HSBC Bank Middle East Limited

Interim Financial Statements 2021

HSBC

Contents

Presentation of information

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

In accordance with IAS 34 the *Interim Report* is intended to provide an update on the *Annual Report and Accounts 2020* and therefore focuses on events during the first six months of 2021 rather than duplicating information previously reported.

Condensed financial statements

Consolidated income statement

	Notes	Half-year to 30 Jun 2021 US$000	30 Jun 2020 US$000
Net interest income		**322,107**	428,894
– interest income		**373,937**	542,629
– interest expense		**(51,830)**	(113,735)
Net fee income	3	**214,802**	211,472
– fee income		**253,127**	252,367
– fee expense		**(38,325)**	(40,895)
Net income from financial instruments held for trading or managed on a fair value basis		**140,031**	112,157
Changes in fair value of long-term debt and related derivatives		**(3,286)**	40
Changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss		**(2,592)**	(3,815)
Gains less losses from financial investments		**1,438**	8,742
Dividend income		**58**	288
Other operating income, net		**28,952**	38,290
Net operating income before change in expected credit losses and other credit impairment charges		**701,510**	796,068
Change in expected credit losses and other credit impairment charges	9	**108,295**	(508,129)
Net operating income		**809,805**	287,939
Employee compensation and benefits		**(273,496)**	(261,545)
General and administrative expenses		**(179,253)**	(170,979)
Depreciation and impairment of property, plant and equipment and right-of-use assets		**(17,549)**	(16,950)
Amortisation and impairment of intangible assets		**(10,585)**	(6,795)
Total operating expenses		**(480,883)**	(456,269)
Operating profit/(loss)		**328,922**	(168,330)
Share of profit/(loss) in associates		**(137)**	(110)
Profit/(loss) before tax		**328,785**	(168,440)
Taxation		**(49,681)**	13,134
Profit/(loss) for the period		**279,104**	(155,306)
Attributable to:			
– shareholders of the parent company		**279,104**	(155,330)
– non-controlling interests		**–**	24
Profit/(loss) for the period		**279,104**	(155,306)

The accompanying notes on pages 7 to 23 form an integral part of these financial statements.

Consolidated statement of comprehensive income

	Half-year to	
	30 Jun 2021	30 Jun 2020
	US$000	US$000
Profit/(loss) for the period	**279,104**	(155,306)
Other comprehensive income/(expense)		
Items that will be reclassified subsequently to profit or loss when specific conditions are met:		
Debt instruments at fair value though other comprehensive income/(expense)	**(4,767)**	11,906
– fair value gains/(losses)	**(5,995)**	3,328
– fair value gains/(losses) transferred to the income statement on disposal	**1,438**	8,305
– expected credit losses recognised in income statement	**(1,057)**	1,926
– income taxes	**847**	(1,653)
Cash flow hedges	**(15,303)**	26,070
– fair value gains/(losses)	**(17,045)**	29,037
– income taxes	**1,742**	(2,967)
Exchange differences	**(1,191)**	(21,073)
Items that will not be reclassified subsequently to profit or loss:		
Remeasurement of defined benefit liability	**(1,961)**	(2,544)
Changes in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	**(2,136)**	11,994
Equity instruments designated at fair value through other comprehensive income – fair value gains/(losses)	**(2,674)**	(3,630)
Other comprehensive income/(expense) for the period, net of tax	**(28,032)**	22,723
Total comprehensive income/(expense) for the period	**251,072**	(132,583)
Attributable to:		
– shareholders of the parent company	**251,072**	(132,607)
– non-controlling interests	**—**	24
Total comprehensive income/(expense) for the period	**251,072**	(132,583)

The accompanying notes on pages 7 to 23 form an integral part of these financial statements.

Consolidated statement of financial position

		At	
	Notes	**30 Jun 2021 US$000**	31 Dec 2020 US$000
Assets			
Cash and balances at central banks		**842,107**	1,240,991
Items in the course of collection from other banks		**52,422**	69,569
Trading assets	*10*	**761,077**	741,594
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	*10*	**25,967**	38,813
Derivatives	*10*	**1,298,108**	1,879,242
Loans and advances to banks		**7,304,127**	7,742,424
Loans and advances to customers	*9*	**18,847,847**	19,350,716
Reverse repurchase agreements – non-trading		**1,947,254**	1,828,851
Financial investments	*10*	**10,778,675**	10,103,834
Prepayments, accrued income and other assets		**1,321,118**	1,271,857
Current tax assets		**303**	11
Interests in associates		**2,729**	2,867
Intangible assets		**127,954**	110,870
Deferred tax assets		**205,394**	219,664
Total assets		**43,515,082**	44,601,303
Liabilities and equity			
Liabilities			
Deposits by banks		**3,866,073**	3,468,222
Customer accounts		**25,722,684**	26,834,947
Repurchase agreements – non-trading		**626,225**	506,475
Items in the course of transmission to other banks		**232,687**	111,462
Trading liabilities	*10*	**314,451**	299,546
Financial liabilities designated at fair value	*7,10*	**2,291,300**	2,823,792
Derivatives	*10*	**1,144,119**	1,799,144
Debt securities in issue	*8*	**2,283,372**	2,000,594
Accruals, deferred income and other liabilities		**1,701,236**	1,641,852
Current tax liabilities		**69,866**	85,740
Provisions		**113,331**	129,583
Total liabilities		**38,365,344**	39,701,357
Equity			
Called up share capital		**931,055**	931,055
Share premium account		**61,346**	61,346
Other reserves		**(144,454)**	(119,765)
Retained earnings		**4,297,373**	4,022,892
Total shareholders' equity		**5,145,320**	4,895,528
Non-controlling interests		**4,418**	4,418
Total equity		**5,149,738**	4,899,946
Total liabilities and equity		**43,515,082**	44,601,303

The accompanying notes on pages 7 to 23 form an integral part of these financial statements.

Neslihan Erkazanci

Chief Financial Officer / Director

Consolidated statement of cash flows

	Half-year to	
	30 Jun 2021	30 Jun 2020
	US$000	US$000
Profit/(loss) before tax	**328,785**	(168,440)
Cash flows from operating activities		
Adjustments for:		
Net gain from investing activities	**(1,482)**	(8,564)
Share of profits/(loss) in associates	**137**	(110)
Other non-cash items included in profit before tax	**(44,798)**	547,703
Change in operating assets	**1,600,234**	(1,024,690)
Change in operating liabilities	**(854,693)**	3,112,639
Elimination of exchange differences[1]	**(262)**	7,154
Tax paid	**(48,962)**	(8,661)
Net cash from/(used) in operating activities	**978,959**	2,457,031
Cash flows from investing activities		
Net cash flows from purchase and sale/maturity of financial investments	**(40,356)**	312,520
Net cash flows from the purchase and sale of property, plant and equipment	**(1,018)**	(3,031)
Net investment in intangible assets	**(27,707)**	(21,852)
Net cash from/(used) in investing activities	**(69,081)**	287,637
Cash flows from financing activities		
Dividends paid to shareholders of the parent company	**—**	—
Net cash from/(used) in financing activities	**—**	—
Net increase in cash and cash equivalents	**909,878**	2,744,668
Cash and cash equivalents at 1 Jan	**7,702,023**	6,145,574
Exchange differences in respect of cash and cash equivalents	**(8)**	(18,214)
Cash and cash equivalents at 30 Jun	**8,611,893**	8,872,028

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

The accompanying notes on pages 7 to 23 form an integral part of these financial statements.

Consolidated statement of changes in equity

			Other reserves						
	Called up share capital and share premium	Retained earnings	Financial assets at FVOCI reserves	Cash flow hedging reserve	Foreign exchange reserve	Merger and other reserves	Total share-holders' equity	Non-controlling interests	Total equity
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
At 1 Jan 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 period	**—**	**279,104**	**—**	**—**	**—**	**—**	**279,104**	**—**	**279,104**
Other comprehensive income/(expense) (net of tax)	**—**	**(3,343)**	**(7,466)**	**(15,303)**	**(1,920)**	**—**	**(28,032)**	**—**	**(28,032)**
– debt instruments at fair value through other comprehensive income	**—**	**—**	**(4,767)**	**—**	**—**	**—**	**(4,767)**	**—**	**(4,767)**
– equity instruments designated at fair value through other comprehensive income	**—**	**—**	**(2,674)**	**—**	**—**	**—**	**(2,674)**	**—**	**(2,674)**
– cash flow hedges	**—**	**—**	**—**	**(15,303)**	**—**	**—**	**(15,303)**	**—**	**(15,303)**
– changes in fair value of financial liabilities designated at fair value arising from changes in own credit risk	**—**	**(2,136)**	**—**	**—**	**—**	**—**	**(2,136)**	**—**	**(2,136)**
– remeasurement of defined benefit liability	**—**	**(1,961)**	**—**	**—**	**—**	**—**	**(1,961)**	**—**	**(1,961)**
– exchange differences	**—**	**754**	**(25)**	**—**	**(1,920)**	**—**	**(1,191)**	**—**	**(1,191)**
Total comprehensive income/(expense) for the period	**—**	**275,761**	**(7,466)**	**(15,303)**	**(1,920)**	**—**	**251,072**	**—**	**251,072**
Other movements	**—**	**(1,280)**	**—**	**—**	**—**	**—**	**(1,280)**	**—**	**(1,280)**
At 30 Jun 2021	**992,401**	**4,297,373**	**7,644**	**8,989**	**(145,766)**	**(15,321)**	**5,145,320**	**4,418**	**5,149,738**
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 period	—	(155,330)	—	—	—	—	(155,330)	24	(155,306)
Other comprehensive income/(expense) (net of tax)	—	9,450	8,216	26,070	(21,013)	—	22,723	—	22,723
– debt instruments at fair value through other comprehensive income	—	—	11,906	—	—	—	11,906	—	11,906
– equity instruments designated at fair value through other comprehensive income	—	—	(3,630)	—	—	—	(3,630)	—	(3,630)
– cash flow hedges	—	—	—	26,070	—	—	26,070	—	26,070
– changes in fair value of financial liabilities designated at fair value arising from changes in own credit risk	—	11,994	—	—	—	—	11,994	—	11,994
– remeasurement of defined benefit liability	—	(2,544)	—	—	—	—	(2,544)	—	(2,544)
– exchange differences	—	—	(60)	—	(21,013)	—	(21,073)	—	(21,073)
Total comprehensive income/(expense) for the period	—	(145,880)	8,216	26,070	(21,013)	—	(132,607)	24	(132,583)
Other movements	—	(548)	(20)	—	—	—	(568)	—	(568)
At 30 Jun 2020	992,401	3,962,437	15,388	46,640	(145,626)	(15,321)	4,855,919	4,418	4,860,337

The accompanying notes on pages 7 to 23 form an integral part of these financial statements.

Notes on the Condensed financial statements

1 Legal status and principal activities

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

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

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

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

2 Basis of preparation and significant accounting policies

(a) Compliance with International Financial Reporting Standards

The interim condensed consolidated financial statements of the group have been prepared in accordance with IAS 34 'Interim Financial Reporting' ('IAS 34') as issued by the International Accounting Standards Board ('IASB') and as adopted by the UK. Therefore they include an explanation of events and transactions that are significant to an understanding of the changes in the financial position and performance of the group since the end of 2020. These interim condensed consolidated financial statements should be read in conjunction with the *Annual Report and Accounts 2020*.

At 30 June 2021, there were no unendorsed standards effective for the half-year to 30 June 2021 affecting these interim condensed 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 applied during the half-year to 30 June 2021

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

(b) Use of estimates and judgements

Management believes that the group's critical accounting estimates and judgements are those which relate to impairment of amortised cost and fair value through other comprehensive income ('FVOCI') financial assets, the valuation of financial instruments, recognition of deferred tax assets, impairment of non-financial assets and provisions. There was no change in the current period to the critical accounting estimates and judgements applied in 2020, which are stated in the *Annual Report and Accounts 2020*.

(c) Composition of the group

There were no changes in the composition of the group in the half-year to 30 June 2021.

(d) Future accounting developments

IFRS 17 'Insurance Contracts' was issued in May 2017, with amendments to the standard issued in June 2021. It has not been adopted for use in the UK. The standard sets out the requirements that an entity should apply in accounting for insurance contracts it issues and reinsurance contracts it holds. Following the amendments, IFRS 17 is effective from 1 January 2023. The group has assessed the impact of IFRS 17 and expects that the standard will have no significant effect, when applied, on the consolidated financial statements of the group.

(e) Accounting policies

The accounting policies applied by the group for these interim condensed consolidated financial statements are consistent with those described in the *Annual Report and Accounts 2020*, as are the methods of computation.

(f) 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.

3 Net fee income

	30 Jun 2021	30 Jun 2020
	US$000	US$000
Cards	**60,018**	58,300
Credit facilities	**19,074**	24,306
Account services	**15,465**	16,340
Unit trust	**9,651**	3,768
Performance / Tender bonds	**30,781**	30,307
Global custody	**20,444**	18,919
Remittances	**16,733**	17,022
Imports/exports	**29,484**	29,094
Insurance agency commission	**4,906**	5,706
Others	**46,571**	48,605
Total Fee Income	**253,127**	252,367
Fee Expense	**(38,325)**	(40,895)
Net Fee Income	**214,802**	211,472

1 *The disclosure has been enhanced for current and prior period to align it to the best practice.*

4 Dividends

No dividends were declared during the period (30 June 2020: nil).

5 Segment analysis

Our global businesses

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

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

Profit/(loss) for the period

	2021				
	Wealth and Personal Banking	Commercial Banking	Global Banking and Markets	Corporate Centre*	Total
Half-year to 30 Jun	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**
Net interest income	**119,991**	**83,385**	**119,786**	**(1,055)**	**322,107**
Net fee income/(expense)	**56,252**	**68,543**	**90,094**	**(87)**	**214,802**
Net income from financial instruments held for trading or managed on a fair value basis	**21,482**	**16,790**	**102,306**	**(547)**	**140,031**
Other income	**4,592**	**11,693**	**(4,110)**	**12,395**	**24,570**
Net operating income before change in expected credit losses and other credit impairment charges	**202,317**	**180,411**	**308,076**	**10,706**	**701,510**
Change in expected credit losses and other credit impairment charges	**4,173**	**13,459**	**90,663**	**–**	**108,295**
Net operating income	**206,490**	**193,870**	**398,739**	**10,706**	**809,805**
Total operating expenses	**(171,388)**	**(117,945)**	**(144,974)**	**(46,576)**	**(480,883)**
Operating profit/(loss)	**35,102**	**75,925**	**253,765**	**(35,870)**	**328,922**
Share of profit/(loss) in associates	**–**	**–**	**–**	**(137)**	**(137)**
Profit/(loss) before tax	**35,102**	**75,925**	**253,765**	**(36,007)**	**328,785**
By geographical region					
U.A.E.	**42,570**	**38,249**	**192,908**	**(13,298)**	**260,429**
Qatar	**(2,214)**	**26,133**	**36,130**	**(322)**	**59,727**
Rest of Middle East	**(5,254)**	**11,543**	**24,727**	**(22,387)**	**8,629**
Profit/(loss) before tax	**35,102**	**75,925**	**253,765**	**(36,007)**	**328,785**

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

Profit/(loss) for the period (continued)

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

Balance sheet information

	2021				
At 30 Jun	**Wealth and Personal Banking US$000**	**Commercial Banking US$000**	**Global Banking and Markets US$000**	**Corporate Centre US$000**	**Total US$000**
Loans and advances to customers (net)	**3,228,649**	**6,301,217**	**9,317,981**	**—**	**18,847,847**
Total assets	**11,180,012**	**10,253,473**	**20,167,555**	**1,914,042**	**43,515,082**
Customer accounts	**13,120,663**	**5,319,573**	**7,282,448**	**—**	**25,722,684**
Total liabilities	**14,267,048**	**6,910,206**	**14,189,293**	**2,998,797**	**38,365,344**
At 31 Dec	2020				
Loans and advances to customers (net)	3,142,919	6,250,448	9,957,349	—	19,350,716
Total assets	11,435,751	9,749,856	21,644,367	1,771,329	44,601,303
Customer accounts	12,586,110	5,329,063	8,919,761	13	26,834,947
Total liabilities	13,450,534	6,849,109	16,710,732	2,690,982	39,701,357

Other financial information

Net operating income by global business

	2021				
Half-year to 30 Jun	**Wealth and Personal Banking US$000**	**Commercial Banking US$000**	**Global Banking and Markets US$000**	**Corporate Centre US$000**	**Total US$000**
Net operating income[1]	**202,317**	**180,411**	**308,076**	**10,706**	**701,510**
– external	**188,287**	**193,652**	**304,485**	**15,086**	**701,510**
– internal	**14,030**	**(13,241)**	**3,591**	**(4,380)**	**—**
Half-year to 30 Jun	2020				
Net operating income[1]	260,570	197,599	329,485	8,414	796,068
– external	223,969	241,369	358,757	(28,027)	796,068
– internal	36,601	(43,770)	(29,272)	36,441	—

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

6 Fair values of financial instruments not carried at fair value

The bases for measuring the fair values of loans and advances to banks and customers, financial investments, deposits by banks, customer accounts, debt securities in issue, subordinated liabilities and non-trading repurchase and reverse repurchase agreements are explained in the *Annual Report and Accounts 2020*.

Fair values of financial instruments not carried at fair value

	At 30 Jun 2021		At 31 Dec 2020	
	Carrying amount	**Fair value**	Carrying amount	Fair value
	US$000	**US$000**	US$000	US$000
Assets				
Loans and advances to banks	**7,304,127**	**7,375,781**	7,742,424	7,831,950
Loans and advances to customers	**18,847,847**	**18,750,628**	19,350,716	19,216,687
Reverse repurchase agreements – non-trading	**1,947,254**	**1,912,523**	1,828,851	1,795,732
Liabilities				
Deposits by banks[1]	**3,866,073**	**3,919,040**	3,468,222	3,544,422
Customer accounts	**25,722,684**	**25,730,291**	26,834,947	26,849,547
Repurchase agreements – non-trading	**626,225**	**626,227**	506,475	502,950
Debt securities in issue	**2,283,372**	**2,269,361**	2,000,594	1,962,882

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

7 Financial liabilities designated at fair value

	At	
	30 Jun 2021	31 Dec 2020
	US$000	US$000
Deposits by bank and customer accounts	**438,030**	517,228
Debt securities in issue (Note 8)	**1,853,270**	2,306,564
Total	**2,291,300**	2,823,792

At 30 June 2021, the accumulated amount of change in fair value attributable to changes in credit risk was a loss of US$16.6m (31 December 2020: US$14.3m loss).

8 Debt securities in issue

	30 Jun 2021	31 Dec 2020
	Carrying amount	Carrying amount
	US$000	US$000
Medium-term notes	**3,186,642**	3,357,158
Non-equity preference shares	**950,000**	950,000
Total debt securities in issue	**4,136,642**	4,307,158
Included within:		
– financial liabilities designated at fair value (Note 7)	**(1,853,270)**	(2,306,564)
Total	**2,283,372**	2,000,594

Movement in medium-term notes at amortised cost

	30 Jun 2021	31 Dec 2020
	US$000	US$000
Balance as at 1 Jan	**1,050,594**	838,486
New issues	**696,686**	412,044
Repayments	**(413,883)**	(199,936)
Other movements	**(25)**	—
Closing balance	**1,333,372**	1,050,594

9 Risk management

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

The interim condensed consolidated financial statements do not include all risk management information and disclosures required in the annual financial statements, they should be read in conjunction with the *Annual Report and Accounts 2020.*

There have been no material changes to our policies and practices regarding risk management and governance as described in the *Annual Report and Accounts 2020.*

Areas of special interest

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

The Covid-19 outbreak and its effect on the global economy have continued to impact our customers, and the future effects of the pandemic remain uncertain. Whilst the economic outlook has broadly improved relative to the same period last year, the speed at which countries and territories are able to return to pre-Covid-19 levels of economic activity will vary based on the levels of government support offered, the level of infection, ability to roll out vaccines and the efficacy of vaccines over various time horizons. Renewed outbreaks, including as a result of the emergence of new variants of the virus, emphasise the ongoing threat of Covid-19.

In the first half of 2021, the change in expected credit losses and other credit impairment charges ('ECL') were a net release of US$108m compared with a charge of US$508m in the first half of 2020. Of the US$616m decrease in ECL period-on-period, US$371m was in respect of Stage 1 and 2 ECL across both the Wholesale and Retail portfolios, US$236m was in respect of the Stage 3 ECL for the Wholesale portfolio and US$9m was in respect of the Stage 3 ECL for the Retail portfolio. The outlook for ECL is highly uncertain as countries emerge from the pandemic at different speeds, government support measures unwind and new virus strains test the efficacy of vaccination programmes.

Stage 1 and 2 ECL is estimated for our portfolios by taking into account relevant information about past events, current conditions and forecasts of future conditions. The decrease in Stage 1 and 2 ECL is due to the improvement in economic outlook in the first half of 2021 compared to the significant build-up of allowances in the first half of 2020 as a result of the worsening economic outlook at the onset of the Covid-19 outbreak. Government restrictions imposed around the world to limit the spread of Covid-19 resulted in a sharp contraction in global economic activity during 2020 with signs of recovery in 2021 as restrictions have eased. Our central scenario used to calculate Stage 1 and 2 ECL assumes that economic activity will recover over the course of 2021. There is a high degree of uncertainty associated with economic forecasts in the current environment and, as a result of this uncertainty, management judgements and estimates reflect a degree of caution. As economic conditions improve, 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 reviewed for reliability and appropriateness prior to inclusion in the financial results.

Wholesale Stage 3 ECLs are losses recognised for individual customer exposures that are in default and for which there is little prospect of future recovery. The decrease in Stage 3 ECL is due to a recovery on a customer in the Health Care sector in the first half of 2021 compounded by significant charges in the UAE in the first half of 2020 in respect a number of corporate customers. Whilst there was a low level of new Stage 3 ECL in the first half of 2021, the impact of the pandemic on the long-term prospects of businesses in vulnerable sectors of the economy is 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.

The group continues to support our personal and business customers, through market-specific measures initiated during the Covid-19 outbreak, and by supporting national schemes that focus on the parts of the economy most impacted by the pandemic. The group's balance sheet and liquidity has remained strong which has allowed us to support our customers during this period. Further details of our customer relief programmes in the UAE are set out below.

The operational support functions on which the group relies are based in a number of countries worldwide, some of which, notably India, have been particularly affected by the Covid-19 outbreak and have recently experienced a significant increase in infection rates. As a result of the Covid-19 outbreak, business continuity responses have been implemented and the majority of service level agreements have been maintained. The group continues to monitor the situation.

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'). The TESS provisions are currently in place until 30 June 2022. Similar schemes have been initiated by regulators in other countries in which the group operates.

The UAE Banking Regulators have issued Joint Guidance on the treatment of expected credit loss provisions in the context of the Covid-19 crisis (the 'Joint Guidance'). Based on the Joint Guidance, the customers that have received payment deferrals within and outside the TESS have been grouped 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 30 Jun 2021	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**	***US$000***	**US$000**	**US$000**	**US$000**	**US$000**
Personal										
– residential	**1,875,482**	**3**	**–**	**289**	**(27,089)**	***1,200***	**3**	**–**	**–**	**–**
– other personal	**1,169,674**	**30**	**–**	**594**	**(134,450)**	***22,600***	**25**	**(1)**	**5**	**(3)**
	3,045,156	**33**	**–**	**883**	**(161,539)**	***23,800***	**28**	**(1)**	**5**	**(3)**
Corporate and commercial										
– commercial, industrial and international trade	**5,866,954**	**51,893**	**0.88**	**204,497**	**(347,765)**	***5,649***	**35,000**	**(232)**	**16,893**	**(1,463)**
– commercial real estate and other property-related	**1,865,928**	**71,191**	**3.82**	**423,975**	**(326,044)**	***29,551***	**14,471**	**(22)**	**56,720**	**(10,539)**
– government	**1,454,269**	**–**	**–**	**–**	**(733)**	***–***	**–**	**–**	**–**	**–**
– other commercial	**2,173,270**	**1,478**	**0.07**	**7,370**	**(211,377)**	***(8,920)***	**1,478**	**(29)**	**–**	**–**
	11,360,421	**124,562**	**1.10**	**635,842**	**(885,919)**	***26,280***	**50,949**	**(283)**	**73,613**	**(12,002)**
Financial										
– non-bank financial institutions	**210,770**	**–**	**–**	**–**	**(1,123)**	***–***	**–**	**–**	**–**	**–**
Total	**14,616,347**	**124,595**	**0.85**	**636,725**	**(1,048,581)**	***50,080***	**50,977**	**(284)**	**73,618**	**(12,005)**

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

	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 2020	US$000	US$000	US$000	US$000	US$000	*US$000*	US$000	US$000	US$000	US$000
Personal										
– residential	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$647m (31Dec 2020: US$843m), representing an Exposure at Default of US$637m (31 Dec 2020: US$858m). As of 30 June 2021, HBME UAE has availed US$2m (31 Dec 2020: US$0.12b) out of the total TESS facility of US$0.46b provided by the UAE Central Bank.
2 This is calculated as a percentage of deferral amount to total gross loans.
3 Total ECL includes Stage 1 and 2 ECL of US$201m (31 Dec 2020: US$268m) and Stage 3 ECL of US$848m (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 and ECL to customers by industry sector – UAE

	Gross carrying value			Expected credit losses		
	30 Jun 2021	31 Dec 2020		**30 Jun 2021**	31 Dec 2020	
At 30 Jun 2021	**US$000**	US$000	**% change**	**US$000**	US$000	**% change**
Personal						
– residential mortgages	**1,875,482**	1,841,053	**1.9**	**(27,089)**	(38,135)	**(29.0)**
– other personal	**1,169,674**	1,157,609	**1.0**	**(134,450)**	(163,013)	**(17.5)**
	3,045,156	2,998,662	**1.6**	**(161,539)**	(201,148)	**(19.7)**
Corporate and commercial						
– commercial, industrial and international trade	**5,866,954**	6,084,514	**(3.6)**	**(347,765)**	(374,041)	**(7.0)**
– commercial real estate and other property-related	**1,865,928**	2,073,074	**(10.0)**	**(326,044)**	(324,132)	**0.6**
– government	**1,454,269**	1,342,671	**8.3**	**(733)**	(1,772)	**(58.6)**
– other commercial	**2,173,270**	2,412,966	**(9.9)**	**(211,377)**	(302,278)	**(30.1)**
	11,360,421	11,913,225	**(4.6)**	**(885,919)**	(1,002,223)	**(11.6)**
Financial						
– non-bank financial institutions	**210,770**	170,427	**23.7**	**(1,123)**	(2,390)	**(53.0)**
Total	**14,616,347**	15,082,314	**(3.1)**	**(1,048,581)**	(1,205,761)	**(13.0)**
Exposure at default	**13,654,177**	14,277,816	**(4.4)**	**N/A**	N/A	**N/A**

Clients benefiting from deferrals – UAE

At 30 Jun 2021			Number of clients deferred	Payment deferrals US$000	Exposure US$000	Impairment Allowance US$000
Segment	**Stage**	**Group**				
Retail banking	Stage 1	Group 1	**12**	**25**	**527**	**8**
		Group 2	**—**	**—**	**—**	**—**
	Total Stage 1		**12**	**25**	**527**	**8**
	Stage 2	Group 1	**1**	**3**	**299**	**10**
		Group 2	**1**	**4**	**54**	**19**
	Total Stage 2		**2**	**7**	**353**	**29**
	Stage 3	Group 1	**—**	**—**	**—**	**—**
		Group 2	**1**	**1**	**89**	**75**
	Total Stage 3		**1**	**1**	**89**	**75**
Total retail banking			**15**	**33**	**969**	**112**
Wholesale banking	Stage 1	Group 1	**3**	**49,472**	**107,400**	**341**
		Group 2	**—**	**—**	**—**	**—**
	Total Stage 1		**3**	**49,472**	**107,400**	**341**
	Stage 2	Group 1	**1**	**1,478**	**7,370**	**147**
		Group 2	**7**	**55,218**	**513,297**	**9,634**
	Total Stage 2		**8**	**56,696**	**520,667**	**9,781**
	Stage 3	Group 1	**—**	**—**	**—**	**—**
		Group 2	**3**	**18,394**	**18,394**	**10,619**
	Total Stage 3		**3**	**18,394**	**18,394**	**10,619**
Total wholesale banking			**14**	**124,562**	**646,461**	**20,741**
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 period – UAE

	Not credit impaired		Credit impaired		
	Stage 1	Stage 2	Stage 3	POCI	Total
At 30 Jun 2021	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**
Personal					
ECL allowance as of start of period	**23,885**	**93,236**	**84,830**	**—**	**201,951**
– residential mortgages	**(1,571)**	**(4,000)**	**(7,221)**	**—**	**(12,792)**
– other personal	**(2,697)**	**(23,283)**	**(1,169)**	**—**	**(27,149)**
ECL allowance as of end of period	**19,617**	**65,953**	**76,440**	**—**	**162,010**
Corporate and commercial					
ECL allowance as of start of period	**46,255**	**133,977**	**848,639**	**4,249**	**1,033,120**
– Corporates	**6,656**	**(45,027)**	**(82,698)**	**167**	**(120,902)**
– government	**(937)**	**(1,259)**	**—**	**—**	**(2,196)**
– non-bank financial institutions	**321**	**(1,955)**	**—**	**—**	**(1,634)**
– Banks	**(366)**	**(304)**	**—**	**—**	**(670)**
ECL allowance as of end of period	**51,929**	**85,432**	**765,941**	**4,416**	**907,718**

ECL movement during the year – UAE (continued)

	Not credit impaired		Credit impaired		
	Stage 1	Stage 2	Stage 3	POCI	Total
At 31 Dec 2020	US$000	US$000	US$000	US$000	US$000
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 adjustments[1] – UAE

	Non-Covid related ECL adjustments	Covid related ECL adjustments	Total ECL adjustments
As at 30 Jun 2021	**US$000**	**US$000**	**US$000**
Retail banking loans:			
– residential mortgages	**—**	**1,200**	**1,200**
– other personal	**—**	**22,600**	**22,600**
Total retail banking loans	**—**	**23,800**	**23,800**
Wholesale banking loans:			
– Non-government obligors	**—**	**26,280**	**26,280**
Total wholesale banking loans	**—**	**26,280**	**26,280**
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.*

Interbank Offered Rates ('IBOR') transition

Throughout the first half of 2021, the group has continued its efforts to provide the capability to offer new near risk-free rate ('RFR') products, and subsequently actively offer customers the ability to transition from Libor based products. Given that the administrator of Libor, International Benchmark Administrator ('IBA'), has confirmed the extension of the publication date of most US dollar Libor tenors until 30 June 2023, the group is focused on active transition away from those demising by 1 January 2022.

Provision of alternative rate and RFR product capabilities

All of our global businesses actively developed and implemented system and operational capabilities for the majority of alternative rates, such as base or prime rates, and RFR products during 2020 and first half 2021, with only a limited number of non-standard products requiring completion in second half of 2021. The group is currently monitoring other industry developments related to credit sensitive rates products to determine the need to develop additional products for our clients and in support of transition from USD Libor.

Transition legacy contracts

The group has planned to materially transition Ibor contracts by 30 September 2021, in line with industry guidelines, and has actively outreached to a material proportion of customers as at the end of first half of 2021. However, given the continued impact of Covid-19 on customers and the market, the transition of Ibor contracts is likely to be increasing the identified regulatory compliance, legal, resilience and operational risks.

Transition discussions are actively occurring with clients and the group will be led by their level of readiness, which is being tracked to ensure adequate planning for operational activities occurring in the second half of 2021. Whilst contractual repapering and rebooking activities will be managed accordingly, as well as any requirements to invoke contractual fallback provisions, legislative solutions may still be required to allow for a smooth transition.

Financial instruments impacted by Ibor reform

	Financial instruments yet to transition to alternative benchmarks, by main benchmark		
	USD Libor	**GBP Libor**	**Others[1]**
At 30 Jun 2021	**US$000**	**US$000**	**US$000**
Non-derivative financial assets[2]	**4,728,149**	**11,609**	**—**
Non-derivative financial liabilities[2]	**2,188,481**	**—**	**—**
Derivative notional contract amount	**25,615,391**	**69,108**	**524,890**
At 31 Dec 2020			
Non-derivative financial assets	6,603,654	10,428	—
Non-derivative financial liabilities	3,679,653	—	—
Derivative notional contract amount	27,755,353	—	—

1 *Comprises financial instruments referencing other significant benchmark rates yet to transition to alternative benchmarks (Euro Libor, Libor and Eonia).*
2 *Gross carrying amount excluding allowances for expected credit losses.*

The amounts in the above table relate to the group's main operating entities where the group has material exposures impacted by Ibor reform, including in the UAE and Qatar. The amounts provide an indication of the extent of the Group's exposure to the Ibor benchmarks that are due to be replaced. Amounts are in respect of financial instruments that:

- contractually reference an interest rate benchmark that is planned to transition to an alternative benchmark;
- have a contractual maturity date beyond the date by which the reference interest rate benchmark is expected to cease; and
- 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. This change reduced the amounts presented at 30 June 2021 in the above table as some financial instruments included at 31 December 2020 will reach their contractual maturity date prior to the extended publication dates. Comparative data have not been re-presented.

Summary of credit risk

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

	At 30 Jun 2021		At 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	**20,004,449**	**(1,156,602)**	20,696,401	(1,345,685)
Loans and advances to banks at amortised cost	**7,306,203**	**(2,076)**	7,746,251	(3,827)
Other financial assets measured at amortised cost	**3,774,419**	**(6,093)**	4,012,810	(8,197)
– cash and balances at central banks	**842,489**	**(382)**	1,241,854	(863)
– items in the course of collection from other banks	**52,422**	**—**	69,569	—
– reverse repurchase agreements – non-trading	**1,947,254**	**—**	1,828,851	—
– prepayments, accrued income and other assets	**932,254**	**(5,711)**	872,536	(7,334)
Total gross carrying amount on balance sheet	**31,085,071**	**(1,164,771)**	32,455,462	(1,357,709)
Loans and other credit-related commitments	**7,282,194**	**(24,590)**	6,639,554	(36,535)
Financial guarantee and similar contract	**1,016,343**	**(11,353)**	1,217,383	(16,675)
Total nominal amount off balance sheet	**8,298,537**	**(35,943)**	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 FVOCI	**10,744,578**	**(935)**	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 30 June 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	**14,074,314**	**4,631,714**	**1,292,224**	**6,197**	**20,004,449**	**(90,727)**	**(155,936)**	**(908,286)**	**(1,653)**	**(1,156,602)**
Loans and advances to banks at amortised cost	**7,281,146**	**25,057**	**—**	**—**	**7,306,203**	**(1,866)**	**(210)**	**—**	**—**	**(2,076)**
Other financial assets measured at amortised cost	**3,642,893**	**128,180**	**3,346**	**—**	**3,774,419**	**(2,039)**	**(708)**	**(3,346)**	**—**	**(6,093)**
Loans and other credit-related commitments	**6,339,756**	**937,994**	**4,444**	**—**	**7,282,194**	**(11,252)**	**(13,026)**	**(312)**	**—**	**(24,590)**
Financial guarantee and similar contracts	**794,813**	**212,053**	**9,477**	**—**	**1,016,343**	**(3,811)**	**(7,540)**	**(2)**	**—**	**(11,353)**
At 30 Jun 2021	**32,132,922**	**5,934,998**	**1,309,491**	**6,197**	**39,383,608**	**(109,695)**	**(177,420)**	**(911,946)**	**(1,653)**	**(1,200,714)**
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)
Loans and other credit-related commitments	5,611,694	977,570	50,290	—	6,639,554	(9,578)	(26,824)	(133)	—	(36,535)
Financial guarantee and similar contracts	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)

Macro-economic forecast, probability weights and management overlays

Expected credit loss impairment allowances recognised in the financial statements reflect the effect of a range of possible economic outcomes, calculated on a probability-weighted basis, based on the economic scenarios 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 starting with three economic scenarios, based on consensus forecast distributions, supplemented by alternative or additional economic scenarios and/or management adjustments where, in management's judgement, the consensus forecast distribution does not adequately capture the relevant risks.

The three economic scenarios represent the 'most likely outcome' (the Central scenario), and two less likely outcomes, referred to as the Upside and Downside scenarios. In normal circumstances, each outer scenario is consistent with a probability of 10%, while the Central scenario is assigned the remaining 80%, according to the decision of the group's senior management. This weighting scheme is deemed appropriate for the unbiased estimation of ECL in most circumstances. Key economic assumptions in the Central scenario are set using the average of forecasts of external economists, helping to ensure that the IFRS 9 scenarios are unbiased and maximise the use of independent information.

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. 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 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. The group determines 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. The group use externally available forecast distributions to help ensure independence in scenario construction. While key economic variables are set with reference to external distributional forecasts, the group 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. The group projects additional variable paths using the external provider's global macro model.

Additional scenarios are created and probability weightage assigned to each scenario are revisited, as required, to address those forward-looking risks that management considers are not adequately captured by the consensus.

In light of the current uncertain economic environment, an alternative Downside scenario ('Additional Downside') has been included and the scenario weighting has been re-assessed to reflect management's view of extreme risks. Central scenario has been assigned a weighting of 65%, the Downside scenario 25% 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 (2021Q3–2026Q2)

	UAE
Probability (%)	**65**
GDP growth rate (%)	
2021: Annual average growth rate	**2.5**
2022: Annual average growth rate	**3.8**
2023: Annual average growth rate	**3.0**
5-year average	**3.6**
Oil price (US$)	
2021: Average oil price	**66.6**
2022: Averahe oil price	**65.2**
2023: Average oil price	**62.7**
5-year average	**64.6**
House price growth (%)	
2021: Annual average growth rate	**(3.9)**
2022: Annual average growth rate	**(0.7)**
2023: Annual average growth rate	**0.3**
5-year average	**0.8**

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**	**25**	**5**
GDP growth rate (%)	**14.9 (1Q22)**	**(3.3) (3Q22)**	**(11.6) (2Q22)**
Oil price (US$)	**93.1 (3Q22)**	**43.4 (1Q22)**	**24.2 (3Q22)**
House price growth (%)	**21.1 (3Q22)**	**(17) (4Q22)**	**(18.1) (2Q22)**

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, the group consider the correlation of forward economic guidance to default rates for a particular industry in a country. For LGD calculations, the group consider the correlation of forward economic guidance to collateral values and realisation rates for a particular country and industry. PDs and LGDs are estimated for the entire term structure of each instrument.

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

IFRS 9 ECL sensitivity to economic scenarios[1]

	UAE	
	Jun 2021	Dec 2020
Reported ECL (US$m)	**201**	250
Gross carrying/nominal amount (US$m)	**45,997**	44,777
Consensus Central scenario	**164**	241
Consensus Upside scenario	**119**	190
Consensus Downside scenario	**257**	330
Additional Downside scenario	**607**	536

1 *Includes Stage 1 and 2 on and off balance sheet financial instruments to which IFRS 9 impairment requirements are applied (including debt instruments measured at FVOCI). Stage 3 exposures are excluded because they are relatively more sensitive to credit factors specific to the obligor than future economic 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 scenarios[1]

	UAE					
	Gross carrying amount	Reported ECL	Central scenario ECL	Upside scenario ECL	Downside scenario ECL	Additional Downside scenario ECL
30 Jun 2021	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**
Mortgages	**1,902**	**55**	**52**	**44**	**60**	**64**
Credit cards	**395**	**73**	**66**	**61**	**80**	**95**
Other	**613**	**28**	**28**	**26**	**29**	**31**
31 Dec 2020						
Mortgages	1,889	66	63	53	73	78
Credit cards	426	92	81	62	107	126
Other	683	38	37	33	41	46

1 *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.

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 30 June 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:	3,190,119	(50,338)	(3,259,326)	79,407	69,207	(29,067)	–	–	–	2
– Transfers from Stage 1 to Stage 2	(1,739,571)	11,939	1,739,571	(11,937)	–	–	–	–	–	2
– Transfers from Stage 2 to Stage 1	4,929,690	(62,277)	(4,929,690)	62,277	–	–	–	–	–	–
– Transfers to Stage 3	–	–	(75,796)	32,123	75,796	(32,123)	–	–	–	–
– Transfers from Stage 3	–	–	6,589	(3,056)	(6,589)	3,056	–	–	–	–
Net remeasurement of ECL arising from transfer of stage	–	27,185	–	(10,248)	–	(65)	–	–	–	16,872
Net new and further lending/(repayments) and changes in risk parameters	(2,210,726)	25,033	1,813,337	34,806	(159,158)	15,596	(7,656)	(166)	(564,203)	75,269
Assets written off	–	–	–	–	(116,195)	116,195	–	–	(116,195)	116,195
Foreign exchange and others	(8,500)	–	(1,487)	52	(14)	62	–	12	(10,001)	126
Others	–	433	–	5,010	–	(5,806)	–	–	–	(363)
At 30 Jun 2021	28,490,029	(107,656)	5,806,818	(176,712)	1,306,145	(908,600)	6,197	(1,653)	35,609,189	(1,194,621)
ECL release/(charge) for the period		52,218		24,558		15,531		(166)	–	92,141
Recoveries	–	–	–	–	–	11,533	–	–	–	11,533
Others	–	–	–	–	–	(3)	–	–	–	(3)
Total ECL release/ (charge) for the period	–	52,218	–	24,558	–	27,061	–	(166)	–	103,671

	At 30 Jun 2021		Six months ended 30 Jun 2021
	Gross carrying/nominal amount	Allowance for ECL	ECL and other credit charges
	US$000	US$000	US$000
As above	35,609,189	(1,194,621)	103,671
Other financial assets measured at amortised cost	3,774,419	(6,093)	2,252
Other instruments not within the scope of IFRS 9			1,311
Summary of financial instruments to which the impairment requirements in IFRS 9 are applied/ Summary consolidated income statement	39,383,608	(1,200,714)	107,234
Debt instruments measured at FVOCI	10,744,578	(935)	1,061
Change in expected credit losses and other credit impairment charges	N/A	(1,201,649)	108,295

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

	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)	—	(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 on loans and advances to banks and customers including loan commitments and financial guarantees for the period ended 30 June 2020

	Non-credit impaired		Credit impaired		
	Stage 1	Stage 2	Stage 3	POCI	Total
	US$000	US$000	US$000	US$000	US$000
ECL release/(charge) for the period	(41,937)	(186,556)	(227,829)	67	(456,255)
Recoveries	—	—	8,332	—	8,332
Others	—	—	917	—	917
Total ECL release/(charge) for the period	(41,937)	(186,556)	(218,580)	67	(447,006)

	At 31 Dec 2020		Six months ended 30 Jun 2020
	Gross carrying/nominal amount	Allowance for ECL	ECL and other credit charges
	US$000	US$000	US$000
Loans and advances to banks and customers including loan commitments and financial	36,299,588	(1,402,722)	(447,006)
Other financial assets measured at amortised cost	4,012,810	(8,197)	(9,495)
Other instruments not within the scope of IFRS 9			(49,722)
Summary of financial instruments to which the impairment requirements in IFRS 9 are applied/Summary consolidated income statement	40,312,398	(1,410,919)	(506,223)
Debt instruments measured at FVOCI	10,744,578	(935)	(1,906)
Change in expected credit losses and other credit impairment charges	N/A	(1,411,854)	(508,129)

Concentration of exposure

Gross loans and advances to customers by industry sector

	Gross loans and advances to customers	
	Total	**As a % of total gross loans**
At 30 Jun 2021	**US$000**	**%**
Personal		
– residential mortgages	**1,902,771**	**9.5**
– other personal	**1,513,426**	**7.6**
	3,416,197	**17.1**
Corporate and commercial		
– commercial, industrial and international trade	**9,258,513**	**46.3**
– commercial real estate and other property-related	**2,461,733**	**12.3**
– government	**1,454,269**	**7.2**
– other commercial	**3,194,685**	**16.0**
	16,369,200	**81.8**
Financial		
– non-bank financial institutions	**219,052**	**1.1**
Total gross loans and advances to customers	**20,004,449**	**100.0**
Impaired loans		
– as a percentage of gross loans and advances to customers	**6.5%**	
Total impairment allowances		
– as a percentage of gross loans and advances to customers	**5.8%**	
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 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	7.1 %	
Total impairment allowances		
– as a percentage of gross loans and advances to customers	6.5 %	

10 Fair values of financial instruments

The accounting policies, control framework and the hierarchy used to determine fair values at 30 June 2021 are consistent with those applied in the *Annual Report and Accounts 2020.*

Financial instruments carried at fair value and bases of valuation

	30 Jun 2021				31 Dec 2020			
	Level 1	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total
	Quoted market price	**Using observable inputs**	**With significant unobservable inputs**		Quoted market price	Using observable inputs	With significant unobservable inputs	
	US$000	**US$000**	**US$000**	**US$000**	US$000	US$000	US$000	US$000
Recurring fair value measurements								
Assets								
Trading assets	**361,633**	**203,212**	**196,232**	**761,077**	152,116	394,423	195,055	741,594
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	**—**	**—**	**25,967**	**25,967**	—	—	38,813	38,813
Derivatives	**—**	**1,295,633**	**2,475**	**1,298,108**	—	1,876,664	2,578	1,879,242
Financial investments	**8,854,418**	**1,889,228**	**35,029**	**10,778,675**	5,859,460	4,206,655	37,719	10,103,834
Liabilities								
Trading liabilities	**146,118**	**168,333**	**—**	**314,451**	139,120	160,426	—	299,546
Financial liabilities designated at fair value	**—**	**2,291,300**	**—**	**2,291,300**	—	2,823,792	—	2,823,792
Derivatives	**—**	**1,138,852**	**5,267**	**1,144,119**	—	1,796,424	2,720	1,799,144

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 nil (2020: nil) transfer from Level 2 to Level 1 Financial Investments and nil (2020:nil) transfers from Level 2 to Level 3 Financial Investments.

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	35,029	—	25,967	—	60,996	—	—
Other derivatives	—	—	—	2,475	2,475	5,267	5,267
Other portfolios	—	196,232	—	—	196,232	—	—
At 30 Jun 2021	**35,029**	**196,232**	**25,967**	**2,475**	**259,703**	**5,267**	**5,267**
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

The basis for determining the fair value of the financial instruments in the table above is explained in the *Annual Report and Accounts 2020.*

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 losses recognised in profit or loss	—	771	(2,592)	(286)	559
– net income from financial instruments held for trading or managed on a fair value basis	—	771	—	—	—
– changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss	—	—	(2,592)	(286)	559
Total gains recognised in other comprehensive income	(2,690)	—	—	—	—
– financial investments: fair value losses	(2,690)	—	—	—	—
Purchases	—	78,630	—	1,054	2,859
Sales	—	(78,224)	(10,254)	(871)	(871)
Settlements	—	—	—	—	—
Transfers in	—	—	—	—	—
At 30 Jun 2021	**35,029**	**196,232**	**25,967**	**2,475**	**5,267**
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 30 Jun 2020	—	771	(2,592)	(286)	559
– net income from financial instruments held for trading or managed on a fair value basis	—	771	—	—	—
– changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss	—	—	(2,592)	(286)	559
At 1 Jan 2020	45,169	79,960	40,731	5,642	442
Total gains/(losses) recognised in profit or loss	—	(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)	—	—
Total losses recognised in other comprehensive income	(7,450)	—	—	—	—
– financial investments: fair value losses	(7,450)	—	—	—	—
Purchases[1]	—	117,230	—	4,419	4,435
Settlements	—	—	(29)	(6,190)	(2,157)
Transfers out	—	—	—	—	—
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 30 Jun 2020	—	(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)	—	—

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.*

11 Contingent liabilities, contractual commitments and guarantees

	30 Jun 2021 US$000	31 Dec 2020 US$000
Guarantees and other contingent liabilities		
Guarantees	**15,779,103**	16,459,976
Commitments		
Documentary credits and short-term trade-related transactions	**709,390**	632,218
Forward asset purchases	**543,348**	–
Standby facilities, credit lines and other commitments to lend	**16,199,550**	16,398,052
Total	**17,452,288**	17,030,270

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

12 Legal proceedings and regulatory matters

The group is party to legal proceedings and regulatory matters in a number of jurisdictions arising out of its normal business operations. Apart from the matters described below (which include matters that are relevant to the group as a subsidiary of HSBC Holdings operating in the Middle East), the group considers that none of the other matters are material. The recognition of provisions is determined in accordance with the accounting policies set out in Note 1 of HSBC's *Annual Report and Accounts 2020.* While the outcomes of legal proceedings and regulatory matters are inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of these matters as at 30 June 2021. Where an individual provision is material, the fact that a provision has been made is stated and quantified, except to the extent that doing so would be seriously prejudicial. Any provision recognised does not constitute an admission of wrongdoing or legal liability. It is not practicable to provide an aggregate estimate of potential liability for our legal proceedings and regulatory matters as a class of contingent liabilities.

Anti-money laundering and sanctions-related

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 July 2020, and consented to a cease-and-desist order with the US Federal Reserve Board ('FRB'), both of which contained certain forward-looking anti-money laundering ('AML') and sanctions-related obligations. HSBC Holdings agreed to retain an independent compliance monitor to produce annual assessments of the Group's AML and sanctions compliance programme (the 'Skilled Person/Independent Consultant').

In February 2020, HSBC's engagement with the Skilled Person/Independent Consultant appointed pursuant to the 2013 Direction concluded. The Role of FCA Skilled Person was assigned to a new individual in Q2 2020 and a new FRB Independent Consultant has been appointed pursuant to the cease-and-desist order in the second quarter of 2020. Separately, in early 2021, a new FRB Consultant was appointed pursuant to the cease-and-desist order.

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, seven 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, including in the EU, Brazil and South Africa, are conducting investigations and reviews into trading by HSBC and others on the foreign exchange markets. HSBC is cooperating with these investigations and reviews 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, HSBC Holdings exited the FX DPA and, in July 2021, the charges deferred by the FX DPA were dismissed.

13 Related party transactions

There were no changes in the related party transactions described in the *Annual Report and Accounts 2020* that have had a significant effect on the financial position or performance of the group in the half-year to 30 June 2021. All related party transactions that took place in the half-year to 30 June 2021 were similar in nature to those disclosed in the *Annual Report and Accounts 2020.*

14 Events after the balance sheet date

These accounts were approved by the Board of Directors on 2 August 2021 and authorised for issue.

Independent Review Report to HSBC Bank Middle East Limited

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

Introduction

We have reviewed the accompanying condensed consolidated interim statement of financial position of HSBC Bank Middle East Limited and its subsidiaries (the 'Group') as at 30 June 2021 and the related condensed consolidated statements of income, comprehensive income, changes in equity and cash flows for the six month period then ended and notes, comprising a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and presentation of this condensed consolidated interim financial information in accordance with International Accounting Standard 34 – 'Interim Financial Reporting' as issued by the International Accounting Standards Board ('IASB') and as adopted by the United Kingdom. Our responsibility is to express a conclusion on this condensed consolidated interim financial information based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, 'Review of interim financial information performed by the independent auditor of the entity'. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed consolidated interim financial information is not prepared, in all material respects, in accordance with International Accounting Standard 34 – 'Interim Financial Reporting' as issued by the IASB and as adopted by the United Kingdom.

PricewaterhouseCoopers Limited

Place: Dubai, United Arab Emirates

Date: 2 August 2021

Audit Principal: Tamsin King (Reference Number I009875)

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PricewaterhouseCoopers Limited is registered with the Dubai Financial Services Authority.

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Regulated by the Dubai Financial Services Authority.

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