	**—**	**—**	**—**	**—**	**(80,040)**	**80,040**	**(80,040)**	**80,040**
Foreign exchange and others	**2,172**	**(7)**	**(3)**	**1**	**50**	**(47)**	**2,219**	**(53)**
Others	**—**	**—**	**—**	**—**	**—**	**(57)**	**—**	**(57)**
At 31 Dec 2021	**5,119,710**	**(34,881)**	**152,915**	**(28,981)**	**110,070**	**(66,202)**	**5,382,695**	**(130,064)**
ECL (charge)/release for the period	**—**	**32,360**		**(6,266)**		**(8,622)**	**—**	**17,472**
Recoveries	**—**	**—**	**—**	**—**	**—**	**20,704**	**—**	**20,704**
Others	**—**	**—**	**—**	**—**	**—**	**(1)**	**—**	**(1)**
Total ECL (charge)/release for the period	**—**	**32,360**	**—**	**(6,266)**	**—**	**12,081**	**—**	**38,175**

Personal lending – Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to customers including loan commitments and financial guarantees at 31 December 2021(continued)

	Non-credit impaired				Credit impaired			
	Stage 1		Stage 2		Stage 3		Total	
	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
At 1 Jan 2020	5,524,806	(28,534)	168,854	(47,303)	194,095	(124,268)	5,887,755	(200,105)
Transfers of financial instruments:	(349,450)	(16,079)	244,841	71,960	104,609	(55,881)	—	—
Net remeasurement of ECL arising from transfer of stage	—	11,896	—	(22,038)	—	(280)	—	(10,422)
Net new and further lending/(repayments) and changes in risk parameters	(365,350)	1,534	(117,009)	(102,447)	(23,582)	(33,017)	(505,941)	(133,930)
Assets written off	—	—	—	—	(116,923)	116,923	(116,923)	116,923
Foreign exchange and others	(3,580)	2	8	4	(90)	85	(3,662)	91
Others	—	—	—	—	—	(23)	—	(23)
At 31 Dec 2020	4,806,426	(31,181)	296,694	(99,824)	158,109	(96,461)	5,261,229	(227,466)
ECL release/(charge) for the period	—	13,430		(124,485)		(33,296)	—	(144,351)
Recoveries	—	—	—	—	—	16,057	—	16,057
Others	—	—	—	—	—	(28)	—	(28)
Total ECL Charge for the period	—	13,430	—	(124,485)	—	(17,267)	—	(128,322)

Credit quality of financial instruments

The group assesses the credit quality of all financial instruments that are subject to credit risk. The credit quality of financial instruments is a point-in-time assessment of PD, whereas stages 1 and 2 are determined based on relative deterioration of credit quality since initial recognition. Accordingly, for non-credit-impaired financial instruments, there is no direct relationship between the credit quality assessment and stages 1 and 2, although typically the lower credit quality bands exhibit a higher proportion in stage 2.

The five credit quality classifications defined below each encompass a range of granular internal credit rating grades assigned to wholesale and personal lending businesses and the external ratings attributed by external agencies to debt securities.

Credit quality classification

	Debt securities and other bills	Wholesale lending	Retail lending
	External credit rating	Internal credit rating	Internal credit rating[2]
Quality classification			
Strong	**A– and above**	**CRR[1]1 to CRR2**	**Band 1 and 2**
Good	**BBB+ to BBB–**	**CRR3**	**Band 3**
Satisfactory	**BB+ to B and unrated**	**CRR4 to CRR5**	**Band 4 and 5**
Sub-standard	**B– to C**	**CRR6 to CRR8**	**Band 6**
Impaired	**Default**	**CRR9 to CRR10**	**Band 7**

1 *Customer risk rating.*
2 *12-month point-in-time probability weighted probability of default ('PD').*

Quality classification definitions

- 'Strong' exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss.
- 'Good' exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk.
- 'Satisfactory' exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk.
- 'Sub-standard' exposures require varying degrees of special attention and default risk is of greater concern.
- 'Impaired' exposures have been assessed as impaired. These also include retail accounts classified as Band 1 to Band 6 that are delinquent by more than 90 days, unless individually they have been assessed as not impaired; and renegotiated loans that have met the requirements to be disclosed as impaired and have not yet met the criteria to be returned to the unimpaired portfolio.

Risk rating scales

The customer risk rating ('CRR') 10-grade scale summarises a more granular underlying 23-grade scale of obligor probability of default ('PD'). All HSBC customers are rated using the 10- or 23-grade scale, depending on the degree of sophistication of the Basel approach adopted for the exposure.

Retail lending credit quality is disclosed based on a 12-month point-in-time probability weighted probability of default.

For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications. The ratings of Standard and Poor's are cited, with those of other agencies being treated equivalently. Debt securities with short-term issue ratings are reported against the long-term rating of the issuer of those securities. If major rating agencies have different ratings for the same debt securities, a prudent rating selection is made in line with regulatory requirements.

Distribution of financial instruments by credit quality at 31 December 2021

	Gross carrying/notional amount							
	Strong	Good	Satisfactory	Sub-Standard	Credit impaired	Total	Allowance for ECL	Net
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
In-scope for IFRS 9								
Loans and advances to customers held at amortised cost	**6,065,555**	**5,494,422**	**5,738,913**	**1,162,903**	**1,157,148**	**19,618,941**	**(995,160)**	**18,623,781**
Loans and advances to banks held at amortised cost	**6,546,636**	**467,918**	**795,984**	**32**	**—**	**7,810,570**	**(3,268)**	**7,807,302**
Cash and balances at central banks	**848,873**	**—**	**—**	**—**	**—**	**848,873**	**(402)**	**848,471**
Items in the course of collection from other banks	**53,900**	**—**	**—**	**—**	**—**	**53,900**	**—**	**53,900**
Reverse repurchase agreements – non-trading	**4,309,649**	**327,656**	**263,444**	**—**	**—**	**4,900,749**	**—**	**4,900,749**
Prepayments, accrued income and other assets	**72,453**	**143,079**	**441,444**	**28,088**	**6,175**	**691,239**	**(5,882)**	**685,357**
– endorsements and acceptances	**62,332**	**137,959**	**238,330**	**28,088**	**2,879**	**469,588**	**(2,580)**	**467,008**
– accrued income and other	**10,121**	**5,120**	**203,114**	**—**	**3,296**	**221,651**	**(3,302)**	**218,349**
Debt instruments measured at fair value through other comprehensive income	**9,310,519**	**—**	**1,593,767**	**—**	**—**	**10,904,286**	**(1,550)**	**10,902,736**
Out-of-scope for IFRS 9								
Trading assets	**667,586**	**61,472**	**377,124**	**—**	**—**	**1,106,182**	**—**	**1,106,182**
Derivatives	**978,193**	**59,290**	**32,040**	**—**	**633**	**1,070,156**	**—**	**1,070,156**
Total gross carrying amount on balance sheet	**28,853,364**	**6,553,837**	**9,242,716**	**1,191,023**	**1,163,956**	**47,004,896**	**(1,006,262)**	**45,998,634**
Percentage of total credit quality	**61%**	**14%**	**20%**	**3%**	**2%**	**100%**		**100%**
Loan and other credit related commitments	**3,530,040**	**2,527,768**	**1,430,960**	**65,861**	**1,081**	**7,555,710**	**(14,167)**	**7,541,543**
Financial guarantees	**1,855,658**	**199,356**	**259,031**	**19,956**	**8,656**	**2,342,657**	**(13,102)**	**2,329,555**
Total nominal amount off balance sheet	**5,385,698**	**2,727,124**	**1,689,991**	**85,817**	**9,737**	**9,898,367**	**(27,269)**	**9,871,098**
At 31 Dec 2021	**34,239,062**	**9,280,961**	**10,932,707**	**1,276,840**	**1,173,693**	**56,903,263**	**(1,033,531)**	**55,869,732**
In-scope for IFRS 9								
Loans and advances to customers held at amortised cost	4,970,054	7,054,849	6,463,458	744,851	1,463,189	20,696,401	(1,345,685)	19,350,716
Loans and advances to banks held at amortised cost	6,607,780	693,312	445,097	62	—	7,746,251	(3,827)	7,742,424
Cash and balances at central banks	1,241,854	—	—	—	—	1,241,854	(863)	1,240,991
Items in the course of collection from other banks	69,569	—	—	—	—	69,569	—	69,569
Reverse repurchase agreements – non-trading	1,537,394	42,967	248,490	—	—	1,828,851	—	1,828,851
Prepayments, accrued income and other assets	233,901	137,474	486,121	9,419	5,621	872,536	(7,334)	865,202
– endorsements and acceptances	148,053	127,919	327,070	9,419	1,560	614,021	(3,274)	610,747
– accrued income and other	85,848	9,555	159,051	—	4,061	258,515	(4,060)	254,455
Debt instruments measured at fair value through other comprehensive income	8,663,349	—	1,405,524	—	—	10,068,873	(2,758)	10,066,115
Out-of-scope for IFRS 9						—		
Trading assets	615,444	26,795	99,355	—	—	741,594	—	741,594
Derivatives	1,665,325	103,049	65,232	42,467	3,169	1,879,242	—	1,879,242
Total gross carrying amount on balance sheet	25,604,670	8,058,446	9,213,277	796,799	1,471,979	45,145,171	(1,360,467)	43,784,704
Percentage of total credit quality	57%	18%	20%	2%	3%	100%		100%
Loan and other credit related commitments	2,842,864	1,928,617	1,777,164	40,619	50,290	6,639,554	(36,535)	6,603,019
Financial guarantees	578,311	315,664	295,734	14,995	12,679	1,217,383	(16,675)	1,200,708
Total nominal amount off balance sheet	3,421,175	2,244,281	2,072,898	55,614	62,969	7,856,937	(53,210)	7,803,727
At 31 Dec 2020	29,025,845	10,302,727	11,286,175	852,413	1,534,948	53,002,108	(1,413,677)	51,588,431

Distribution of financial instruments to which the impairment requirements in IFRS 9 are applied, by credit quality and stage allocation at 31 December 2021

	Gross carrying/notional amount							
	Strong	Good	Satisfactory	Sub-standard	Credit impaired	Total	Allowance for ECL	Net
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Gross carrying amount on balance sheet	**27,207,585**	**6,433,075**	**8,833,552**	**1,191,023**	**1,163,323**	**44,828,558**	**(1,006,262)**	**43,822,296**
– stage 1	**26,873,705**	**5,983,352**	**7,164,440**	**289,816**	**—**	**40,311,313**	**(84,511)**	**40,226,802**
– stage 2	**333,880**	**449,723**	**1,669,112**	**896,908**	**—**	**3,349,623**	**(90,722)**	**3,258,901**
– stage 3	**—**	**—**	**—**	**—**	**1,161,824**	**1,161,824**	**(829,530)**	**332,294**
– POCI	**—**	**—**	**—**	**4,299**	**1,499**	**5,798**	**(1,499)**	**4,299**
Nominal amount off balance sheet	**5,385,698**	**2,727,124**	**1,689,991**	**85,817**	**9,737**	**9,898,367**	**(27,269)**	**9,871,098**
– stage 1	**5,204,278**	**2,619,382**	**1,445,072**	**49,312**	**—**	**9,318,044**	**(10,105)**	**9,307,939**
– stage 2	**181,420**	**107,742**	**244,919**	**36,505**	**—**	**570,586**	**(17,075)**	**553,511**
– stage 3	**—**	**—**	**—**	**—**	**9,737**	**9,737**	**(89)**	**9,648**
– POCI	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
At 31 Dec 2021	**32,593,283**	**9,160,199**	**10,523,543**	**1,276,840**	**1,173,060**	**54,726,925**	**(1,033,531)**	**53,693,394**
Gross carrying amount on balance sheet	23,323,901	7,928,602	9,048,690	754,332	1,468,810	42,524,335	(1,360,467)	41,163,868
– stage 1	22,222,779	6,013,985	6,458,145	227,371	—	34,922,280	(101,758)	34,820,522
– stage 2	1,101,122	1,914,617	2,590,545	526,961	—	6,133,245	(247,556)	5,885,689
– stage 3	—	—	—	—	1,454,957	1,454,957	(1,009,654)	445,303
– POCI	—	—	—	—	13,853	13,853	(1,499)	12,354
Nominal amount off balance sheet	3,421,175	2,244,281	2,072,898	55,614	62,969	7,856,937	(53,210)	7,803,727
– stage 1	3,150,343	1,855,047	1,539,923	13,365	—	6,558,678	(13,246)	6,545,432
– stage 2	270,832	389,234	532,975	42,249	—	1,235,290	(39,829)	1,195,461
– stage 3	—	—	—	—	62,969	62,969	(135)	62,834
– POCI	—	—	—	—	—	—	—	—
At 31 Dec 2020	26,745,076	10,172,883	11,121,588	809,946	1,531,779	50,381,272	(1,413,677)	48,967,595

Past due but not impaired gross financial instruments

Past due but not impaired gross financial instruments are those loans where, although customers have failed to make payments in accordance with the contractual terms of their facilities, they have not met the impaired loan criteria. This is typically when a loan is less than 90 days past due and there are no other indicators of impairment.

Further examples of exposures past due but not impaired include individually assessed mortgages that are in arrears more than 90 days, but there are no other indicators of impairment and the value of collateral is sufficient to repay both the principal debt and all potential interest for at least one year or short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation but there is no concern over the creditworthiness of the counterparty.

The following table provides an analysis of gross loans and advances to customers held at amortised cost which are past due but not considered impaired. There are no other significant balance sheet items where past due balances are not considered impaired.

Stage 2 days past due analysis

	Gross carrying amount			Allowance for ECL			ECL coverage %		
	Stage 2	1 to 29 DPD	30 and > DPD	Stage 2	1 to 29 DPD	30 and > DPD	Stage 2	1 to 29 DPD	30 and > DPD
	US$000	US$000	US$000	US$000	US$000	US$000	%	%	%
Loans and advances to customers held at amortised cost	**3,218,945**	**126,694**	**20,106**	**(90,051)**	**(6,312)**	**(7,092)**	**(2.8)**	**(5.0)**	**(35.3)**
– personal	**144,004**	**20,306**	**16,469**	**(28,988)**	**(4,265)**	**(6,970)**	**(20.1)**	**(21.0)**	**(42.3)**
– corporate and commercial	**3,067,801**	**106,388**	**3,637**	**(61,063)**	**(2,047)**	**(122)**	**(2.0)**	**(1.9)**	**(3.4)**
– non-bank financial institutions	**7,140**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Loans and advances to banks at amortised cost	**25,032**	**—**	**—**	**(175)**	**—**	**—**	**(0.7)**	**—**	**—**
Other financial assets measured at amortised cost	**105,646**	**—**	**—**	**(495)**	**—**	**—**	**(0.5)**	**—**	**—**
At 31 Dec 2021	**3,349,623**	**126,694**	**20,106**	**(90,721)**	**(6,312)**	**(7,092)**	**(2.7)**	**(5.0)**	**(35.3)**
Loans and advances to customers held at amortised cost	5,872,001	115,989	86,246	(244,803)	(10,267)	(22,477)	(4.2)	(8.9)	(26.1)
– personal	293,501	16,700	32,018	(99,828)	(8,237)	(17,140)	(34.0)	(49.3)	(53.5)
– corporate and commercial	5,509,911	99,289	54,228	(142,587)	(2,030)	(5,337)	(2.6)	(2.0)	(9.8)
– non-bank financial institutions	68,589	—	—	(2,388)	—	—	(3.5)	—	—
Loans and advances to banks at amortised cost	147,112	—	—	(1,110)	—	—	(0.8)	—	—
Other financial assets measured at amortised cost	114,132	—	—	(1,643)	—	—	(1.4)	—	—
At 31 Dec 2020	6,133,245	115,989	86,246	(247,556)	(10,267)	(22,477)	(4.0)	(8.9)	(26.1)

Impaired loans

Impaired and stage 3 loans and advances are those that meet any of the following criteria:

- Wholesale loans and advances classified as Customer Risk Rating ('CRR') 9 or CRR 10. These grades are assigned when the group considers that either the customer is unlikely to pay their credit obligations in full without recourse to security, or when the customer is more than 90 days past due on any material credit obligation to the group.
- Retail loans and advances classified as Band 10. These grades are typically assigned to retail loans and advances more than 90 days past due unless individually they have been assessed as not impaired.
- Renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet its contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

Renegotiated loans and forbearance

Where a loan is modified due to significant concerns about the borrower's ability to meet contractual payments when due, a range of forbearance strategies is employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default, foreclosure or repossession.

Identifying renegotiated loans

Loans are identified as renegotiated loans when the group modifies the contractual payment terms due to significant credit distress of the borrower. 'Forbearance' describes concessions made on the contractual terms of a loan in response to an obligor's financial difficulties. The group classifies and reports loans on which concessions have been granted under conditions of credit distress as 'renegotiated loans' when their contractual payment terms have been modified because the group has significant concerns about the borrowers' ability to meet contractual payments when due.

When considering modification terms, the borrower's continued ability to repay is assessed and where they are unrelated to payment arrangements, whilst potential indicators of impairment, these loans are not considered as renegotiated loans. Loans that have been identified as renegotiated retain this designation until maturity or derecognition. A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement is made on substantially different terms or if the terms of an existing agreement are modified such that the renegotiated loan is substantially a different financial instrument. Any new loans that arise following derecognition events will continue to be disclosed as renegotiated loans.

Credit Quality of Renegotiated Loans

Under IFRSs, an entity is required to assess whether there is objective evidence that financial assets are impaired at the end of each reporting period. A loan is impaired and an impairment allowance is recognised when there is objective evidence of a loss event that has an effect on the cash flows of the loan which can be reliably estimated.

When the group grants a concession to a customer that it would not otherwise consider, as a result of their financial difficulty, this is objective evidence of impairment and impairment losses are measured accordingly.

A renegotiated loan is presented as impaired when:

- there has been a change in contractual cash flows as a result of a concession which the lender would otherwise not consider, and;
- it is probable that without the concession, the borrower would be unable to meet contractual payment obligations in full.

This presentation applies unless the concession is insignificant and there are no other indicators of impairment.

The renegotiated loan will continue to be disclosed as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

Loans that have been identified as renegotiated retain this designation until maturity or derecognition. When a loan is restructured as part of a forbearance strategy and the restructuring results in derecognition of the existing loan, such as in some debt consolidations, the new loan is disclosed as renegotiated.

When determining whether a loan that is restructured should be derecognised and a new loan recognised, the group considers the extent to which the changes to the original contractual terms result in the renegotiated loan, considered as a whole, being a substantially different financial instrument.

Renegotiated loans and advances to customers by industry sector at 31 December 2021

	First lien residential mortgages	Other personal lending	Corporate and commercial	Non-bank financial institutions	Renegotiated loans
	US$000	US$000	US$000	US$000	US$000
Stage 1	**—**	**—**	**405**	**—**	**405**
Stage 2	**—**	**6**	**89,480**	**—**	**89,486**
Stage 3	**48,718**	**16,619**	**379,123**	**3,115**	**447,575**
Renegotiated loans At 31 Dec 2021	**48,718**	**16,625**	**469,008**	**3,115**	**537,466**
Allowance for expected credit losses on renegotiated loans					**318,596**
Stage 1	—	—	—	—	—
Stage 2	—	—	86,023	—	86,023
Stage 3	58,953	31,338	534,812	3,118	628,221
Renegotiated loans At 31 Dec 2020	58,953	31,338	620,835	3,118	714,244
Allowance for expected credit losses on renegotiated loans					428,782

For retail lending, unsecured renegotiated loans are generally segmented from other parts of the loan portfolio. Renegotiated expected credit loss assessments reflect the higher rates of losses typically encountered with renegotiated loans. For wholesale lending, renegotiated loans are typically assessed individually. Credit risk ratings are intrinsic to the impairment assessments. The individual impairment assessment takes into account the higher risk of the future non-payment inherent in renegotiated loans.

For details of our impairment policies on loans and advances and financial investments, see Note 2.2(i) on the Financial Statements.

Gross loans and advances to customers by industry sector

	Gross loans and advances to customers	
	Total	As a % of total gross loans
At 31 Dec 2021	**US$000**	**%**
Personal		
– residential mortgages	**1,952,556**	**10.0**
– other personal	**1,625,337**	**8.2**
	3,577,893	**18.2**
Corporate and commercial		
– commercial, industrial and international trade	**8,859,072**	**45.2**
– commercial real estate and other property-related	**2,554,613**	**13.0**
– government	**2,004,280**	**10.2**
– other corporate and commercial	**2,430,994**	**12.4**
	15,848,959	**80.8**
Financial		
– non-bank financial institutions	**192,089**	**1.0**
Total gross loans and advances to customers	**19,618,941**	**100.0**
Impaired loans		
– as a percentage of gross loans and advances to customers	**5.92%**	
Total impairment allowances		
– as a percentage of gross loans and advances to customers	**5.08%**	
At 31 Dec 2020		
Personal		
– residential mortgages	1,868,782	9.0
– other personal	1,500,795	7.3
	3,369,577	16.3
Corporate and commercial		
– commercial, industrial and international trade	9,849,848	47.6
– commercial real estate and other property-related	2,645,608	12.8
– government	1,342,671	6.5
– other corporate and commercial	3,315,512	16.0
	17,153,639	82.9
Financial		
– non-bank financial institutions	173,185	0.8
Total gross loans and advances to customers	20,696,401	100.0
Impaired loans		
– as a percentage of gross loans and advances to customers	7.07%	
Total impairment allowances		
– as a percentage of gross loans and advances to customers	6.50%	

Collateral and other credit enhancements held

Loans and advances held at amortised cost

Although collateral can be an important mitigant of credit risk, it is the group's practice to lend on the basis of the customer's ability to meet their obligations out of cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided without security. However, for other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of default, the group may utilise the collateral as a source of repayment. Depending on its form, collateral can have a significant financial effect in mitigating the group's exposure to credit risk.

The tables below provide a quantification of the value of fixed charges the group holds over specific asset (or assets) where the group has a history of enforcing, and are able to enforce, the collateral in satisfying a debt in the event of the borrower failing to meet its contractual obligations, and where the collateral is cash or can be realised by sale in an established market. The collateral valuation in the tables below excludes any adjustments for obtaining and selling the collateral.

The group may also manage its risk by employing other types of collateral and credit risk enhancements, such as second charges, other liens and unsupported guarantees, but the valuation of such mitigants is less certain and their financial effect has not been quantified. In particular, loans shown in the tables below as not collateralised or partially collateralised may benefit from such credit mitigants.

Personal lending: residential mortgage loans including loan commitments by level of collateral at 31 December

	Gross carrying/nominal amount	
	2021	2020
	US$000	US$000
Stage 1		
Fully collateralised	**1,818,335**	1,671,087
LTV ratio:		
– less than 50%	**493,851**	233,170
– 51% to 60%	**499,712**	215,159
– 61% to 70%	**492,791**	306,627
– 71% to 80%	**257,165**	493,890
– 81% to 90%	**57,835**	325,051
– 91% to 100%	**16,981**	97,190
Partially collateralised (A):	**14,689**	46,885
LTV ratio:		
– 101% to 110%	**4,932**	25,126
– 111% to 120%	**3,442**	6,292
– greater than 120%	**6,315**	15,467
– *collateral value on A*	***13,032***	*39,806*
Total	**1,833,024**	1,717,972
Stage 2		
Fully collateralised	**61,906**	56,765
LTV ratio:		
– less than 50%	**22,630**	10,794
– 51% to 60%	**15,797**	1,564
– 61% to 70%	**15,390**	10,815
– 71% to 80%	**2,856**	23,436
– 81% to 90%	**3,855**	7,527
– 91% to 100%	**1,378**	2,629
Partially collateralised (B):	**3,380**	9,102
LTV ratio:		
– 101% to 110%	**343**	1,685
– 111% to 120%	**3,007**	177
– greater than 120%	**30**	7,240
– *collateral value on B*	***2,114***	*6,547*
Total	**65,286**	65,867
Stage 3		
Fully collateralised	**45,507**	45,116
LTV ratio:		
– less than 50%	**10,801**	9,624
– 51% to 60%	**3,272**	2,153
– 61% to 70%	**7,938**	6,107
– 71% to 80%	**11,006**	9,991
– 81% to 90%	**5,925**	8,469
– 91% to 100%	**6,565**	8,772
Partially collateralised (C):	**8,739**	39,827
LTV ratio:		
– 101% to 110%	**2,996**	5,494
– 111% to 120%	**886**	10,052
– greater than 120%	**4,857**	24,281
– *collateral value on C*	***5,249***	*31,779*
Total	**54,246**	84,943
At 31 Dec	**1,952,556**	1,868,782

The above table shows residential mortgage lending including off-balance sheet loan commitments by level of collateral. The collateral included in the table above consists of first charges on real estate.

The LTV ratio is calculated as the gross on balance sheet carrying amount of the loan and any off-balance sheet loan commitment at the balance sheet date divided by the value of collateral. The methodologies for obtaining residential property collateral values vary, but are typically determined through a combination of professional appraisals, house price indices or statistical analysis. Valuations must be updated on a regular basis and, as a minimum, at intervals of every three years.

Other personal lending

The other personal lending consists primarily of motor vehicle, credit cards, personal loans, margin lending and overdrafts. Motor vehicle lending is generally collateralised by the motor vehicle financed and margin lending is backed by the relevant marketable security. Credit cards, personal loans and overdrafts are unsecured.

Collateral on loans and advances

Commercial real estate loans and advances

Collateral held is analysed separately below for commercial real estate and for other corporate, commercial and financial (non-bank) lending. The analysis includes off-balance sheet loan commitments, primarily undrawn credit lines.

Wholesale lending: commercial real estate loans and advances including loan commitments by level of collateral at 31 December

	Gross carrying/nominal amount	
	2021	2020[1]
	US$000	US$000
Stage 1		
Not collateralised	**516,922**	863,578
Fully collateralised	**164,841**	283,380
LTV ratio:		
– less than 50%	**2,744**	25,418
– 51% to 75%	**–**	73,540
– 76% to 90%	**40,114**	137,925
– 91% to 100%	**121,983**	46,497
Partially collateralised (A):	**183,138**	172,419
– *collateral value on A*	***100,269***	*103,926*
Total	**864,901**	1,319,377
Stage 2		
Not collateralised	**466,011**	441,998
Fully collateralised	**153,472**	67,933
LTV ratio:		
– less than 50%	**80,432**	67,933
– 51% to 75%	**69,850**	–
– 76% to 90%	**239**	–
– 91% to 100%	**2,951**	–
Partially collateralised (B):	**176,082**	–
– *collateral value on B*	***133,043***	–
Total	**795,565**	509,931
Stage 3		
Not collateralised	**30,747**	30,718
Fully collateralised	**141,051**	5,968
LTV ratio:		
– less than 50%	**–**	5,968
– 51% to 75%	**5,974**	–
– 76% to 90%	**38,607**	–
– 91% to 100%	**96,470**	–
Partially collateralised (C):	**–**	212,096
– *collateral value on C*	**–**	*157,916*
Total	**171,798**	248,782
At 31 Dec	**1,832,264**	2,078,090

1 *Certain prior year line items amounting to US$112m have been updated to reflect the correct classification.*

The collateral included in the table above consists of fixed first charges on real estate and charges over cash for commercial real estate. These facilities are disclosed as not collateralised if they are unsecured or benefit from credit risk mitigation from guarantees, which are not quantified for the purposes of this disclosure.

The value of commercial real estate collateral is determined through a combination of professional and internal valuations and physical inspection. Due to the complexity of valuing collateral for commercial real estate, local valuation policies determine the frequency of review based on local market conditions. Revaluations are sought with greater frequency when, as part of the regular credit assessment of the obligor, material concerns arise in relation to the transaction which may reflect on the underlying performance of the collateral, or in circumstances where an obligor's credit quality has declined sufficiently to cause concern that the principal payment source may not fully meet the obligation (i.e. the obligor's credit quality classification indicates it is at the lower end, that is sub-standard, or approaching impaired). Where such concerns exist the revaluation method selected will depend upon the loan-to-value relationship, the direction in which the local commercial real estate market has moved since the last valuation and, most importantly, the specific characteristics of the underlying commercial real estate which is of concern.

Other corporate, commercial and financial (non-bank) lending is analysed separately below reflecting the difference in collateral held on the portfolios. For financing activities in corporate and commercial lending that are not predominantly commercial real estate-oriented, collateral value is not strongly correlated to principal repayment performance. Collateral values are generally refreshed when an obligor's general credit performance deteriorates and we have to assess the likely performance of secondary sources of repayment should it prove necessary to rely on them.

Wholesale lending: other corporate, commercial and financial (non-bank) loans and advances including loan commitments by level of collateral by stage at 31 December

	Gross carrying/nominal amount	
	2021	2020[1]
	US$000	US$000
Stage 1		
Not collateralised	**22,205,850**	19,534,945
Fully collateralised	**715,125**	251,843
LTV ratio:		
– less than 50%	**171,758**	31,964
– 51% to 75%	**32,356**	70,677
– 76% to 90%	**95,317**	127,311
– 91% to 100%	**415,694**	21,891
Partially collateralised (A):	**1,084,136**	1,891,630
– *collateral value on A*	***226,007***	*587,047*
Total	**24,005,111**	21,678,418
Stage 2		
Not collateralised	**4,159,170**	5,736,832
Fully collateralised	**185,925**	319,232
LTV ratio:		
– less than 50%	**8,299**	244,105
– 51% to 75%	**80,637**	51,142
– 76% to 90%	**17,452**	20,425
– 91% to 100%	**79,537**	3,560
Partially collateralised (B):	**577,741**	1,013,860
– *collateral value on B*	***301,943***	*287,537*
Total	**4,922,836**	7,069,924
Stage 3		
Not collateralised	**696,785**	734,905
Fully collateralised	**26,517**	99,567
LTV ratio:		
– less than 50%	**1,658**	9,148
– 51% to 75%	**2**	2,590
– 76% to 90%	**2,689**	2,584
– 91% to 100%	**22,168**	85,245
Partially collateralised (C):	**222,540**	285,261
– *collateral value on C*	***68,538***	*85,551*
Total	**945,842**	1,119,733
POCI		
Not collateralised	**1,499**	–
Fully collateralised	**4,299**	13,853
LTV ratio:		–
– 91% to 100%	**4,299**	13,853
Partially collateralised (C):	**–**	–
– *collateral value on C*	**–**	–
Total	**5,798**	13,853
At 31 Dec	**29,879,587**	29,881,928

1 *Certain prior year line items amounting to US$536m have been updated to reflect the correct classification.*

Other credit risk exposures

In addition to collateralised lending described above, other credit enhancements are employed and methods used to mitigate credit risk arising from financial assets. These are described in more detail below.

Securities issued by governments, banks and other financial institutions may benefit from additional credit enhancement, notably through government guarantees that reference these assets.

The group's maximum exposure to credit risk includes financial guarantees and similar arrangements that the group issues or enters into, and loan commitments that the group are irrevocably committed to. Depending on the terms of the arrangement, the group may have recourse to additional credit mitigation in the event that a guarantee is called upon or a loan commitment is drawn and subsequently defaults.

Derivatives

The International Swaps and Derivatives Association ('ISDA') Master Agreement is our preferred agreement for documenting derivatives activity. It provides the contractual framework within which dealing activity across a full range of over-the-counter ('OTC') products is conducted, and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or another pre-agreed termination event occurs. It is common, and our preferred practice, for the parties to execute a Credit Support Annex ('CSA') in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between the parties to mitigate the counterparty risk inherent in outstanding positions.

Treasury Risk

Overview

Treasury risk is the risk of having insufficient capital, liquidity or funding resources to meet financial obligations and satisfy regulatory requirements. Treasury risk also includes the risk to our earnings or capital due to non-trading book foreign exchange exposures and changes in market interest rates. Treasury risk arises from changes to the respective resources and risk profiles driven by customer behaviour, management decisions or the external environment.

Approach and policy

Our objective in the management of treasury risk is to maintain appropriate levels of capital, liquidity, funding, foreign exchange and market risk to support our business strategy, and meet our regulatory and stress testing-related requirements. Our approach to treasury management is driven by our strategic and organisational requirements, taking into account the regulatory, economic and commercial environment. We aim to maintain a strong capital and liquidity base to support the risks inherent in our business and invest in accordance with our strategy, meeting both consolidated and local regulatory requirements at all times.

Our policy is underpinned by our risk management framework, our internal capital adequacy assessment process ('ICAAP') and our internal liquidity adequacy assessment process ('ILAAP'). The risk framework incorporates a number of measures aligned to our assessment of risks for both internal and regulatory purposes. These risks include credit, market, operational, non trading book foreign exchange risk, and interest rate risk in the banking book.

Capital risk, liquidity risk, interest rate risk in the banking book and non-trading book foreign exchange risk are the responsibility of the Risk Committee ('RC'). The Treasury function actively manages these risks on an ongoing basis, supported by the Asset and Liability Management Committee ('ALCO'), overseen by Treasury Risk Management and the Risk Management Meeting ('RMM').

Assessment and risk appetite

Our capital management policy is underpinned by a global capital management framework and our ICAAP. The framework incorporates key capital risk appetites for CET1 and total capital. The ICAAP is an assessment of our capital position, outlining regulatory capital resources and requirements resulting from our business model, strategy, risk profile and management, performance and planning, risks to capital, and the implications of stress testing. Our assessment of capital adequacy is driven by an assessment of risks. These risks include credit, market, operational, structural foreign exchange, interest rate risk in the banking book and credit concentration risk. The ICAAP supports the determination of the consolidated capital risk appetite and target ratios, as well as enables the assessment and determination of capital requirements by regulators.

We aim to ensure that management has oversight of our liquidity and funding risks by maintaining comprehensive policies, metrics and controls. We meet internal minimum requirements and any applicable regulatory requirements at all times. These requirements are assessed through the ILAAP, which ensures that operating entities have robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of liquidity risk over an appropriate set of time horizons, including intra-day. The ILAAP informs the validation of risk tolerance and the setting of risk appetite. It also assesses the capability to manage liquidity and funding effectively. These metrics are set and managed locally but are subject to robust global review and challenge to ensure consistency of approach and application of the Group's policies and controls.

Stress testing and recovery planning

We use stress testing to evaluate the robustness of plans and risk portfolios. Stress testing also informs the ICAAP and ILAAP and supports recovery planning. It is an important output used to evaluate how much capital and liquidity we require in setting risk appetite for capital and liquidity risk. It is also used to re-evaluate business plans where analysis shows capital, liquidity and/or returns do not meet their target.

Risks to capital and liquidity

Outside the stress testing framework, other risks may be identified that have the potential to affect our RWAs, capital and/or liquidity position. Downside and upside scenarios are assessed against our management objectives, and mitigating actions are assigned as necessary. We closely monitor future regulatory changes and continue to evaluate the impact of these upon our capital and liquidity requirements.

Liquidity and Funding

Overview

At 31 December 2021, we were above regulatory minimum liquidity and funding levels. We maintain sufficient unencumbered liquid assets to comply with local and regulatory requirements. We further enhanced our liquidity framework in 2021 to include an internal liquidity metric, which is being used to monitor and manage liquidity risk via a low-point measure across a 270-day horizon, taking into account recovery capacity.

Contingency planning

We maintain a contingency plan which can be enacted in the event of internal or external triggers which threaten the liquidity or funding position. We also have a recovery plan addressing the actions that management would consider taking in a stress scenario if the position deteriorates and threatens to breach risk appetite and regulatory minimum levels. The recovery plan sets out a range of appropriate actions which could feasibly be executed in a stressed environment to recover the position.

Management of Liquidity and Funding Risk

Liquidity coverage ratio ('LCR')

The LCR aims to ensure that a bank has sufficient unencumbered high-quality liquid assets to meet its liquidity needs in a 30 calendar day liquidity stress scenario. For the calculation of the LCR, HSBC Group follows the guidelines set by the European Commission and we follow the Dubai Financial Services Authority ('DFSA') approach.

Net stable funding ratio ('NSFR')

HSBC Group's internal liquidity and funding risk management framework requires all entities to use the net stable funding ratio ('NSFR') as a basis for ensuring operating entities raise sufficient stable funding to support their business activities. The NSFR requires institutions to maintain minimum amount of stable funding based on assumptions of asset liquidity.

Depositor concentration and wholesale market term funding maturity concentration

The LCR and NSFR metrics assume a stressed outflow based on a portfolio of depositors within each deposit segment. The validity of these assumptions is challenged if the portfolio of depositors is not large enough to avoid depositor concentration. Operating entities are exposed to term re-financing concentration risk if the current maturity profile results in future maturities being overly concentrated in any defined period.

The group monitors depositor concentration and term funding maturity concentration. Both metrics are subject to limits.

Liquid assets

Liquid assets are held and managed on a stand-alone operating entity basis. Most are held directly by the Markets Treasury department, primarily for the purpose of managing liquidity risk in line with the internal policy.

Liquid assets also include any unencumbered liquid assets held outside Markets Treasury departments for any other purpose. The internal framework gives ultimate control of all unencumbered assets and sources of liquidity to Markets Treasury.

Further details in respect of the group's Liquidity and Funding ratios are set out on page 74 of the *Annual Report and Accounts 2021*.

Primary sources of funding

Our primary sources of funding are customer current accounts and savings deposits payable on demand or at short notice. We issue unsecured wholesale securities to supplement customer deposits and to change the currency mix, maturity profile or location of our liabilities.

Ordinary share capital and retained reserves, non-core capital instruments and intergroup borrowings are also a source of stable funding.

Customer deposits in the form of current accounts and savings deposits payable on demand or at short notice form a significant part of our funding, and the group places considerable importance on maintaining their stability. For deposits, stability depends upon maintaining depositor confidence in our capital strength and liquidity, and on competitive and transparent pricing.

Of total liabilities of US$41,512m at 31 December 2021, funding from customers amounted to US$27,010m, of which US$26,888m was contractually repayable within one year.

An analysis of cash flows payable by the group under financial liabilities by remaining contractual maturities at the balance sheet date is included in Note 26.

Assets available to meet these liabilities, and to cover outstanding commitments to lend (US$18,330m), included cash, central bank balances, items in the course of collection and treasury and other bills (US$7,917m); loans to banks (US$7,808m, including US$6,896m repayable within one year); and loans to customers (US$18,623m, including US$7,739m repayable within one year). In the normal course of business, a proportion of customer loans contractually repayable within one year will be extended.

Ordinary share capital and retained reserves, non-core capital instruments and intergroup borrowings are also a source of stable funding.

Market risk

Market risk management

Market risk is the risk that movements in market factors, such as foreign exchange rates, interest rates, credit spreads, equity prices and commodity prices, will reduce our income or the value of our portfolios.

The group's exposure to market risk is separated into trading or non-trading portfolios. Trading portfolios comprise positions arising from market-making and warehousing of customer-derived positions. Non-trading portfolios include positions that primarily arise from the interest rate management of the group's retail and commercial banking assets and liabilities and financial investments designated as fair value through other comprehensive income.

Market risk measures

Monitoring and limiting market risk exposures

The group's objective is to manage and control market risk exposures while maintaining a market profile consistent with the group's risk appetite. The group uses a range of tools to monitor and limit market risk exposures, including:

- sensitivity measures include sensitivity of net interest income and sensitivity for structural foreign exchange, which are used to monitor the market risk positions within each risk type;
- value at risk ('VaR') is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence; and
- in recognition of VaR's limitations the group augments VaR with stress testing to evaluate the potential impact on portfolio values of more extreme, though plausible, events or movements in a set of financial variables.

Market risk is managed and controlled through limits approved by the Risk Management Meeting for HSBC Holdings and our various global businesses. These limits are allocated across business lines and to the HSBC Group's legal entities.

The management of market risk is principally undertaken in Markets and Security Services ('MSS'). VaR limits are set for portfolios, business line, products and risk types, with market liquidity being a primary factor in determining the level of limits set.

HSBC Group Risk, an independent unit within HSBC Group, is responsible for our market risk management policies and measurement techniques. The group has an independent market risk management and control function that is responsible for measuring market risk exposures in accordance with the policies defined by HSBC Group Risk, and monitoring and reporting these exposures against the prescribed limits on a daily basis. The group assesses the market risks arising on each product in its business and to transfer them to either its MSS unit for management, or to separate books managed under the supervision of the local ALCO. Our aim is to ensure that all market risks are consolidated within operations that have the necessary skills, tools, management and governance to manage them professionally. In certain cases where the market risks cannot be fully transferred, the group identifies the impact of varying scenarios on valuations or on net interest income resulting from any residual risk positions.

Sensitivity analysis

Sensitivity analysis measures the impact of individual market factor movements on specific instruments or portfolios, including interest rates, foreign exchange rates and equity prices, such as the effect of a one basis point change in yield. We use sensitivity measures to monitor the market risk positions within each risk type. Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

Value at risk

Value at risk ('VaR') is a technique that estimates the potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence.

The VaR models used by the group are predominantly based on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates, such as interest rates and foreign exchange rates. The models also incorporate the effect of option features on the underlying exposures. The historical simulation models assess potential market movements with reference to data from the past two years and calculate VaR to a 99% confidence level and for a one-day holding period.

The group routinely validates the accuracy of its VaR models by back-testing the actual daily profit and loss results, adjusted to remove non-modelled items such as fees and commissions, against the corresponding VAR numbers. Statistically, the group would expect to see losses in excess of VaR only 1% of the time over a one-year period. The actual number of excesses over this period can therefore be used to gauge how well the models are performing.

Although a valuable guide to risk, VaR should always be viewed in the context of its limitations:

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

Trading and non-trading portfolio

The following table provides an overview of the reporting of the risks within this section:

	Portfolio	
	Trading	**Non-trading**
Risk type		
Foreign exchange and commodity[1]	**VaR**	**VaR**
Interest rate	**VaR**	**VaR**
Credit spread	**VaR**	**VaR**

1 *The reporting of commodity risk is consolidated with foreign exchange risk and is not applicable to non-trading portfolios.*

Value at risk of the trading and non-trading portfolio

The group VaR, both trading and non-trading, is below:

Value at risk

	2021	2020
	US$000	US$000
At 31 Dec	**3,881**	2,738
Average	**4,070**	3,525
Maximum	**6,097**	6,401
Minimum	**2,171**	2,162

Trading portfolios

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

Market-making and position-taking is undertaken within MSS. The VaR for such trading intent activity at 31 December 2021 was US$1.6m (2020: US$2.76m).

VaR by risk type for the trading intent activities

	Foreign exchange (FX) US$000	Interest rate US$000	Credit spread US$000	Total US$000
At 31 Dec 2021[1]	**378**	**1,501**	**517**	**1,595**
Average	**990**	**2,667**	**580**	**2,931**
Maximum	**2,102**	**5,038**	**1,733**	**5,261**
Minimum	**252**	**1,367**	**211**	**1,546**
At 31 Dec 2020	244	2,294	495	2,756
Average	635	2,480	529	2,678
Maximum	2,315	4,058	2,836	4,390
Minimum	191	1,501	115	1,610

1 *The total VaR is non-additive across risk types due to diversification effects.*

Non-trading portfolios

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

Interest rate risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas, such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts, and the re-pricing behaviour of managed rate products.

The control of market risk in the non-trading portfolios is based on transferring the risks to the books managed by MSS and Markets Treasury ('MKTY') or the local ALCO. The net exposure is typically managed through the use of interest rate swaps within agreed limits. The VaR for these portfolios is included within the group VaR.

VaR by risk type for the non-trading activities

	Interest rate US$000	Credit spread US$000	Total US$000
At 31 Dec 2021	**3,273**	**649**	**3,409**
Average	**3,039**	**956**	**3,213**
Maximum	**4,852**	**1,649**	**5,151**
Minimum	**1,383**	**469**	**2,106**
At 31 Dec 2020	1,731	1,461	2,795
Average	1,898	2,073	2,827
Maximum	3,260	5,248	4,931
Minimum	1,235	333	1,532

Gap risk

A gap event is a significant and sudden change in market price with no accompanying trading opportunity. Such movements may occur, for example, when, in reaction to an adverse event or unexpected news announcement, some parts of the market move far beyond their normal volatility range and become temporarily illiquid.

Given the characteristics, these transactions will not have significant impact on VaR or to market risk sensitivity measures. The group captures the risks for such transactions within the stress testing scenarios and monitors gap risk on an ongoing basis.

The group incurred no material losses (2020: nil) arising from gap risk movements in the underlying market price on such transactions in the 12 months ended 31 December 2021.

De-peg risk

For certain currencies (pegged or managed) the spot exchange rate is pegged at a fixed rate (typically to USD), or managed within a predefined band around a pegged rate. De-peg risk is the risk of the peg or managed band changing or being abolished, and moving to a floating regime.

Using stressed scenarios on spot rates, the group is able to analyse how de-peg events would impact the positions held by the group. This complements traditional market risk metrics, such as historical VaR, which may not fully capture the risk involved in holding positions in pegged currencies. Historical VaR relies on past events to determine the likelihood of potential profits or losses. However, pegged or managed currencies may not have experienced a de-peg event during the historical timeframe being considered.

Structural foreign exchange exposures

Structural foreign exchange exposures represent net investments in subsidiaries, branches or associates, the functional currencies of which are currencies other than the US dollar. An entity's functional currency is the currency of the primary economic environment in which the entity operates.

Exchange differences on structural exposures are recorded in 'Other comprehensive income'. The main operating currencies of the group are UAE dirham and other Gulf currencies that are linked to the US dollar.

The group's policy is to hedge structural foreign currency exposures only in limited circumstances. The group's structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that the group's capital ratio is protected from the effect of changes in exchange rates. This is usually achieved by ensuring that the rates of structural exposures in a given currency to risk-weighted assets denominated in that currency is broadly equal to the capital ratio. The group considers hedging structural foreign currency exposures only in limited circumstances to protect the capital ratio or the US dollar value of capital invested. Such hedging would be undertaken using forward foreign exchange contracts or by financing the borrowings in the same currencies as the functional currencies involved.

Net interest income sensitivity

A principal part of the group's management of market risk in non-trading portfolios is monitoring the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). The group aims, through our management of market risk in non-trading portfolios, to mitigate the impact of prospective interest rate movements which could reduce future net interest income, while balancing the cost of hedging such activities on the current net revenue stream.

For simulation modelling, businesses use a combination of scenarios relevant to their local businesses and markets and standard scenarios which are required throughout the HSBC Group. The latter are consolidated to illustrate the combined pro forma effect on the group's consolidated portfolio valuations and net interest income.

Projected net interest income sensitivity figures represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and the group's current interest rate risk profile. This effect, however, does not incorporate actions which would probably be taken by MSS or in the business units to mitigate the effect of interest rate risk. In reality, MSS seeks proactively to change the interest rate risk profile to minimise losses and optimise net revenues. The projections also assume that interest rates of all maturities move by the same amount (although rates are not assumed to become negative in the falling rates scenario) and, therefore, do not reflect the potential impact on net interest income of some rates changing while others remain unchanged. In addition, the projections take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates linked to other bases (such as Central Bank rates or product rates over which the entity has discretion in terms of the timing and extent of rate changes). The projections make other simplifying assumptions, including that all positions run to maturity.

Defined benefit pension scheme

Market risk also arises within the group's defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows.

Capital management

The Dubai Financial Services Authority ('DFSA') is the lead regulator of the bank.

The bank's objective is to ensure that capital resources are at all times adequate and efficiently used. This implies assessing the bank's capital demand and maintaining the capital supply at the required level. The bank's approach to capital management is driven by strategic and organisational requirements, taking into account the regulatory, economic and commercial environment in which it operates in. The bank's policy on capital management is underpinned by a capital management process and the internal capital adequacy assessment process, which enables it to manage its capital in a consistent manner.

The DFSA supervises the bank and, receives information on the capital adequacy of, and sets capital requirements for, the bank. Individual branches and subsidiaries are directly regulated by their local banking supervisors, where applicable, who set and monitor their capital adequacy requirements.

Further details in respect of the group's Capital requirement are set out on page 76 of the *Annual Report and Accounts 2021.*

32 Contingent liabilities, contractual commitments and guarantees

	2021	2020
	US$000	US$000
Guarantees and other contingent liabilities		
Guarantees	**17,248,568**	16,459,976
Commitments		
Documentary credits and short-term trade-related transactions	**510,891**	632,218
Undrawn formal standby facilities, credit lines and other commitments to lend	**17,819,455**	16,398,052
At 31 Dec	**18,330,346**	17,030,270

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

Included in the above are the following contingent liabilities on account of other members of the HSBC Group:

	2021	2020
	US$000	US$000
Guarantees and assets pledged by the bank as collateral security	**3,988,589**	2,908,969
Documentary credits and short-term trade-related transactions	**133,902**	179,355
At 31 Dec	**4,122,491**	3,088,324

Guarantees

The group provides guarantees and similar undertakings on behalf of both third-party customers and other entities within the group. These guarantees are generally provided in the normal course of the group's banking business. The principal types of guarantees provided, and the maximum potential amount of future payments which the group could be required to make at 31 December were as follows:

	2021		2020	
	Guarantees in favour of third parties	**Guarantees by the group in favour of other HSBC Group entities**	Guarantees in favour of third parties	Guarantees by the group in favour of other HSBC Group entities
	US$000	**US$000**	US$000	US$000
Financial guarantees[1]	**762,757**	**1,579,900**	923,313	294,070
Credit-related guarantees[2]	**3,740,578**	**674,202**	4,206,464	793,415
Other guarantees	**8,756,644**	**1,734,487**	8,421,229	1,821,485
At 31 Dec	**13,259,979**	**3,988,589**	13,551,006	2,908,970

1 *Financial guarantees are contracts that require the issuer to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due.*

2 *Credit-related guarantees are contracts that have similar features to financial guarantee contracts. The amounts disclosed in the above table are nominal principal amounts and reflect the group's maximum exposure under a large number of individual guarantee undertakings. The risks and exposures arising from guarantees are captured and managed in accordance with the group's overall credit risk management policies and procedures. Guarantees with terms of more than one year are subject to the group's annual credit review process.*

Other commitments

In addition to the commitments disclosed above, at 31 December 2021 the group had no capital commitments to purchase, within one year, land and building and other fixed assets (2020: nil).

Associates

The group and its operations are contingently liable with respect to lawsuits and other matters that arise in the normal course of business. Management is of the opinion that the eventual outcome of the legal and financial liability is not expected to materially affect the group's financial position and operations.

33 Finance lease receivables

The group leases a variety of assets to third parties under finance leases, including transport assets (such as aircraft). At the end of lease terms, assets may be sold to third parties or leased for further terms. Rentals are calculated to recover the cost of assets less their residual value, and earn finance income.

	2021			2020		
	Total future minimum payments	**Unearned finance income**	**Present value**	Total future minimum payments	Unearned finance income	Present value
	US$000	**US$000**	**US$000**	US$000	US$000	US$000
Lease receivables:						
– no later than one year	**8,183**	**(1,350)**	**6,833**	25,049	(1,582)	23,467
– later than one year and no later than five years	**42,736**	**(3,353)**	**39,383**	43,648	(4,847)	38,801
– later than five years	**4,092**	**(204)**	**3,888**	11,352	(406)	10,946
At 31 Dec	**55,011**	**(4,907)**	**50,104**	80,049	(6,835)	73,214

34 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 these matters are material. The recognition of provisions is determined in accordance with the accounting policies set out in Note 2 of the group's *Annual Report and Accounts 2021*. 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 31 December 2021. Where an individual provision is material, the fact that a provision has been made is stated and quantified, except to the extent 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

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

In December 2012, among other agreements, 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 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 Holdings agreed to retain an independent compliance monitor to produce annual assessments of the Group's AML and sanctions compliance programme. In 2020, HSBC Holding's engagement with the independent compliance monitor, acting in his roles as both Skilled Person and Independent Consultant, concluded. The role of FCA Skilled Person was assigned to a new individual in the second quarter of 2020. Separately, in early 2021, a new FRB Independent Consultant was appointed pursuant to the cease-and-desist order.

US Anti-Terrorism Act Related Litigation

Since November 2014, a number of lawsuits have been filed in federal courts in the US against various HSBC companies including HSBC Bank Middle East Limited 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, eight actions that include HSBC Bank Middle East Limited remain pending in federal courts in New York or the District of Columbia. The courts have granted HSBC's motions to dismiss in several of the cases, however appeals remain pending in one case, and another is also subject to appeal. The remaining actions are at a very early stage.

Foreign exchange rate investigations and litigation

Various regulators and competition authorities around the world are conducting investigations and reviews into trading by HSBC and others on the foreign exchange markets. HSBC is cooperating with these investigations and reviews several of which are ongoing and settlements relevant to the group are detailed below.

In January 2018, following the conclusion of the US Department of Justice's ('DoJ') investigation into HSBC's historical foreign exchange activities, 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. In January 2021, the FX DPA expired and, in August 2021, the charges deferred by the FX DPA were dismissed.

In December 2021, the EC issued a settlement decision finding that a number of banks, including HSBC, engaged in anti-competitive practices in an online chatroom between 2011 and 2012 in the foreign exchange spot market. The EC imposed a EUR 174.3m fine on HSBC in connection with this matter.

Other litigation

In 2019, the group was included as a defendant in a US$30m claim filed before the Courts of the United Arab Emirates against other joint defendants for the provision of banking information and documents only. The plaintiff later amended the claim to include the group as a defendant to the monetary claims already filed against the other co-defendants. Two additional parties were joined to the proceedings in January 2020, and a further party joined the proceedings as an intervener following the issuance of an expert's report.

In November 2020, the Court of First Instance dismissed the case in its entirety against all defendants including the group. The plaintiff appealed the case to the Court of Appeal where the case is currently under assessment by a panel of experts who initially issued a report adverse to the defendants including the group, but which has been returned to the same panel for reconsideration and reissuance. The group considers it to be possible that the judgment will be against it. The potential undiscounted amount of the total payments that the group could be required to make, if there was an adverse decision related to the lawsuit, is estimated to be approximately US$30m plus interest and costs. However, any adverse judgment, if issued, would be on a joint and several liability basis with two other defendants and therefore the group's liability could be significantly less.

35 Related party transactions

The ultimate parent company of the group is HSBC Holdings plc, which is incorporated in England.

Copies of the HSBC Holdings plc financial statements may be obtained from the following address:

HSBC Holdings plc

8 Canada Square

London

E14 5HQ

Related parties of the group include the parent, fellow subsidiaries, associates, joint ventures, post-employment benefit plans for HSBC employees, Key Management Personnel as defined by IAS 24 'Related Party Disclosures', close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced by Key Management Personnel or their close family members. Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of HSBC Bank Middle East Limited and the group and includes members of the Boards of Directors of HSBC Bank Middle East Limited.

Particulars of transactions with related parties are tabulated below. The disclosure of the year-end balance and the highest amounts outstanding during the year is considered to be the most meaningful information to represent the amount of the transactions and outstanding balances during the year.

Key Management Personnel

The emoluments of a number of the Key Management Personnel are paid by other HSBC Group companies who make no recharge to the group. The Directors are also Directors of a number of other HSBC Group companies and it is not possible to make a reasonable apportionment of their emoluments in respect of each of the companies. Accordingly, no emoluments in respect of the Directors paid by other HSBC Group companies and applicable to the group has been included in the following disclosure.

Transactions, arrangements and agreements including Key Management Personnel

Compensation of Key Management Personnel

	2021	2020
	US$000	US$000
Remuneration (wages and bonus)	3,639	2,148
Post-employment benefits	67	48
Share-based payments	1,671	640
Year ended 31 Dec	**5,377**	2,836

The table below sets out transactions which fall to be disclosed under IAS 24 between the group and the Key Management Personnel of both the bank and its parent company, HSBC Holdings plc, and their connected persons or controlled companies.

Transactions and balances during the year with Key Management Personnel

	2021		2020	
	Highest amounts outstanding during year	**Balance at 31 Dec**	Highest amounts outstanding during year	Balance at 31 Dec
	US$000	**US$000**	US$000	US$000
Key Management Personnel[1]				
Credit cards	**73**	**73**	54	54

1 *Includes Key Management Personnel, close family members of Key Management Personnel and entities that are controlled or jointly controlled by Key Management Personnel or their close family members.*

The above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Transactions with other related parties

Associates

Transactions and balances during the year with associates

	2021		2020	
	Highest balance during the year	**Balance at 31 Dec**	Highest balance during the year	Balance at 31 Dec
	US$000	**US$000**	US$000	US$000
Amounts due to associates	**1,226**	**1,226**	1,305	1,305

The above outstanding balances arose in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

Transactions of the group with HSBC Holdings plc and fellow subsidiaries of HSBC Holdings plc

Transactions detailed below include amounts due to/from HSBC Holdings plc

	2021		2020	
	Highest balance during the year	**Balance at 31 Dec**	Highest balance during the year	Balance at 31 Dec
	US$000	**US$000**	US$000	US$000
Assets				
Other assets	**1,413**	**189**	2,951	688
Liabilities				
Other liabilities	**14,532**	**1,962**	13,494	5,834

	For the year ended 31 Dec 2021	For the year ended 31 Dec 2020
	US$000	US$000
Income statement		
Fee income	**98**	—
Other operating income	**51**	1,519
General and administrative expenses	**6,229**	49,772

Transactions detailed below include amounts due to/from fellow subsidiaries of HSBC Holdings plc

	2021		2020	
	Highest balance during the year	**Balance at 31 Dec**	Highest balance during the year	Balance at 31 Dec
	US$000	**US$000**	US$000	US$000
Assets				
Derivatives	**1,437,042**	**777,568**	1,437,042	1,437,042
Loans and advances to banks (including reverse repos)	**2,406,343**	**2,296,785**	3,128,806	2,065,461
Other assets	**860,553**	**128,539**	371,330	122,148
Liabilities				
Trading liabilities	**437,884**	**437,884**	153,475	—
Deposits by banks	**3,482,758**	**3,468,634**	2,440,006	2,440,006
Derivatives	**1,529,271**	**855,305**	1,683,841	1,529,271
Subordinated amounts due	**950,000**	**475,000**	950,000	950,000
Other liabilities	**664,266**	**62,911**	207,984	66,580
Off-balance sheet				
Guarantees	**4,104,781**	**3,988,589**	3,134,031	2,908,969
Documentary credit and short-term trade-related transactions	**265,950**	**133,902**	261,615	179,355

Transactions detailed below include amounts due to/from fellow subsidiaries of HSBC Holdings plc (continued)

	For the year ended 31 Dec 2021	For the year ended 31 Dec 2020
	US$000	US$000
Income Statement		
Interest income	**2,588**	2,743
Interest expense	**43,038**	54,814
Fee income	**60,042**	59,820
Fee expense	**16,247**	11,147
Other operating income	**44,583**	42,844
General and administrative expenses	**290,744**	204,075

The above outstanding balances arose in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

Transactions between HSBC Bank Middle East Limited and its subsidiaries

Transactions detailed below include amounts due to/from HSBC Bank Middle East Limited and its subsidiaries

	2021		2020	
	Highest balance during the year	**Balance at 31 Dec**	Highest balance during the year	Balance at 31 Dec
	US$000	**US$000**	US$000	US$000
Assets				
Loans and advances to customers	**2,211**	**2,084**	2,117	2,081
Liabilities				
Customer accounts	**47,602**	**26,523**	26,908	26,894

The above outstanding balances arose in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

36 Events after the balance sheet date

UAE Federal Corporate Tax ('FCT')

Subsequent to the year end, UAE announced FCT on 31 January 2022 which will be effective for accounting periods beginning on or after 1 June 2023. It is mentioned in the announcement that the UAE FCT will be applicable across all Emirates and will apply to all business and commercial activities alike, except for the extraction of natural resources which will continue to be subject to Emirate level taxation. The detailed regulation is yet to be issued and enacted.

As the Law was not published and substantially enacted as at 31 December 2021, the impact of the announcement has not been considered on the financial position of the Company as 31 December 2021. Further, due to FCT introduction, there could be some adverse implication on the deferred tax asset recognized by the bank based on Emirate Tax Laws. The Management is currently evaluating the impact on the ETR and deferred tax based on the available information and by considering various scenarios and potential tax rates that might apply to the group. The actual impact will be reflected in the reporting period in which tax regulations are substantially enacted, with such substantial enactment clarifying the revised tax rate and relevant rules applicable on the bank under FCT.

Approval of accounts

These accounts were approved by the Board of Directors on 22 February 2022 and authorised for issue.

Additional information

This section includes information that is required to be disclosed as part of our regulatory reporting obligations or that is relevant to a complete understanding of the group's *Annual Report and Accounts 2021* and is provided in accordance with certain best practice disclosure principles. In particular, it provides further information on the group's current top and emerging risks, liquidity and funding ratios, and capital requirements and structure. It also includes information about how we do business. The information in this section is not audited.

Top and emerging risks

Our current top and emerging risks are as follows:

Externally driven

Geopolitical risks

Regional geopolitical risks have been influenced by the change in the US Presidency at the beginning of 2021. The US troop withdrawal from Afghanistan and the revival of nuclear talks with Iran have set the backdrop for more constructive cooperation between the region's key regional powers. Saudi Arabia, Bahrain, Egypt and the UAE ended the blockade of Qatar in early 2021, leading in turn to an improved diplomatic dialogue and economic activity between Turkey, Saudi Arabia and the UAE. Meanwhile the Abraham Accords that were signed in late 2020 have set a positive tone for the region's relations with Israel. The most significant geopolitical risk factor in the region remains the Iran nuclear issue, with any breakdown in progress likely to lead to a rise in diplomatic tensions and increased sanctions pressure from the US. The markets in which HSBC operates in the region are not most at-risk from economic and civil unrest that continues elsewhere, such as Yemen, Syria, Iraq and Lebanon. We monitor geopolitical developments on an ongoing basis to assess their potential impact on our business.

Macroeconomic & credit risks

The economic recovery from Covid-19 gained momentum across the Middle East and the outlook remains strong, although uncertainties remain regarding the potential for the emergence of new coronavirus variants, supply chain constraints, inflationary pressures, and higher interest rates. Public finances across the Middle East have improved, supported by higher oil prices and fiscal reforms. Credit conditions improved in the retail portfolio and remained stable in the wholesale portfolio, highlighting a need to maintain our focus on credit quality. We closely monitor economic developments in key markets and sectors and undertake scenario analysis. We stress test portfolios of particular concern to identify sensitivity to loss under a range of scenarios, taking management action to rebalance exposures and manage risk appetite where necessary.

Climate-related risks

Our risk management priorities are focusing on embedding a climate risk management framework including: assessing the physical and transition risk in our wholesale credit portfolio, reviewing retail mortgage exposures in respect of natural hazard risk and developing scenarios internally for risk management, planning and stress testing. We have implemented a climate risk management framework leveraging HSBC global best practice to drive the proactive management of key risks associated with climate change.

Financial Crime risk environment

The financial crime threats we face have continued to evolve, often in tandem with broader geopolitical, socioeconomic and technological shifts across our markets. A number of Middle East countries have recently been or will be subject in the near future to a mutual evaluation review by the Financial Action Task Force (FATF), with Turkey added to the FATF Grey List in 2021. The UAE is also under continuous review with a decision expected in February 2022 on whether the UAE will also be added to the FATF Grey List. Should this occur, this could impact HSBC UAE's operations and this is being monitored closely at present.

We continue to enhance our financial crime risk management capabilities. We are investing in next generation capabilities to fight financial crime through the application of advanced analytics and artificial intelligence. We are strengthening and investing in our fraud and surveillance controls, to introduce next generation capabilities to protect both customers and the Group. We continue to work closely with our regulators and engage in public-private partnerships, playing an active role in shaping the industry's financial crime controls for the future, notably with respect to the enhanced, and transparent, use of technology.

Regulatory compliance risk environment including Conduct

We proactively monitor for regulatory developments to ensure that we fully understand the evolving regulatory landscape and implement any applicable change in a timely way. We engage, wherever possible, with governments and regulators in the countries and territories in which we operate, to make a positive contribution to the evolving regulatory landscape and ensure that new requirements are considered properly and can be implemented effectively. We launched our simplified Conduct approach to align to the Group's new purpose and values.

Cyber threat and un-authorised access to systems

We continually evaluate threat levels for the most prevalent attack types and their potential outcomes. We strengthen our controls to reduce the likelihood and impact of advanced malware, data leakage, exposure through third parties and security vulnerabilities. We continue to enhance our cybersecurity capabilities, including Cloud security, identity and access management, metrics and data analytics, and third-party security reviews. An important part of our defence strategy is ensuring our colleagues remain aware of cybersecurity issues and know how to report incidents.

Internally driven

Operational and resilience risk

IT systems infrastructure, resilience and digitization

We are committed to investing in the reliability and resilience of our IT systems supporting critical processes. We continue to invest in transforming how software solutions are developed, delivered and maintained. We concentrate on improving system resilience and service continuity testing. We continue to ensure security is built into our software development life cycle and improved our testing processes and tools. We continue to upgrade many of our IT systems, simplify our service provision and replace older IT infrastructure and applications. We are executing on planned initiatives to drive digital adoption and reduce manual transactions and are increasing our investment in technology to drive improved customer experience and operational efficiency.

Data management

We monitor proactively the quality, availability and security of data that supports our customers and our internal processes through our global data management framework, and we aim to resolve any identified data issues in a timely manner. We continue to modernise our data and analytics infrastructure through investments in cloud technology, data visualisation, machine learning and artificial intelligence.

Risks arising from the receipt of services from third parties

We have enhanced our control framework for external supplier arrangements to ensure the risks associated with third party arrangements are understood and managed effectively. We have applied the same control standards to intragroup arrangements as we have for external third party arrangements to ensure we are managing them effectively.

Change execution risk

Our success in delivering our strategic priorities and continuing to address regulatory change and other top and emerging risks is dependent on the effective and safe delivery of change across the Bank. We continue to work to strengthen our change management practices to deliver sustainable change.

Model Risk

We enhanced the monitoring and review of model performance through our Model Risk Management function. The Model Risk Management team aims to provide strong and effective review and challenge of any future redevelopment of these models. We appointed a model risk steward in the Region to support, oversee and guide the global businesses and functions on model risk management. The risk steward provides close monitoring of changes in model behaviour, working closely with business and function model owners and sponsors. We updated the model risk policy and introduced model risk standards to enable a more risk-based approach to model risk management.

Risks associated with workforce capability, capacity and environmental factors with potential impact on growth

We continue to monitor workforce capacity and capability requirements and have put in place measures to ensure our people are properly supported and able to work safely during the Covid-19 outbreak. There is a particular risk associated with the increase in workforce nationalization requirements for banks driven by local authorities in the GCC. Non-availability of appropriate talent within the local nationals workforce and increasing competition hunt for talent remains a key risk impacting workforce capacity and capability. We have complied with the workforce nationalisation requirements in all countries in which we operate and continue to invest in recruitment and retention of local nationals. We promote a diverse and inclusive workforce and provide active support across a wide range of health and well-being activities. We continue to build our 'speak-up' culture through active campaigns. We have launched the Future Skills curriculum through HSBC University to help provide critical skills that will enable employees and the group to be successful in the future. We continue to develop succession plans for key management roles, with actions agreed and reviewed on a regular basis by the group's Board.

Liquidity and Funding Ratios

As at 31 December 2021, HSBC Bank Middle East was above regulatory and internal minimum levels for the LCR and NSFR metrics.

Liquidity coverage ratio ('LCR')

The LCR metric is designed to promote the short-term resilience of a bank's liquidity profile, and became a minimum regulatory standard from 1 October 2015, under European Commission ('EC') Delegated Regulation 2015/61.

Delegated Act ('DA') LCR

	2021	2020
	%	%
HSBC Bank Middle East Limited	**295**	389

The group additionally computes and reports a DFSA-basis LCR, which differs from the Delegated Act ('DA') LCR primarily with respect to the haircuts applied to liquid securities under DA issued by Gulf Cooperation Council ('GCC') sovereign issuers and outflow percentages applied for off-balance sheet items and retail deposits.

DFSA LCR

	2021	2020
	%	%
HSBC Bank Middle East Limited	**299**	400

Net stable funding ratio ('NSFR')

The European calibration of NSFR is pending following the Basel Committee's final recommendation in October 2014. The group calculates NSFR in line with Basel Committee on Banking Supervision's publication number 295 (BCBS295).

NSFR-295

	2021	2020
	%	%
HSBC Bank Middle East Limited	**155**	164

The DFSA implementation of NSFR was effective from June 2018. It differs from the Group NSFR with respect to weightings applied for off-balance sheet items, retail deposits and in the calculation for derivatives.

DFSA NSFR

	2021	2020
	%	%
HSBC Bank Middle East Limited	**156**	164

Components of Net Stable Funding Ratio at 31 December 2021

		Unweighted value by residual maturity				
In currency amount (US$000)		**No maturity**	**< 6 months**	**6 months to < 1yr**	**≥ 1yr**	**Weighted values**
ASF (available stable funds) Item						
1	**Capital**	–	–	–	5,860,815	5,860,815
2	Regulatory Capital[1]	–	–	–	5,860,815	5,860,815
3	Other capital	–	–	–	–	–
4	**Retail deposits/PSIAs and deposits/PSIAs from small business customers:**	–	13,326,268	–	–	11,993,642
5	Stable Deposits/PSIAs	–	–	–	–	–
6	Less stable deposits/PSIAs	–	13,326,268	–	–	11,993,642
7	**Wholesale funding:**	–	17,949,331	1,085,178	5,373,879	12,093,622
8	Operational deposits / operational accounts		5,534,937	–	–	2,767,468
9	Other wholesale funding		12,414,394	1,085,178	5,373,879	9,326,154
10	**Liabilities with matching interdependent assets**	–	–	–	–	–
11	**Other liabilities:**	–	1,838,283	3,020	20,926	22,437
12	NSFR derivative liabilities and net liabilities for Shari'a compliant hedging contracts	–	–	–	–	–
13	All other liabilities and equity not included in the above categories	–	1,838,283	3,020	20,926	22,437
14	**Total ASF**	–	33,113,882	1,088,198	11,255,620	29,970,516
RSF (Required stable funds) Item						
15	**Total NSFR high-quality liquid assets ('HQLA')**	–	11,024,832	1,467,614	2,770,849	388,612
16	**Deposits/PSIAs held at other financial institutions for operational purposes**	–	–	–	–	–
17	**Performing loans and securities (including Shari'a compliant securities):**	–	11,195,805	3,636,641	13,340,063	15,747,528
18	Performing loans to financial institutions secured by Level 1 HQLA	–	1,151,206	–	–	115,121
19	Performing loans to financial institutions secured by non-Level 1 HQLA and unsecured performing loans to financial institutions	–	5,475,222	774,738	2,374,450	3,583,102
20	Performing loans to non-financial corporate clients, loans to retail and small business customers, and loans to sovereigns, Central Banks and PSEs,	–	4,468,270	2,779,407	9,084,269	10,695,999
21	*– of which: with a risk weight of less than or equal to 50%*	–	*476,184*	*161,297*	*3,247,342*	*2,408,723*
22	Performing residential mortgages,	–	81,515	76,462	1,695,639	1,181,153
23	*– of which: with a risk weight of less than or equal to 50%*	–	*81,515*	*76,462*	*1,695,639*	*1,181,153*
24	Securities that are not in default and do not qualify as HQLA, including exchange-traded equities	–	19,592	6,034	185,705	172,153
25	**Assets with matching interdependent liabilities**	–	–	–	–	–
26	**Other Assets**	–	1,594,068	6,157	624,552	1,402,586
27	Physical traded commodities, including gold	–	–	–	–	–
28	Assets posted as initial margin for derivative contracts/Shari'a compliant hedging contracts and contributions to default funds of CCPs	–	–	–	–	–
29	NSFR derivative assets	–	–	–	62,915	62,915
30	NSFR derivative liabilities before deduction of variation margin posted	–	–	–	202,879	202,879
31	All other assets not included in the above categories	–	1,594,068	6,157	358,758	1,136,792
32	**Off-balance sheet items**	–	35,955,433	–	–	1,709,061
33	**Total RSF**	–	59,770,138	5,110,412	16,735,464	19,247,787
34	**Net Stable Funding Ratio (%)**					156

1 Capital reported under NSFR does not include the deductions accounted in regulatory capital used for capital adequacy ratio.

Components of Net Stable Funding Ratio at 31 December 2020 (continued)

In currency amount (US$000)		Unweighted value by residual maturity: No maturity	< 6 months	6 months to < 1yr	≥ 1yr	Weighted values
ASF (available stable funds) Item						
1	Capital	–	–	–	5,959,188	5,959,188
2	Regulatory Capital	–	–	–	5,959,188	5,959,188
3	Other capital	–	–	–	–	–
4	Retail deposits/PSIAs and deposits/PSIAs from small business customers:	–	12,762,222	–	–	11,486,000
5	Stable Deposits/PSIAs	–	–	–	–	–
6	Less stable deposits/PSIAs	–	12,762,222	–	–	11,486,000
7	Wholesale funding:	–	16,023,589	2,105,018	4,457,069	11,999,785
8	Operational deposits/operational accounts		5,168,494	–	–	2,584,247
9	Other wholesale funding		10,855,095	2,105,018	4,457,069	9,415,538
10	Liabilities with matching interdependent assets	–	–	–	–	–
11	Other liabilities:	–	1,185,672	–	–	–
12	NSFR derivative liabilities and net liabilities for Shari'a compliant hedging contracts	–	–	–	–	–
13	All other liabilities and equity not included in the above categories	–	1,185,672	–	–	–
14	Total ASF	–	29,971,483	2,105,018	10,416,257	29,444,973
RSF (Required stable funds) Item						
15	Total NSFR high-quality liquid assets (HQLA)	–	12,977,770	256,832	2,592,399	398,363
16	Deposits/PSIAs held at other financial institutions for operational purposes	–	–	–	–	–
17	Performing loans and securities (including Shari'a compliant securities):	–	10,351,173	3,804,997	11,665,501	14,753,557
18	Performing loans to financial institutions secured by Level 1 HQLA	–	1,509,800	–	–	150,980
19	Performing loans to financial institutions secured by non-Level 1 HQLA and unsecured performing loans to financial institutions	–	2,685,755	322,190	1,531,228	2,095,186
20	Performing loans to non- financial corporate clients, loans to retail and small business customers, and loans to sovereigns, Central Banks and PSEs,	–	6,044,017	3,362,938	8,370,838	11,201,772
21	*– of which: with a risk weight of less than or equal to 50%*	–	*1,043,525*	*446,375*	*3,084,593*	*2,749,935*
22	Performing residential mortgages,	–	79,210	74,588	1,545,184	1,081,269
23	*– of which: with a risk weight of less than or equal to 50%*	–	*79,210*	*74,588*	*1,545,184*	*1,081,269*
24	Securities that are not in default and do not qualify as HQLA, including exchange-traded equities	–	32,391	45,281	218,251	224,350
25	Assets with matching interdependent liabilities	–	–	–	–	–
26	Other Assets	–	488,415	–	729,363	1,217,778
27	Physical traded commodities, including gold	–	–	–	–	–
28	Assets posted as initial margin for derivative contracts/Shari'a compliant hedging contracts and contributions to default funds of CCPs	–	–	–	–	–
29	NSFR derivative assets	–	–	–	80,278	80,278
30	NSFR derivative liabilities before deduction of variation margin posted	–	–	–	373,695	373,695
31	All other assets not included in the above categories	–	488,415	–	275,390	763,805
32	Off-balance sheet items	–	34,258,568	–	–	1,586,521
33	Total RSF	–	58,075,926	4,061,829	14,987,263	17,956,219
34	Net Stable Funding Ratio (%)					164

Capital requirement

The DFSA's capital requirements are prescribed in the DFSA Prudential – Investment, Insurance Intermediation and Banking Module ('PIB'). In accordance with the PIB:

1. the capital requirement for an authorised firm is calculated, subject to (2), as the higher of:
   a. the applicable Base Capital Requirement as set out in the PIB; or
   b. its Risk Capital Requirement plus applicable Capital Buffer Requirements.
2. where the authorised firm has an Individual Capital Requirement ('ICR') imposed on it then the Capital Requirement is its ICR plus Risk Capital Requirement plus applicable Capital Buffer Requirements.

An authorised firm must calculate its Risk Capital Requirement as the sum of the following:

- the Credit Risk Capital Requirement;
- the Market Risk Capital Requirement;
- the Operational Risk Capital Requirement; and
- the Displaced Commercial Risk Capital Requirement, where applicable.

Further, the bank is subject to a Capital Conservation Buffer of 2.5% of Risk Weighted Assets and must constitute only CET1 Capital.

The PIB requires an authorised firm to:

- appropriately apply a risk-weight to all on-balance sheet assets and off-balance sheet exposures for capital adequacy purposes. A risk-weight is based on a Credit Quality Grade aligned with the likelihood of counterparty default;
- calculate the Credit Risk Capital Requirement for its on-balance sheet assets and off-balance sheet exposures; and
- reduce the Credit Risk Capital Requirement for its on-balance sheet assets and off-balance sheet exposures where the exposure is covered fully or partly by some form of eligible Credit Risk mitigant.

The DFSA has granted approval to the bank to use HSBC Group internal models for the purposes of calculating Market Risk Requirements.

The bank uses the Standardised Approach for the calculation of Operational Risk Capital Requirement.

The bank's regulatory capital is divided into two tiers:

- Tier 1 capital comprises equity share capital, share premium, retained earnings, other comprehensive income and other reserves. This is adjusted for the amount of cash flow hedge reserve related to gains or losses on cash flow hedges of financial instruments, all unrealised gains or losses on liabilities that are valued at fair value and which result from changes in the bank's own credit quality and deduction for intangible assets.
- Tier 2 capital comprises qualifying non-equity preference share capital, share premium and general provisions limited to 1.25% of Credit Risk Weighted Assets.

In response to the Covid-19 pandemic, DFSA in its letter to the bank dated 25 June 2020, decided to extend and refresh its approach to IFRS9 transitional arrangements by introducing a prudential filter to smoothen the impact of Covid 19 related ECLs on banks' capital resources. The bank in response to DFSA letter, starting 30 June 2020 elected to apply transitional arrangement for a 5-years transition period using dynamic approach as follows:

- Compare Stage 1 and Stage 2 ECL provisions at the respective reporting date with the ECL provisions as at 31 December 2019.
- Add back 100% of the increased ECLs to its Core Equity Tier 1 ('CET1') capital in the 2020 and 2021 Financial Years. This add back will then be phased out on a straight line basis over the subsequent years i.e.2022-2024.

Below figures are post-application of the capital relief provided by the prudential filter:

Capital structure at 31 December (solo basis)

	2021 US$000	2020 US$000
Composition of regulatory capital		
Common Equity Tier 1 capital[1]	**4,906,654**	4,969,411
Total Tier 1 capital	**4,906,654**	4,969,411
Tier 2 capital	**791,912**	989,777
Total regulatory capital	**5,698,566**	5,959,188
Risk-weighted assets		
Credit and counterparty risk	**24,957,290**	26,461,218
Market risk	**4,075,576**	1,761,875
Operational risk	**2,917,008**	3,044,479
	31,949,874	31,267,572
Capital ratios		
Common Equity Tier 1 ratio (%)	**15.36**	15.89
Capital adequacy ratio (%)	**17.84**	19.06
Leverage ratio (%)	**6.89**	7.47

1 *Adjustments to/deductions from CET1 Capital.*

	2021 US$000	2020 US$000
Other Intangible Assets	**154,091**	110,870
Deferred tax assets	**5,374**	21,388
Reserves	**4,648**	9,830

Environmental, social and governance review

We aim to achieve our purpose and deliver our strategy in a way that is sustainable, and to build strong relationships with all of our stakeholders. This section sets out our approach to our environment, stakeholders and governance.

ENVIRONMENTAL

Our Climate Strategy

Becoming a net zero bank

The Group announced the ambition to become a net zero bank in October 2020, in our own operations and supply chain by 2030 or sooner, and aiming to align our financed emissions to net zero by 2050 or sooner. In May 2021, HSBC Group shareholders approved a special resolution on climate change at the AGM that commits us to set, disclose and implement a strategy with short-and medium-term targets to align our provision of finance with the goals and timelines of the Paris Agreement.

On this basis, the Group defined targets to 2030 for the financed emissions of our oil and gas, and power and utilities portfolios, aligned with global sector decarbonisation pathways set out by the IEA in its net zero emissions by 2050 scenario. These targets have been set at a Group-level, and can be found as part of our Group disclosures.

Supporting our customers through transition

On the basis of the Group's commitment to align our ambition with the Paris agreement aim of limiting temperature increases to 1.5C above pre-industrial levels, inferring that the global economy needs to be net zero by 2050. HSBC Group aims to provide between US$750bn and US$1tn in financing and investment by 2030 to support customers in their transition to lower carbon emissions and a sustainable future.

Sustainable Finance

The group provides lending for specific sustainable and transition finance activities. Products include project finance (e.g. financing of renewable infrastructure projects), as well as green, social and sustainability linked loans. Our cumulative financing is almost US$3.6bn at the end of 2021, as compared to US$2.3bn in 2020. Key highlights in 2021 included landmark sustainability-linked loans the group helped structure for Etihad Airways and few other customers.

Etihad Airways has pledged to reduce its carbon emissions to 50% of 2019 levels by 2035 on the way to reaching net zero by 2050. As part of this transition, we helped Etihad Airways raise US$1.2bn with the first sustainability-linked loan in the global aviation industry. We held joint ESG structuring and coordinator roles, as well as being joint book runner and mandated lead arranger.

For retail banking customers, in 2021 the group introduced a range of Sustainable Finance lending products including personal loans, providing discounted interest rates in the UAE for solar panels to be retrofitted on to residential properties. The group also offer discounted rates on our vehicle loans for Electric and Hybrid Vehicles to encourage customers to reduce their driving emissions. Further, we have partnered with Sustainable City to give residents preferential rates on their sustainable housing development, we are looking to further this initiative by partnering with other developers in the UAE. With this range of products available, we have seen increase in our Sustainable Finance lending balances from US$4.3m in January 2021 to US$15.3m as of the end of December 2021. Aside from lending, we have partnered with MasterCard's Priceless Planet Coalition to help restore the UAE's mangrove forests, customers can now donate their credit card reward points to plant and maintain mangroves in the UAE, a vital part of the coastal ecosystem for wildlife as well as helping to sequester carbon.

The group provides advisory services to facilitate the flow of capital and to provide access to capital markets. Products include: green, social and sustainable bonds and sukuk, transition bonds and sukuk, finance advisory mandates (including those covering debt and equity capital markets). Our cumulative facilitation is almost US$0.9bn at the end of 2021, increasing from US$0.5bn at the end of 2020.

Our approach to our own operations

2021 has been the year of operationalizing and implementing the reduce and replace elements of our strategy, to be net zero in our operations and supply chain by 2030 or sooner.

Our energy consumption

HSBC have committed to reducing energy consumption by 50% by 2030, against 2019 baseline. In 2021, the group's total greenhouse gas emissions were 13,015 tonnes, a reduction of 51% compared to 2019 (our baseline year) and a reduction of 32% versus the previous year (2020)*. We have made progress in our own renewable energy production installing solar panels in Adliya branch, Bahrain which will generate approximately 67% of the building's energy requirements.

** For the group countries which are included in our HSBC Group ESG reporting (Bahrain, Kuwait, Qatar and UAE).*

Business travel

The group's travel emissions have reduced by 88% in 2021 (against 2019 baseline) as a result of ongoing international travel restrictions. As international travel gradually opens up, the focus will be on education and review of travel policy to reduce overall travel and take into consideration the carbon emission impact of travel where meeting online is not appropriate.

Engaging with our supply chain

Engaging our suppliers remains a crucial part of our strategy. In 2021, we are now incorporating carbon emissions related questions in our vendor selection process for new supplier contracts to ensure that sustainability is a key consideration in our commercial decisions.

Our approach to climate risk

Our approach to sustainability policies

The Group's sustainability risk policies cover agricultural commodities, chemicals, defence, energy, forestry, mining and metals, UNESCO World Heritage Sites and Ramsar-designated wetlands. These policies define our appetite for business in these sectors and seek to encourage customers to meet good international standards of practice. Where we identify activities that could cause material negative impacts, we will only provide finance if we can confirm customers are managing these risks responsibly. Our sustainability policies continue to be aligned with our approach to climate risk, as well as our net zero commitments.

At the heart of our net zero plan is an aim to align our financed emissions – emissions produced by our portfolio of customers – to the Paris Agreement goal of net zero by 2050 or sooner. The most significant contribution we can make is to support our customers' transition to lowering carbon through transition financing, which is financial support that helps heavy-emitting companies take action to become more environmentally sustainable over time.

Managing risk for our stakeholders

We see managing climate risk as an opportunity to create value for our customers, our shareholders, our people and the communities we operate in. To achieve this, we continue to enhance our risk appetite and the supporting policies and controls to manage the financial and non-financial risks in our banking portfolios and to help identify opportunities to support our customers in managing their own climate risks. We manage climate risk across all our businesses in line with our Group-wide risk management framework.

The group actively supported a Wholesale customer as sustainability coordinator in structuring and raising a sustainability linked syndicated loan. The group helped the customer in selecting a set of sustainability performance targets which are ambitious and meaningful, and fully aligned with the customer's sustainability strategy.

SOCIAL

Customers

Customer satisfaction and feedback

We listen and act on our customers and clients feedback across the region, with Net Promoter Score ('NPS') being used as the consistent metric to assess our customer experience performance. In the key market of the UAE we benchmark our performance against our peers to provide a rank position and our NPS score has improved for Wholesale and Retail in 2021.

Within 2021 we have introduced a new complaints tracking tool allowing better capture of a complaint as well as enhanced root cause analysis, discussion and reporting. Complaint numbers for 2021 have been within tolerance with complaints mostly related to issues around payment delays and account mandate discrepancies.

Across the group in Retail we track our key channel interactions (branch, RM, contact centre, mobile and online) with the majority of countries trending positively against targets. In Commercial Banking to provide more opportunity for client feedback, we launched relational NPS ('rNPS') across UAE, Bahrain, Kuwait and Qatar, with all markets recording positive NPS results and providing a mechanism to close the loop with clients in a timely manner.

The UAE bank in our customers' pocket strategy accelerated in 2021, more than doubling the number of mobile features and experiences launched for customers than the previous year. Customers are more satisfied with the UAE mobile banking app features, reflected in our iNPS score on mobile tripling this year. In 2021, majority of payments and transfers in the UAE were completed through mobile and online banking.

Employees

Our organization has been shaped by the many cultures and communities we serve, with 3,273 full time equivalent employees in 5 markets representing 88 nationalities as at 31 December 2021. Our culture is underpinned by our values and we are striving to build a fully inclusive organization that prioritizes well-being, invests in learning and careers and prepares our colleagues for the future of work.

The future of work

As the Covid-19 pandemic continues to impact our people, businesses and communities, we are continuing to prioritise our colleagues' safety, welfare and development as they continue to adapt to new working arrangements. The Covid-19 outbreak taught us many roles can be undertaken effectively outside of our branches and offices, accelerating our focus on enabling greater flexibility in future working arrangements and establishing working environments that are suitable for varying types of task. Reskilling continues to play a key role in how we build future skills with investment in technology to support employees to access development content at anytime and anywhere.

Inclusion

Our employees and the societies they represent and serve span many cultures and communities. We believe this diversity makes us stronger, and we are dedicated to building a diverse and connected workforce where everyone feels a sense of belonging. We continue efforts to build more gender-balanced teams. Female employees represent almost 45% of total employees and 29.7% of senior leaders (classified as global career band 3 and above). Initiatives to support employees with disabilities and to strengthen the ethnic and cultural diversity of our teams activated in 2020 continue to drive enhancements and progress toward our inclusion aspirations.

Well-being

The well-being of our people continues to remain a key priority with focus on mental health, physical health, financial capability and work-life balance. Well-being initiatives this year included improvements to family friendly policies, the launch of the Headspace App, onsite health check-ups in the UAE, and a wide variety of regional awareness sessions throughout the year on topics such as embracing happiness, sleep, maintaining balance in life and how to manage finances more effectively.

Learning and skills development

Developing the skills of our colleagues is critical to energising our organisation and building a dynamic, inclusive culture. Our Future Skills programme helps prepare our people for the changing skills required in the future workplace. We have a growing range of tools and resources to help colleagues take ownership of their development and career. This includes the HSBC University, our My HSBC Career portal which offers career development resources and Degreed, our learning experience platform that is a one stop shop for all learning content and enables employees to own and drive skill development and personal growth.

Employee engagement

The group's employee survey, Snapshot, helps us to understand our employee engagement levels and the results are reported to executive committees and used by managers to make decisions and take action. In December 2021, the aggregated Employee Engagement survey score was 74% favourable (stable as compared to the same period in 2020). We encourage a 'speak up' culture. At times individuals may not feel comfortable speaking up through their immediate reporting line and therefore our global whistleblowing channel, HSBC Confidential, provides colleagues and other stakeholders with a means of raising concerns confidentially.

Communities

Supporting Communities

Community Investment projects

We have been present in the Middle East for more than 75 years. We have a long standing commitment to our internal and external stakeholders that we deliver on through our philanthropic activities. In 2021, our charitable giving for the group totaled US$3.7m. Our employees spent 481 hours volunteering during working and non-working hours in HSBC supported projects. We acknowledge that the move to a more skill-based volunteering has reduced the total number of volunteers and volunteering hours, but we are confident that we are creating relevant impact. We focus on the areas of Future Skills (for young adults and entrepreneurs) and in unlocking next-generation climate solutions to accelerate the transition to net zero.

Future Skills and Entrepreneurship

The Group's Future Skills and Entrepreneurship agenda supported 15 projects benefitting more than 10,000 people and contributed with more than US$2.8m.

The six-awards winning program, Tatawwar, empowered more than 5,300 students, 1,382 schools and 78 teachers. This program supports building social entrepreneurial skills amongst youth across the region.

Additionally, we have helped more than 1,000 social enterprises build their ESG metrics and become investor ready through the C3 Social Impact Accelerator and TiE Mentorship Programme.

Climate Solutions Partnership

In May 2021, the Group formed globally the Climate Solutions Partnership ('CSP') with the World Resources Institute and WWF, backed by US$100m of our philanthropic capital to accelerate support for innovative solutions tackling climate change. The partnership aims to scale up climate innovation ventures, nature-based solutions ('NbS') and help to transition the energy sector towards renewables in Asia.

In the UAE, we are collaborating with Emirates Nature-WWF, the Environment Agency in Abu Dhabi and the International Centre for Biosaline Agriculture on a project that aims to provide a science-based innovative approach to strengthen synergies between coastal ecosystems, including mangroves, seagrasses, saltmarshes' conservation and restoration with climate action. It is a multi-year commitment of US$4.2m exploring commercial and investable opportunities based on nature, climate mitigation and benefits for people's resilience (with a focus on food security and innovation, recreation & ecotourism).

The group is also actively involved in the climate innovation component of the CSP. We are selecting the best innovative ventures in the region and supporting them using WWF's purpose-built platform, Impactio. Ventures are reviewed on the climate impact, technical and financial aspects of their business and the top rated, most impactful ones benefit from a tailored support package that includes access to specific experts within WWF, WRI, HSBC and others as well as opportunities for exposure with our networks.

Financial Inclusion

In 2021, the group launched it's Saving for Good partnership with Injaz Al-Arab, which aims to equip economically vulnerable workers in Bahrain, Kuwait, Qatar and the UAE with financial literacy skills. These individuals and their families are often highly vulnerable to social upheaval and economic shocks such as Covid-19 pandemic. Injaz trained 55 group employee volunteers to deliver a series of six two-hour workshops under the programme, which aims to reach a total of 1,950 migrant workers, and to encourage at least 35% of them to open a savings account.

GOVERNANCE

How ESG is governed

We act on our responsibility to run our business in a way that upholds high standards of corporate governance. We are committed to working with our regulators to manage the safety of the financial system, adhering to the spirit and the letter of the rules and regulations governing our industry. In our endeavor to restore trust in our industry, we aim to act with courageous integrity and learn from past events to help prevent their recurrence. We meet our responsibilities to society, including through being transparent in our approach to paying taxes. We also seek to ensure we respect global standards on human rights in our workplace and our supply chains through screening and remediation, and continually work to improve our compliance management capabilities. We acknowledge that increasing financial inclusion is a continuing effort, and we are carrying out a number of initiatives to increase access to financial services.

Our respect for human rights

In the UAE, we have trained more than 100 front-line staff in human rights issues, and incorporated a questionnaire into our annual credit reviews for customers in seven sectors considered higher risk as there is limited data available to assess the level of human rights risk related to our customers.

We have also worked with our suppliers to identify potential risks associated with them not complying with the Group's Ethical and Environmental Code of Conduct. The Group has developed an assessment tool which is currently being deployed in the UAE to audit high risk suppliers and setting corrective action plans that is expected to lead to the closure of virtually all the high and medium risks identified.

Conduct: Our Product responsibilities

We are committed to providing customers with products that meet their financial needs facilitating cross-border trade and payment services, and providing access to products and services offered by other global businesses. Good conduct at HSBC means that we deliver fair outcomes for customers, and maintain the orderly and transparent operation of financial markets.

We have policies and procedures to help deliver fair outcomes for our customers, and to maintain orderly and transparent financial markets. Conduct principles are embedded into the way we develop, distribute, structure and execute products and services.

Safeguarding data

The threat of cyber-attacks remains a concern for our organization, as it does across the entire financial sector. Failure to protect our operations from internet crime or cyber-attacks may result in financial loss, disruption for customers or a loss of data. This could undermine our reputation and ability to attract and retain customers. The group invested in business and technical controls to help prevent, detect and react to these threats. The group has strengthened controls to reduce the likelihood and impact of advanced malware, data leakage, infiltration of payment systems and denial of service attacks.

We are committed to protecting and respecting the data we hold and process, in accordance with the laws and regulations of the geographies in which we operate. Our Group-wide privacy policy and principles aim to provide a consistent global approach to managing data privacy risk, and must be applied by all of our global businesses and global functions. In 2021, the group embedded an enhanced data privacy risk management framework across all countries in which it operates.

Our approach with our suppliers

The Group has an ethical and environmental code of conduct for suppliers of goods and services, which all contracted suppliers are required to comply with. Our supplier management principles and code of conduct are available at www.hsbc.com/our-approach/risk-and-responsibility/working-with-suppliers.

Financial crime risk management

We have continued our efforts to combat financial crime risks and reduce their impact on our organization and the markets we operate and serve. These financial crime risks include money laundering, terrorist and proliferation financing, tax evasion, bribery and corruption, sanctions and fraud. As part of this work, we have made progress on several key initiatives, enabling us to manage and mitigate these risks more effectively, and further our pioneering work in financial crime risk management across the financial services industry. We have embedded a strong financial crime risk management framework across all global businesses and all countries and territories in which we operate.

We operate a zero tolerance approach to bribery and corruption, and consider such activity to be unethical and contrary to good governance. Our global anti-bribery and corruption policy sets out the key principles and minimum control requirements that enable us to mitigate bribery and corruption risk and comply with all laws and regulations in the countries where we operate.

HSBC Bank Middle East Limited

Head Office
Level 1, Building No. 8, Gate Village
Dubai International Financial Centre
DIFC, PO Box 30444, Dubai, UAE

Middle East Management Office

HSBC Tower
Downtown
P O Box 66
Dubai
United Arab Emirates

ALGERIA

Oriental Business Park branch
Oran branch

BAHRAIN

Seef – Main Branch
Adliya Branch

KUWAIT

Kuwait City – Sharq Area

QATAR

Doha – Airport Road (Main Branch)
Doha – City Centre
Doha – Salwa Road
Doha - Msheireb

UNITED ARAB EMIRATES

Abu Dhabi – Old Airport Road
Dubai – Deira Al Muraqqabat
Dubai – Bur Dubai
Dubai – Jumeirah
Jebel Ali – Free Trade Zone
Fujairah – Hamad Bin Abdulla St
Ras Al Khaimah – Al Dhait
Sharjah – King Faisal Road
5 Customer Service Units and 2 Management Offices

Principal Subsidiary Companies

HSBC Middle East Securities LLC
HSBC Middle East Asset Company LLC
HSBC Insurance Services (Lebanon) S.A.L.
HSBC Bank Middle East Representative Office Morocco S.A.R.L.

Associated Companies

MENA Infrastructure Fund (GP) Limited

Special Connections With These Members Of The HSBC Group

HSBC Bank Oman S.A.O.G.
HSBC Bank Egypt S.A.E.
HSBC Securities (Egypt) S.A.E.
HSBC Electronic Data Service Delivery (Egypt) S.A.E.
HSBC Saudi Arabia
The Saudi British Bank
HSBC Private Bank (Suisse) SA (DIFC Branch)
HSBC Middle East Leasing Partnership
HSBC Bank A.S.

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