

HSBC Bank Australia Ltd

A.C.N. 006 434 162

Financial Report

Year Ended 31 December 2011



The world's local bank

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Directors Report

The Directors of HSBC Bank Australia Limited (the "Company" or the "Bank") submit their report, together with the financial report of the Company and of the consolidated entity, being the Company and its controlled entities, for the financial year ended 31 December 2011 and the auditor's report thereon.

DIRECTORS

The Directors of the Company at any time during or since the end of the financial year are:

Graham J Bradley AM	Non-Executive Chairman	
Paulo C T Maia	Chief Executive Officer	
Richard G Humphry AO	Non-Executive Director	
Alexander A Flockhart CBE	Non-Executive Director	
Carol J Austin	Non-Executive Director	
Peter Wong	Non-Executive Director	Resigned 01 February 2011
Guy Harvey-Samuel	Non-Executive Director	Appointed 01 February 2011

PRINCIPAL ACTIVITIES

The principal activities of the consolidated entity during the financial year were the provision of financial services comprising lending, deposit taking, domestic and international trade finance, custodial securities services, payments & cash management, money market services, interest rate and foreign currency trading and services, capital markets services, financial advice and futures clearing services.

The Company is domiciled in Victoria and is a public limited company incorporated in Australia. The registered office is Level 32, HSBC Centre, 580 George Street Sydney.

RESULT OF OPERATIONS

In 2011, HSBC Bank Australia Limited and its controlled entities reported a net profit from continuing operations before tax of \$255.7m, an increase of 16.5% from 2010. Profits increased as a result of growth in net interest income and fees in the Company's Retail Banking and Wealth Management and Commercial Banking businesses principally due to increased customer loans and deposits. However this revenue growth was partly offset by a decrease in trading income within Global Markets due to the challenging market conditions. Loan impairment charges, recoveries, and other credit risk provisions improved compared to 2010, due to improved credit quality within the cards and commercial banking portfolios and continued low levels of delinquencies in the mortgage book.

Total assets were \$24.0 billion, up 7.2% from 2010 due principally to the increase in commercial banking, mortgages and cards portfolios. The Bank also continues to hold high levels of liquid assets in line with HSBC Group policy.

Total Capital ratio under APRA rules was 10.6% at 31 December 2011 (12.5% at 31 December 2010). The higher ratio at the end of 2010 included \$200m Tier 2 issuance in November 2010 in anticipation of a redemption of \$200m in May 2011. The Bank will continue to maintain a strong capital position ensuring compliance with expected Basel III changes and to maintain sufficient profits for future growth. Tier 1 capital was 8.4% at 31 December 2011 (8.4% at 31 December 2010), which reflects strong retained earnings growth on the back of growth in residential mortgages and commercial banking loans, partly offset by dividend payments to shareholders. Risk Weighted Assets grew 11% on a combined basis in 2011.

DIVIDENDS

Dividends paid or declared by the Company to members since the end of the previous financial year were \$88.0m (2010: \$82.0m), which was comprised of \$85.0m (2010: \$79.0m) paid on Ordinary Shares and \$3.0m (2010: \$3.0m) paid on Preference Shares. Dividend payments increased from 2010 to 2011 reflecting the growth in profits, and were in line with the Company's capital management strategy to retain sufficient profits to self-capitalise future growth.

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

HSBC Bank Australia Limited continued to maintain a strong liquidity policy in line with the HSBC Group, which, together with a strong capital position ensured that the Company was able to effectively service its longstanding commitment to its customers as well as strengthen its competitive position in the domestic market. In the opinion of the Directors, there were no significant changes in the state of affairs of the Company or the consolidated entity during the financial year under review.

ENVIRONMENTAL REGULATION

The Company and its controlled entities are not subject to any particular or significant environmental regulation under a law of the Commonwealth or of a State or Territory.

EVENTS SUBSEQUENT TO REPORTING DATE

There has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity, in future financial years.

LIKELY DEVELOPMENTS

Information about likely developments in the operations of the consolidated entity and the expected results of those operations in future financial years has not been included in this report because disclosure of the information would be likely to result in unreasonable prejudice to the consolidated entity.

NON-AUDIT SERVICES

During the financial year KPMG, the consolidated entity's auditor, has performed certain other services in addition to their statutory duties.

The Directors have considered the non-audit services provided during the financial year by KPMG and in accordance with written advice provided by resolution of the audit committee, are satisfied that the provision of those non-audit services by the Company's auditor is compatible with, and did not compromise, the auditor independence requirements of the Corporations Act 2001 for the following reasons:

- All non-audit assignments were approved in accordance with the process set out in HSBC Holdings plc's Audit Committee terms of reference on the agreed framework for engaging auditors for non-audit services; and
- The non-audit services provided do not undermine the general principles relating to auditor independence as set out in Professional Statement F1 *Professional Independence*, as they did not involve reviewing or auditing the auditor's own work, acting in a management or decision making capacity for the Company, acting as an advocate for the Company or jointly sharing risks and rewards.

Details of the amounts paid to the auditor of the consolidated entity, KPMG, and its related practices for audit and non-audit services provided during the year are set out in note 5 of the financial statements.

LEAD AUDITOR'S INDEPENDENCE DECLARATION

The lead auditor's independence declaration is set out on page 90 and forms part of the Directors' Report for the year ended 31 December 2011.

INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS

During the financial year, the consolidated entity has caused to be paid premiums in respect of contracts insuring all the directors and certain officers of the Company and its controlled entities against any liability incurred in their role as directors or officers of the entity, except where:

- a) the liability arises out of conduct involving a wilful breach of duty; or
- b) there has been a contravention of Sections 182 and/or 183 of the Corporations Act 2001.

The Directors have not included details of the nature of liabilities covered or the amount of premium paid in respect of the directors' and officers' liability contracts, as such disclosure is prohibited under the terms of the contract.

DIRECTORS' BENEFITS

No director of the Company has, since the end of the previous financial year, received or become entitled to receive a benefit (other than a benefit included in the aggregate amount of remuneration received or due and receivable by Directors shown in the consolidated financial statements) by reason of a contract made by the Company, a controlled entity or a related body corporate with the director or with a firm in which the director is a member, or with an entity in which the director has a substantial interest, other than that disclosed in the attached financial statements.

ROUNDING OFF OF AMOUNTS

The Company is of the kind referred to in an ASIC Class Order 98/100 dated 10 July 1998 (updated by CO 05/641 effective 28 July 2005 and CO 06/51 effective 31 January 2006) and, in accordance with that Class Order, amounts in this report and the accompanying financial statements, where appropriate, have been rounded to the nearest million dollars except where otherwise stated.

The report is made with a resolution of the Directors.

Graham J Bradley
Chairman

Paulo C T Maia
Director

Dated at Sydney this 14th day of February 2012.

Income Statements

For The Year Ended 31 December 2011

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
Interest income	2(i)	1,395.4	1,113.4	1,395.4	1,113.4
Interest expense	2(ii)	(810.0)	(645.7)	(811.6)	(647.5)
Net interest income		585.4	467.7	583.8	465.9
Fee and commission income	2(iv)	201.9	178.5	202.8	180.1
Fee and commission expense	2(iv)	(31.0)	(28.7)	(30.2)	(28.5)
Net fee and commission income		170.9	149.8	172.6	151.6
Net trading income/(loss)	2(v)	(24.2)	59.1	(24.2)	59.1
Net loss from financial instruments designated at fair value	2(vi)	-	(7.3)	-	(7.3)
Net gain/(loss) from disposal of financial investments	2(vii)	(1.1)	4.9	(1.1)	4.9
Other operating income	2(iii)	43.4	40.4	46.7	110.6
Net other operating income/(loss)		18.1	97.1	21.4	167.3
Operating income before loan impairment charges, recoveries and other credit risk provisions		774.4	714.6	777.8	784.8
Loan impairment charges, recoveries and other credit risk provisions	3(i)	(53.3)	(72.9)	(57.9)	(87.0)
Impairment of investment in subsidiaries	3(ii)	-	-	-	(56.7)
Net operating income		721.1	641.7	719.9	641.1
Operating expenses					
- staff costs	4	(250.3)	(219.7)	(250.3)	(219.7)
- premises and equipment	4	(51.7)	(46.5)	(51.7)	(46.5)
- administrative expenses	4	(106.4)	(102.2)	(106.4)	(102.1)
- other expenses	4	(57.0)	(54.0)	(57.2)	(54.0)
Total operating expenses		(465.4)	(422.4)	(465.6)	(422.3)
Profit before income tax		255.7	219.3	254.3	218.8
Income tax expense	6	(78.5)	(66.7)	(77.1)	(62.4)
Profit for the period		177.2	152.6	177.2	156.4
Attributable to:					
Equity holders of the parent		177.2	152.6	177.2	156.4

The notes on pages 14 to 86 are an integral part of these consolidated financial statements.

Statements Of Financial Position

As At 31 December 2011

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
ASSETS					
Cash and balances at central banks	27(b)	398.0	399.2	398.0	399.2
Items in the course of collection from other banks		1.6	1.2	1.6	1.2
Trading assets	7	-	22.8	-	22.8
Derivatives	8	91.5	81.6	91.5	81.6
Loans and advances to banks	26(c)	1,979.6	1,821.1	1,979.6	1,821.1
Loans and advances to customers	26(c)	15,769.8	14,174.5	15,769.8	14,174.5
Financial investments	9	4,586.2	3,466.8	4,586.2	3,466.8
Property plant & equipment	10	28.4	18.7	28.4	18.7
Intangible assets	12	59.3	59.9	59.3	59.9
Other assets	13	970.4	2,193.3	973.6	2,184.8
Deferred tax assets	14(a)	77.1	103.1	77.1	103.1
TOTAL ASSETS		23,961.9	22,342.2	23,965.1	22,333.7
LIABILITIES AND EQUITY					
Deposits by banks		644.5	753.4	644.5	753.4
Customer accounts		17,790.3	15,952.0	17,790.3	15,952.0
Trading liabilities	15	260.4	205.5	260.4	205.5
Items in the course of transmission to other banks		22.1	21.6	22.1	21.6
Derivatives	8	113.6	80.2	113.6	80.2
Debt securities on issue	17	1,387.0	1,191.7	1,106.8	834.6
Provisions for liabilities and charges	18	49.7	49.7	49.7	49.7
Other liabilities	19	2,149.4	2,433.3	2,432.4	2,781.5
Employee benefits	20	30.0	23.5	30.0	23.5
Subordinated liabilities	16	242.0	442.0	242.0	442.0
TOTAL LIABILITIES		22,689.0	21,152.9	22,691.8	21,144.0
NET ASSETS		1,272.9	1,189.3	1,273.3	1,189.7
EQUITY					
Share capital	21	811.0	811.0	811.0	811.0
Reserves		2.8	8.9	2.8	8.9
Retained earnings		459.1	369.4	459.5	369.8
TOTAL EQUITY		1,272.9	1,189.3	1,273.3	1,189.7

The notes on pages 14 to 86 are an integral part of these consolidated financial statements.

Statements Of Comprehensive Income

For The Year Ended 31 December 2011

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
Profit for the period		177.2	152.6	177.2	156.4
Other comprehensive income:					
Available for sale investments:					
- Fair value gains taken to equity		13.7	9.9	13.7	9.9
- Net amount transferred to the income statement		(23.2)	(0.3)	(23.2)	(0.3)
- Deferred tax on items taken directly to or transferred from equity		3.2	(3.2)	3.2	(3.2)
Cash flow hedges:					
- Net amount transferred to income statement		3.9	2.2	3.9	2.2
- Effective portion of changes in fair value		(5.7)	0.5	(5.7)	0.5
- Deferred tax on items taken directly to or transferred from equity		0.5	(0.8)	0.5	(0.8)
Assets revaluation reserve:					
- Transferred from revaluation reserve due to subsidiary rationalisation programme		-	-	-	(23.2)
Other comprehensive income/ (expense) taken to equity during the period		(7.6)	8.3	(7.6)	(14.9)
Total comprehensive income for the period		169.6	160.9	169.6	141.5
Attributable to:					
Equity holders of the parent		169.6	160.9	169.6	141.5

The notes on pages 14 to 86 are an integral part of these consolidated financial statements.

Statements Of Changes in Equity

For The Year Ended 31 December 2011 - Consolidated

\$'m	Share capital	Available for Sale Reserve	Cash flow Hedging Reserve	Capital contribution Reserve	Retained Profits	Total
Balance at 1 January 2011	811.0	3.3	(3.2)	8.8	369.4	1,189.3
Total comprehensive income for the year						
Profit for the year	-	-	-	-	177.2	177.2
Other comprehensive income, net of income tax						
Cash flow hedges	-	-	-	-	-	-
- Effective portion of changes in fair value	-	-	(4.0)	-	-	(4.0)
- Net amount transferred to profit and loss	-	-	2.7	-	-	2.7
Available for sale assets						
- Net Change in fair value	-	9.6	-	-	-	9.6
- Net amount transferred to Profit and loss	-	(15.9)	-	-	-	(15.9)
Total other comprehensive income	-	(6.3)	(1.3)	-	-	(7.6)
Total comprehensive income for year	-	(6.3)	(1.3)	-	177.2	169.6
Transactions with Owners, recorded directly in equity						
Contributions by and distributions to owners						
- Share based payments contributed in the year	-	-	-	6.2	-	6.2
recycled to Profit and loss	-	-	-	(0.5)	0.5	-
other	-	-	-	(4.2)	-	(4.2)
- Dividends to equity holders	-	-	-	-	(88.0)	(88.0)
Total Contributions by and distributions to owners	-	-	-	1.5	(87.5)	(86.0)
Balance at 31 December 2011	811.0	(3.0)	(4.5)	10.3	459.1	1,272.9

The notes on pages 14 to 86 are an integral part of these consolidated financial statements.

Statements Of Changes in Equity (continued)

For The Year Ended 31 December 2010 - Consolidated

\$'m	Share capital	Available for Sale Reserve	Cash flow Hedging Reserve	Capital contribution Reserve	Retained Profits	Total
Balance at 1 January 2010	811.0	(3.1)	(5.1)	7.2	298.5	1,108.5
Total comprehensive income for the year						
Profit for the year	-	-	-	-	152.6	152.6
Other comprehensive income, net of income tax						
Cash flow hedges						
- Effective portion of changes in fair value	-	-	0.3	-	-	0.3
- Net amount transferred to profit and loss	-	-	1.6	-	-	1.6
Available for sale assets						
- Net Change in fair value	-	6.4	-	-	-	6.4
- Net amount transferred to Profit and loss	-	-	-	-	-	-
Total other comprehensive income	-	6.4	1.9	-	-	8.3
Total comprehensive income for year	-	6.4	1.9	-	152.6	160.9
Transactions with Owners, recorded directly in equity						
Contributions by and distributions to owners						
- Share based payments						
contributed in the year	-	-	-	4.5	-	4.5
recycled to Profit and loss	-	-	-	(0.3)	0.3	-
other	-	-	-	(2.6)	-	(2.6)
- Dividends to equity holders	-	-	-	-	(82.0)	(82.0)
Total Contributions by and distributions to owners	-	-	-	1.6	(81.7)	(80.1)
Balance at 31 December 2010	811.0	3.3	(3.2)	8.8	369.4	1,189.3

The notes on pages 14 to 86 are an integral part of these consolidated financial statements.

Statements Of Changes in Equity (continued)

For The Year Ended 31 December 2011 - Company

\$'m	Share capital	Available for Sale Reserve	Cash flow Hedging Reserve	Capital contribution Reserve	Retained Profits	Total
Balance at 1 January 2011	811.0	3.3	(3.2)	8.8	369.8	1,189.7
Total comprehensive income for the year						
Profit for the year	-	-	-	-	177.2	177.2
Other comprehensive income, net of income tax						
Cash flow hedges						
- Effective portion of changes in fair value	-	-	(4.0)	-	-	(4.0)
- Net amount transferred to profit and loss	-	-	2.7	-	-	2.7
Available for sale assets						
- Net Change in fair value	-	9.6	-	-	-	9.6
- Net amount transferred to Profit and loss	-	(15.9)	-	-	-	(15.9)
Total other comprehensive income	-	(6.3)	(1.3)	-	-	(7.6)
Total comprehensive income for year	-	(6.3)	(1.3)	-	177.2	169.6
Transactions with Owners, recorded directly in equity						
Contributions by and distributions to owners						
- Share based payments						
contributed in the year	-	-	-	6.2	-	6.2
recycled to Profit and loss	-	-	-	(0.5)	0.5	-
other	-	-	-	(4.2)	-	(4.2)
- Dividends to equity holders	-	-	-	-	(88.0)	(88.0)
Total Contributions by and distributions to owners	-	-	-	1.5	(87.5)	(86.0)
Balance at 31 December 2011	811.0	(3.0)	(4.5)	10.3	459.5	1,273.3

The notes on pages 14 to 86 are an integral part of these consolidated financial statements.

Statements Of Changes in Equity (continued)

For The Year Ended 31 December 2010 - Company

\$'m	Share capital	Asset revaluation reserve	Available for Sale Reserve	Cash flow Hedging Reserve	Capital contribution Reserve	Retained Profits	Total
Balance at 1 January 2010	811.0	23.2	(3.1)	(5.1)	7.2	295.1	1,128.3
Total comprehensive income for the year							
Profit for the year	-	-	-	-	-	156.4	156.4
Other comprehensive income, net of income tax							
Cash flow hedges							
- Effective portion of changes in fair value	-	-	-	0.3	-	-	0.3
- Net amount transferred to profit and loss	-	-	-	1.6	-	-	1.6
Available for sale assets							
- Net Change in fair value	-	-	6.4	-	-	-	6.4
- Net amount transferred to Profit and loss	-	-	-	-	-	-	-
Asset revaluation reserve							
-Transferred to profit and loss due to subsidiary rationalisation programme	-	(23.2)	-	-	-	-	(23.2)
Total other comprehensive income	-	(23.2)	6.4	1.9	-	-	(14.9)
Total comprehensive income for year	-	(23.2)	6.4	1.9	-	156.4	141.5
Transactions with Owners, recorded directly in equity							
Contributions by and distributions to owners							
- Share based payments							
contributed in the year	-	-	-	-	4.5	-	4.5
recycled to Profit and loss	-	-	-	-	(0.3)	0.3	-
other	-	-	-	-	(2.6)	-	(2.6)
- Dividends to equity holders	-	-	-	-	-	(82.0)	(82.0)
Total Contributions by and distributions to owners	-	-	-	-	1.6	(81.7)	(80.1)
Balance at 31 December 2010	811.0	-	3.3	(3.2)	8.8	369.8	1,189.7

The notes on pages 14 to 86 are an integral part of these consolidated financial statements.

Statements of Cash flows

For The Year Ended 31 December 2011

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
Cash Flows from Operating Activities					
Interest received		1,384.4	1,100.0	1,372.8	1,106.7
Interest paid		(815.3)	(589.8)	(805.9)	(598.8)
Other operating income received		185.7	300.1	187.6	301.8
Other expenses paid		(485.4)	(361.1)	(485.1)	(360.6)
Loans and bills advanced		(652.3)	(5,987.4)	(655.5)	(6,007.0)
Net increase in deposits and other borrowings		1,535.6	3,352.0	1,459.1	3,197.4
Net decrease in trading assets		26.5	2,186.5	26.5	2,186.6
Net increase / (decrease) in trading liabilities		54.9	(239.4)	54.9	(239.4)
Cash inflows / (outflows) from movements in other assets/liabilities		112.3	(120.5)	111.8	(120.8)
Income tax paid		(58.9)	(32.7)	(58.9)	(32.7)
Net cash provided by/(used in) operating activities	27(a)	1,287.5	(392.3)	1,207.3	(566.8)
Cash Flows from Investing Activities					
Net decrease / (increase) in investment securities		(1,137.7)	278.3	(1,137.7)	278.2
Purchase of property, plant and equipment		(19.5)	(13.7)	(19.5)	(13.6)
Proceeds from the sale of investments		1.6	-	1.6	-
Dividends received from controlled entities		-	-	3.3	70.2
Net cash used in investing activities		(1,155.6)	264.6	(1,152.3)	334.8
Cash Flows from Financing Activities					
Net increase / (decrease) in debt securities on issue		195.3	(246.1)	272.2	(141.8)
Subordinated debt (redeemed) / issued		(200.0)	200.0	(200.0)	200.0
Dividends paid		(88.0)	(82.0)	(88.0)	(82.0)
Net cash used in financing activities		(92.7)	(128.1)	(15.8)	(23.8)
Net increase / (decrease) in cash and cash equivalents held		39.2	(255.8)	39.2	(255.8)
Cash and cash equivalents at the beginning of the year		(304.3)	(48.5)	(304.3)	(48.5)
Cash and cash equivalents at the end of the year	27(b)	(265.1)	(304.3)	(265.1)	(304.3)

The notes on pages 14 to 86 are an integral part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

HSBC Bank Australia Limited is a company domiciled in Australia. The consolidated financial report of the Company for the year ended 31 December 2011 comprises the Company and its subsidiaries (together referred to as the "consolidated entity" or "group"). References to "HSBC", "the Group" or "the HSBC Group" within this document mean HSBC Holdings plc together with its subsidiaries.

a) Statement of compliance

The financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards ("AASBs"), including Australian Interpretations, adopted by the Australian Accounting Standards Board ("AASBs") and the Corporations Act 2001. The consolidated financial report of the consolidated entity and the financial report of the Company comply with International Financial Reporting Standards ("IFRS") and interpretations adopted by the International Accounting Standards Board ("IASB").

The financial report was authorised for issue by the Board of Directors on 14 February 2012.

b) Basis of preparation

The financial report is presented in Australian dollars.

The financial report is prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, trading assets/liabilities, assets and liabilities designated at fair value and financial instruments classified as available-for-sale. The methods used to measure fair values are discussed further in note 1(i).

The Company is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 (updated by CO 05/641 effective 28 July 2005 and CO 06/51 effective 31 January 2006) and in accordance with that Class Order, amounts in the financial report and Directors' Report have been rounded off to the nearest million dollars, unless otherwise stated.

The preparation of a financial report in conformity with AASBs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities, income and expenses. Use of available information and application of judgement are inherent in the formation of estimates. Actual results in the future may differ from those reported. In this regard, management believes that the critical accounting policies where judgement is necessarily applied are those which relate to loan impairment, impairment of available-for-sale financial investments, financial asset and liability classification, goodwill impairment, liabilities and charges, qualifying hedge relationships and the valuation of financial instruments (see 'Accounting estimates and judgements' in note 1(ab)).

Further information about key assumptions concerning the future, and other key sources of estimation uncertainty, are set out in these notes on the financial statements. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The accounting policies set out below (Note 1(c) to Note 1 (ac)) have been applied consistently to all periods presented in the consolidated financial report and the accounting policies have been applied consistently by consolidated entities.

Certain comparative amounts have been reclassified to conform with the current year's presentation.

The following amendments to existing standards have been adopted by the consolidated entity. The adoption of the amendments are effective after 1 January 2011 or 1 July 2011 and have no significant effect on the consolidated financial statements:

- AASB 124 'Related Party Disclosures';
- AASB 2009-12 'Amendments to Australian Accounting Standards';
- AASB 2010-4 'Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project';
- AASB 2010-5 'Amendments to Australian Accounting Standards';
- AASB 2010-6 'Amendments to Australian Accounting Standards – Disclosures on Transfers of Financial Assets'; and
- AASB 1054 'Australian Additional Disclosures'.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

c) Principles of Consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Investments in subsidiaries are carried at their cost of acquisition less provision for diminution in the Company's financial statements.

(ii) Special purpose entities

Special purpose entities are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets, or the execution of specific borrowing or lending transactions. The financial statements of special purpose entities are included in the consolidated entity's financial statements where the substance of the relationship is that the consolidated entity controls the special purpose entity.

(iii) Transactions eliminated on consolidation

Intragroup balances and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

d) Foreign Currency Transactions

Items included in each of the entities of the consolidated entity are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The consolidated entity's financial statements are presented in Australian dollars which is the Bank's functional and presentation currency.

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Australian dollars at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Australian dollars at foreign exchange rates ruling at the dates the fair value was determined.

e) Trading assets and trading liabilities

(i) Treasury bills, loans and advances to and from customers, loans and advances to and from banks, debt securities, structured deposits, equity shares, own debt issued and short positions in securities are classified as held for trading if they have been acquired principally for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. These financial assets or financial liabilities are recognised on trade date when the consolidated entity enters into contractual arrangements with counterparties to purchase or sell securities, and are normally derecognised when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently, their fair values are remeasured. All gains and losses from changes in the fair value of these assets and liabilities, together with related interest income and expense and dividends are recognised in the Income Statement in 'Net trading income' as they arise.

f) Financial investments

Treasury bills, debt securities and equity shares intended to be held on a continuing basis, other than those designated at fair value, are classified as 'available-for-sale'. Financial investments are recognised on trade date, when the consolidated entity enters into contractual arrangements with counterparties to purchase securities, and are normally derecognised when either the securities are sold or the borrowers repay their obligations.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

f) Financial investments (continued)

Available-for-sale securities are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value and changes therein are recognised in equity in the 'Available-for-sale' reserve (Note 22(a) and Statement of changes in equity) until the securities are either sold or impaired. When available-for sale securities are sold, cumulative gains or losses previously recognised in equity are recognised in the income statement as 'Gains/ (losses) from disposal of financial investments'.

Interest income is recognised on available-for-sale debt securities using the effective interest rate method, calculated over the asset's expected life. Premiums and/or discounts arising on the purchase of dated investment securities are included in the calculation of their effective interest rates. Dividends are recognised in the Income Statement when the right to receive payment has been established. Financial investments are recognised using trade date accounting.

At each balance sheet date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset or group of assets. Impairment losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated. If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the Income Statement, is removed from equity and recognised in the income statement.

Impairment losses for available-for-sale debt securities and equity are recognised within 'Loan impairment charges, recoveries and other credit risk provisions'.

Once an impairment loss has been recognised on an available-for-sale financial asset, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the nature of the available-for-sale financial asset concerned:

- for an available-for sale debt security, a subsequent decline in the fair value of the instrument is recognised in the income statement if, and only if there is objective evidence of impairment. Objective evidence of impairment occurs when as a result of one or more loss events, the estimated future cash flows of the financial asset are impacted that can be reliably measured. Where there is no objective evidence of impairment, the decline in the fair value of the financial asset is recognised directly in equity. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the Income Statement, the impairment loss is reversed through the Income Statement to the extent of the increase in fair value;
- for an available-for sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised directly in equity. Impairment losses recognised on an equity security are not reversed through the Income Statement. Subsequent decreases in the fair value of the available-for-sale equity securities are recognised in the Income Statement, only to the extent that further cumulative impairment losses have been incurred.

g) Financial instruments designated at fair value

Financial instruments, other than those held for trading, are classified in this category if they meet the criteria set out below, and are so designated by management.

The consolidated entity may designate financial instruments at fair value when the designation eliminates or significantly reduces valuation or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities, or recognising gains and losses on them, on different bases. The class of financial instruments that meet this criteria are long-term debt issues. The interest payable on certain fixed rate long-term debt securities issued has been matched with the interest on 'receive fixed/pay variable' interest rate swaps as part of a documented interest rate risk management strategy. An accounting mismatch would arise if the debt securities issued were accounted for at amortised cost, because the related derivatives are measured at fair value with changes in the fair value recognised in the Income Statement. By designating the long-term debt at fair value, the movement in the fair value of the long-term debt will also be recognised in the Income Statement.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

g) Financial instruments designated at fair value (continued)

The fair value designation, once made, is irrevocable. Financial assets and financial liabilities so designated are recognised initially at fair value, with transaction costs taken directly to the Income Statement, and are subsequently remeasured at fair value. Financial assets and financial liabilities are recognised using trade date accounting.

Gains and losses from changes in the fair value of such assets and liabilities are recognised in the Income Statement as they arise, together with related interest income and expense and dividends, within 'Net income/ (loss) from financial instruments designated at fair value'.

Gains and losses arising from the changes in fair value of derivatives that are managed in conjunction with financial assets or financial liabilities designated at fair value are included in 'Net income/ (loss) from financial instruments designated at fair value'.

h) Sale and repurchase agreements

Where 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 re-sell ('reverse repos') are not recognised on the balance sheet and the consideration paid is recorded in 'Advances to customers' or 'Placings with banks' as appropriate. The difference between the sale and repurchase price is treated as interest income and recognised over the life of the agreement.

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. The transfer of securities to counterparties under these agreements is not normally reflected on the balance sheet. Cash collateral advanced or received is recorded as an asset or a liability respectively.

Securities borrowed are not recognised on the balance sheet. If they are sold on to third parties, an obligation to return the securities is recorded as a trading liability and measured at fair value, and any gains or losses are included in 'Net trading income'.

i) Determination of fair value

All financial instruments are recognised initially at fair value. The fair value of a financial instrument on initial recognition is normally the transaction price, i.e. the fair value of the consideration given or received. In certain circumstances, however, the initial fair value may be used on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities. Where independent prices are not available, fair values are determined by using valuation techniques which refer to observable market data. These include comparison with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

For certain investments, fair values may be determined in whole or in part using valuation techniques based on assumptions that are not supported by prices from current market transactions or observable market data.

j) Derivatives and hedge accounting

(i) Derivatives

Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values of exchange-traded derivatives are obtained from quoted market prices. Fair values of over the counter ("OTC") derivatives are obtained using valuation techniques, discounted cash flow models and option pricing models.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

j) Derivatives and hedge accounting (continued)

In the normal course of business, the fair value of a derivative on initial recognition is the transaction price (i.e. the fair value of the consideration given or received). In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or based on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the consolidated entity recognises a trading gain or loss on inception of the derivative.

When unobservable market data have a significant impact on the valuation of derivatives, the entire initial change in fair value indicated by the valuation model is not recognised immediately in the Income Statement but is recognised over the life of the transaction on an appropriate basis, or is recognised in the Income Statement when the inputs become observable, or when the transaction matures or is closed out.

Derivatives may be embedded in other financial instruments, for example, a convertible bond with an embedded conversion option. Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract, the terms of the embedded derivative are the same as those of a stand-alone derivative, and the combined contract is not designated at fair value through profit and loss. These embedded derivatives are measured at fair value with changes therein recognised in the Income Statement.

Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

The method of recognising fair value gains and losses depends on whether the derivatives are held for trading, or are designated as hedging instruments, and if the latter, the nature of the risks being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the Income Statement. When derivatives are designated as hedges, the consolidated entity classifies them as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedges') or (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability; or a forecast transaction ('cash flow hedge'). Hedge accounting is applied to derivatives designated as hedging instruments in a fair value or cash flow hedge provided certain criteria are met.

(ii) Hedge accounting

At the inception of a hedging relationship, the consolidated entity documents the relationship between the hedging instruments and hedged items, its risk management objective and its strategy for undertaking the hedge. The consolidated entity also requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the derivatives that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of hedged items. Interest on designated qualifying hedges is included in 'Net interest income'.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded as 'Net trading income' in the Income Statement, along with changes in the fair value of the asset, liabilities or group thereof, that are attributable to the hedged risk.

If a hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment to the carrying amount of the hedged item is amortised to the Income Statement in 'Net interest income' based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised whereby it is released to the Income Statement immediately.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity within the cash flow hedging reserve. Any gain or loss in fair value relating to an ineffective portion is recognised immediately in the Income Statement within 'Net trading income'.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

j) Derivatives and hedge accounting (continued)

Amounts accumulated in equity are recycled to the Income Statement in the periods in which the hedged item will affect profit or loss. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity until the forecast transaction is eventually recognised in the Income Statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the Income Statement.

Hedge effectiveness testing

To qualify for hedge accounting, the consolidated entity requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness). Actual effectiveness (retrospective effectiveness) must also be demonstrated on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method the consolidated entity adopted for assessing hedge effectiveness will depend on its risk management strategy.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness, the changes in fair value or cash flows must offset each other in the range of 80 per cent to 125 per cent for the hedge to be deemed effective.

Hedge ineffectiveness is recognised in the Income Statement in 'Net trading income'.

(iii) Derivatives that do not qualify for hedging

All gains and losses from changes in the fair value of any derivative that do not qualify for hedge accounting are recognised immediately in the Income Statement. These gains and losses are reported in 'Net trading income'. The interest on derivatives managed in conjunction with debt securities issued by the consolidated entity which are designated at fair value is recognised in 'Interest expense'. All other gains and losses on these derivatives are reported in 'Net income from financial instruments designated at fair value'.

k) Derecognition of financial assets and liabilities

Financial assets are derecognised when the rights to receive cash flows from the assets has expired; or when the consolidated entity has transferred its contractual right to receive the cash flows of the financial assets, and substantially all the risks and rewards of ownership; or where control is not retained. Financial liabilities are derecognised when they are extinguished, that is when the obligation is discharged, cancelled or expires.

l) Offsetting financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards or for gains or losses arising from a group of similar transactions, such as in the consolidated entity's trading activities.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

m) Property, plant and equipment

(i) Recognition and measurement

Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses (see note 10).

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the cost of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

(ii) Subsequent costs

The consolidated entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the consolidated entity and the cost of the item can be measured reliably. All other costs are recognised in the Income Statement as an expense as incurred.

(iii) Depreciation

Depreciation is charged to the Income Statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. The estimated useful lives in the current and comparative periods are as follows:

- | | |
|--------------------------|-----------------------|
| • Plant and equipment | 3-5 years |
| • Fixtures and fittings | 3-5 years |
| • Leasehold improvements | life of the leasehold |

The residual value, the useful life and the depreciation method applied to an asset are reassessed at least annually.

n) Goodwill and intangible assets

(i) Goodwill

Goodwill arises on business combinations when the cost of acquisition exceeds the fair value of the consolidated entity's share of the identifiable assets, liabilities and contingent liabilities acquired. Goodwill is allocated to cash-generating units for the purposes of impairment testing. Goodwill is tested for impairment at the lowest level at which goodwill is monitored for internal management purposes. Impairment testing is performed at least annually, and whenever there is an indication that the cash-generating unit may be impaired, by comparing the recoverable amount from a cash-generating unit with the carrying amount of its net assets, including attributable goodwill. The recoverable amount of an asset is the higher of its fair value less cost to sell, and its value in use. Value in use is the present value of the expected future cash flows from a cash-generating unit. If the recoverable amount from the cash generating unit is less than the carrying value, an impairment loss is charged to the Income Statement.

Goodwill is stated at cost less accumulated impairment losses, which are charged to the Income Statement (see note 12).

Any excess of the consolidated entity's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of an acquired business over the cost to acquire is recognised immediately in the Income Statement. At the date of disposal of a business, attributable goodwill is included in the consolidated entity's share of net assets in the calculation of the gain or loss on disposal.

(ii) Intangible assets

Intangible assets include computer softwares. Intangible assets that have an indefinite useful life, or are not yet ready for use, are tested for impairment annually.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

n) Goodwill and intangible assets (continued)

Intangible assets that have a finite useful life are stated at cost less amortisation and accumulated impairment losses and are amortised over their estimated useful lives. Estimated useful life is the lower of legal duration and expected economic life.

Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

o) Loans and Advances to Banks and Customers

Loans and advances to banks and customers include loans and advances originated by the consolidated entity, which are not intended to be sold in the short term and have not been classified either as held for trading or designated at fair value. Loans and advances are recognised when cash is advanced to borrowers. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment losses (see note 1(q)).

Loan and advances classified as held for trading or designated at fair value are reported as trading instruments, or financial instruments designated at fair value, respectively (notes 1(e) and 1(g)).

p) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition, and include cash and balances at central banks, treasury bills and other eligible bills, loans and advances to banks, and certificates of deposit. For the purposes of the statement of cash flows, cash includes cash on hand, deposits held at call with banks, government treasury bills and investments in cash net of local clearing accounts.

q) Impairment of assets

The carrying amounts of the consolidated entity's assets, other than deferred tax assets (see note 1(z)), are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

For goodwill, the recoverable amount is estimated at each balance sheet date (see note 12).

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the Income Statement, unless an asset has previously been revalued, in which case the impairment loss is recognised as a reversal to the extent of that previous revaluation with any excess recognised through profit or loss.

Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to cash-generating units and then, to reduce the carrying amount of the other assets in the unit on a pro rata basis.

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is recognised in profit or loss even though the financial asset has not been derecognised. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in profit or loss.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

q) Impairment of Assets (continued)

(i) Calculation of recoverable amount

The recoverable amount of the consolidated entity's investments in held-to-maturity securities and receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition of these financial assets). Receivables with a short duration are not discounted.

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

(ii) Reversals of impairment

An impairment loss in respect of a held-to-maturity security or receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of an investment in an equity instrument classified as available for sale is not reversed through profit or loss. If the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss shall be reversed, with the amount of the reversal recognised in the Income Statement.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

r) Impairment of loans and advances

It is the consolidated entity's policy that each operating company will recognise losses for impaired loans promptly where there is objective evidence that impairment of a loan or portfolio of loans has occurred. This is done on a consistent basis in accordance with the established HSBC Group guidelines. There are two basic methods of calculating impairment losses: those calculated on individual loans and those losses assessed on a collective basis. Losses expected as a result of future events, no matter how likely, are not recognised.

(i) Individually assessed loans

Impairment losses on individually assessed accounts are determined by an evaluation of the exposures on a case-by-case basis. The consolidated entity assesses at each balance sheet date whether there is any objective evidence that a loan is impaired. This procedure is applied to all accounts that are considered individually significant. In determining such impairment losses on individually assessed accounts, the following factors are considered:

- the consolidated entity's aggregate exposure to the customer;
- the viability of the customer's business model and capability to trade successfully out of financial difficulties and generate sufficient cash flow to service their debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors' commitments ranking ahead of, or *pari passu* with, the consolidated entity and the likelihood of other creditors continuing to support the consolidated entity;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding;
- the ability of the borrower to obtain and make payments in the relevant foreign currency if loans are not in local currency; and
- where available, the secondary market price for the debt.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

r) Impairment of loans and advances (continued)

Impairment loss is calculated by comparing the present value of the expected future cash flows, discounted at the original effective interest rate of the loan, with its current carrying value and the amount of any loss is charged in the Income Statement. The carrying amount of impaired loans is reduced through the use of an allowance account.

(ii) Collectively assessed loans

Impairment losses are calculated on a collective basis in two different scenarios:

- in respect of losses which have been incurred but have not yet been identified on loans subject to individual assessment for impairment (see section (i)); and
- for homogeneous groups of loans that are not considered individually significant.

• *Incurred but not yet identified impairment*

Where loans have been individually assessed and no evidence of loss has been identified, these loans are grouped together on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss. This loss covers loans that are impaired at the balance sheet date but which will not be individually identified as such until some time in the future. The collective impairment loss is determined after taking into account:

- historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between a loss occurring and that loss being identified and evidenced by the establishment of an allowance against the loss on an individual loan; and
- management's experienced judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

Regional management for each identified portfolio determines the estimated period between a loss occurring and its identification.

• *Homogeneous groups of loans*

For homogeneous groups of loans that are not considered individually significant, two alternative methods are used to calculate allowances on a portfolio basis.

- When appropriate empirical information is available, the consolidated entity utilises roll rate methodology. This methodology utilises a statistical analysis of historical trends of the probability of default and amount of consequential loss, assessed at each time period for which the customer's contractual payments are overdue. The amount of loss is based on the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio. Other historical data and an evaluation of current economic conditions are also considered to calculate the appropriate level of impairment allowance based on inherent loss.
- In other cases, when the portfolio size is small or when information is insufficient or not sufficiently reliable to adopt a roll rate methodology, the consolidated entity adopts a formulaic approach which allocates rolling average loss rates over the outstanding receivable amount. Loss rates are based on the discounted expected future cash flows from a portfolio.

Roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

(iii) Loan write-offs

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from the realisation of security have been received.

(iv) Reversals of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed to the extent it is now excessive by reducing the loan impairment allowance account. The amount of any reversal is recognised in the Income Statement.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

r) Impairment of loans and advances (continued)

(v) Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans in order to achieve an orderly realization are recorded as assets held for sale and reported in 'Other assets'. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan, net of impairment allowance amounts, at the date of exchange. No depreciation is provided in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recorded as an impairment loss and included in the Income Statement. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative impairment loss, is recognised in the Income Statement.

(vi) Renegotiated loans

Loans that have been individually identified as impaired and whose terms have been subsequently renegotiated and which have been performing satisfactorily for a certain period are no longer treated as impaired.

s) Debt securities on issue, subordinated liabilities, deposits by banks and customers

Debt securities on issue, subordinated liabilities, deposits by banks and customers are initially measured at fair value, which is the consideration received, net of directly attributable transaction costs incurred. Subsequent measurement is at amortised cost using the effective interest method to amortise the difference between proceeds net of directly attributable transaction costs and the redemption amount over the expected life of the debt.

t) Share capital

Shares are classified as equity when there is no contractual obligation to transfer cash or other financial assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax. Incremental costs directly attributable to the issue of equity instruments as consideration for the acquisition of a business are included in the cost of acquisition.

Preference share capital is classified as equity if it is non-redeemable, or redeemable only at the Company's option, and any dividends are discretionary. Dividends thereon are recognised as distributions within equity upon declaration by the Directors.

u) Employee benefits

(i) Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the Income Statement as incurred.

(ii) Long-term service benefits

The liability for employee entitlements to long service leave represents the present value of the estimated future cash outflows to be made by the employer resulting from employees' services provided up to the balance date. The provision has been calculated using estimated future increases in wage and salary rates, including related on-costs, and is discounted using the rates attaching to national government securities at balance date that most closely match the terms of maturity of the related liabilities.

(iii) Equity (HSBC Holdings plc) compensation plans

Certain employees are eligible for equity instruments in HSBC Holdings plc, the ultimate parent entity, under various compensation plans as outlined in note 20b). In accordance with AASB 2 'Share-based Payments', these transactions are accounted for as equity settled because:

- HSBC Holdings plc has been determined to be the grantor of its equity instruments for all share award and share option plans across the Group directly to the employees of the Bank; and
- HSBC Holdings plc accounts for these transactions as equity settled, the consolidated entity accounts for these transaction with employee as equity-settled in their separate financial statements

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

u) Employee benefits (continued)

The cost of share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted, and recognised as an expense on a straight-line basis over the vesting period, with the corresponding credit to 'Capital contribution received under share-based payment'. The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately. Where HSBC Holdings plc enters into share-based payment arrangements involving employees of the consolidated entity and the consolidated entity has pre-funded an 'Employee Benefit Trust' (EBT) to buy HSBC Holdings plc shares in the market, the consolidated entity credits its 'Share-based payment liabilities to HSBC Holdings plc' on a straight-line basis over the vesting period for the amount of shares expected to vest measured at the market value of the shares. Any difference between this amount and AASB 2 expense recognised is recognised as 'Capital contribution received under share-based payment'. Where the consolidated entity has funded an EBT on behalf of HSBC Holdings plc, it will recognise shares held in the EBT as available-for-sale assets. These assets are measured in accordance with AASB 139.

Fair value is determined by using appropriate valuation models, taking into account the terms and conditions upon which the equity instruments were granted. Market performance conditions are taken into account when estimating the fair value of equity instruments at the date of grant, so that an award is treated as vesting irrespective of whether the market performance condition is satisfied, provided all other conditions are satisfied.

Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

A cancellation that occurs during the vesting period is treated as an acceleration of vesting and recognised immediately for the amount that would otherwise have been recognised for services over the remaining vesting period.

(iv) Termination benefits

Termination benefits are recognised as an expense when the consolidated entity is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date. Termination benefits for voluntary redundancies are recognised if the consolidated entity has made an offer encouraging voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

v) Provisions for liabilities and charges

A provision is recognised in the balance sheet when the consolidated entity has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

A provision for restructuring is recognised when the consolidated entity has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly. Future operating costs are not provided for.

w) Financial guarantees

Financial guarantees are contracts that require the consolidated entity to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value which is generally the fee received or receivable, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of initial fair value less cumulative amortisation and the present value of any expected payment (when a payment under the guarantee has become probable). Financial guarantees are included within other liabilities.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

x) Revenue

(i) Interest income and expense

Interest income and expense for all interest-bearing financial instruments, except those classified as held-for-trading or designated at fair value are recognised in 'Interest income' and 'Interest expense' in the Income Statement using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the consolidated entity estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the consolidated entity that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

Interest on impaired financial assets is recognised at the original effective interest rate of the financial asset applied to the impaired carrying amount.

(ii) Non interest income

- Fee and commission income

The consolidated entity earns fee and commission income from a diverse range of services it provides to its customers. Fee and commission income is accounted for as follows:

- if the income is earned on the execution of a significant act, it is recognised as revenue when the significant act has been completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as the arrangement for the acquisition of shares or other securities);
- if the income is earned as services are provided, it is recognised as revenue as the services are provided (for example, portfolio and other management advisory and service fees); and
- if the income is an integral part of the effective interest rate of a financial instrument, it is recognised as an adjustment to the effective interest rate (for example, loan commitment fees) and recorded in 'Interest income'.

- Dividend income

Dividend income is recognised when the right to receive payment is established.

- Trading income

Trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with related interest income, expense and dividends. Income and expenses arising from economic hedging activities which do not qualify for hedge accounting under AASB 139, as well as from ineffective portion of qualifying hedges, are also included in 'Net trading income'.

- Net income/ (loss) from financial instruments designated at fair value

Net income from financial instruments designated at fair value comprises all gains and losses from changes in the fair value of such financial assets and financial liabilities, together with interest income and expense and dividend income attributable to those financial instruments.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

y) Finance and operating leases

Assets leased to customers under agreements which transfer substantially all the risks and rewards associated with ownership, other than legal title, are classified as finance leases. Where the consolidated entity is a lessor under finance leases the amounts due under the leases, after deduction of unearned charges, are included in 'Loans and advances to banks' or 'Loans and advances to customers' as appropriate. Finance income receivable is recognised over the periods of the leases so as to give a constant rate of return on the net investment in the leases.

All other leases are classified as operating leases. Where the consolidated entity is the lessee, the leased assets are not recognised on the balance sheet. Rentals payable under operating leases are accounted for on a straight-line basis over the periods of the leases and are included in 'property and equipment expenses'. Lease incentives received are recognised in the Income Statement as an integral part of the total lease expense.

z) Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

The following temporary differences are not provided for: initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend is recognised.

HSBC Australia Holdings Pty Ltd and its wholly-owned Australian resident entities which include the company have formed a tax-consolidated group with effect from 1 July 2002 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is HSBC Australia Holdings Pty Limited.

The current and deferred tax amounts for the tax-consolidated group are allocated among the entities in the group using a 'separate taxpayer within group' approach whereby each entity in the tax-consolidated group measures its current and deferred taxes as if it continued to be a separately taxable entity in its own right. Intercompany transactions are not eliminated.

Any current tax liabilities (or assets) and deferred tax assets arising from unused tax losses assumed by the head entity from the subsidiaries in the tax consolidated group are recognised in conjunction with any tax funding arrangement amounts (refer below). Any difference between these amounts is recognised by the Company as an equity contribution from or distribution to the head entity.

The members of the tax-consolidated group have entered into a tax funding agreement which sets out the funding obligations of members of the tax-consolidated group in respect of tax amounts. The tax funding agreement requires payments equal to the current tax liability (asset) assumed by the head entity and any tax-loss deferred tax asset assumed by the head entity.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

z) Income tax (continued)

The members of the tax-consolidated group have also entered into a valid Tax Sharing Agreement under the tax consolidation legislation which sets out the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations and the treatment of entities leaving the tax consolidated group.

The Company recognises deferred tax assets arising from unused tax losses of the tax-consolidated group to the extent that it is probable that future taxable profits of the tax-consolidated group will be available against which the asset can be utilised.

Any subsequent period adjustments to deferred tax assets arising from unused tax losses as a result of revised assessments of the probability of recoverability is recognised by the head entity only.

The Tax Laws Amendment ("Taxation of Financial Arrangements") Act 2009 ("TOFA legislation") was enacted during 2009. The TOFA legislation provides a framework for the taxation of financial arrangements, potentially providing closer alignment between tax and accounting requirements. The regime also includes comprehensive tax hedging rules that would allow the tax recognition of gains and losses on many hedging instruments to be matched to the accounting recognition of gains and losses of the underlying hedged items.

TOFA is mandatory for the tax consolidated group for tax years beginning on or after 1 July 2010. There are specific transitional provisions in relation to the taxation of existing financial arrangements outstanding at the transition date (i.e. there is a choice to bring pre-commencement financial arrangements into the new regime subject to a balancing adjustment being calculated on transition to be returned over the next succeeding four tax years).

The tax consolidated group has made an election to bring pre-commencement financial arrangements into the new regime during 2011.

aa) Goods and services tax

Revenue, expenses and assets are recognised net of the amount of goods and services tax ("GST"), except where the amount of GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the Australian Tax Office ("ATO") is included as a current asset or liability in the balance sheet.

Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities, which are recoverable from, or payable to, the ATO are classified as operating cash flows.

ab) Accounting estimates and judgements

The estimates and judgements that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

- *Impairment of goodwill*

Note 12 contains information about the assumptions and their risk factors relating to goodwill impairment. The consolidated entity assesses whether goodwill is impaired at least annually in accordance with the accounting policy in note 1(n). These calculations involve an estimation of the recoverable amount of the cash-generating units to which the goodwill is allocated.

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ab) Accounting estimates and judgements (continued)

- *Provision for liabilities and charges*

The consolidated entity assesses whether it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation as a result of past events. These calculations involve an estimation of the potential loss and likelihood of that loss.

- *Determining fair values*

The consolidated entity's accounting policy for valuation of financial instruments is included in note 1(j) and is discussed further within note 8 'Derivatives' and note 26 'Additional Financial Instrument disclosures'.

When fair values are determined by using valuation techniques which refer to observable market data because independent prices are not available, management will consider the following when applying a valuation model:

- (i) The likelihood and expected timing of future cash flows on the instrument. These cash flows are usually governed by the terms of the instrument, although management judgement may be required when the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt,
- (ii) An appropriate discount rate for the instrument. Management determines this rate based on its assessment of the appropriate spread of the rate for the instrument over the risk-free rate; and
- (iii) Judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative models.

- *Loan impairment*

Application of the consolidated entity's methodology for assessing loan impairment, as set out in note 1(r), involves considerable judgment and estimation.

For individually significant loans, judgment is required in determining first, whether there are indications that an impairment loss may have already been incurred, and then estimating the amount and timing of expected cash flows, which form the basis of the impairment loss that is recorded.

For collectively assessed loans, judgment is involved in selecting and applying the criteria for grouping together loans with similar credit characteristics, as well as in selecting and applying the statistical and other models used to estimate the losses incurred for each group of loans in the reporting period. The benchmarking of loss rates, the assessment of the extent to which historical losses are representative of current conditions and the ongoing refinement of modelling methodologies provide a means of identifying changes that may be required, but the process is inherently one of the estimation.

- *Impairment of available-for-sale financial investments*

Judgment is required in determining whether or not a decline in fair value of an available-for-sale financial investment below its original costs is of such a nature as to constitute impairment, and thus whether an impairment loss needs to be recognised under AASB 139.

- *Financial asset and liability classification*

The consolidated entity's accounting policies provide scope for assets and liabilities to be designated on inception into different accounting categories in certain circumstances.

- In classifying financial assets or liabilities as "trading", the consolidated entity has determined that it meets the description of trading assets and liabilities set out in accounting policy 1(e).

Details of the consolidated entity's classification of financial assets and liabilities are given in note 1(e) to 1(h).

Notes to the Consolidated Financial Statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ab) Accounting estimates and judgements (continued)

- *Qualifying hedge relationships*

In designating financial instruments as qualifying hedge relationships, the consolidated entity has determined that it expects the hedge to be highly effective over the life of the hedging instrument.

In accounting for derivatives as cash flow hedges, the consolidated entity has determined that the hedged cash flow exposure relates to highly probable future cash flows.

ac) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2012, and have not been applied in preparing this financial report. None of these are expected to have a significant effect on the financial report of the consolidated entity, except for IFRS 9 Financial Instruments, which becomes mandatory for the consolidated entity's 2015 financial report and could change the classification and measurement of financial assets. The consolidated entity does not plan to adopt this standard early and the extent of the impact has not been determined.

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
2. BANKING OPERATING INCOME					
(i) Interest income					
Loans & advances to banks		93.1	30.7	93.1	30.7
Loans & advances to customers		1,029.3	864.6	1,029.3	864.6
Financial Investments		209.4	189.8	209.4	189.8
Related corporations		63.3	28.0	63.3	28.0
Key management personnel		0.3	0.3	0.3	0.3
		<u>1,395.4</u>	<u>1,113.4</u>	<u>1,395.4</u>	<u>1,113.4</u>
Total interest income		1,400.0	1,173.2	1,400.0	1,173.2
Less:					
- Interest income classified as 'Net trading income'	2(v)	(4.6)	(59.8)	(4.6)	(59.8)
		<u>1,395.4</u>	<u>1,113.4</u>	<u>1,395.4</u>	<u>1,113.4</u>
Included within various captions under interest income for the year ended 31 December 2011 is a total of \$3.2m (2010: \$3.5m) accrued on impaired financial assets.					
(ii) Interest Expense					
Deposits by banks		28.0	26.6	28.0	26.6
Customer accounts		615.9	475.3	615.9	475.3
Debt securities on issue		76.1	74.3	60.1	55.5
Subordinated liabilities		22.4	13.7	22.4	13.7
Related corporations		67.6	55.8	85.2	76.4
		<u>810.0</u>	<u>645.7</u>	<u>811.6</u>	<u>647.5</u>
Total interest expense		820.5	663.1	822.1	664.9
Less:					
- Interest expense classified as 'Net trading income'	2(v)	(10.5)	(10.1)	(10.5)	(10.1)
- Interest expense classified as 'Net income / (loss) from financial instruments designated at fair value'	2(vi)	-	(7.3)	-	(7.3)
		<u>810.0</u>	<u>645.7</u>	<u>811.6</u>	<u>647.5</u>
(iii) Other Operating Income					
Dividend income		-	-	3.3	70.2
Related corporations		42.5	39.6	42.5	39.6
Other income		0.9	0.8	0.9	0.8
		<u>43.4</u>	<u>40.4</u>	<u>46.7</u>	<u>110.6</u>

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
2. BANKING OPERATING INCOME (continued)					
(iv) Fee and commission income					
Fees and commissions		190.8	168.3	190.9	168.9
Fee income on fiduciary activities		11.1	10.2	11.9	11.2
		<u>201.9</u>	<u>178.5</u>	<u>202.8</u>	<u>180.1</u>
Fee and commission expense					
Fees and commissions		29.0	27.0	28.2	26.8
Fees payable on fiduciary activities		2.0	1.7	2.0	1.7
		<u>31.0</u>	<u>28.7</u>	<u>30.2</u>	<u>28.5</u>
(v) Net trading income/(loss)					
Trading income					
- Foreign exchange		(13.3)	29.3	(13.3)	29.3
- Fixed income		(4.0)	(21.9)	(4.0)	(21.9)
- Other		(1.2)	1.4	(1.2)	1.4
		<u>(18.5)</u>	<u>8.8</u>	<u>(18.5)</u>	<u>8.8</u>
Gains / (losses) from hedging activities:					
Fair value Hedges:					
- Net gain/(loss) on hedged items attributable to the hedged risk		23.6	1.3	23.6	1.3
- Net gain/(loss) on hedging instruments		(23.4)	(0.8)	(23.4)	(0.8)
Cash flow hedges:					
- Net gain/ (loss) on termination of cash flow hedges		-	0.1	-	0.1
		<u>0.2</u>	<u>0.6</u>	<u>0.2</u>	<u>0.6</u>
Net interest income on trading activities:					
- Interest income	2(i)	4.6	59.8	4.6	59.8
- Interest expense	2(ii)	(10.5)	(10.1)	(10.5)	(10.1)
		<u>(5.9)</u>	<u>49.7</u>	<u>(5.9)</u>	<u>49.7</u>
Total net trading income/(loss)		<u>(24.2)</u>	<u>59.1</u>	<u>(24.2)</u>	<u>59.1</u>

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
2. BANKING OPERATING INCOME (continued)					
(vi) Net income / (loss) from financial instruments designated at fair value					
Change in fair value of financial assets and liabilities designated at fair value		-	0.1	-	0.1
Change in fair value of derivatives designated at fair value		-	(0.1)	-	(0.1)
		-	-	-	-
Net interest income on financial instruments designated at fair value		-	-	-	-
- Interest expense	2(ii)	-	(7.3)	-	(7.3)
		-	(7.3)	-	(7.3)
Total net loss from financial instruments designated at fair value		-	(7.3)	-	(7.3)

Gains and losses from changes in the fair value of the consolidated entity's issued debt securities may arise from changes in the consolidated entity's own credit risk.

(vii) Net gains/(loss) from disposal of financial investments

Net gain/(loss) on disposal of available for sale securities

(1.1)	4.9	(1.1)	4.9
(1.1)	4.9	(1.1)	4.9

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company			
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m		
3							
		LOAN IMPAIRMENT CHARGES, RECOVERIES AND OTHER CREDIT RISK PROVISIONS					
(i)		Loan Impairment Charges, Recoveries And Other Credit Risk Provisions					
		Income Statement charge					
		Loan impairment charges:					
		- New allowances	94.5	107.8	94.5	107.8	
		- Reversal of allowances no longer required	(21.9)	(7.7)	(21.9)	(7.7)	
		- Recoveries of amounts previously written off	(19.3)	(27.2)	(14.7)	(13.1)	
			<u>53.3</u>	<u>72.9</u>	<u>57.9</u>	<u>87.0</u>	
		- Individually assessed allowances charged	1.7	28.9	6.4	43.0	
		- Collectively assessed allowances charged	51.6	44.0	51.5	44.0	
			<u>53.3</u>	<u>72.9</u>	<u>57.9</u>	<u>87.0</u>	
		Total loan impairment charges and other credit risk provisions					
			<u>53.3</u>	<u>72.9</u>	<u>57.9</u>	<u>87.0</u>	
		Total outstanding allowances					
		Loans and advances to customers:					
		- Individually assessed allowances	26	38.4	39.6	38.4	39.6
		- Collectively assessed allowances	26	36.9	33.9	36.9	33.9
		Total allowances		<u>75.3</u>	<u>73.5</u>	<u>75.3</u>	<u>73.5</u>
(ii)		Impairment of investment in subsidiaries					
		- Provision of diminution in value	11	-	-	-	79.9
		- Transfer of asset revaluation reserve to Income Statement due to subsidiary rationalisation programme	11	-	-	-	(23.2)
							<u>56.7</u>
4.		OPERATING EXPENSES					
		Staff costs					
		Wages and salaries	170.1	144.6	170.1	144.6	
		Bonuses	37.8	38.8	37.8	38.8	
		Retirement and termination benefits	20(a)	17.6	15.3	17.6	15.3
		Share-based payment transactions	20(b)	6.2	4.5	6.2	4.5
		Other		18.6	16.5	18.6	16.5
			<u>250.3</u>	<u>219.7</u>	<u>250.3</u>	<u>219.7</u>	

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
4. OPERATING EXPENSES (continued)					
Premises and equipment					
Property rental		31.3	27.5	31.3	27.5
Hire of equipment		4.4	4.0	4.4	4.0
Repairs and maintenance		2.0	1.5	2.0	1.5
EDP costs		2.1	2.6	2.1	2.6
Utilities		2.6	2.4	2.6	2.4
Depreciation		9.3	8.4	9.3	8.4
Other		0.0	0.1	0.0	0.1
		<u>51.7</u>	<u>46.5</u>	<u>51.7</u>	<u>46.5</u>
Administrative expenses					
Advertising and marketing		51.4	46.4	51.4	46.4
Legal and professional fees		4.8	6.7	4.8	6.7
Communications		7.0	10.8	7.0	10.8
Business information costs		4.9	5.0	4.9	5.0
Printing and stationery		8.5	9.3	8.5	9.3
Travel and entertainment		6.1	5.8	6.1	5.8
Auditor's remuneration	5	1.6	1.6	1.6	1.6
Insurance		2.0	1.5	2.0	1.5
Losses from fraud		4.5	2.7	4.5	2.7
Contracted services		8.1	4.4	8.1	4.4
Other		7.5	8.0	7.4	7.9
		<u>106.4</u>	<u>102.2</u>	<u>106.4</u>	<u>102.1</u>
Other expenses					
Intercompany management fees	30	55.8	49.4	56.0	49.4
Provision for contingent liabilities and charges	18	-	-	-	-
Amortisation of intangibles	12	1.2	4.6	1.2	4.6
		<u>57.0</u>	<u>54.0</u>	<u>57.2</u>	<u>54.0</u>
		Consolidated	Consolidated	Company	Company
		2011	2010	2011	2010
		\$	\$	\$	\$
5. AUDITOR'S REMUNERATION					
Audit services					
Auditor of the consolidated entity - KPMG Australia					
Audit and review of financial reports		879,643	898,859	879,643	898,859
Regulatory and other audit services		611,347	608,920	598,028	585,600
		<u>1,490,990</u>	<u>1,507,779</u>	<u>1,477,671</u>	<u>1,484,459</u>
Other services					
Auditor of the consolidated entity – KPMG Australia					
Taxation services		69,771	60,060	69,771	60,060
Other assurance services		-	4,945	-	4,945
		<u>69,771</u>	<u>65,005</u>	<u>69,771</u>	<u>65,005</u>

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
6. INCOME TAX EXPENSE					
Recognised in the Income Statement					
(a) Current tax expense					
Current year		(84.2)	(78.2)	(82.8)	(73.9)
Adjustments for prior years		(0.1)	6.7	(0.1)	6.7
		<u>(84.3)</u>	<u>(71.5)</u>	<u>(82.9)</u>	<u>(67.2)</u>
Deferred tax expense					
Origination and reversal of temporary differences		6.5	11.7	6.5	11.7
Adjustments for prior years		(0.7)	(6.9)	(0.7)	(6.9)
	14(b)	<u>5.8</u>	<u>4.8</u>	<u>5.8</u>	<u>4.8</u>
Total income tax expense in Income Statement		<u><u>(78.5)</u></u>	<u><u>(66.7)</u></u>	<u><u>(77.1)</u></u>	<u><u>(62.4)</u></u>
Attributable to:					
Continuing operations		(78.5)	(66.7)	(77.1)	(62.4)
		<u><u>(78.5)</u></u>	<u><u>(66.7)</u></u>	<u><u>(77.1)</u></u>	<u><u>(62.4)</u></u>
Numerical reconciliation between tax expense and pre-tax net profit					
Profit for the period		177.2	152.6	177.2	156.4
Total income tax expense		<u>78.5</u>	<u>66.7</u>	<u>77.1</u>	<u>62.4</u>
Profit excluding income tax		<u>255.7</u>	<u>219.3</u>	<u>254.3</u>	<u>218.8</u>
Income tax using the domestic corporation tax rate of 30%		<u>(76.7)</u>	<u>(65.8)</u>	<u>(76.3)</u>	<u>(65.6)</u>
(Increase) / decrease in income tax expense due to:					
Non-deductible expenses		(1.0)	(0.7)	(1.0)	(17.7)
Non-taxable revenue		-	-	1.0	21.1
		<u>(77.7)</u>	<u>(66.5)</u>	<u>(76.3)</u>	<u>(62.2)</u>
(Under) / over provided in prior years		(0.8)	(0.2)	(0.8)	(0.2)
Income tax expense on pre-tax net profit		<u><u>(78.5)</u></u>	<u><u>(66.7)</u></u>	<u><u>(77.1)</u></u>	<u><u>(62.4)</u></u>
(b) Deferred tax recognised directly in equity					
Relating to available for sale and cash flow hedging reserves	14(b)	3.7	(4.0)	3.7	(4.0)
		<u>3.7</u>	<u>(4.0)</u>	<u>3.7</u>	<u>(4.0)</u>

Notes to the Consolidated Financial Statements

	Consolidated		Company	
	2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
7. TRADING ASSETS				
Trading assets:				
Balances with related entities	-	3.0	-	3.0
Treasury and other eligible bills	-	-	-	-
Debt securities	-	19.8	-	19.8
Loans and advances to banks	-	-	-	-
Loans and advances to customers	-	-	-	-
	-	22.8	-	22.8
Trading assets:				
- Which may not be repledged or resold or are not subject to repledge or resale by counterparties	-	22.8	-	22.8
	-	22.8	-	22.8
Analysis of debt securities, treasury and other eligible bill by issuer				
- Australian government securities and Australian government agencies	-	-	-	-
- Bank and building societies	-	19.8	-	19.8
	-	19.8	-	19.8

8. DERIVATIVES

Derivatives are financial instruments that derive their value from the price of an underlying item such as equities, bonds, interest rates, foreign exchange, credit spreads, commodities and equity or other indices.

Derivatives enable users to increase, reduce or alter exposure to credit or market risks. The consolidated entity makes markets in derivatives for its customers and uses derivatives to manage its exposure to credit and market risks.

Derivatives are carried at fair value and shown in the balance sheet as separate totals of assets and liabilities. Asset and liability values represent the cost or benefit to the consolidated entity of replacing all transactions with positive or negative fair value respectively, assuming that all the consolidated entity's relevant counterparties default at the same time, and that transactions can be replaced instantaneously.

Derivative assets and liabilities on different transactions are only netted if the transactions are with the same counterparty, a legal right of set-off exists and the cash flows are intended to be settled on a net basis. Changes in the values of derivatives are recognised in accordance with the consolidated entity's accounting policy as described in note 1(j).

Use of derivatives

The consolidated entity transacts derivatives for three primary purposes: to create risk management solutions for clients, for proprietary trading purposes, and to manage and hedge the consolidated entity's own risks. For accounting purposes, derivative instruments are classified as held either for trading or hedging. Derivatives that are held as hedging instruments are formally designated as hedges as defined in AASB 139. All other derivative instruments are classified as held-for trading. The held-for-trading classification includes two types of derivative instruments. The first type are those used in sales and trading activities, and those instruments that are used for risk management purposes but which for various reasons do not meet the qualifying criteria for hedge accounting. The second type of held for trading category includes derivatives managed in conjunction with financial instruments designated at fair value. These activities are described more fully below.

Notes to the Consolidated Financial Statements

8. DERIVATIVES (continued)

The consolidated entity'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, with offsetting deals being utilised to achieve this where necessary. When entering into derivative transactions, the consolidated entity employs the same credit risk management procedures to assess and approve potential credit exposures as are used for traditional lending.

Trading derivatives

Most of the consolidated entity'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 in derivatives are entered into principally for the purpose of generating profits from short-term fluctuations in price or margin. Positions may be traded actively or be held over a period of time to benefit from expected changes in currency rates, interest rates, equity prices or other market parameters. Trading includes market-making, positioning and arbitrage activities. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume; positioning means managing market risk positions in the expectation of benefiting from favourable movements in prices, rates or indices; arbitrage involves identifying and profiting from price differentials between markets and products.

As mentioned above, other derivatives classified as held-for-trading include non-qualifying hedging derivatives, ineffective hedging derivatives and the components of hedging derivatives that are excluded from assessing hedge effectiveness. Non-qualifying hedging derivatives are entered into for risk management purposes but do not meet the criteria for hedge accounting. These include derivatives managed in conjunction with financial instruments designated at fair value. Ineffective hedging derivatives were previously designated as hedges, but no longer meet the criteria for hedge accounting. Gains and losses from changes in the fair value of derivatives that do not qualify for hedge accounting are reported in 'Net trading income'.

Hedging derivatives

The consolidated entity uses derivatives (principally interest rate swaps) for hedging purposes in the management of its own asset and liability portfolios and structural positions. This enables the consolidated entity to optimise the overall cost of accessing debt capital markets, and to mitigate the market risk, which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities.

The accounting treatment of hedge transactions varies according to the nature of the instrument hedged and the type of hedge transactions. Derivatives may qualify as hedges for accounting purposes if they are fair value hedges or cash flow hedges. These are described under the relevant headings below.

With respect to exchange rate and interest rate contracts, the notional or contractual amounts of these instruments indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Fair value hedges

The consolidated entity's fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates.

For qualifying fair value hedges, all changes in the fair value of the derivative and in the fair value of the item in relation to the risk being hedged are recognised in income. If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortised to income as a yield adjustment over the remainder of the hedging period.

Notes to the Consolidated Financial Statements

8. DERIVATIVES (continued)

The fair values of outstanding derivatives designated as fair value hedges at 31 December 2011 were assets of \$0.7m (2010: \$1.3m) and liabilities of \$25.9m (2010: \$0.8m).

	Consolidated		Company	
	2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
Gains or losses arising from fair value hedges				
Gains / (losses):				
- on hedging instruments	(23.4)	(0.8)	(23.4)	(0.8)
- on the hedged items attributable to the hedged risk	23.6	1.3	23.6	1.3
	0.2	0.5	0.2	0.5

Cash flow hedges

The consolidated entity is exposed to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. 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 principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedges of forecast transactions. These are initially recognised directly in equity as gains or losses not recognised in the Income Statement and are transferred to current period earnings when the forecast cash flows affect net profit or loss.

The consolidated entity also enters into 'micro cash flow hedges' where it seeks to hedge the exposure to the variability of future cash flows of an individual floating rate financial asset or financial liability or future cash flows of a forecast transaction attributable to movements in interest rates that could affect reported earnings.

At 31 December 2011, the fair values of outstanding derivatives designated as cash flow hedges of forecast transactions were assets of \$4.5m (2010: \$2.8m) and liabilities of \$11.1m (2010: \$7.8m).

Notes to the Consolidated Financial Statements

8. DERIVATIVES (continued)

Cash flow hedges (continued)

The schedule of forecast principal balances on which the expected interest cash flows arise as at 31 December 2011 is as follows:

	3 months or less \$'m	More than 3 months but less than 1 year \$'m	5 years or less but more than 1 year \$'m
Consolidated and company			
At 31 December 2011			
Cash inflows from assets	400.0	400.0	200.0
Cash outflows from liabilities	-	135.0	278.0
Net cash inflows / (outflows)	400.0	265.0	(78.0)
At 31 December 2010			
Cash inflows from assets	2,640.5	1,229.9	100.0
Cash outflows from liabilities	435.0	405.0	245.0
Net cash inflows / (outflows)	2,205.5	824.9	(145.0)

Notes to the Consolidated Financial Statements

8. DERIVATIVES (continued)

Fair value of open positions by product type

The following table summarises the fair values of third party and inter company derivatives' open positions by product contract type.

	Consolidated		Company	
	2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
Assets:				
Trading derivatives				
Third party				
- Exchange rate	33.8	44.3	33.8	44.3
- Interest rate	15.6	3.5	15.6	3.5
	49.4	47.8	49.4	47.8
Related entities				
- Exchange rate	22.2	20.4	22.2	20.4
- Interest rate	14.3	9.3	14.3	9.3
- Equity	0.4	-	0.4	-
	36.9	29.7	36.9	29.7
Hedging derivatives				
Third party				
- Interest rate	-	0.1	-	0.1
		0.1		0.1
Related entities				
- Interest rate	5.2	4.0	5.2	4.0
	5.2	4.0	5.2	4.0
	91.5	81.6	91.5	81.6
Liabilities:				
Trading derivatives				
Third party				
- Exchange rate	31.3	37.4	31.3	37.4
- Interest rate	-	0.8	-	0.8
	31.3	38.2	31.3	38.2
Related entities				
- Exchange rate	17.6	25.1	17.6	25.1
- Interest rate	25.1	8.3	25.1	8.3
- Equity	2.6	-	2.6	-
	45.3	33.4	45.3	33.4
Hedging derivatives				
Third party				
- Interest rate	1.8	2.5	1.8	2.5
	1.8	2.5	1.8	2.5
Related entities				
- Interest rate	35.2	6.1	35.2	6.1
	35.2	6.1	35.2	6.1
	113.6	80.2	113.6	80.2

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
9. FINANCIAL INVESTMENTS					
Available-for-sale securities at fair value					
- Debt securities		4,026.1	3,369.9	4,026.1	3,369.9
- Treasury and other eligible bills		560.1	95.3	560.1	95.3
- Equity securities		-	1.6	-	1.6
		<u>4,586.2</u>	<u>3,466.8</u>	<u>4,586.2</u>	<u>3,466.8</u>
Available-for-sale securities					
- Which may not be repledged or resold or are not subject to repledge or resale by counterparties		4,539.9	3,466.8	4,539.9	3,466.8
- Which may be repledged or resold or are subject to repledge or resale by counterparties		46.3	-	46.3	-
		<u>4,586.2</u>	<u>3,466.8</u>	<u>4,586.2</u>	<u>3,466.8</u>
Analysis of available for sale securities by issuer:					
- Government securities and Australian government agencies		1,659.6	295.9	1,659.6	295.9
- Banks and building societies		2,926.6	3,170.9	2,926.6	3,170.9
		<u>4,586.2</u>	<u>3,466.8</u>	<u>4,586.2</u>	<u>3,466.8</u>
10. PROPERTY, PLANT & EQUIPMENT					
Leasehold improvements at cost					
Balance at 1 January		45.2	35.9	45.2	35.9
Assets acquired		12.5	9.3	12.5	9.3
Assets disposed		-	-	-	-
Balance at 31 December		<u>57.7</u>	<u>45.2</u>	<u>57.7</u>	<u>45.2</u>
Furniture, fittings, office equipment at cost					
Balance at 1 January		53.3	48.9	53.3	48.9
Assets acquired		6.5	4.4	6.5	4.4
Assets disposed		-	-	-	-
Balance at 31 December		<u>59.8</u>	<u>53.3</u>	<u>59.8</u>	<u>53.3</u>
Leasehold improvements accumulated depreciation					
Balance at 1 January		(34.9)	(29.8)	(34.9)	(29.8)
Depreciation charge for the year		(5.6)	(5.1)	(5.6)	(5.1)
Disposals		-	-	-	-
Balance at 31 December		<u>(40.5)</u>	<u>(34.9)</u>	<u>(40.5)</u>	<u>(34.9)</u>
Furniture, fittings, office equipment accumulated depreciation					
Balance at 1 January		(44.9)	(41.6)	(44.9)	(41.6)
Depreciation charge for the year		(3.7)	(3.3)	(3.7)	(3.3)
Disposals		-	-	-	-
Balance at 31 December		<u>(48.6)</u>	<u>(44.9)</u>	<u>(48.6)</u>	<u>(44.9)</u>
Carrying amounts					
At 1 January		18.7	13.4	18.7	13.4
At 31 December		<u>28.4</u>	<u>18.7</u>	<u>28.4</u>	<u>18.7</u>

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
11. GROUP ENTITIES					
(a) SHARES IN CONTROLLED ENTITIES					
Unlisted securities at cost					
Shares in controlled entities at cost (1)		-	-	79.9	79.9
Less: provision for impairment (1)		-	-	(79.9)	(79.9)
		-	-	-	-

(1) Under a previous version of Australian accounting standards, shares in controlled entities were measured at fair value on a class of assets basis. On transition to A-IFRS in 2005, the deemed cost of the investment in controlled entities was the fair value of the net assets.

Over time activities within the subsidiaries have been migrated to HSBC Bank Australia. HSBC Bank Australia is in the process of deregistering dormant legacy entities. As part of this exercise, retained profits and capital have been upstreamed through dividends and capital redemptions from subsidiaries. As a consequence of the deemed cost calculated above, this has resulted in impairments of \$79.9m being recognised in the 2010 year and the reversal of the asset revaluation reserve of \$23.2m during 2010.

(b) CONTROLLED ENTITIES

All controlled entities are incorporated in Australia.

Name of Entity	Note	2011 %	2010 %	Place of incorporation
Controlling Entity:				
HSBC Bank Australia Limited				Australia
Controlled entities:				
HSBC Custody Nominees (Australia) Limited		100	100	Australia
HSBC Finance Holdings (Australia) Pty Ltd		100	100	Australia
HSBC Securities (Australia) Pty Limited	(1)	0	100	Australia
Midland Australia Pty Limited		100	100	Australia
ACN 087 652 113 Pty Ltd		100	100	Australia
HSBC Securities Investments (Australia) Pty Ltd	(1)	0	100	Australia
Lion Series 2007-1 Trust	(2)	-	-	Australia
Lion Series 2009-1 Trust	(3)	-	-	Australia

(1) HSBC Securities (Australia) Pty Limited and HSBC Securities Investments (Australia) Pty Ltd were de-registered in March 2011.

(2) Although the Company does not hold any ownership interests in Lion Series 2007-1 Trust, it receives substantially all of the benefits related to the Lion Trust securitisation programme. Consequently, the Company consolidates this entity. This trust was established on 22 April 2007.

(3) The Company established the Lion 2009-1 Trust in July 2009 and purchased \$1.6 billion of customer mortgages, enabling the creation of notes eligible for repo with the RBA, as part of consolidated entity's contingency liquidity plan. The Company does not hold any ownership interests in Lion Series 2009-1 Trust. It owns all the notes and receives substantially all of the benefits related to the Lion Trust securitisation programme. As a result, the Company consolidates this entity.

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
12. INTANGIBLE ASSETS					
GOODWILL					
Cost and carrying amount					
Opening balance at 1 January		58.7	58.7	58.7	58.7
Closing balance at 31 December		58.7	58.7	58.7	58.7
INTERNALLY DEVELOPED SOFTWARES					
Cost					
Opening balance at 1 January		13.2	13.2	13.2	13.2
Additions		0.6	-	0.6	-
Closing balance at 31 December		13.8	13.2	13.8	13.2
Accumulated Amortisation					
At 1 January		12.0	7.4	12.0	7.4
Amortisation charges for the year		1.2	4.6	1.2	4.6
At 31 December		13.2	12.0	13.2	12.0
Carrying amounts					
At 1 January		1.2	5.8	1.2	5.8
At 31 December		0.5	1.2	0.5	1.2
TOTAL INTANGIBLE ASSETS		59.3	59.9	59.3	59.9

Segment allocation of Goodwill

In recognition of Australian Accounting Standard AASB 138: Intangible Assets, the consolidated entity's carrying amount of goodwill as at 31 December 2011 is disclosed for each segment of business.

Retail Banking and Wealth Management	57.4	57.4	57.4	57.4
Global Banking and Markets	1.3	1.3	1.3	1.3
	58.7	58.7	58.7	58.7

Notes to the Consolidated Financial Statements

12. INTANGIBLE ASSETS (continued)

Impairment Tests for Goodwill

Goodwill has been allocated for impairment testing purposes to cash generating units in the following business segments: Retail Banking and Wealth Management and Global Banking and Markets. Under AASB 136: Impairment of assets, a cash-generating unit to which goodwill has been allocated shall be tested for impairment annually, and whenever there is an indication that the unit may be impaired. The key assumptions in calculating the recoverable amounts of these segments are disclosed below.

i) Retail Banking and Wealth Management

Goodwill allocated to Retail Banking and Wealth Management arose from the acquisition in 2001 by HSBC Bank Australia Limited of NRMA Building Society Group Limited. The Retail Banking and Wealth Management units' impairment test is based on fair value calculations.

Retail Banking and Wealth Management units' fair value has been assessed for the year ended 31 December 2011 by calculating a PE value, with industry average price earning's ratio for retail banks of 9 to 12 applied against the current year earnings of the unit from continuing operations to determine an upper and lower recoverable amount.

This recoverable amount exceeds the carrying amount of goodwill of \$57.4m, such that management considers that it is not reasonably possible for the assumed price to earnings ratio to change so significantly as to eliminate this excess.

ii) Global Banking and Markets

The Global Banking and Markets unit's impairment test is based on value in use calculations.

The business and associated clients that were purchased through the State Street acquisition generated a net profit after tax during the year ended 31 December 2011 that exceeded the carrying amounts of the business unit's goodwill.

With a carrying goodwill value of \$1.3m, discounted cash flow models utilising both two and five year time spans and discount rates of BBSW resulted in a recoverable amount in excess of the carrying amount of the unit.

The recoverable amount exceeds the carrying amount of goodwill of \$1.3m, such that management considers that it is not reasonably possible for the assumed future earnings to change so significantly as to eliminate this excess.

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
13. OTHER ASSETS					
Prepayments and accrued income		110.4	95.9	113.6	87.9
Receivables from related entities		494.5	1,661.4	494.5	1,661.4
Other assets		215.9	237.9	215.9	237.4
Assets held for resale		7.4	2.0	7.4	2.0
Acceptances and endorsements		142.2	196.1	142.2	196.1
		<u>970.4</u>	<u>2,193.3</u>	<u>973.6</u>	<u>2,184.8</u>

In both 2011 and 2010, assets held for resale mainly comprised assets acquired by repossession of collateral for realisation.

Notes to the Consolidated Financial Statements

14. TAX ASSETS AND LIABILITIES

Current tax assets and liabilities

The consolidated entity and the Bank have no current tax assets or liabilities. In accordance with the tax consolidated legislation the immediate parent entity, HSBC Australia Holding Pty Limited (HIHA), as head of the Australian tax consolidated group has assumed the current tax liability / (asset) initially recognised by members in the tax consolidated group and in accordance with the Tax Funding Agreement, the members in the tax consolidation group recognise a corresponding intercompany asset / liability to the head entity.

Recognised deferred tax assets and liabilities

a) Deferred tax assets and liabilities are attributable to the following:

Consolidated and Company	Deferred Tax Assets		Deferred Tax Liabilities		Net Deferred Tax Assets	
	2011	2010	2011	2010	2011	2010
	\$'m	\$'m	\$'m	\$'m	\$'m	\$'m
Loans and advances to customers	14.9	47.8	(7.2)	(8.3)	7.7	39.5
Debt securities on issue - asset	-	6.0	-	(2.6)	-	3.4
Tangible fixed assets	15.8	13.1	-	-	15.8	13.1
Trading assets/ derivatives	-	0.9	-	(51.8)	-	(50.9)
Prepayments and accrued income	0.1	0.2	-	-	0.1	0.2
Customer accounts	-	-	-	(5.0)	-	(5.0)
Debt securities on issue - liabilities	-	4.2	-	(3.2)	-	1.0
Trading liabilities/ derivatives	-	51.8	-	(0.5)	-	51.3
Other liabilities/ accrued expenses	25.1	23.6	(0.1)	(0.1)	25.0	23.5
Accruals and deferred income	10.4	12.6	-	-	10.4	12.6
Provision for contingent liabilities and commitments	14.9	14.9	-	-	14.9	14.9
Cash flow hedging reserve	2.0	1.4	-	-	2.0	1.4
Available for sale securities reserve	1.2	-	-	(1.9)	1.2	(1.9)
Total tax assets/(liabilities)	84.4	176.5	(7.3)	(73.4)	77.1	103.1

b) Movement in temporary differences during the year

Consolidated and Company	Balance 1 Jan 11	Recognised in income	Recognised in equity	DTA Transfer to HIHA	Balance 31 Dec 11
	\$'m	\$'m	\$'m	\$'m	\$'m
Loans and advances to customers	39.5	0.9	-	(32.7)	7.7
Debt securities on issue - asset	3.4	(1.0)	-	(2.4)	-
Tangible fixed assets	13.1	2.7	-	-	15.8
Trading assets/ derivatives	(50.9)	4.2	-	46.7	-
Prepayments and accrued income	0.2	(0.1)	-	-	0.1
Customer accounts	(5.0)	(1.0)	-	6.0	-
Debt securities on issue - liabilities	1.0	0.1	-	(1.1)	-
Trading liabilities/ derivatives	51.3	(4.8)	-	(46.5)	-
Other liabilities/accrued expenses	23.5	1.5	-	-	25.0
Accruals and deferred income	12.6	3.3	-	(5.5)	10.4
Provision for contingent liabilities and commitments	14.9	-	-	-	14.9
Cash flow hedging reserve	1.4	-	0.6	-	2.0
Available for sale securities reserve	(1.9)	-	3.1	-	1.2
	103.1	5.8	3.7	(35.5)	77.1

Notes to the Consolidated Financial Statements

14. TAX ASSETS AND LIABILITIES (continued)

b) Movement in temporary differences during last year

Consolidated and Company	Balance	Recognised in	Recognised in	Balance
	1 Jan 10	income	equity	31 Dec 10
	\$'m	\$'m	\$'m	\$'m
Loans and advances to customers	34.7	4.8	-	39.5
Debt securities on issue - asset	(1.4)	4.8	-	3.4
Tangible fixed assets	13.0	0.1	-	13.1
Trading assets/ derivatives	(46.4)	(4.5)	-	(50.9)
Prepayments and accrued income	0.1	0.1	-	0.2
Deposits by banks	0.1	(0.1)	-	-
Customer accounts	(1.6)	(3.4)	-	(5.0)
Debt securities on issue - liabilities	6.0	(5.0)	-	1.0
Trading liabilities/ derivatives	43.6	7.7	-	51.3
Other liabilities/ accrued expenses	21.8	1.7	-	23.5
Accruals and deferred income	14.0	(1.4)	-	12.6
Provision for contingent liabilities and commitments	14.9	-	-	14.9
Cash flow hedging reserve	2.2	-	(0.8)	1.4
Available for sale securities reserve	1.3	-	(3.2)	(1.9)
	102.3	4.8	(4.0)	103.1

During 2011, an election was made to apply the transitional provisions of the TOFA legislation to pre-TOFA financial arrangements resulting in the transfer of relevant net deferred tax assets amounting to \$35.5m (2010: nil) to the consolidated Head Entity, HSBC Australia Holdings Pty Limited (HIHA).

Note	Consolidated		Company	
	2011	2010	2011	2010
	\$'m	\$'m	\$'m	\$'m

15. TRADING LIABILITIES

Balances with related entities	1.0	-	1.0	-
Bonds and medium-term notes	119.1	159.2	119.1	159.2
Customer accounts	140.3	46.3	140.3	46.3
	260.4	205.5	260.4	205.5

16. SUBORDINATED LIABILITIES

Subordinated debt due May 2016, callable from May 2011	-	200.0	-	200.0
Subordinated debt due March 2018, callable from March 2013	42.0	42.0	42.0	42.0
Subordinated debt due November 2020, callable from November 2015	200.0	200.0	200.0	200.0
	242.0	442.0	242.0	442.0

Regulatory approval is required from Australian Prudential Regulation Authority ("APRA"), Financial Services Authority ("FSA") and Hong Kong Monetary Authority ("HKMA") before any of the subordinated debt can be repaid.

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
17. DEBT SECURITIES ON ISSUE					
Certificate of deposit		473.8	404.6	473.8	404.6
Bonds and medium-term notes		913.2	787.1	633.0	430.0
		<u>1,387.0</u>	<u>1,191.7</u>	<u>1,106.8</u>	<u>834.6</u>

18. PROVISIONS FOR LIABILITIES AND CHARGES

Balance at 1 January	49.7	49.7	49.7	49.7
Balance at 31 December	<u>49.7</u>	<u>49.7</u>	<u>49.7</u>	<u>49.7</u>

The consolidated entity and company has provisions in respect of litigation and guarantees. With respect to litigation provisions, which at the date of adoption of the accounts have not been resolved, an assessment of the consolidated entity's likely loss has been made and a provision made where appropriate.

19. OTHER LIABILITIES

Payables to related entities	1,762.8	2,004.0	2,046.6	2,364.5
Accruals and deferred income	176.4	175.3	175.4	163.1
Other liabilities	68.0	57.9	68.2	57.8
Acceptances and endorsements	142.2	196.1	142.2	196.1
	<u>2,149.4</u>	<u>2,433.3</u>	<u>2,432.4</u>	<u>2,781.5</u>

20. EMPLOYEE BENEFITS

Liability for annual leave	9.9	8.3	9.9	8.3
Payable to related entity with respect to share based payments	6.7	4.2	6.7	4.2
Liability for long service leave	13.4	11.0	13.4	11.0
Total employee benefits	<u>30.0</u>	<u>23.5</u>	<u>30.0</u>	<u>23.5</u>

a) Defined contribution plans

The consolidated entity and company makes contributions to the staff superannuation scheme, a defined contribution plan. The amount recognised as expense was \$16.4m for the year ended 31 December 2011 (2010: \$14.3m).

Notes to the Consolidated Financial Statements

20. EMPLOYEE BENEFITS (continued)

b) Share based payments

The consolidated entity's key management personnel and employees participate in both discretionary and voluntary HSBC Holdings plc compensation plans. Discretionary share plans include performance and restricted/achievement share awards. Discretionary options plans are the Executive Share Option Plan and the Group Share Option Plan (ESOP/GSOP).

Sharesave, a voluntary compensation plan eligible to all employees, is a savings related share option plan.

During 2011, \$6.2m (2010: \$4.5m) was charged to the Income Statement by the Company and the consolidated entity in respect of share-based transactions settled in equity. This expense was computed from the fair values of the share-based payment transactions when contracted, arising under employee share awards made in accordance with HSBC Holdings plc's reward structures.

The terms of the share plans have been adjusted accordingly to maintain the value of the awards and these adjustments are set out in the tables below.

Calculation of fair values

The fair value of services received in return for shares awarded is measured by reference to fair value of the shares.

Fair values of share options, measured at the date of grant of the option, are calculated using a binomial lattice model methodology that is based on the underlying assumptions of the Black-Scholes model. When modelling options with vesting dependent on HSBC Holdings plc's Total Shareholder Return ("TSR") over a period, the TSR performance targets are incorporated into the model using Monte-Carlo simulation. The expected life of options depends on the behaviour of option holders, which is incorporated into the option model on the basis of historic observable data. The fair values calculated are inherently subjective due to the assumptions made and the limitations of the model used.

The significant weighted average assumptions used to estimate the fair value of the options granted were as follows:

	1 year Savings- Related Share Option Schemes	3 year Savings- Related Share Option Schemes	5 year Savings- Related Share Option Schemes
2011			
Risk-free interest rate	0.83%	1.68%	2.51%
Expected life (years)	1	3	5
Expected volatility	25%	25%	25%
Closing share price on grant date (GBP)	637.14p	637.14p	637.14p
Exercise price (GBP)	509.71p	509.71p	509.71p
Dividend growth	4.5% per annum	4.5% per annum	4.5% per annum
Exchange rate AUD/GBP	1.49	1.49	1.49
2010			
Risk-free interest rate	0.71%	1.94%	2.85%
Expected life (years)	1	3	5
Expected volatility	30%	30%	30%
Closing share price on grant date (GBP)	682.00p	682.00p	682.00p
Exercise price (GBP)	545.73p	545.73p	545.73p
Dividend growth	4.5% per annum	4.5% per annum	4.5% per annum
Exchange rate AUD/GBP	1.65	1.65	1.65

The risk-free rate was determined from the UK gilts yield. Expected life is not a single input parameter but a function of various behavioural assumptions. Expected volatility is estimated by considering both historic average share price volatility and implied volatility derived from traded options over HSBC Holdings plc shares of similar maturity to those of the employee options. Expected dividend yields are incorporated into the valuation model for share options and awards, where applicable and are in line with consensus analyst forecasts.

Notes to the Consolidated Financial Statements

20. EMPLOYEE BENEFITS (continued)

The HSBC Share Plan

The HSBC Share Plan was adopted by HSBC Holdings plc in 2005. Under this Plan, Performance Share awards, Achievement Share awards and Restricted Share awards may be made. The aim of the HSBC Share Plan is to align the interests of executives to the creation of shareholder value and recognise individual performance and potential. Awards are also made under this plan for recruitment and retention purposes.

Restricted Share and Achievement Share awards

Restricted share awards are made to eligible employees for retention and recruitment or as a part of deferral of annual bonus. These awards vest between one and three years from the date of the award.

Achievement shares were launched in 2005 and were utilised to promote widespread interest in HSBC shares amongst employees and are awarded to eligible employees after taking into account the employee's performance in the prior year. High-performing and/or high-potential senior and middle managers are normally eligible to receive achievement shares as part of the annual pay review process. Shares are awarded without corporate performance conditions and are released to employees over one to three years provided the employees have remained employed by the HSBC Group for this period.

Additional awards can be made during the 3-year vesting period. At the end of the three years, the original award together with the additional share awards will be released.

	2011 Number (000's)	2010 Number (000's)
Outstanding at the beginning of the period	886	451
Forfeited during the period	(10)	(23)
Released during the period	(216)	(97)
Granted during the period	493	555
Outstanding at 31 December	<u>1,153</u>	<u>886</u>

The weighted average fair value of shares awarded by the consolidated entity for restricted and achievement share awards in 2011 was \$10.50 (2010: \$11.37).

Savings-related Share option Plans

Savings-Related Share Option Plans invite eligible employees to enter into savings contracts to save up to the Australian dollar equivalent of £250 per month, with the option to use the savings to acquire shares. The aim of the plans is to align the interests of all employees with the creation of shareholder value. The options are exercisable within three months following the first anniversary of the commencement of a one-year savings contract or within six months following either the third or the fifth anniversary of the commencement of three-year or five-year savings contracts respectively. The exercise price is at 20 per cent (2010: 20 per cent) discount to the market value immediately preceding the date of invitation.

	Weighted average exercise price 2011	Number of options 2011 000's	Weighted average exercise price 2010	Number of options 2010 000's
Outstanding at the beginning of the period	\$5.72	789.6	\$6.37	888.6
Forfeited / expired during the period	\$7.17	(131.0)	\$7.11	(83.9)
Exercised during the period	\$8.44	(37.8)	\$5.95	(135.8)
Granted during the period	\$7.94	170.0	\$11.35	120.7
Outstanding at the end of the period	\$5.72	<u>790.8</u>	\$5.72	<u>789.6</u>
Exercisable at the end of the period	-	<u>-</u>	-	<u>-</u>

The weighted average fair value of options granted during the year was \$2.00 (2010: \$2.56). The weighted average share price at the date the share options were exercised was \$8.56 (2010: \$5.95). The exercise price range and weighted average remaining contractual life for options outstanding at the balance sheet date were as follows:

Exercise price range (\$)	2011 \$5.06-\$11.66	2010 \$5.08 - \$11.70
Weighted average remaining contractual life (years)	1.39	2.11

Notes to the Consolidated Financial Statements

20. EMPLOYEE BENEFITS (continued)

HSBC Holdings Group Share Option Plan and Executive Share Option Scheme

The HSBC Holdings Group Share Option Plan and the HSBC Holdings Executive Share Option scheme were long-term incentive plans under which certain HSBC employees between 1993 and 2005 were awarded share options. The aim of the plans was to align the interests of those higher performing employees with the creation of shareholder value. This was achieved by setting certain TSR targets which would normally have to be attained in order for the awards to vest. The exercise price equals the share price at the date of grant and options are normally exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions. Options granted after May 2005 are made under the HSBC Share Plan.

	Weighted average exercise price 2011	Number of options 2011 000's	Weighted average exercise price 2010	Number of options 2010 000's
Outstanding at the beginning of the period	\$12.31	754.4	\$14.52	802.5
Forfeited / expired during the period	\$11.68	(135.0)	\$13.36	(26.4)
Exercised during the period	\$9.31	(7.5)	\$12.38	(21.7)
Outstanding at the end of the period	\$10.54	611.9	\$12.31	754.4
Exercisable at the end of the period	-	-	-	-

The weighted average share price at the date the share options were exercised was \$10.68 (2010: \$12.38). The exercise price range and weighted average remaining contractual life for options outstanding at the balance sheet date were as follows:

	2011	2010
Exercise price range (\$)	\$9.68-\$13.23	\$9.72 - \$13.28
Weighted average remaining contractual life (years)	1.6	2.2

	Consolidated		Company	
	2011	2010	2011	2010
Note	\$'m	\$'m	\$'m	\$'m

21. CAPITAL

Issued Capital				
656,795,689 ordinary shares fully paid	751.0	751.0	751.0	751.0
6,000 non-redeemable preference shares	60.0	60.0	60.0	60.0
	811.0	811.0	811.0	811.0

Ordinary shares

Holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholder meetings. In the event of winding up of the Company, ordinary shareholders rank after all other shareholders and creditors and are fully entitled to any proceeds of liquidation.

Preference shares

Subject to a declaration by the Directors, the holders of preference shares have an entitlement to dividends at a rate of 5% per annum subject to certain conditions being met by the Company as set out in the Memorandum and Articles of Association. The key condition prior to the dividend being declared is that shareholder funds exceed \$500 million and the dividend is paid out of current year profits available for distribution. The dividend entitlement is non-cumulative.

Notes to the Consolidated Financial Statements

22. RESERVES AND RETAINED EARNINGS

(a) Reserves

Asset revaluation reserve

The asset revaluation reserve relates to investment in subsidiaries previously measured at fair value on a class of assets basis in 2000 in accordance with previous Australian accounting standards.

Available for sale securities reserve

The available for sale securities reserve includes the cumulative net change in the fair value of available-for-sale investments until the investment is derecognised.

Cash flow hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

Capital contribution reserve

This reserve represents the capital contribution received by the consolidated entity from the ultimate parent entity, HSBC Holdings plc, in respect of the various share based payment schemes in operation.

(b) Dividends

Dividends to shareholders of the parent company amounted to \$88.0m in 2011 (2010: \$82.0m). Of this, \$85.0m (2010:\$79.0m) was dividends paid on ordinary share capital and \$3.0m (2010: \$3.0m) was paid on preference shares classified as equity.

	Company 2011		Company 2010	
	\$ per Share	Total \$'m	\$ per share	Total \$'m
<i>Ordinary shares</i>				
Dividend 1	0.029	19.0	0.056	37.0
Dividend 2	0.033	22.0	0.030	20.0
Dividend 3	0.033	22.0	0.033	22.0
Dividend 4	0.033	22.0	-	-
		<u>85.0</u>		<u>79.0</u>
<i>Preference Shares</i>				
Dividend 1	500.000	3.0	500.000	3.0
		<u>3.0</u>		<u>3.0</u>

Notes to the Consolidated Financial Statements

	Consolidated		Company	
	2011	2010	2011	2010
	\$'m	\$'m	\$'m	\$'m
23. COMMITMENTS				
(a) Lease commitments				
Aggregate non-cancellable operating lease expenditure contracted for at balance date, but not provided for in the financial statements:				
Payable not later than 1 year	27.7	22.7	27.7	22.7
Payable between 1 and 5 years	83.2	53.2	83.2	53.2
Payable over 5 years	29.7	36.4	29.7	36.4
	<u>140.6</u>	<u>112.3</u>	<u>140.6</u>	<u>112.3</u>

The consolidated entity leases property under operating leases expiring from one to ten years. Leases generally provide the consolidated entity with a right of renewal at which time all terms are renegotiated. Lease payments comprise a base amount plus an incremental contingent rental. Contingent rentals are based on either movements in the Consumer Price Index or operating performance criteria.

(b) Other commitments				
Documentary credits and trade related transactions	331.0	279.7	331.0	279.7
Undrawn lending facilities	8,908.7	8,315.7	8,908.7	8,315.7
	<u>9,239.7</u>	<u>8,595.4</u>	<u>9,239.7</u>	<u>8,595.4</u>

24. CONTINGENT LIABILITIES

(a) Contingent liabilities in respect of guarantees given	<u>1,256.4</u>	<u>1,079.7</u>	<u>1,256.4</u>	<u>1,079.7</u>
(b) Letters of credit and other contingencies	<u>1,165.9</u>	<u>728.4</u>	<u>1,165.9</u>	<u>728.4</u>

(c) HSBC Bank Australia Limited and its controlled entities have commitments in respect of foreign exchange contracts, futures and options contracts, forward rate agreements, and currency and interest rate swap contracts. The commitments have been entered into in the normal course of business and it is not envisaged that any irrecoverable liability will arise from these contracts.

(d) The consolidated entity is defending an action brought by various external parties. It is not practicable for the Directors to reliably measure any additional contingent liability other than that already provided for in note 18.

25. FIDUCIARY ACTIVITIES

Funds under custody	<u>115,879.3</u>	<u>120,063.1</u>	<u>115,879.3</u>	<u>120,063.1</u>
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Consolidated entity provides custody and clearing services to global custodians, fund managers and broker dealers.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES

(a) Risk management

All activities undertaken by the consolidated entity involve analysing, evaluating, accepting and managing some degree of risk or combination of risks. The most important types of risks are credit risk (which includes country and cross-border risk), liquidity risk, market risk and operational risk. Market risk includes foreign exchange, interest rate and credit spread risk.

The consolidated entity's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date administrative and information systems. The consolidated entity regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice. Individual responsibility and accountability, instilled through training, are designed to deliver a disciplined, conservative and constructive culture of risk management and control.

The Bank's Audit and Risk Committee of the Board oversees the management of risk within the Bank and the Bank's risk appetite and future risk strategy, including capital and liquidity management strategy. The Bank's Risk Management Committee exercises oversight of the Bank's risk framework.

For the following market risk, credit risk and liquidity risk management notes, the disclosures are for the consolidated entity as management monitor risk on a consolidated basis and because the market risk, credit risk and liquidity risk of the Company are not considered materially different for separate disclosure. The exception is capital management where this is monitored for both the Company and consolidated entity.

The market risk limit structures in the consolidated entity are governed and set by Group Market Risk Management (MRM) in London which also monitors all high level limits as reported by the consolidated entity for the trading book interest rate exposures and mark to market loss referral limits. Additionally, The Hongkong and Shanghai Banking Corporation Limited (HBAP) overviews market risk exposures for its related entities, including the consolidated entity, and reports all significant limit excesses to HBAP Executive Committee. At the consolidated entity level, all approved market risk limits are monitored and reported in detail on a daily basis.

It is HSBC Group policy that excesses over market risk limits should only arise in exceptional circumstances and where it is anticipated that an excess may occur, pre-approval should be sought from MRM. Details of the size of the excess, duration and reason will be required before approval is recommended. Excesses not pre-approved will be identified and reported as such by Treasury Risk Management the following business day. A formal report is completed for every excess position identified which is signed off by the Head of Treasury Services, the Treasurer, the CRO and the CEO. This report is distributed to HBAP Market Risk Management, HBAP Head of Interest Rates, GHQ Market Risk Management and HBAP HTR ("Regional Controls"). All excess positions identified for the month are reported to HSBC Bank Australia Limited Assets and Liability Management Committee ("ALCO"). All excesses are reported to the HSBC Bank Australia Limited's Board of Directors on a quarterly basis.

In addition to the approved overall consolidated entity trading book limits, detailed written sub-limits are also placed on individual dealers and their authority to trade outside normal trading hours and to trade off the premises. The authority for the trading book to trade any treasury products and the limits for such exposures requires the written concurrence of MRM before any transactions can be booked by the consolidated entity.

It is HSBC Group policy and practice that all market risk limits must be formally documented in the market risk limit mandate in a standard format which clearly details the applicable limits and permitted products that can be booked in the trading book. Any amendment to these limits are documented. In all cases transactions can only be booked after the limits have been formally approved.

The HSBC Group limits must also adhere to restrictions placed on the entity's positions by regulatory bodies or legislation within the relevant country of operation.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Market Risk Disclosures

Market risk is the risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices will reduce the consolidated entity's income or the value of its portfolios.

The objective of HSBC's market risk management is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the HSBC Group's status as a premier provider of financial products and services. In addition to this, HSBC provide regular market risk information to governing authorities, such as APRA and the FSA in order to satisfy regulatory reporting requirements.

HSBC separates exposures to market risk into either trading or non-trading portfolios. Trading portfolios include those positions arising from market-making, proprietary position-taking and other marked-to-market positions so designated. Non-trading portfolios primarily arise from the interest rate and foreign exchange risk management of HSBC's retail and commercial banking assets and liabilities.

The management of market risk is principally undertaken by Treasury within the consolidated entity and supervised by the ALCO. All market risk arising from retail, personal and commercial banking is transferred (by the interest rate buy-in or similar processes) to the Treasury non-trading portfolio book, irrespective of the size of the positions, and then managed within the appropriate market risk limits by Treasury. The reason for centralising risk is to ensure that all market risks are consolidated within operations that have the necessary skills, tools, management and governance to manage such risks professionally.

Market risk limits are approved by the HSBC Group Management Board in the annual HSBC Risk Management Committee meeting. Limits are based on portfolios, products and risk types, with market liquidity being a principal factor in determining the level of limits set. Market Risk Management, an independent unit within Global Markets, develops the HSBC Group's market risk management policies and measurement techniques. Treasury within the consolidated entity is responsible for measuring market risk exposures in accordance with the policies defined by Market Risk Management, and monitoring and reporting these exposures against the prescribed limits on a daily basis.

At both portfolio and position levels, market risk is monitored and controlled using a complementary set of techniques. These include VAR and, for interest rate risk, present value of a basis point movement in interest rates, together with stress and sensitivity testing and concentration limits. These techniques quantify the impact on capital of varied market movements.

Value at risk ("VaR")

The principal tool used by HSBC to monitor and limit market risk exposure is VaR. VaR is a technique that simulates losses that could occur given a portfolio holding at a point in time as a result of movements in market rates, prices and credit spread over a specified historical time horizon and to a given confidence interval.

The VaR models used by HSBC are based on historical simulation. The historical simulation models derive plausible future scenarios from historical market rate time series, taking account of inter-relationships between different markets and rates, for example, between interest rates and foreign exchange rates. The models also incorporate the impact of option features in the underlying exposures.

The historical simulation models used by HSBC incorporate the following features:

- A historical simulation using market rate and price movements are calculated with reference to foreign exchange rates, commodity prices, interest rates, credit spreads, equity prices and the associated volatility data using a two year time window;
- VaR is calculated using a 99 per cent confidence interval; and
- VaR is calculated for a one-day holding period.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Market Risk Disclosures (continued)

HSBC 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, HSBC would expect to see losses in excess of VAR only one per cent 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 and identify if the model is overly conservative or not.

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

- 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 1-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a 1-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

HSBC recognises these limitations by augmenting its VaR limits with other position and sensitivity limit structures. Additionally, HSBC applies a wide range of stress testing, both on individual portfolios and on the Group's consolidated positions. HSBC's stress-testing regime provides senior management with an assessment of the financial impact of identified extreme events on the market risk exposures of HSBC.

Total and trading VaR for the consolidated entity was as follows:

	Total VaR		Trading VaR	
	Year Ended 31 December		Year Ended 31 December	
	2011	2010	2011	2010
	\$'m	\$'m	\$'m	\$'m
At 31 December	5.0	2.1	0.2	0.1
Average	2.5	2.6	0.1	0.3
Maximum	5.1	3.7	0.6	0.7
Minimum	1.1	1.2	0.1	0.1

Total VaR at 31 December 2011 has increased to \$5.0m from \$2.1m at 31 December 2010, average VaR in 2011 is \$0.1m lower than the 2010 average. An increased level of liquid assets to satisfy liquidity requirements, combined with a volatile bond and interest rate market resulted in increased VaR towards the end of 2011.

Total Trading VaR at 31 December 2011 has increased from \$0.1m in 2010 to \$0.2m due to increase in the magnitude of the PVBP and volatility in the Trading book.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Market Risk Disclosures (continued)

Present Value of a Basis Point ("PVBP")

The HSBC Group has adopted the PVBP measurement as the standard approach to measuring and setting market risk interest rate limits.

The present value of a basis point ("PVBP") is one of the most widely used and accepted methods for quantifying outright interest rate risk. It expresses the impact on the present value of a position of a one basis point increase in the interest rate used to calculate the present value e.g. a change from 5.00% to 5.01%. This is a more accurate expression of interest rate sensitivity and exposure than any other method and is the most appropriate methodology for portfolios where the value of the transactions is very sensitive to interest rate movements.

Therefore all interest rate exposure limits for the banking book are expressed in the form of forward PVBP limits which have an overall total limit. There are also PVBP sub-limits by time buckets which are based on HSBC Group defined futures buckets which cover the period from today out to 33 years (or tenor that is applicable in each particular trading book).

The utilisation calculations used by the HSBC Group and the consolidated entity are:

- a single currency transaction will contribute limit utilisation in that currency.
- a forward FX transaction will contribute limit utilisation in two currencies.
- exposure is created in each forward period up to maturity.
- the PVBP calculation is based on an increase of one basis point in interest rates.
- a positive cash flow in the future will show a negative PVBP and a negative cash flow will show a positive PVBP exposure.
- all risk sensitivity exposures are measured in USD equivalent, local currency exposures are converted at the applicable spot foreign exchange rate to their USD equivalent.
- utilisation across different currencies within time bands is calculated gross and utilisation within a currency across different time bands is calculated net.

The relevant PVBP limit for each currency covering the time bands of allowable transactions is approved annually. In addition there will be an overall total PVBP limit for the trading book.

Credit Spread Delta ("CS01")

The HSBC Group employs a similar measure to PVBP for a basis point increase in credit spreads of underlying securities held in the trading book. CS01 measures the change in present value for a 1bps parallel upward shift in the underlying credit spread curve. The CS01 risk measure then highlights the sensitivity of bond values to changes in underlying credit spreads.

CS01 limits are maintained at an entity level and approved annually. The limits are further broken down into Moody's/ S&P rating buckets (i.e. AAA, AA, A and BBB), as well as measuring the CS01 exposure against the obligor level again classified by Moody's/S&P rating buckets.

Non-trading portfolios

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

Market 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 optionality in certain product areas, for example, mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand, for example, current accounts. The prospective change in future net interest income from non-trading portfolios will be reflected in the current realisable value of these positions, should they be sold or closed prior to maturity. In order to manage this risk optimally, market risk in non-trading portfolios is transferred to Treasury or to separate books managed under the supervision of ALCO.

The transfer of market risk to books managed by Treasury or supervised by ALCO is usually achieved by a series of internal deals between the business units and these books. When the behavioural characteristics of a product differ from its contractual characteristics, the behavioural characteristics are assessed to determine the true underlying interest rate risk.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Market Risk Disclosures (continued)

ALCO is required to regularly monitor all such behavioural assumptions and interest rate risk positions, to ensure they comply with interest rate risk limits established by the Group Management Board.

As noted above, in certain cases, the non-linear characteristics of products cannot be adequately captured by the risk transfer process. For example, both the flow from customer deposit accounts to alternative investment products and the precise prepayment speeds of mortgages will vary at different interest rate levels. In such circumstances, simulation modelling is used to identify the impact of varying scenarios on valuations and net interest income.

Once market risk has been consolidated in Global Market or ALCO-managed books, the net exposure is typically managed through the use of interest rate swaps within agreed limits.

Within the consolidated entity, banking entities also monitor the sensitivity of projected net interest income under varying interest rate scenarios. The consolidated entity aims, through its management of market risk in non-trading portfolios, to mitigate the impact of prospective interest rate movements which could reduce future net interest income, whilst balancing the cost of such hedging activities on the current net revenue stream.

(c) Credit Risk Disclosures

Credit risk is the risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises principally from lending, trade finance and also from off-balance sheet products such as counterparty risk guarantees. Credit risk also arises when issuers of debt securities are downgraded and, as a result, the value of the consolidated entity's assets falls. Of the risks in which we engage, Credit risk generates the largest regulatory capital requirement.

The Credit risk department fulfils the role of an independent credit control unit as part of the Global Risk function in HSBC's Group Management Office (GMO). Credit approval authorities are delegated by the Board of HSBC Group to the most senior Chief Executive Officers, who receive commensurate authorities from their own boards. The high level oversight and management of credit risk provided by the Global Risk function in GMO includes:

- Formulating HSBC Group credit policies. Compliance, subject to approved dispensations, is mandatory for all operating companies which must develop local credit policies consistent with HSBC Group policies;
- Guide operating companies on appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain higher-risk sectors;
- Undertaking an independent review and objective assessment of risk. Group Risk assesses all commercial non-bank credit facilities and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken;
- Monitoring the performance and management of portfolios across the HSBC Group to control exposure to sovereign entities, banks and other financial institutions, as well as debt securities which are not held solely for the purpose of trading to set policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to our capital base, and remain within internal and regulatory limits;
- Control cross-border exposures;
- Review and develop the risk rating framework and systems. The Group Chief Risk Officer chairs the Credit Risk Analytics Oversight Committee, which reports to the Risk Management Meeting and oversees risk rating model governance for both wholesale and retail business;
- Report on retail portfolio performance, high risk portfolios, risk concentrations, country limits and cross-border exposures, large impaired accounts, impairment allowances and stress testing results and recommendations to the Risk Management Meeting, the Group Risk Committee and the Board; and
- Act on behalf of HSBC Holdings as the primary interface, for credit-related issues, with the Bank of England, the FSA, local regulators, rating agencies, analysts and counterparts in major banks and non-bank financial institutions.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(c) Credit Risk Disclosures (continued)

Special attention is paid to problem exposures in order to accelerate remedial action. Where appropriate, specialist units are established by operating companies to provide customers with support in order to help them avoid default whenever possible. Group and Regional Credit Review and Risk Identification teams regularly review exposures and processes in order to provide an independent, rigorous assessment of credit risk across the HSBC Group, reinforce secondary risk management controls and share best practice. Internal audit, as a tertiary control function, focuses on risks with a global perspective and on the design and effectiveness of primary and secondary control, carrying out oversight audits via sampling of global/regional control frameworks, themed audits of key or emerging risks and project audits to assess major change initiatives.

The consolidated entity's Credit risk department has the following principal objectives:

- Maintain a strong culture of responsible lending and a robust risk policy and control framework;
- To both partner and challenge our businesses in defining, implementing and continually re-evaluating our risk appetite; and
- Ensure there is independent, expert scrutiny of credit risks, their costs and their mitigation.

The consolidated entity is required to implement credit policies, procedures and lending guidelines which conform to HSBC Group standards, with credit approval authorities delegated from the Board of Directors of the consolidated entity to the Chief Executive Officer. The management of the consolidated entity includes a Chief Risk Officer who reports to the local Chief Executive Officer on credit-related issues and has a functional reporting line to the Regional Chief Risk Officer. The consolidated entity is responsible for the quality and performance of its credit portfolios and for monitoring and controlling all credit risks in its portfolios, including those subject to central approval by Group Credit and Risk. This includes managing its own risk concentrations by market sector, geography and product. Local systems are in place to enable the consolidated entity to control and monitor exposures by customer and retail product segments.

Credit exposure

The following table presents the maximum exposure to credit risk of financial instruments, before taking into account any collateral held or other credit enhancements unless such credit enhancements meet the offsetting requirements. For financial assets recognised on the balance sheet, the exposure to credit risk equals their carrying amount. For financial guarantees granted, the maximum exposure to credit risk is the maximum amount that the consolidated entity would have to pay if the guarantees are called upon. For loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities, the maximum exposure to credit risk is the full amount of the committed facilities.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(c) Credit Risk Disclosures (continued)

Maximum exposure to Credit Risk

	Consolidated	
	2011 \$'m	2010 \$'m
Cash and balances at central banks	398.0	399.2
Items in course of collection from other banks	1.6	1.2
Trading assets		
- Balances with Related entities	-	3.0
- Treasury and other eligible bills	-	-
- Debt securities	-	19.8
- Loans and advances to banks	-	-
- Loans and advances to customers	-	-
Total trading assets	-	22.8
Derivatives	91.5	81.6
Loans and advances to banks	1,979.6	1,821.1
Loans and advances to customers	15,769.8	14,174.5
Financial investments - Debt securities	4,026.1	3,369.9
- Treasury and other eligible bill	560.1	95.3
Total financial investments	4,586.2	3,465.2
Other assets		
- Endorsements and acceptances	142.2	196.1
- Receivables from related parties	494.5	1,661.4
- Accrued income	106.1	90.9
- Other	214.0	223.3
Total other assets	956.8	2,171.7
Financial guarantees and contingent liabilities	1,256.4	1,079.7
Loan commitments and other credit related commitments	9,268.3	8,595.4
At 31 December	34,308.2	31,812.4

Collateral and other credit enhancements

Loans and advances

It is HSBC Group's policy to establish that loans are within the customer's capacity to repay, rather than to rely excessively on security. Depending on the customer's standing and the type of product, facilities may be unsecured. Nevertheless, collateral can be an important mitigant of credit risk.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(c) Credit Risk Disclosures (continued)

Collateral and other credit enhancements (continued)

When appropriate, the consolidated entity is required to implement guidelines on the acceptability of specific classes of collateral or credit risk mitigation, and determine suitable valuation parameters. Such parameters are expected to be conservative, reviewed regularly and supported by empirical evidence. Security structures and legal covenants are required to be subject to regular review to ensure that they continue to fulfil their intended purpose and remain in line with local market practice. The collateral types are as follows:

- in the personal sector, mortgages over residential properties;
- in the commercial and industrial sector, charges over business assets such as premises, stock and debtors;
- in the commercial real estate sector, charges over the properties being financed and personal guarantees; and
- in the financial sector, charges over financial instruments such as debt securities and equities in support of trading facilities.

Collateral held on impaired assets as at 31 December 2011 was \$67.1m (2010: \$57.7m).

Other financial assets

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities and other eligible bills are generally unsecured with the exception of asset backed securities and similar instruments, which are secured by pools of financial assets.

Credit quality of loans and advances

The consolidated entity'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 Bank's retail business, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

Four broad classifications described the credit quality of the HSBC Group's lending and debt securities portfolios. These classifications each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending business, as well as the external ratings attributed by external agencies to debt securities. There is no direct correlation between the internal and external ratings at granular level, except to the extent each falls within a single quality classification

Quality Classification	Wholesale lending and Derivatives	Retail lending	Debt securities/ Other
Strong	CRR 1 to CRR 2	EL 1 to EL 2	A- and above
Medium	CRR 3 to CRR 5	EL 3 to EL 5	B+ to BBB+, and unrated
Sub-standard	CRR 6 to CRR 8	EL 6 to EL 8	B and below
Impaired	CRR 9 to CRR 10	EL 9 to EL 10	Impaired

CRR fall within the following categories:

1. 'Strong' – Exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/ or low levels of expected loss. Retail accounts operate within product parameters and only exceptionally show any period of delinquency.
2. 'Medium' – Exposures require closer monitoring, with low to moderate default risk. Retail accounts typically show only short periods of delinquency, with losses expected to be minimal following the adoption of recovery processes.
3. 'Sub-standard' – Exposures require varying degrees of special attention and default risk of greater concern. Retail portfolio segments show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(c) Credit Risk Disclosures (continued)

Credit quality of loans and advances (continued)

4. 'Impaired' – Exposures have been assessed, individually or collectively, as impaired. The HSBC Group observes the conservative disclosure convention, reflected in the quality classification definition above, that all retail accounts delinquent by 90 days or more are considered impaired. Such accounts may occur in any retail Expected Loss ("EL") grade, whereby in the higher quality grades the grading assignment will reflect the offsetting of the impact of delinquency status by credit risk mitigation in one form or another.

The HSBC Group's credit risk rating systems are an integral part of the Bank's sound management of risk. The Customer Risk Rating (CRR) scale provides a summary indicator of risk, based on information about a borrower's financial condition including cash flow, profitability and debt profile, market indicators, industry and operational background, management capabilities and other indicators that help to assess the customer's repayment ability. The CRR is assessed adopting a time horizon for Profitability of Default (PD) of 12 months, irrespective of the term of facilities. The CRR scale may be used at either two levels of granularity, according to local Basel II requirements, the sophistication of the business and the availability of default and loss data.

The CRR 10-grade scale above summarises a more granular underlying 23-grade scale of obligor PD. The 23-grade scale was introduced in September 2010 following the harmonisation of PDs for three asset classes (banks, sovereigns and corporates) into one scale which required an additional PD band. All distinct HSBC customers are rated using the 10 or 23-grade scale, depending on the degree of sophistication of the Basel II approach adopted for the exposure.

The EL 10-grade scale for retail business summarises a more granular underlying EL scale for these customer segments; this combines obligor and facility/product risk factors in a composite measure.

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.

For the purpose of the following disclosure, retail loans which are past due up to 89 days and are not otherwise classified as EL9 or EL10 are not disclosed within the EL grade to which they relate, but are separately classified as past due but not impaired.

For local reporting purposes, the Bank adopted the APRA Standardised approach to Credit, Market and Operational risk as of 1 January 2008.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(c) Credit Risk Disclosures (continued)

Distribution of financial instruments by credit quality

At 31 December 2011	Neither past due or impaired			Past due	Impaired	Total
	Strong	Medium	Sub - Standard	but not impaired		
	\$'m	\$'m	\$'m	\$'m	\$'m	\$'m
Cash and balances at central banks	398.0	-	-	-	-	398.0
Items in the course of collection from other banks	1.6	-	-	-	-	1.6
Trading Assets						
- loans and advances to customers	-	-	-	-	-	-
- treasury and other eligible bills	-	-	-	-	-	-
- debt securities	-	-	-	-	-	-
- balances with related entities	-	-	-	-	-	-
	-	-	-	-	-	-
Derivatives	52.2	39.3	-	-	-	91.5
Loans and advances held at amortised cost - Gross						
- loans and advances to banks	1,978.6	-	-	1.0	-	1,979.6
- loans and advances to customers	10,504.1	4,643.7	188.8	385.2	123.4	15,845.2
	12,482.7	4,643.7	188.8	386.2	123.4	17,824.8
Financial investments						
- treasury and other eligible bills	560.1	-	-	-	-	560.1
- debt securities	4,026.1	-	-	-	-	4,026.1
	4,586.2	-	-	-	-	4,586.2
Other assets						
- endorsements and acceptances	18.1	123.6	0.5	-	-	142.2
- receivables from related parties	494.5	-	-	-	-	494.5
- other	228.0	91.9	0.2	-	-	320.1
	740.6	215.5	0.7	-	-	956.8
Total	18,261.3	4,898.5	189.5	386.2	123.4	23,858.9

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

c) Credit Risk Disclosures (continued)

Distribution of financial instruments by credit quality (continued)

At 31 December 2010	Neither past due or impaired			Past due but not impaired	Impaired	Total
	Strong	Medium	Sub - Standard			
	\$'m	\$'m	\$'m	\$'m	\$'m	\$'m
Cash and balances at central banks	399.2	-	-	-	-	399.2
Items in the course of collection from other banks	1.2	-	-	-	-	1.2
Trading Assets						
- loans and advances to customers	-	-	-	-	-	-
- treasury and other eligible bills	-	-	-	-	-	-
- debt securities	19.8	-	-	-	-	19.8
- balances with related entities	3.0	-	-	-	-	3.0
	22.8	-	-	-	-	22.8
Derivatives	53.8	24.0	3.8	-	-	81.6
Loans and advances held at amortised cost - Gross						
- loans and advances to banks	1,820.6	0.1	-	0.4	-	1,821.1
- loans and advances to customers	9,389.2	4,097.7	285.7	362.7	112.7	14,248.0
	11,209.8	4,097.8	285.7	363.1	112.7	16,069.1
Financial investments						
- treasury and other eligible bills	95.3	-	-	-	-	95.3
- debt securities	3,280.5	89.4	-	-	-	3,369.9
	3,375.8	89.4	-	-	-	3,465.2
Other assets						
- endorsements and acceptances	6.0	189.7	0.4	-	-	196.1
- receivables from related parties	1,661.4	-	-	-	-	1,661.4
- other	238.0	75.9	0.3	-	-	314.2
	1,905.4	265.6	0.7	-	-	2,171.7
Total	16,968.0	4,476.8	290.2	363.1	112.7	22,210.8

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

c) Credit Risk Disclosures (continued)

Financial instruments which were past due but not impaired aging analysis

The amounts in the following table reflect exposures designated as past due but not impaired. Examples of exposures designated past due but not impaired include loans that have missed the most recent payment date but on which there is no evidence of impairment; corporate loans fully secured by cash collateral; short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

	Up to 29 days \$'m	30-59 days \$'m	60-89 days \$'m	90-180 days \$'m	Over 180 days \$'m	Total \$'m
At 31 December 2011						
Loans and advances held at amortised cost						
- loans and advances to banks	1.0	-	-	-	-	1.0
- loans and advances to customers	339.7	32.5	13.0	-	-	385.2
	<u>340.7</u>	<u>32.5</u>	<u>13.0</u>	<u>-</u>	<u>-</u>	<u>386.2</u>
At 31 December 2010						
Loans and advances held at amortised cost						
- loans and advances to banks	0.4	-	-	-	-	0.4
- loans and advances to customers	298.0	36.3	25.9	2.5	-	362.7
	<u>298.4</u>	<u>36.3</u>	<u>25.9</u>	<u>2.5</u>	<u>-</u>	<u>363.1</u>

Loans and Advances to Customers and Impairment Allowances

	2011 \$'m	2010 \$'m
Grossed amount of impaired loans	123.4	112.7
Allowance for individual impairment	(38.4)	(39.6)
Allowance for collective impairment	(11.1)	(11.6)
Carrying amount	<u>73.9</u>	<u>61.5</u>
Gross amount of loans not individually impaired	15,721.7	14,135.3
Allowance for collective impairment	(25.8)	(22.3)
Carrying amount	<u>15,695.9</u>	<u>14,113.0</u>

Impaired loans and advances

For individually assessed accounts, loans are treated as impaired as soon as there is objective evidence that an impairment loss has been incurred. The criteria used by HSBC to determine that there is such objective evidence include, inter alia:

- known cash flow difficulties experienced by the borrower;
- overdue contractual payments of either principal or interest;
- breach of loan covenants or conditions;
- the probability that the borrower will enter bankruptcy or other financial realisation; and
- a significant downgrading in credit rating by an external credit rating agency.

For accounts in portfolios of homogeneous loans, impairment allowances are calculated on a collective basis, as set out below.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

c) Credit Risk Disclosures (continued)

Movements in Impairment Allowances

	Consolidated		Company	
	2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
Allowance for individual impairment				
Balance opening	39.6	53.0	39.6	53.0
Impairment charge for the year	1.7	28.9	6.4	43.0
Net write off	(2.9)	(42.3)	(7.6)	(56.4)
Balance closing	38.4	39.6	38.4	39.6
Allowance for collective impairment				
Balance opening	33.9	36.3	33.9	36.3
Impairment charge for the year	51.6	44.0	51.5	44.0
Net write off	(48.6)	(46.4)	(48.5)	(46.4)
Balance closing	36.9	33.9	36.9	33.9

Impairment assessment

In accordance with HSBC's policy, the consolidated entity is required to make allowance for impaired loans promptly and on a consistent basis.

Management regularly evaluates the adequacy of the established allowances for impaired loans by conducting a detailed review of the loan portfolio, comparing performance and delinquency statistics with historical trends and assessing the impact of current economic conditions.

Individually assessed impairment allowances

HSBC Group policy requires the level of impairment allowances on individual facilities that are above materiality thresholds to be reviewed at least semi-annually, and more regularly when individual circumstances require. The review normally encompasses collateral held (including re-confirmation of its enforceability) and an assessment of actual and anticipated receipts. For significant commercial and corporate debts, specialised loan 'work-out' teams with experience in insolvency and specific market sectors are used to assess likely losses on significant individual exposures. Individually assessed impairment allowances are only reversed when the HSBC Group has reasonable and objective evidence of a reduction in the established loss estimate.

Incurred but not yet identified impairment

The period between a loss occurring and its identification is estimated by local management for each identified portfolio. In general, the periods used vary between four and twelve months although, in exceptional cases, longer periods are warranted.

The basis on which impairment allowances for incurred but not yet identified losses is established in each reporting entity is documented and reviewed by senior Group Credit and Risk management to ensure conformity with HSBC Group policy.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

c) Credit Risk Disclosures (continued)

Homogeneous groups of loans

In normal circumstances, historical experience is the most objective and relevant information from which to assess inherent loss within each portfolio. In circumstances where historical loss experience provides less relevant information about the inherent loss in a given portfolio at the balance sheet date – for example, where there have been changes in economic conditions or regulations – management considers the more recent trends in the portfolio risk factors which may not be adequately reflected in its statistical models and, subject to guidance from Group Credit and Risk, adjusts impairment allowances accordingly.

Collectively assessed allowances are generally calculated monthly and charges for new allowances, or reversals of existing allowances, are determined for each separately identified portfolio.

Impairment allowances

When impairment losses occur, HSBC reduces the carrying amount of loans and advances and held-to maturity financial investments through the use of an allowance account. When impairment of available-for-sale financial assets occurs, the carrying amount of the asset is reduced directly.

Loan write-offs

Unsecured consumer facilities are normally written off after they reach 180 days overdue.

In the event of bankruptcy, or analogous proceedings, write-off can occur earlier.

Cross-border exposures

Management assesses the vulnerability of countries to foreign currency payment restrictions when considering impairment allowances on cross-border exposures. This assessment includes an analysis of the economic and political factors existing at the time. Economic factors include the level of external indebtedness, the debt service burden and access to external sources of funds to meet the debtor country's financing requirements. Political factors taken into account include the stability of the country and its government, threats to security, and the quality and independence of the legal system.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

c) Credit Risk Disclosures (continued)

Impairment allowances are applied to all qualifying exposures within these countries unless these exposures and the inherent risks are:

- performing, trade-related and of less than one year's maturity;
- mitigated by acceptable security cover which is, other than in exceptional cases, held outside the country concerned;
- in the form of securities held for trading purposes for which a liquid and active market exists, and which are measured at fair value daily;
- performing facilities with principal (excluding security) of US\$1million or below; or
- performing facilities with maturity dates shorter than three months.

Concentration of exposure

Concentrations of credit risk exist when a number of counterparties are engaged in similar activities, or operate in the same geographical areas or industry sectors and have similar economic characteristics so that their ability to meet contractual obligations is similarly affected by changes in economic, political or other conditions.

Credit Risk Exposure by Industry

	Trading Assets \$'m	Financial Investments \$'m	Loans and Advances to Customers \$'m	Loans and Advances to Banks \$'m	Derivatives \$'m	Total \$'m
2011						
Class of Asset						
Property	-	-	1,470.0	-	-	1,470.0
Trade	-	-	1,351.2	-	7.2	1,358.4
Financial institutions	-	2,926.6	176.2	1,979.6	42.7	5,125.1
Manufacturing	-	-	653.8	-	11.7	665.5
Personal						
-Residential mortgages	-	-	9,092.4	-	-	9,092.4
-Credit card and other personal lending	-	-	1,286.4	-	-	1,286.4
Primary industry	-	-	40.3	-	5.4	45.7
Other	-	1,659.6	1,699.5	-	24.5	3,383.6
Total gross credit risks	-	4,586.2	15,769.8	1,979.6	91.5	22,427.1

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

c) Credit Risk Disclosures (continued)

	Trading Assets \$'m	Financial Investments \$'m	Loans and Advances to Customers \$'m	Loans and Advances to Banks \$'m	Derivatives \$'m	Total \$'m
2010						
Class of Asset						
Property	-	-	1,485.4	-	-	1,485.4
Trade	-	-	1,017.8	-	7.2	1,025.0
Financial institutions	22.8	3,169.3	63.4	1,821.1	36.5	5,113.1
Manufacturing	-	-	539.0	-	11.5	550.5
Personal						
-Residential mortgages	-	-	8,250.9	-	-	8,250.9
-Credit card and other personal lending	-	-	1,222.4	-	-	1,222.4
Primary industry	-	-	218.9	-	5.4	224.3
Other	-	295.9	1,376.7	-	21.0	1,693.6
Total gross credit risks	22.8	3,465.2	14,174.5	1,821.1	81.6	19,565.2

Renegotiated loans

Restructuring activity is designed to manage customer relationships, maximise collection opportunities and, if possible, avoid foreclosure or repossession. Such activities include extended payment arrangements, approved external debt management plans, deferring foreclosure, modification, loan rewrites and/or deferral of payments pending a change in circumstances. Following restructuring, an overdue consumer account is normally reset from delinquent to current status. Restructuring policies and practices are based on indicators or criteria which, in the judgments of local management, indicate that repayment will probably continue. These policies are required to be kept under continual review and their application varies according to the nature of the market, the product, and the availability of empirically based data. When empirical evidence indicates an increased propensity to default on restructured accounts, the use of roll rate methodology ensures this factor is taken into account when calculating impairment allowances. The value of renegotiated loans in 2011 was \$0.7m (2010: \$52.5m).

Collateral and Other Credit Enhancements Obtained

The consolidated entity obtained assets by taking possession of collateral held as security, or calling upon other credit enhancements. The carrying amount outstanding as at the year end was as follows:

Nature of Assets	Consolidated	
	Carrying amount obtained in:	
	2011 \$'m	2010 \$'m
Residential property	7.4	2.0
	<u>7.4</u>	<u>2.0</u>

Repossessed assets are non-financial assets acquired in exchange for loans in order to achieve an orderly realisation, and are reported in the balance sheet within 'Other assets' at the lower of fair value (less costs to sell) and the carrying amount of the loan (net of any impairment allowance).

Repossessed properties are made available for sale in an orderly fashion, with the proceeds used to reduce or repay the outstanding indebtedness. Where excess funds are available after the debt has been repaid, they are available either for other secured lenders with lower priority or are returned to the customer. HSBC does not generally occupy repossessed properties for its business use.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(d) Liquidity and Funding Management Disclosures

Liquidity relates to the ability of a company to meet its obligations as they fall due. The HSBC Group maintains a stable and diversified funding base of core retail and corporate customer deposits as well as portfolios of highly liquid assets. The objective of the HSBC Group's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due.

Liquidity risk is the risk that the consolidated entity does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows. Funding risk (a form of liquidity risk) arises when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.

The objective of the consolidated entity's liquidity and funding management framework is to ensure that all foreseeable funding commitments can be met when due, and that access to the wholesale markets is co-ordinated and cost-effective. To this end, the consolidated entity maintains a diversified funding base comprising core retail and corporate customer deposits and institutional balances. This is complimented with wholesale funding and portfolios of highly liquid assets diversified by currency and maturity which are held to enable us to respond quickly and smoothly to unforeseen liquidity requirements.

HSBC Group requires the consolidated entity to maintain strong liquidity positions and manage the liquidity profiles of its assets, liabilities and commitments with the objective of ensuring that its cash flows are balanced appropriately and that all its anticipated obligations can be met when due.

Policies and procedures

The management of liquidity and funding is primarily carried out locally by the consolidated entity in accordance with practices and limits set by the HSBC Group Management Board. These limits vary by local financial unit to take account of the depth and liquidity of the market in which the entity operates. It is HSBC's general policy that each banking entity should be self-sufficient with regards to funding its own operations. Exceptions are permitted to facilitate the efficient funding of certain short-term treasury requirements and start-up operations or branches which do not have access to local deposit markets, all of which are funded under clearly defined internal and regulatory guidelines and limits from HSBC's largest banking operations. These internal and regulatory limits and guidelines serve to place formal limitations on the transfer of resources between HSBC entities and are necessary to reflect the broad range of currencies, markets and time zones within which HSBC operates.

The consolidated entity's liquidity and funding management process includes:

- projecting cash flows by Australian dollar equivalent and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet advances to deposit ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- managing the concentration and profile of debt maturities;
- maintaining debt financing plans;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensuring a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crisis, while minimising adverse long-term implications for the business.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both business as usual and stress conditions, HSBC Group specific and systematic. All liquidity policies and procedures are subject to review and approval by Asset and Liability Committee (ALCO). Responsibility for management of day to day (operational) liquidity rests with the Balance Sheet Management Unit within the Global Markets Division. A summary report of key liquidity indicators, including all exceptions and remedial action taken, is submitted regularly to ALCO.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(d) Liquidity and Funding Management Disclosures (continued)

Primary sources of funding

Current accounts and savings deposits payable on demand or at short notice form a significant part of the consolidated entity's funding, and we place considerable importance on maintaining their stability. For deposits, stability depends upon preserving depositor confidence in our capital strength and liquidity, and on competitive and transparent pricing.

Professional markets are accessed for the purposes of providing additional funding, maintaining a presence in local money markets and optimising asset and liability maturities. In aggregate, the consolidated entity's banking entities are liquidity providers to the inter-bank market, placing significantly more funds with other banks than they borrow.

Of total liabilities of \$22,688.9m at 31 December 2011 (2010: \$21,152.9m), funding from customers amounted to \$17,790.3m (2010: \$15,952.0m) of which \$17,752.4 (2010: \$15,875.5m) was contractually repayable within one year. However, although the contractual repayments of many customer accounts are on demand or at short notice, in practice short-term deposit balances remain stable as inflows and outflows broadly match.

Cash flows payable by the consolidated entity under financial liabilities by remaining contractual maturities

	On demand \$'m	Due within 3 months \$'m	Due between 3 and 12 months \$'m	Due between 1 and 5 years \$'m	Due after 5 years \$'m
At 31 December 2011					
Deposits by banks	594.0	50.6	-	-	-
Customer accounts	11,566.0	5,177.5	1,129.6	38.9	7.7
Items in the course of transmission to other banks	-	22.1	-	-	-
Debt securities on issue	-	126.0	383.3	758.1	408.1
Financial liabilities designated at fair value	-	-	-	-	-
Subordinated liabilities	-	4.4	13.3	287.3	-
Other financial liabilities	1,236.4	375.8	472.3	40.7	1.5
	13,396.4	5,756.5	1,998.5	1,125.0	417.3
Financial guarantee contracts	1,174.3	-	-	-	-
Loan commitments	6,998.5	2,269.7	-	-	-
	21,569.2	8,026.2	1,998.5	1,125.0	417.3
At 31 December 2010					
Deposits by banks	637.0	113.8	3.1	-	-
Customer accounts	9,427.6	4,674.9	1,926.0	85.8	6.9
Items in the course of transmission to other banks	-	21.6	-	-	-
Debt securities on issue	-	260.9	296.1	408.1	535.7
Financial liabilities designated at fair value	-	-	-	-	-
Subordinated liabilities	-	7.3	216.7	308.9	-
Other financial liabilities	501.3	309.7	358.2	1,316.8	-
	10,565.9	5,388.2	2,800.1	2,119.6	542.6
Financial guarantee contracts*	1,039.5	-	-	-	-
Loan commitments	6,740.5	1,854.9	-	-	-
	18,345.9	7,243.1	2,800.1	2,119.6	542.6

*Financial Guarantees are recognised in the earliest period in which payment is due from the entity.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(d) Liquidity and Funding Management Disclosures (continued)

Cash flows payable by the consolidated entity under financial liabilities by remaining contractual maturities (continued)

The balances in the above table will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments. Liabilities in trading portfolios have not been analysed by contractual maturity because trading assets and liabilities are typically held for short periods of time.

The HSBC Group emphasises the importance of core current accounts and savings accounts as a source of funds to finance lending to customers, and discourages reliance on short-term professional funding. This is achieved by placing limits on HSBC Group banking entities which restrict their ability to increase loans and advances to customers without corresponding growth in core customer deposits or long term debt funding. This measure is referred to as the 'advance to core funding; ratio (previously referred to as the 'advances to deposits' ratio).

The ratio describes loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year. Loans and advances to customers which are part of reverse repurchase arrangements, and where the HSBC Group receives securities which are deemed to be liquid, are excluded from the advances to core funding ratio. The distinction between core and non-core deposits generally means that the HSBC Group's measure of advances to core funding is more restrictive than that which can be inferred from the published financial statements.

Advances to core funding ratio

	Consolidated	
	Year Ended 31 December	
Year End	2011	2010
Maximum	121.77%	116.17%
Minimum	103.82%	105.76%
Average	112.53%	110.00%

Liquidity strengthened in financial year 2011 mainly due to the growth in core deposits, which outstripped the growth in advances. The standby liquidity commitment from The Hongkong and Shanghai Banking Corporation Limited was decreased to US\$0.62 billion from US\$1.3 billion in 2010, whilst maintaining strong liquidity ratio.

Wholesale funding tenor stretching beyond 6 months moved from overall 81.1% of total debt issuances as at 31 December 2010 to 70.0% as at 31 December 2011.

Projected cash flow scenario analysis

The HSBC Group uses a number of standard projected cash flow scenarios designed to model both HSBC Group-specific and market-wide liquidity crises, in which the rate and timing of deposit withdrawals and drawdowns on committed lending facilities are varied, and the ability to access interbank funding and term debt markets and to generate funds from asset portfolios is restricted. The scenarios are modelled by all HSBC Group banking entities. The appropriateness of the assumptions under each scenario is regularly reviewed. In addition to the HSBC Group's standard projected cash flows scenarios, individual entities are required to design their own scenarios to reflect specific local market conditions, products and funding bases.

Contingent liquidity risk

In the normal course of business, the HSBC Group entities provide customers with committed facilities and standby facilities to corporate customers. These facilities increase the funding requirements of the HSBC Group when customers choose to raise drawdown levels over and above their normal utilisation rates. The liquidity risk consequences of increased levels of drawdown are analysed in the form of projected cash flows under different stress scenarios. Limits are set for non-cancellable contingent funding commitments by Group after due consideration of each entity's ability to fund them. The limits are split according to the borrower and the size of the committed line.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(e) Operational Risk Disclosures

Operational risk is the risk of loss arising from fraud, unauthorised activities, error, omission, inefficiency, systems failure or external events. It is inherent in every business organisation and covers a wide spectrum of issues.

HSBC manages this risk through a controls-based environment in which processes are documented, authorisation is independent and transactions are reconciled and monitored. This is supported by an independent programme of periodic reviews undertaken by Internal Audit, and by monitoring external operational risk events, which ensure that HSBC stays in line with industry best practice and takes account of lessons learned from publicised operational failures within the financial services industry.

HSBC has codified its operational risk management process by issuing a high level standard, supplemented by more detailed formal guidance. This explains how HSBC manages operational risk by identifying, assessing, monitoring, controlling and mitigating the risk, rectifying operational risk events, and implementing any additional procedures required for compliance with local regulatory requirements. The processes undertaken are by reference to scale and nature of each HSBC operation. The HSBC standard covers the following:

- operational risk management responsibility is assigned to senior management within each business operation;
- information systems are used to record the identification and assessment of operational risks and to generate appropriate, regular management reporting;
- assessments are undertaken of the operational risks facing each business and the risks inherent in its processes, activities and products. Risk assessment incorporates a regular review of identified risks to monitor significant changes;
- operational risk loss data is collected and reported to senior management at the business unit level. Aggregate operational risk losses are recorded and details of incidents above a materiality threshold are reported to Group Head Office. A regular report on operational losses is made to Group Audit Committee and the Risk Management Meeting; and
- a risk mitigation, including insurance, is considered where this is cost-effective.

The HSBC Group maintains and tests contingency facilities to support operations in the event of disasters.

Additional reviews and tests are conducted in the event that any HSBC office is affected by a business disruption event, to incorporate lessons learnt in the operational recovery from those circumstances. Plans have been prepared for the continued operation of the HSBC Group's business, with reduced staffing levels, should a flu pandemic occur.

Operational risk issues are addressed by the Operational Risk Management Group which in turn reports to the Risk Management Committee (RMC), established to oversee the Bank's overall risk framework. The RMC is a sub-committee of the Bank's Audit and Risk Committee of the Board.

(f) Fair Value of Financial Assets and Liabilities

Fair values of financial instruments carried at fair value

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Financial instruments measured at fair value on an ongoing basis include trading assets and liabilities, instruments designated at fair value, derivatives, and financial investments classified as available-for-sale (including treasury and other eligible bills, debt securities, and equity securities).

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(f) Fair Value of Financial Assets and Liabilities (continued)

Determination of fair value of financial instruments carried at fair value

Fair values are determined according to the following hierarchy:

(a) Level 1 - Quoted market price

Financial instruments with quoted prices for identical instruments in active markets.

(b) 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.

(c) Level 3 - Valuation technique with significant non-observable inputs

Financial instruments valued using models where one or more significant inputs are not observable.

The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used.

The majority of valuation techniques employ only observable market data, and so the reliability of the fair value measurement is high. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are not observable. For these instruments, the fair value derived is more judgemental.

'Not observable' in this context means that there is little or no current market data available from which to determine the level at which an arm's length transaction would likely occur, but it generally does not mean that there is absolutely no market data available upon which to base a determination of fair value (historical data may, for example, be used). Furthermore, the assessment of hierarchy level is based on the lowest level of input that is significant to the fair value of the financial instrument. Consequently, the level of uncertainty in the determination of the unobservable inputs will generally give rise to valuation uncertainty that is less than the fair value itself.

The valuation models used where quoted market prices are not available incorporate certain assumptions that the HSBC Group anticipates would be used by a market participant to establish fair value. Where the HSBC Group anticipates that there are additional considerations not included within the valuation model, adjustments may be adopted outside the model. Examples of such adjustments are:

- Credit risk adjustment: an adjustment to reflect the credit worthiness of the over-the-counter derivatives counterparties.
- Market data/ model uncertainty: an adjustment to reflect uncertainties in fair values based on uncertain market data inputs (e.g. as a result of illiquidity) or in areas where the choice of valuation model is particularly subjective.

Transaction costs are not included in the fair value calculation. Trade origination costs such as brokerage, fee expenses, and post-trade costs are included in operating expenses. The future cost of administering the over-the-counter derivative portfolio is also not included in fair value, but is expensed as incurred.

A detailed description of the valuation techniques applied to instruments of particular interest follow:

- Loans: Loans are valued from broker quotes and/ or market data consensus providers where available. Where unavailable, fair value will be determined based on an appropriate credit spread derived from other market instruments issued by the same or comparable entities.
- Debt securities, Treasury and eligible bills: These instruments are valued based on quoted market prices from an exchange, dealer, broker, industry group or pricing service, where available. When they are unavailable, the fair value is determined by reference to quoted market prices for similar instruments, adjusted as appropriate for the specific circumstances of the instruments.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(f) Fair Value of Financial Assets and Liabilities (continued)

- **Derivatives:** Over-the-counter (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 derivatives products, such as interest rate swap and European options, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some discrepancy in 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. Finally, some inputs are not observable, but can generally be estimated from historic data or other sources. Examples of inputs that are generally observable include foreign exchange spot and forward rates, benchmark interest rate curves and volatility surfaces for commonly traded option products. Examples of inputs that may be unobservable include volatility surfaces, in whole or in part, for less commonly traded option products, and correlations between market factors.
- **Debt securities in issues – designated at fair value:** In certain circumstances, the group applies the fair value option to own debt in issue. Where available, the fair value will be based upon quoted prices in an active market for the specific instrument concerned. Where not available, the fair value will be based upon an Own Issuance Curve constructed from HSBC Bank Australia Limited funding grid as well as the credit gradient grid which is based on Credit Default Swap Spreads for HSBC Holdings Plc. The fair value of these instruments therefore includes the effect of own credit spread. Gains and losses arising from changes in the credit spread of liabilities issued by the group reverse over the contractual life of the debt.
- **Issued structured notes and certain hybrid instrument liabilities** are included within trading liabilities, and marked at fair value. The credit spread applied to these instruments is derived from the spreads at which the group issues structured notes. These market spreads are significantly tighter than credit spreads observed in vanilla debt or credit default swap markets.

Consolidated	Valuation techniques -					
	Quoted Market Price \$'m	Using observable inputs \$'m	With significant unobservable inputs \$'m	Total Third Party \$'m	Amount with HSBC* \$'m	Total \$'m
At 31 December 2011						
<i>Assets</i>						
Trading assets	-	-	-	-	-	-
Derivatives	0.0	49.3	0.1	49.4	42.1	91.5
Available for sale investments	1,893.2	2,693.1	0.0	4,586.3	-	4,586.3
<i>Liabilities</i>						
Trading liabilities	-	224.1	35.3	259.4	1.0	260.4
Derivatives	0.0	33.0	0.1	33.1	80.5	113.6
At 31 December 2010						
<i>Assets</i>						
Trading assets	-	19.8	-	19.8	2.9	22.7
Derivatives	0.0	47.9	-	47.9	33.7	81.6
Available for sale investments	422.2	3,044.5	0.0	3,466.8	-	3,466.8
<i>Liabilities</i>						
Trading liabilities	-	195.9	9.5	205.5	-	205.5
Derivatives	0.0	40.8	-	40.8	39.5	80.3

*Transactions with HSBC are predominantly instruments based on observable inputs. As described below the risk associated instruments with significant unobservable inputs are all backed out to other HSBC entities.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(f) Fair Value of Financial Assets and Liabilities (continued)

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

The following table provides a reconciliation of the movement between opening and closing balances of external Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs:

Consolidated	Liabilities Held for Trading	
	2011 \$'m	2010 \$'m
At 1 January	9.5	25.2
Total gains or losses recognised in profit or loss	(0.7)	1.5
Settlements	10.4	(23.8)
Transfer in / (out) of Level 3	16.1	6.6
At 31 December	35.3	9.5
Total gains or losses recognised in profit or loss relating to those liabilities held at the end of the reporting period	(0.7)	1.5
Total gains or losses recognised in profit or loss at the end of the reporting period	(0.7)	1.5

Effects of changes in significant non-observable assumptions to reasonably possible alternatives:

The trading liabilities valued using a valuation technique with significant unobservable inputs relate to certain structured notes issued by the Company. The embedded derivatives contained within these notes are 'back to back' with an identical but offsetting inter-company derivative transaction with a HSBC 'Risk Taking' site. Accordingly there will be no net change to the Company or the consolidated entity of changes in significant non observable assumptions to reasonably possible alternatives as any change in market value of trading liabilities will be exactly offset by the change in value of the offsetting inter-company derivatives.

Changes in fair value recorded in the Income Statement

The following table details changes in fair values recognised in the Income Statement during the period, where the fair value is estimated using valuation techniques that incorporate significant assumptions that are not supported by prices from observable current market transactions in the same instrument, and are not based on observable market data:

- the table details the total change in fair value of these instruments; it does not isolate that component of the change that is attributable to the non-observable component; and
- instruments valued with significant non-observable inputs are frequently dynamically hedged with instruments valued using observable inputs; the table does not include any changes in fair value of these hedges.

Transfer in Level 1, Level 2 and Level 3

Transfer out of Level 3 to Level 2 occurred in respect of certain trading liabilities as valuations in these liabilities become observable during the year.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(f) Fair Value of Financial Assets and Liabilities (continued)

Fair value of financial instruments not carried at fair value

The fair values of financial instruments that are not recognised at fair value on the balance sheet are calculated as described below.

The calculation of fair value incorporates the group's estimate of the amount at which financial assets could be exchanged, or financial liabilities settled, between knowledgeable, willing parties in an arm's length transaction.

The following types of financial instruments are measured at amortised cost unless they are held for trading or designated at fair value through profit or loss. Where assets or liabilities are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the assets or liabilities so hedged includes a fair value adjustment for the hedged risk only. Fair values at the balance sheet date of the assets and liabilities set out below are estimated for the purpose of disclosure as follows:

- Advances to customers – The fair value of advances to customers is estimated using discounted cash flow models, using an estimate of the discount rate that a market participant would use in valuing instruments with similar maturity, repricing and credit risk characteristics. The fair value of a loan portfolio reflects both loan impairments at the balance sheet date and estimates of market participants' expectation of credit losses over the life of the loans.
- 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 either the prices of, or future earning streams of, equivalent quoted securities.
- Deposits and customers accounts – The fair value of deposits and customer accounts is estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of deposits repayable on demand is assumed to be the amount payable on demand at the balance sheet date.
- Debt securities in issue and subordinated liabilities – The fair value of debt securities in issue and subordinated liabilities is based on quoted market prices for the same or similar instruments at the balance sheet date.

The following table lists those financial instruments for which their carrying amounts are a reasonable approximation of fair values because, for example, they are short term in nature or reprice to current market rates frequently:

Assets	Liabilities
Cash and balances at central banks	Items in the course of transmission to other banks
Items in the course of collection from other banks	Endorsements and acceptances
Endorsements and acceptances	Short-term payables within 'Other liabilities'
Short-term receivables within 'Other assets'	Accruals
Accrued income	

The following table provides an analysis of the fair value of financial instruments not measured at fair value in the balance sheet. For all other instruments the fair value is equal to the carrying value:

Consolidated	31 December 2011		31 December 2010	
	Carrying value \$'m	Fair value \$'m	Carrying value \$'m	Fair value \$'m
Assets				
Loan and advances to banks	1,979.6	1,979.6	1,821.1	1,821.1
Loan and advances to customers	15,769.8	15,766.6	14,174.5	14,146.0
Liabilities				
Deposit by banks	644.5	644.5	753.4	753.4
Customer accounts	17,790.3	17,790.3	15,952.0	15,965.1
Debt securities in issue	1,387.0	1,385.6	1,191.7	1,194.2
Subordinated liabilities	242.0	242.1	442.0	441.8

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(g) Capital Management

The Bank, is an Authorised Deposit Taking Institution ("ADI") and is subject to APRA regulation under the authority of the Banking Act 1959.

The local regulator sets and monitors the Bank and consolidated entity's capital requirements under a tiered approach to the measurement of the entity's capital adequacy covering:

- Level 1 – Bank; and
- Level 2 – consists of the consolidated group, excluding non-controlled subsidiaries and subsidiaries with non financial operations and securitisation special purpose vehicles.

The capital adequacy framework under the Basel II regime, implemented since January 2008, seeks to promote regulatory capital requirements that are more comprehensive and sensitive to risk and therefore more aligned to the risk appetites of individual banks. It closely aligns regulatory capital with economic capital and introduces a spectrum of risk measurement approaches. The application of Pillar 2 in Australia is intended to ensure individual banks hold adequate capital to support their individual risk profiles and to encourage institutions to develop and apply improved risk management techniques in monitoring and managing risks.

APRA adopts a risk-based capital assessment framework generally consistent with the guidelines agreed by the Basel Committee on Banking Supervision: A Revised Framework ("Basel II"). APRA requires ADIs to maintain a minimum ratio of total capital to total risk weighted assets (RWAs) of at least 8% at both level 1 and level 2, with at least half of this capital in the form of Tier 1 capital. In addition, individual ADIs are subject to APRA imposed specific minimum capital ratios, referred to as Prudential Capital Ratio (PCR), which may be higher than the standard minimum of 8%. The bank is required to be above allocated PCR at all times and should immediately inform APRA of any breach with details of planned remedial action to be initiated to redress capital shortfall. The Board approved internal capital policy establishes capital floors above PCR allowing for adequate buffers to deal with potential capital pressures and to account for overall risk profile of the bank.

The Bank has adopted the standardised approach to credit risk and operational risk with relevant capital requirements based on standards mandated by APRA.

The Bank capital position at both level 1 and 2 is monitored on a continuous basis and reported monthly to the ALCO. The Bank capital ratios were in compliance with APRA set minimum capital adequacy requirements and Board approved targets and triggers throughout 2011.

APRA has refined the definition of Tier 1 capital to coincide with the implementation of AIFRS for regulatory reporting on July 2006 and again with the implementation of Basel II regime in January 2008. A three component structure to Tier 1 reaffirms APRA approach to de-couple the definition of capital from the Australian Accounting Standards.

- Fundamental capital – comprised of ordinary shares, retained earnings, general reserves, current year earnings net of tax expenses, declared dividends and minority interests. To constitute at least 75% of net Tier 1 capital.
- Residual capital – comprised of all other items qualifying for Tier 1 status, including preference shares and innovative Tier 1 instruments. Limited to a maximum of 25% of net Tier 1 capital with innovative Tier 1 capital limited to 15% of net Tier 1 capital. Any excesses to be transferred to upper tier 2 capital.
- Innovative capital – to include instruments that may contain an incentive for the issuer to call, such as a step up provision or an option to convert to ordinary shares. Any other Tier 1 instruments not in the form of shares.

For any component of capital to be included in the bank capital base it must satisfy prudential requirements, both in form and substance. A component of capital at level 1 cannot be upgraded to a higher category of capital when reported at level 2. Any planned reduction of capital, other than dividend payments not exceeding the bank after tax earnings in the financial year to which those relate, must be authorised by APRA.

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(g) Capital Management (continued)

The bank's main strategic capital objectives are to:

- Meet regulatory capital requirements while minimising shareholders equity through diversification of capital resources;
- Maintain capital ratios above internally set benchmarks to ensure against unanticipated losses and allow continued operation as a going concern;
- Deliver payments of annual dividends; and
- Operate within a set leverage ratio

The Bank and consolidated entity's regulatory capital position at 31 December was as follows:

	Consolidated	
	2011	2010
	\$'m	\$'m
NOTES TO CAPITAL MANAGEMENT		
TIER 1		
Paid-up capital	751.0	751.0
Retained profits brought forward	356.4	280.4
Current year profit	89.1	70.8
Current year earnings – deferred income	2.8	6.9
General reserve reversal	(10.4)	(2.0)
Recycling of capital contribution reserve to retained profits	0.5	0.3
Non-cumulative non-redeemable preference shares	60.0	60.0
Less: capital expenses – software costs & IT development expenditure	(0.8)	(6.9)
Less: goodwill	(58.7)	(58.7)
Less: available for sale reserve	(2.8)	-
Less: deferred taxation (excluding deferred tax on portfolio provision, part of general provisioning)	(68.5)	(94.3)
Unrealised (gains)/losses on bank own credit worthiness	0.2	
Less: Equity and other capital investments in holding companies of ADI's (and equivalent entities overseas), (50% Tier 1)	-	(0.8)
TOTAL TIER 1 CAPITAL	1,118.8	1,006.7
TIER 2		
Subordinated debt	242.0	442.0
General reserve for credit loss	68.7	63.6
Deferred Tax on general reserve for credit loss	(8.6)	(10.2)
Available for sale reserve (profit)	-	2.2
Less: Equity and other capital investments in holding companies of ADI's (and equivalent entities overseas), (50% Tier 2)	-	(0.8)
TOTAL TIER 2 CAPITAL	302.1	496.8
TOTAL CAPITAL BASE	1,420.9	1,503.5
Tier 1 capital ratio (minimum 6%)	8.36%	8.36%
Total capital ratio (minimum 9%)	10.61%	12.49%

Notes to the Consolidated Financial Statements

26. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(g) Capital Management (continued)

Tier 1 Capital has grown in 2011 due to increased earnings after tax allied with the strategy to retain an increased proportion of profits to fund growth. The Tier 1 Capital ratio has remained constant compared to 2010.

The net decrease in the Capital Base and Capital Base ratio in 2011 is due to the calling of subordinated debt of \$200m in May 2011.

	Note	Consolidated		Company	
		2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
27. NOTES TO THE STATEMENT OF CASH FLOWS					
(a) Reconciliation of net cash flows from operating activities to operating profit after income tax					
Profit for the period		177.2	152.6	177.2	156.4
Depreciation and amortisation		10.5	13.0	10.5	13.0
Decrease / (increase) in interest receivable		(11.1)	(13.4)	(22.6)	(6.7)
Increase in interest payable		(5.3)	55.9	5.7	48.7
Loan impairment charges		53.3	72.9	57.9	87.0
Impairment of investment in subsidiaries			-		56.7
Loss on the sale of investments		1.1	-	1.1	-
Increase in deferred taxes		33.7	(0.8)	33.7	(0.8)
Decrease/ (increase) in provision for employee entitlements		8.5	0.3	8.5	(0.3)
Decrease in intercompany receivable account		19.6	34.5	19.5	30.5
Decrease in intercompany payable account		-	-	-	(70.2)
Increase/ (decrease) in sundry debtors		(40.1)	53.3	(44.5)	53.2
Decrease/ (increase) in sundry creditors		(36.9)	48.5	(36.5)	48.9
Changes in operating assets and liabilities					
Net decrease in trading assets		26.5	2,186.5	26.5	2,186.6
Net increase in trading liabilities		54.9	(239.4)	54.9	(239.4)
Cash inflows/(outflows) from movements in other assets/liabilities		112.3	(120.5)	111.8	(120.8)
Loans and bills sold and matured / (advanced)		(652.3)	(5,987.7)	(655.5)	(6,007.0)
Net increase in deposits and other borrowings		1,535.6	3,352.0	1,459.1	3,197.4
Cash flows from operations		1,287.5	(392.3)	1,207.3	(566.8)

Notes to the Consolidated Financial Statements

Note	Consolidated		Company	
	2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
27. NOTES TO THE STATEMENT OF CASH FLOWS (continued)				
(b) Reconciliation of cash				
Cash and cash equivalents at the end of the financial year as shown in the statement of cash flows are reconciled to the related items in the balance sheet as follows:				
Coins, notes and cash at banks	398.0	399.2	398.0	399.2
Trading and investment securities less than 3 months	-	19.8	-	19.8
Nostros / vostros	(663.1)	(723.3)	(663.1)	(723.3)
	<u>(265.1)</u>	<u>(304.3)</u>	<u>(265.1)</u>	<u>(304.3)</u>

(c) Financing facilities

At 31 December 2011, the consolidated entity had a committed standby facility of \$601.5m (2010: \$1,277.1m) from a related corporation. At 31 December 2011 and 31 December 2010, the facility was unused. At 31 December 2011, the consolidated entity had uncommitted credit facilities of \$9,930.5 (2010: \$9,911.8m) of which \$8,941.0 was unused (2010: \$8,955.3m unused).

The total external subordinated liabilities on issue at 31 December 2011 were \$242.0m (2010: \$442.0m).

28. ASSETS PLEDGED AS SECURITY FOR LIABILITIES AND COLLATERAL ACCEPTED AS SECURITY FOR ASSETS

Collateral accepted as security for assets

In respect of reverse repurchase agreements, the fair value of collateral held by the consolidated entity which was permitted to be sold or repledged amounted to \$2,292.0m (2010: \$3,244.0m), and by the Company of \$2,292.0m (2010: \$3,244.0m). The fair value of such collateral actually sold or repledged by the consolidated entity amounted to \$0.0m (2010: \$102.0m) and by the Company of \$0.0m (2010: \$102.0m).

No debt securities have been pledged as collateral to secure liabilities as a result of sale and repurchase agreements.

These transactions are conducted under terms that are usual and customary to collateralised transactions, including, where relevant, standard repurchase agreements.

Notes to the Consolidated Financial Statements

29. SECURITISATIONS AND OTHER STRUCTURED TRANSACTIONS

The consolidated entity enters into transactions from time to time by which it transfers recognised financial assets directly to the third parties or to special purpose entities. These transfers may give rise to the full or partial derecognition of the financial assets concerned.

- Full derecognition occurs when the consolidated entity transfers its contractual right to receive cash flows from the financial assets, or retains the right but assumes an obligation to pass on the cash flows from the assets, and transfers substantially all the risks and rewards of ownership. The risks include credit, interest rate, currency, prepayment and other price risks.
- Partial derecognition occurs when the Bank sells or otherwise transfers financial assets in such a way that some but not substantially all of the risks and rewards of ownership are transferred but control is retained. These financial assets are recognised on the balance sheet to the extent of the bank's continuing involvement.

The carrying amount of the assets not derecognised and their associated liabilities are:

	Consolidated				Company			
	Carrying amount of asset		Carrying amount of related liability		Carrying amount of asset		Carrying amount of related liability	
	2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m	2011 \$'m	2010 \$'m
Debt Securities sold under arrangements to repurchase	46.3	-	-	-	46.3	-	-	-
Loans and advances to customers (1) (2)	274.8	351.1	274.8	351.1	274.8	351.1	274.8	351.1
Total	274.8	351.1	274.8	351.1	274.8	351.1	274.8	351.1

(1) The Bank has performed two mortgage loan securitisations, whereby it has sold mortgage loans to the Lion Series 2007-1 Trust (launched in April 2007) and the Lion Series 2009-1 Trust (launched in July 2009) who funded their purchases through the issue of securities. The Bank provides swaps and services (including servicing and trust management) to the Trusts on an arms length basis in accordance with the APRA Prudential Guidelines (APS120 "Securitisation") and is entitled to the residual income from each of the Trusts. The mortgage loans are not considered to meet the criteria for derecognition in AASB 139 for both the pass through tests and the transfer of risks and rewards tests. To reflect the cash flows that have occurred, a loan between the Trust and the Bank is recognised at an interest rate that reflects the combined contractual arrangements between the Trust and the Bank ("the imputed loan"). The implied interest rate represents the flows from the imputed loan, the interest rate swaps and the residual distribution payable to the Bank.

(2) The Bank owns all the securities in the Lion Series 2009-1 Trust and provides it with a liquidity facility in addition to the aforementioned swaps and services as the purpose of the Lion Series 2009-1 securitisation was to create instruments that were eligible to be repoed with the Reserve Bank of Australia, (following its announcement in 2009 that it would accept under repurchase agreements any AUD domestic-issued residential mortgage-backed securities (RMBS) with a public rating of AAA or equivalent from one of the major credit ratings agencies provided they were tradeable in the secondary market, made regular coupon payments and be based on a true sale of mortgages into a bankruptcy remote Special Purpose Vehicle (SPV)). Since none of the instruments have been repoed with the Reserve Bank of Australia, no assets have been deemed to be transferred to the Lion Series 2009-1 Trust.

No assets (2010: \$nil) were transferred in the year that did not qualify for derecognition.

Notes to the Consolidated Financial Statements

30. RELATED PARTY DISCLOSURES

Controlling Entities

The ultimate chief entity of the wholly owned group is HSBC Holdings plc, a company incorporated in England and Wales.

Ownership interest in related parties

Interests held in related parties are set out in Note 11.

	Consolidated		Company	
	2011	2010	2011	2010
	\$	\$	\$	\$
Amounts receivable from or payable to related parties				
Aggregate amounts receivable:				
Other related entities	494,531,354	1,664,321,627	494,531,354	1,664,321,627
Aggregate amounts payable:				
Other related entities	1,763,771,208	2,004,040,205	2,047,657,820	2,364,449,343
Aggregate of amounts received or receivable from or paid or payable to related parties during the year				
Interest revenue:				
Other related entities	63,266,921	69,093,719	63,266,921	69,093,719
Key management personnel	310,153	276,615	310,153	276,615
Interest expense:				
Other related entities	68,634,134	58,587,111	86,239,383	79,233,566
Management fees paid:				
Other related corporations	55,827,808	49,397,256	56,027,808	49,397,256
Management fees received:				
Other related corporations	42,545,887	39,551,821	42,545,887	39,551,821
Fee income:				
Other related corporations	3,491,449	5,934,138	3,491,449	5,934,138
Fee expense:				
Other related corporations	1,778,488	2,533,137	1,778,488	2,533,137
Dividend income:				
Wholly owned subsidiaries	33,275	-	3,282,162	70,220,122
Dividend expense:				
Controlling entities	88,000,000	82,000,000	88,000,000	82,000,000

Notes to the Consolidated Financial Statements

30. RELATED PARTY DISCLOSURES (continued)

Transactions with related parties

All transactions with related parties during the financial year were conducted on normal commercial terms and conditions.

Various related entities were counterparties in respect of certain foreign exchange contracts, swap contracts and forward rate agreements undertaken by the consolidated entity. All such contracts are undertaken at arms length under normal commercial terms and conditions.

Loans and lease receivables outstanding as at balance date included \$197,655,307 (Consolidated) (2010: \$122,166,193), which were guaranteed by The Hongkong and Shanghai Banking Corporation Limited and other related corporations under normal commercial terms and conditions.

Management accounting and administrative services were provided by the Company to certain related entities free of charge within the Group. Otherwise these services are charged on a time and cost basis.

31. KEY MANAGEMENT PERSONNEL DISCLOSURES

The following were key management personnel of the consolidated entity at any time during the reporting period and unless otherwise indicated were key management personnel for the entire period:

Executive Directors:

Paulo C T Maia (Chief Executive Officer)

Non-Executive Directors:

Graham J Bradley
Richard G Humphry
Alexander A Flockhart
Carol J Austin
Peter Wong
Guy Harvey-Samuel

Resigned 01 February 2011
Appointed 01 February 2011

Executives:

John J McKenna (Chief Financial Officer)
Mike J Arnold (Chief Financial Officer)
Noel G McNamara (Head of Commercial Banking)
James M J C Hogan (Head of Commercial Banking)
Graham Heunis (Head of Retail Banking and Wealth Management)
Garry Richmond (Company Secretary)
Robert Agati (Company Secretary)
Darren W Rowbotham (Chief Technology and Services Officer)
Brenton Hush (Chief Technology and Services Officer)
Bridget Powell (General Counsel)
Paddy Padmanabhan (Chief Risk Officer)
Gavin Powell (Head of Markets)
Chris Russell (Head of Global Banking)
Francine Biddulph (Head of Human Resources)
Kate Epworth (Head of Group Communications and Corporate Sustainability)
Vic Wolff (Head of Marketing)

Resigned 15 August 2011
Appointed 05 October 2011
Resigned 01 September 2011
Appointed 26 September 2011

Resigned 07 July 2011
Appointed 19 October 2011
Resigned 23 January 2011
Appointed 17 January 2011

Appointed 1 October 2010

Notes to the Consolidated Financial Statements

	Consolidated		Company	
	2011	2010	2011	2010
	\$	\$	\$	\$
31. KEY MANAGEMENT PERSONNEL DISCLOSURES (continued)				
Transactions with key management personnel				
The key management personnel compensations included in 'staff costs' (see note 4) are as follows:				
Short term employee benefits				
Cash salary, fees and short-term compensated absences	4,979,847	4,152,927	4,979,847	4,152,927
Short-term cash profit-sharing and other bonuses	3,510,521	2,439,939	3,510,521	2,439,939
Non-monetary benefits	743,625	479,372	743,625	479,372
Other short-term employee benefits	1,380,989	563,250	1,380,989	563,250
	<u>10,614,982</u>	<u>7,635,488</u>	<u>10,614,982</u>	<u>7,635,488</u>
Post employment benefits				
Pension and superannuation benefits	445,404	393,061	445,404	393,061
Other post-employment benefits	31,032	23,679	31,032	23,679
	<u>476,436</u>	<u>416,740</u>	<u>476,436</u>	<u>416,740</u>
	<u>11,091,418</u>	<u>8,052,228</u>	<u>11,091,418</u>	<u>8,052,228</u>
Share based payments granted during the year	2,152,366	2,464,600	2,152,366	2,464,600

Other transactions with key management personnel

In addition to their salaries, the consolidated entity also provides non-cash benefits to its key management personnel, and contributes to a post-employment defined contribution plan on their behalf.

Executive officers are eligible to participate in the ultimate chief entity's share option programme (see note 20).

Apart from the details disclosed in this note, no director has entered into a material contract with the company or the consolidated entity since the end of the previous financial year and there were no material contracts involving Directors' interests existing at year-end.

Loans to key management personnel and their related parties

The aggregate amount of loans to key management personnel of any entity in the consolidated entity*

	4,614,747	5,507,297	4,614,747	5,507,297
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Loan repayments received

	859,424	901,846	859,424	901,846
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* These amounts are included in loans and advances to customers to the accounts.

Fringe Benefits Tax ("FBT") is paid on all subsidised interest loans to Directors and this, together with the FBT benchmark interest rate, is included as part of those Directors' remuneration.

Notes to the Consolidated Financial Statements

32. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The following is an analysis, by remaining contractual maturities at balance date, of selected asset and liability accounts and represents the actual obligation date expected for the asset or liability to be recovered or settled within one year, and greater than one year.

Consolidated	2011			2010		
	Due within one year \$'m	Due after one year \$'m	Total \$'m	Due within one year \$'m	Due after one year \$'m	Total \$'m
Assets						
Cash and balances at central bank	398.0	-	398.0	399.2	-	399.2
Items in the course of collection from other banks	1.6	-	1.6	1.2	-	1.2
Loan and advances to banks	1,905.6	74.0	1,979.6	1,821.1	-	1,821.1
Loans and advances to customers	6,064.0	9,705.8	15,769.8	5,287.7	8,886.8	14,174.5
Financial investments	3,021.3	1,564.9	4,586.2	2,258.9	1,207.9	3,466.8
Other assets	809.6	160.8	970.4	2,028.8	164.5	2,193.3
Liabilities						
Deposits by banks	644.5	-	644.5	753.4	-	753.4
Customer accounts	17,752.5	37.8	17,790.3	15,875.5	76.5	15,952.0
Items in the course of transmission to other banks	22.1	-	22.1	21.6	-	21.6
Debt securities on issue	448.9	938.1	1,387.0	505.8	685.9	1,191.7
Other liabilities	2,149.4	-	2,149.4	1,183.3	1,250.0	2,433.3
Employee benefits	26.0	4.0	30.0	21.0	2.5	23.5
Subordinated liabilities	-	242.0	242.0	200.0	242.0	442.0

33. SUBSEQUENT EVENTS

There has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity, in future financial years.

Directors Declaration

1. In the opinion of the Directors of HSBC Bank Australia Limited:

- (a) the financial statements and notes set out on pages 4 to 86 are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the financial position of the Company and the consolidated entity as at 31 December 2011, and of their performance, as represented by the results of their operations and their cash flows, for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and
- (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable; and
- (c) the financial report also complies with International Financial Reporting Standards as disclosed in Note1(a).

Dated at Sydney this 14th day of February 2012.

Signed in accordance with a resolution of the Directors:

Graham J Bradley
Chairman

Paulo C T Maia
Director

Independent Audit Report

Report on the financial report

We have audited the accompanying financial report of HSBC Bank Australia Limited (the Company), which comprises statements of financial position as at 31 December 2011, statements of comprehensive income, income statements, statements of changes in equity and statements of cash flow for the year ended on that date, a summary or description of significant accounting policies and other explanatory notes 1 to 33 and the directors' declaration set out on pages 89 of the Group comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Act 2001. This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In note 1, the directors also state, in accordance with Australian Accounting Standard AASB 101 Presentation of Financial Statements, that the financial report comprising the financial statements and notes, complies with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We performed the procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001 and Australian Accounting Standards (including the Australian Accounting Interpretations), a view which is consistent with our understanding of the Company's and the Group's financial position and of their performance.

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

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*.

Audit opinion

In our opinion:

- (a) the financial report of HSBC Bank Australia Limited is in accordance with the Corporations Act 2001, including:
- (i) giving a true and fair view of the Company's and the Group's financial position as at 31 December 2011 and of their performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001.
- (b) the financial report also complies with International Financial Reporting Standards as disclosed in note 1.

KPMG

Peter Russell
Partner
Sydney
February 2012

Lead Auditors Independence Declaration Under Section 307C Of The Corporations Act 2001

To: the directors of HSBC Bank Australia Limited

I declare that, to the best of my knowledge and belief, in relation to the audit for the financial year ended 31 December 2011 there have been:

- no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and
- no contraventions of any applicable code of professional conduct in relation to the audit.

KPMG

Peter Russell
Partner
Sydney
February 2012

INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS

During the financial year, the consolidated entity has caused to be paid premiums in respect of contracts insuring all the directors and certain officers of the Company and its controlled entities against any liability incurred in their role as directors or officers of the entity, except where:

- a) the liability arises out of conduct involving a wilful breach of duty; or
- b) there has been a contravention of Sections 182 and/or 183 of the Corporations Act 2001.

The Directors have not included details of the nature of liabilities covered or the amount of premium paid in respect of the directors' and officers' liability contracts, as such disclosure is prohibited under the terms of the contract.

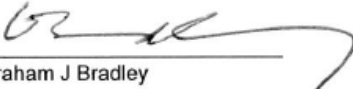
DIRECTORS' BENEFITS

No director of the Company has, since the end of the previous financial year, received or become entitled to receive a benefit (other than a benefit included in the aggregate amount of remuneration received or due and receivable by Directors shown in the consolidated financial statements) by reason of a contract made by the Company, a controlled entity or a related body corporate with the director or with a firm in which the director is a member, or with an entity in which the director has a substantial interest, other than that disclosed in the attached financial statements.


ROUNDING OFF OF AMOUNTS

The Company is of the kind referred to in an ASIC Class Order 98/100 dated 10 July 1998 (updated by CO 05/641 effective 28 July 2005 and CO 06/51 effective 31 January 2006) and, in accordance with that Class Order, amounts in this report and the accompanying financial statements, where appropriate, have been rounded to the nearest million dollars except where otherwise stated.

The report is made with a resolution of the Directors.



Graham J Bradley
Chairman



Paulo C T Maia
Director

Dated at Sydney this 14th day of February 2012.

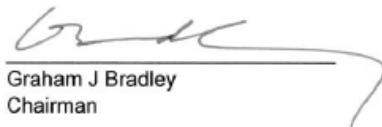
Directors Declaration

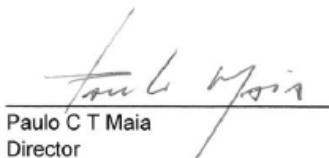
1. In the opinion of the Directors of HSBC Bank Australia Limited:

- (a) the financial statements and notes set out on pages 4 to 86 are in accordance with the Corporations Act 2001, including:
- (i) giving a true and fair view of the financial position of the Company and the consolidated entity as at 31 December 2011, and of their performance, as represented by the results of their operations and their cash flows, for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and
- (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable; and
- (c) the financial report also complies with International Financial Reporting Standards as disclosed in Note1(a).

Dated at Sydney this 14th day of February 2012.

Signed in accordance with a resolution of the Directors:


Graham J Bradley
Chairman


Paulo C T Maia
Director



Independent auditor's report to the members of HSBC Bank Australia Ltd

Report on the financial report

We have audited the accompanying financial report of HSBC Bank Australia Ltd (the Company), which comprises the statements of financial position as at 31 December 2011, and income statements and statements of comprehensive income, statements of changes in equity and statements of cash flows for the year ended on that date, notes 1 to 33 comprising a summary of significant accounting policies and other explanatory information and the directors' declaration of the company and the Group comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement whether due to fraud or error. In note 1, the directors also state, in accordance with Australian Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial report that gives a true and fair view 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We performed the procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001* and Australian Accounting Standards, a true and fair view which is consistent with our understanding of the Company's and the Group's financial position and of their performance.

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



Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*

Auditor's opinion

In our opinion:

- (a) the financial report of HSBC Bank Australia Ltd is in accordance with the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the Company's and the Group's financial position as at 31 December 2011 and of their performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001.
- (b) the financial report also complies with International Financial Reporting Standards as disclosed in note 1.

A handwritten signature in cursive script, appearing to read 'KPMG', positioned above the printed KPMG logo.

KPMG

A handwritten signature in cursive script, appearing to read 'Peter Russell', positioned above the printed name and title.

Peter Russell
Partner

Sydney

14 February 2012



Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To: the directors of HSBC Bank Australia Limited

I declare that, to the best of my knowledge and belief, in relation to the audit for the financial year ended 31 December 2011 there have been:

- (a) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and
- (b) no contraventions of any applicable code of professional conduct in relation to the audit.

A handwritten signature in blue ink that reads 'KPMG'.

KPMG

A handwritten signature in blue ink that reads 'Peter Russell'.

Peter Russell
Partner

Sydney

14 February 2012