

HSBC Bank Australia Ltd  
A.B.N. 48 006 434 162

# Financial Report

Year Ended 31 December 2015

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## Directors Report

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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 2015 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	
Carol J Austin	Non-Executive Director	
Guy D Harvey-Samuel	Non-Executive Director	
Richard G Humphry AO	Non-Executive Director	Resigned 25 October 2015
Mark G Johnson	Non-Executive Director	
Jayant Rikhye	Non-Executive Director	
Anthony W Cripps	Chief Executive Officer	
Michael J Arnold	Chief Financial Officer	Resigned 30 October 2015

### 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 a public limited company incorporated in Australia. The registered office is Level 32, HSBC Centre, 580 George Street, Sydney NSW 2000.

### RESULT OF OPERATIONS

In 2015, HSBC Bank Australia Limited and its controlled entities reported a profit from continuing operations before tax of \$315.2m down from \$329.9m in 2014. Operating income before loan impairment charges was up by 4.4%, however the results were negatively impacted by two specific corporate impairment provisions and increased operating expenses mainly incurred offshore partially due to the depreciation of the AUD.

Total assets increased to \$30.4 billion driven by increases in customer advances and liquid assets holdings. Customer advances increased largely due to growth in the mortgage portfolio following successful campaigns. Cash holdings increased principally as a result of the increased requirement associated with being a Tier 1 Clearer (the Bank became a Tier 1 Clearer in November 2015) and this was funded through a sale and repurchase agreement. The Bank continues to hold high levels of other liquid assets in line with HSBC Group policy.

### DIVIDENDS

Dividends paid or declared by the Company to shareholders since the end of the previous financial year were \$123.4m (2014: \$111.8m). Dividend payments increased from 2014 in line with the Bank's dividend policy.

### SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

HSBC Bank Australia Limited continued to maintain a strong liquidity policy in line with local regulatory requirements and 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 maintaining 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

PricewaterhouseCoopers LLP ('PwC') were appointed as auditor of the HSBC PLC group, with PwC Australia appointed to be auditor to the consolidated entity for the year ended 31 December 2015, replacing KPMG.

Details of the amounts paid to the auditor of the consolidated entity (PwC for the year ended 31 December 2015 and KPMG for the period ended 31 December 2014), and its related practices for audit and non-audit services provided during the year are set out in note 7 of the financial statements.

During the financial year PwC 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 PwC 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.

## LEAD AUDITOR'S INDEPENDENCE DECLARATION

The lead auditor's independence declaration is set out on page 83 and forms part of the Directors' Report for the year ended 31 December 2015.

## INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS

During the financial year, the consolidated entity 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.

## REGULATORY DISCLOSURES

Full details of the market disclosures under Pillar 3 as required by Australian Prudential Standard 330 "Public Disclosure" are provided in the Regulatory Disclosures section of the Bank's website at [www.hsbc.com.au](http://www.hsbc.com.au).

## 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

  
Anthony W Cripps  
Director and Chief Executive Officer

Dated at Sydney this 12 February 2016

## Income Statements

### For The Year Ended 31 December 2015

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
Interest income	4(i)	979.6	1,050.2	979.6	1,050.2
Interest expense	4(ii)	(361.5)	(418.2)	(363.8)	(421.3)
Net interest income		618.1	632.0	615.8	628.9
Fee and commission income	4(iv)	203.5	216.2	203.8	216.6
Fee and commission expense	4(iv)	(31.4)	(37.6)	(29.5)	(35.0)
Net fee and commission income		172.1	178.6	174.3	181.6
Net trading income/(loss)	4(v)	53.5	4.8	53.5	4.8
Net loss from financial instruments designated at fair value	4(vi)	(1.0)	(2.9)	(1.0)	(2.9)
Net gain/(loss) from disposal of financial investments	4(vii)	7.7	0.1	7.7	0.1
Other operating income	4(iii)	93.6	91.7	98.2	91.7
Net other operating income/(loss)		153.8	93.7	158.4	93.7
Operating income before loan impairment charges and other credit risk provisions		944.0	904.3	948.5	904.2
Loan impairment charges and other credit risk provisions	5	(69.3)	(54.1)	(74.4)	(55.6)
Net operating income		874.7	850.2	874.1	848.6
Operating expenses					
- staff costs	6	(271.8)	(254.7)	(271.8)	(254.7)
- premises and equipment	6	(57.0)	(54.9)	(57.0)	(54.9)
- administrative expenses	6	(124.4)	(124.4)	(124.3)	(124.2)
- other expenses	6	(106.3)	(86.3)	(106.3)	(86.3)
Total operating expenses		(559.5)	(520.3)	(559.4)	(520.1)
Profit before income tax		315.2	329.9	314.7	328.5
Income tax expense	8	(94.5)	(99.3)	(92.9)	(98.9)
Profit for the year		220.7	230.6	221.8	229.6
Attributable to:					
Equity holders of the parent		220.7	230.6	221.8	229.6

The notes on pages 14 to 79 are an integral part of these consolidated financial statements.

## Statements of Comprehensive Income

### For The Year Ended 31 December 2015

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>Profit for the year</b>		220.7	230.6	221.8	229.6
<b>Other comprehensive income:</b>					
<i>Items that may be reclassified to Profit and Loss</i>					
Available for sale investments:					
- Fair value gains / (losses) taken to equity		(25.1)	4.9	(25.1)	4.9
- Net amount transferred to / (from) the income statement		4.7	(2.3)	4.7	(2.3)
- Deferred tax on items taken directly to or transferred from equity		5.6	(0.6)	5.6	(0.6)
Cash flow hedges:					
- Net amount transferred to income statement		5.2	4.4	5.2	4.4
- Effective portion of changes in fair value		(5.2)	(16.2)	(5.2)	(16.2)
- Deferred tax on items taken directly to or transferred from equity		0.4	3.2	0.4	3.2
<b>Other comprehensive income taken to equity during the period</b>		(14.4)	(6.6)	(14.4)	(6.6)
<b>Total comprehensive income for the period</b>		206.3	224.0	207.4	223.0
Attributable to:					
Equity holders of the parent		206.3	224.0	207.4	223.0

The notes on pages 14 to 79 are an integral part of these consolidated financial statements.

## Statements of Financial Position

As at 31 December 2015

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>ASSETS</b>					
Cash and balances at central banks	30(b)	2,224.9	763.8	2,224.9	763.8
Items in the course of collection from other banks		2.9	4.5	2.9	4.5
Derivatives	10	56.0	98.8	56.0	98.8
Loans and advances to banks	28(b)	121.5	179.5	121.5	179.5
Loans and advances to customers	9	18,837.2	16,850.4	18,837.2	16,850.4
Financial investments	11	5,710.1	3,665.2	5,710.1	3,665.2
Receivables from related entities	33	2,927.3	3,844.5	2,927.3	3,844.5
Other assets	15	329.3	320.0	328.6	319.1
Property plant & equipment	12	9.9	15.2	9.9	15.2
Intangible assets	14	62.9	63.5	62.9	63.5
Net deferred tax assets	16(a)	99.4	81.0	99.4	81.0
<b>TOTAL ASSETS</b>		<b>30,381.4</b>	<b>25,886.4</b>	<b>30,380.7</b>	<b>25,885.5</b>
<b>LIABILITIES AND EQUITY</b>					
Deposits by banks		360.5	342.3	360.5	342.3
Sale and Repurchase Agreements - non trading		990.4	-	990.4	-
Customer accounts		23,713.9	22,348.2	23,713.9	22,348.2
Trading liabilities	17	41.6	86.3	41.6	86.3
Financial liabilities designated at fair value	17	43.2	43.5	43.2	43.5
Items in the course of transmission to other banks		25.0	26.2	25.0	26.2
Derivatives	10	91.0	123.1	91.0	123.1
Debt securities on issue	19	-	154.9	-	19.9
Provisions for liabilities and charges	20	4.7	2.3	4.7	2.3
Payables to related entities	33	3,023.3	521.2	3,023.0	657.3
Other liabilities	21	294.1	331.5	293.5	330.4
Employee benefits	22	81.9	78.1	81.9	78.1
Subordinated liabilities	18	-	200.0	-	200.0
<b>TOTAL LIABILITIES</b>		<b>28,669.6</b>	<b>24,257.6</b>	<b>28,668.7</b>	<b>24,257.6</b>
<b>NET ASSETS</b>		<b>1,711.8</b>	<b>1,628.8</b>	<b>1,712.0</b>	<b>1,627.9</b>
<b>EQUITY</b>					
Share capital	23	811.0	811.0	811.0	811.0
Reserves	24	(0.7)	13.6	(0.7)	13.6
Retained earnings		901.5	804.2	901.7	803.3
<b>TOTAL EQUITY</b>		<b>1,711.8</b>	<b>1,628.8</b>	<b>1,712.0</b>	<b>1,627.9</b>

The notes on pages 14 to 79 are an integral part of these consolidated financial statements.



## Statements of Changes in Equity

### For The Year Ended 31 December 2015 - Consolidated

\$'m	Share capital	Available for Sale Reserve	Cash flow Hedging Reserve	Capital contribution Reserve	Retained Profits	Total
<b>Balance at 1 January 2015</b>	811.0	17.4	(9.9)	6.1	804.2	1,628.8
<b>Total comprehensive income for the year</b>						
Profit for the year	-	-	-	-	220.7	220.7
<b>Other comprehensive income, net of income tax</b>						
Cash flow hedges						
- Effective portion of changes in fair value	-	-	(4.8)	-	-	(4.8)
- Net amount transferred to Income Statement	-	-	5.2	-	-	5.2
Available for sale assets						
- Net Change in fair value	-	(19.5)	-	-	-	(19.5)
- Net amount transferred to Income Statement	-	4.7	-	-	-	4.7
<b>Total other comprehensive income</b>	-	(14.8)	0.4	-	-	(14.4)
<b>Total comprehensive income for year</b>	-	(14.8)	0.4	-	220.7	206.3
<b>Transactions with Owners, recorded directly in equity</b>						
Contributions by and distributions to owners						
- Share based payments	-	-	-	0.1	-	0.1
- Dividends to equity holders	-	-	-	-	(123.4)	(123.4)
Total Contributions by and distributions to owners	-	-	-	0.1	(123.4)	(123.3)
<b>Balance at 31 December 2015</b>	811.0	2.6	(9.5)	6.2	901.5	1,711.8

The notes on pages 14 to 79 are an integral part of these consolidated financial statements.

## Statements of Changes in Equity (continued)

### For The Year Ended 31 December 2014 - Consolidated

\$'m	Share capital	Available for Sale Reserve	Cash flow Hedging Reserve	Capital contribution Reserve	Retained Profits	Total
<b>Balance at 1 January 2014</b>	811.0	15.4	(1.3)	5.6	685.9	1,516.6
<b>Total comprehensive income for the year</b>						
Profit for the year	-	-	-	-	230.6	230.6
<b>Other comprehensive income, net of income tax</b>						
Cash flow hedges						
- Effective portion of changes in fair value	-	-	(13.0)	-	-	(13.0)
- Net amount transferred to Income Statement	-	-	4.4	-	-	4.4
Available for sale assets						
- Net Change in fair value	-	4.1	-	-	-	4.1
- Net amount transferred to Income Statement	-	(2.1)	-	-	-	(2.1)
<b>Total other comprehensive income</b>	-	2.0	(8.6)	-	-	(6.6)
<b>Total comprehensive income for year</b>	-	2.0	(8.6)	-	230.6	224.0
<b>Transactions with Owners, recorded directly in equity</b>						
Contributions by and distributions to owners						
- Share based payments				0.5	(0.5)	-
- Dividends to equity holders	-	-	-	-	(111.8)	(111.8)
Total Contributions by and distributions to owners	-	-	-	0.5	(112.3)	(111.8)
<b>Balance at 31 December 2014</b>	811.0	17.4	(9.9)	6.1	804.2	1,628.8

The notes on pages 14 to 79 are an integral part of these consolidated financial statements.

## Statements of Changes in Equity (continued)

### For The Year Ended 31 December 2015 - Company

\$'m	Share capital	Available for Sale Reserve	Cash flow Hedging Reserve	Capital contribution Reserve	Retained Profits	Total
<b>Balance at 1 January 2015</b>	811.0	17.4	(9.9)	6.1	803.3	1,627.9
<b>Total comprehensive income for the year</b>						
Profit for the year	-	-	-	-	221.8	221.8
<b>Other comprehensive income, net of income tax</b>						
Cash flow hedges						
- Effective portion of changes in fair value	-	-	(4.8)	-	-	(4.8)
- Net amount transferred to Income Statement	-	-	5.2	-	-	5.2
Available for sale assets						
- Net Change in fair value	-	(19.5)	-	-	-	(19.5)
- Net amount transferred to Income Statement	-	4.7	-	-	-	4.7
<b>Total other comprehensive income</b>	-	(14.8)	0.4	-	-	(14.4)
<b>Total comprehensive income for year</b>	-	(14.8)	0.4	-	221.8	207.4
<b>Transactions with Owners, recorded directly in equity</b>						
Contributions by and distributions to owners						
- Share based payments	-	-	-	0.1	-	0.1
- Dividends to equity holders	-	-	-	-	(123.4)	(123.4)
Total Contributions by and distributions to owners	-	-	-	0.1	(123.4)	(123.3)
<b>Balance at 31 December 2015</b>	811.0	2.6	(9.5)	6.2	901.7	1,712.0

The notes on pages 14 to 79 are an integral part of these consolidated financial statements.

## Statements of Changes in Equity (continued)

### For The Year Ended 31 December 2014 - Company

\$'m	Share capital	Available for Sale Reserve	Cash flow Hedging Reserve	Capital contribution Reserve	Retained Profits	Total
<b>Balance at 1 January 2014</b>	811.0	15.4	(1.3)	5.6	686.0	1,516.7
<b>Total comprehensive income for the year</b>						
Profit for the year	-	-	-	-	229.6	229.6
<b>Other comprehensive income, net of income tax</b>						
Cash flow hedges						
- Effective portion of changes in fair value	-	-	(13.0)	-	-	(13.0)
- Net amount transferred to Income Statement	-	-	4.4	-	-	4.4
Available for sale assets						
- Net Change in fair value	-	4.1	-	-	-	4.1
- Net amount transferred to Income Statement	-	(2.1)	-	-	-	(2.1)
<b>Total other comprehensive income</b>	-	2.0	(8.6)	-	-	(6.6)
<b>Total comprehensive income for year</b>	-	2.0	(8.6)	-	229.6	223.0
<b>Transactions with Owners, recorded directly in equity</b>						
Contributions by and distributions to owners						
- Share based payments	-	-	-	0.5	(0.5)	-
- Dividends to equity holders	-	-	-	-	(111.8)	(111.8)
Total Contributions by and distributions to owners	-	-	-	0.5	(112.3)	(111.8)
<b>Balance at 31 December 2014</b>	811.0	17.4	(9.9)	6.1	803.3	1,627.9

The notes on pages 14 to 79 are an integral part of these consolidated financial statements.

## Statements of Cash flows

### For The Year Ended 31 December 2015

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>Cash Flows from Operating Activities</b>					
Interest received		959.2	1,064.5	959.2	1,064.5
Interest paid		(368.1)	(420.3)	(370.6)	(423.4)
Other operating income received		338.2	265.7	338.3	269.2
Other expenses paid		(609.4)	(477.9)	(606.7)	(478.7)
Loans and bills advanced		(1,846.3)	2.3	(1,851.4)	0.8
Net increase/(decrease) in deposits and other borrowings		4,637.4	560.8	4,502.6	522.7
Net increase/(decrease) in trading assets		10.7	2.2	10.7	2.2
Net increase/(decrease) in trading liabilities		(44.7)	(25.9)	(44.7)	(25.9)
Net increase/(decrease) from movements in other assets/liabilities		2.5	80.4	2.5	80.5
Income tax paid		(105.5)	(118.2)	(105.5)	(118.2)
<b>Net cash provided by/(used in) operating activities</b>	30	<b>2,974.0</b>	<b>933.6</b>	<b>2,834.4</b>	<b>893.7</b>
<b>Cash Flows from Investing Activities</b>					
Proceeds from portfolio disposal		-	354.3	-	354.3
Net decrease/(increase) in investment securities		(3,795.6)	299.4	(3,795.6)	299.4
Purchase of property, plant and equipment		(1.9)	(2.6)	(1.9)	(2.6)
Dividends received from controlled entities		-	-	4.6	-
Proceeds/(payments) for Intangible Assets		(0.4)	(4.8)	(0.4)	(4.8)
Proceeds on sale of investments		1,748.1	-	1,748.1	-
<b>Net cash used in investing activities</b>		<b>(2,049.8)</b>	<b>646.3</b>	<b>(2,045.2)</b>	<b>646.3</b>
<b>Cash Flows from Financing Activities</b>					
Net increase/(decrease) in debt securities on issue		(155.2)	(634.2)	(20.2)	(594.3)
Subordinated debt redeemed		(200.0)	-	(200.0)	-
Proceeds from subordinated debt issue		250.0	-	250.0	-
Dividends paid		(123.4)	(111.8)	(123.4)	(111.8)
<b>Net cash used in financing activities</b>		<b>(228.6)</b>	<b>(746.0)</b>	<b>(93.6)</b>	<b>(706.1)</b>
Net increase/(decrease) in cash and cash equivalents held		695.6	833.9	695.6	833.9
Cash and cash equivalents at the beginning of the year		4,267.6	3,433.7	4,267.6	3,433.7
Cash and cash equivalents at the end of the year	30	<b>4,963.2</b>	<b>4,267.6</b>	<b>4,963.2</b>	<b>4,267.6</b>

The notes on pages 14 to 79 are an integral part of these consolidated financial statements.

## Notes to the Consolidated Financial Statements

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### 1. REPORTING ENTITY

HSBC Bank Australia Limited (the Company) is a company domiciled in Australia. The consolidated financial report of the Company for the year ended 31 December 2015 comprises the Company and its subsidiaries (together referred to as the "consolidated entity" or "group"). References to "HSBC" or "the HSBC Group" within this document mean HSBC Holdings plc together with its subsidiaries. The Company and group are for-profit entities.

### 2. BASIS OF PREPARATION

#### 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 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 12 February 2015.

#### b) Basis of Measurement

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 29.

#### c) Functional and Presentational Currency

The financial report is presented in Australian dollars, which is the Bank's functional currency.

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.

#### d) Critical Accounting Estimates and Judgements in Applying Accounting Policies

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.

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 that are deemed critical to the results and financial position, in terms of the materiality of the items to which the policies are applied and the high degree of judgement involved, including the use of assumptions and estimation, are discussed below.

- *Loan impairment*

Application of the consolidated entity's methodology for assessing loan impairment, as set out in note 3(f), involves considerable judgement and estimation.

For individually significant loans, judgement 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.

## Notes to the Consolidated Financial Statements

### 2. BASIS OF PREPARATION (continued)

#### d) Critical Accounting Estimates and Judgements in Applying Accounting Policies (continued)

For collectively assessed loans, judgement 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 estimation.

- *Valuation of financial Instruments*

The consolidated entity's accounting policy for valuation of financial instruments is included in note 3(j) and is discussed further within note 10 'Derivatives' and note 29 'Fair Value of Financial Assets and Liabilities'.

The best evidence of fair value is a quoted price in an actively traded principal market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. Where a financial instrument has a quoted price in an active market, the fair value of the total holding of the financial instrument is calculated as the product of the number of units and quoted price. The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. Valuation techniques may incorporate assumptions about factors that other market participants would use in their valuations, including:

- (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.

A range of valuation techniques is employed, dependent on the instrument type and available market data. Most valuation techniques are based upon discounted cash flow analyses, in which expected future cash flows are calculated and discounted to present value using a discounting curve. Prior to considering credit risk, the expected future cash flows may be known, as would be the case for the fixed leg of an interest rate swap, or may be uncertain and require projection, as would be the case for the floating leg of an interest rate swap. 'Projection' utilises market forward curves, if available. In option models, the probability of different potential future outcomes must be considered. In addition, the value of some products are dependent on more than one market factor, and in these cases it will typically be necessary to consider how movements in one market factor may affect the other market factors. The model inputs necessary to perform such calculations include interest rate yield curves, exchange rates, volatilities, correlations, prepayment and default rates. For interest rate derivatives with collateralised counterparties and in significant currencies, the group uses a discounting curve that reflects the overnight interest rate ('OIS discounting').

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

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

Judgement 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.

## Notes to the Consolidated Financial Statements

### 2. BASIS OF PREPARATION (continued)

#### d) Critical Accounting Estimates and Judgements in Applying Accounting Policies (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.

#### e) Changes in Accounting Policies

There are no new standards adopted during 2015 that have a material impact on the financial statements.

#### f) Future Accounting Developments

At 31 December 2015, a number of standards and interpretations, and amendments thereto, had been issued by the AASB, which are not effective for the group's consolidated financial statements as at 31 December 2015. In addition to the projects to complete financial instrument accounting and revenue recognition, discussed below, there are other projects on lease accounting which, together with the standards described below, will represent significant changes to accounting requirements in the future.

In July 2014, the AASB issued AASB 15 'Revenue from Contracts with Customers'. The standard is effective for annual periods beginning on or after 1 January 2017 with early adoption permitted. AASB 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied. The standard should be applied retrospectively, with certain practical expedients available. The group is currently assessing the impact of this standard but it is not practicable to quantify the effect as at the date of the publication of these financial statements.

In September 2014, the AASB issued AASB 9 'Financial Instruments', which is the comprehensive standard to replace AASB 139 'Financial Instruments: Recognition and Measurement', and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

##### *Classification and measurement*

The classification and measurement of financial assets will depend on the entity's business model for their management and their contractual cash flow characteristics and result in financial assets being at classified and measured amortised cost, fair value through Other Comprehensive Income ('FVOCI') or fair value through profit or loss. In many instances, the classification and measurement outcomes will be similar to AASB 139, although some differences will arise. For example, since AASB 9 does not apply embedded derivative accounting to financial assets, equity securities will be measured at fair value through profit or loss or, in limited circumstances, at fair value through OCI. The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in population of financial assets measured at amortised cost or fair value compared with AASB139. The classification of financial liabilities is essentially unchanged, except that, for certain liabilities measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in OCI.

##### *Impairment*

The impairment requirements apply to financial assets measured at amortised cost, FVOCI, lease receivables, certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of commitments and guarantees) is required for expected credit losses ('ECL') resulting from default events that are possible within the next 12 months ('12 month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL').

The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the probability of default occurring over the remaining life of the financial instrument, rather than by considering an increase in ECL.



## Notes to the Consolidated Financial Statements

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### 2. BASIS OF PREPARATION (continued)

#### f) Future Accounting Developments (continued)

The assessment of credit risk, as well as the estimation of ECL, are required to be unbiased, probability-weighted and should incorporate all available information which is relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under AASB139 and the resulting impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with AASB139.

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link between it and risk management strategy and permitting the former to be applied to a greater variety of hedging instruments and risks. The standard does not explicitly address macro hedge accounting strategies, which are being considered in a separate project. To remove the risk of any conflict between existing macro hedge accounting practice and the new general hedge accounting requirements, AASB 9 includes an accounting policy choice to remain with AASB 139 hedge accounting.

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. Hedge accounting is generally applied prospectively from that date.

The mandatory application date for the standard as a whole is 1 January 2018, but it is possible to apply the revised presentation for certain liabilities measured at fair value from an earlier date. The group intends to revise the presentation of fair value gains and losses relating to the entity's own credit risk on certain liabilities. If this presentation was applied at 31 December 2015, the effect would be to increase or decrease profit before tax with the opposite effect on other comprehensive income based on the change in fair value attributable to changes in the group's credit risk for the year, with no effect on net assets.

The group is currently assessing the impact that the rest of AASB 9 will have on the financial statements through a groupwide project which has been in place since 2012, but due to the complexity of the classification and measurement, impairment, and hedge accounting requirements and their inter-relationships, it is not possible at this stage to quantify the potential effect.

On 13 January 2016, the IASB issued IAS16 Leases, which will be operative for period commencing 1 January 2019. As at the date of signing, the AASB has not adopted the standard for use in Australia but is expected to adopt it in its meeting on 23-24 February 2015. The standard will require recognition of operating lease commitments on balance sheet together with a right of use asset. Given the timing of the release of the standard, HSBC has not yet assessed the potential impact of the new standard but does not expect the impact to be material.

## Notes to the Consolidated Financial Statements

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### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statements. Certain comparative amounts have been reclassified to conform with the current year presentation.

#### a) Principles of Consolidation

##### (i) Subsidiaries

Subsidiaries are entities controlled by the Company. The Company controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Investments in subsidiaries are carried at their cost of acquisition, less provision for impairment, 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.

#### b) 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.

## Notes to the Consolidated Financial Statements

### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### c) 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 rate method. The effective interest rate method is a way of calculating the amortised cost of a financial asset or a financial liability (or groups of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

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

#### d) Non Interest Income

**Fee income** is earned from a diverse range of services provided by the group to its customers. Fee income is accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third-party, such as an arrangement for the acquisition of shares or other securities);
- income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees); and
- income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and recorded in 'Interest income' (note 3(c)).

**Net 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 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. Interest income and expense and dividend income arising on these financial instruments are also included, except for interest arising from debt securities issued, and derivatives managed in conjunction with those debt securities, which is recognised in 'Interest expense' (note 4vi).

**Dividend Income** is recognised when the right to receive payment is established.

#### e) Loans and Advances to Banks and Customers

These include loans and advances originated by the group which are not classified as either held for trading or designated at fair value. They are recognised when cash is advanced to a borrower and derecognised when either the borrower repays its obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest rate method, less any reduction from impairment or uncollectibility. Where exposures are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment relating only to the hedged risk.

Loans and advances are reclassified to 'Assets held for sale' when they meet the criteria presented in note 3(v); however, their measurement continues to be measured in accordance with this policy.

## Notes to the Consolidated Financial Statements

### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### f) Impairment of Loans and Advances

Losses for impaired loans are promptly recognised when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances are calculated on individual loans and on groups of loans assessed collectively. Impairment losses are recorded as charges to the income statement. The carrying amount of impaired loans on the statement of financial position is reduced through the use of impairment allowance accounts. Losses which may arise from future events are not recognised.

##### (i) Individually assessed loans

The factors considered in determining whether a loan is individually significant for the purposes of assessing impairment include the size of the loan, the number of loans in the portfolio, and the importance of the individual loan relationship, and how this is managed.

Loans that meet the above criteria will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify a collective assessment.

Loans considered as individually significant are typically to corporate and commercial customers, are for larger amounts and are managed on an individual basis. These loans are assessed individually at each balance sheet date to identify whether objective evidence of impairment exists based on the following criteria:

- known cash flow difficulties experienced by the borrower;
- contractual payments of either principal or interest being past due for more than 90 days;
- the probability that the borrower will enter bankruptcy or other financial realisation;
- a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in the forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and
- there has been deterioration in the financial condition or outlook of the borrower such that its ability to repay is considered doubtful.

For those loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

- the group's aggregate exposure to the customer;
- the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service 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 group and the likelihood of other creditors continuing to support the company;
- 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 currency of the loan if not denominated in local currency; and
- when available, the secondary market price of the debt.

The realisable value of security is determined based on the current market value when the impairment assessment is performed. The value is not adjusted for expected future changes in market prices; however, adjustments are made to reflect local conditions, such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at the loan's original effective interest rate and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

## Notes to the Consolidated Financial Statements

### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### f) Impairment of Loans and Advances (continued)

##### (ii) Collectively assessed loans

Impairment is assessed collectively to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment or for homogeneous groups of loans that are not considered individually significant.

##### *Incurred but not yet identified impairment*

Individually assessed loans for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for a collective impairment assessment. These credit risk characteristics may include country of origination, type of business involved, type of products offered, security obtained or other relevant factors. This assessment captures impairment losses that the group has incurred as a result of events occurring before the balance sheet date, which the group is not able to identify on an individual loan basis, and that can be reliably estimated. When information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed individually.

The collective impairment allowance is determined after taking into account:

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

The period between a loss occurring and its identification is estimated by local management for each identified portfolio based on economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. The estimated period between a loss occurring and its identification may vary over time as these factors change.

##### *Homogeneous groups of loans*

Statistical methods are used to determine collective impairment losses for homogeneous groups of loans not considered individually significant. Losses in these groups of loans are recorded individually when individual loans are removed from the group and written off. The methods that are used to calculate collective allowances are:

- When appropriate empirical information is available, the group utilises roll-rate methodology, which employs statistical analyses of historical data and experience of delinquency and default to reliably estimate the amount of loans that will eventually be written off as a result of the events occurring before the balance sheet date and which the group is not able to identify individually. Individual loans are grouped using ranges of past due days; statistical analysis is then used to estimate the likelihood that loans in each range will progress through the various stages of delinquency and become irrecoverable. Additionally, individual loans are segmented based on their credit characteristics as described above. In applying this methodology, adjustments are made to estimate the periods of time between a loss event occurring and its discovery, for example through a missed payment, (known as the emergence period) and the period of time between discovery and write-off (known as the outcome period). Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio, and the carrying amount of the portfolio. In certain highly developed markets, sophisticated models also take into account behavioural and account management trends as revealed in, for example, bankruptcy and rescheduling statistics.
- When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, the group adopts a basic formulaic approach based on historical loss rate experience, or a discounted cash flow model. Where a basic formulaic approach is undertaken, management estimates that typically it takes between six and twelve months between a loss occurring and its identification.

The inherent loss within each portfolio is assessed on the basis of statistical models using historical data observations, which are updated periodically to reflect recent portfolio and economic trends. When the most recent trends arising from changes in economic, regulatory or behavioural conditions are not fully reflected in the statistical models, they are taken into account by adjusting the impairment allowances derived from the statistical models to reflect these changes as at the balance sheet date. Roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

## Notes to the Consolidated Financial Statements

### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### f) Impairment of Loans and Advances (continued)

##### (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. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write off may be earlier.

##### (iv) Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognised in the income statement.

##### (v) Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans in order to achieve an orderly realisation are recorded as assets held for sale and reported in 'Other assets' if the carrying amounts of the assets are recovered principally through sale, the assets are available-for-sale in their present condition and their sale is highly probable. 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 charged 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 within 'Other operating income' 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 as a gain in 'Other operating income' in the income statement, together with any realised gains or losses on disposal. Debt securities or equities acquired in debt-to-debt/equity swaps are included in 'Financial investments' and are classified as available-for-sale.

##### (vi) Renegotiated loans

Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or should be considered past due. The carrying amounts of loans that have been classified as renegotiated retain this classification until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument.

#### g) Trading Assets and Trading Liabilities

Treasury bills, customer accounts, loans and advances to and from banks, debt securities, structured deposits, equity shares, own debt issued and short positions in securities which have been acquired or incurred principally for the purpose of selling or repurchasing in the near term, or are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking, are classified as held for trading. Financial assets and financial liabilities are recognised on trade date, when the group enters into contractual arrangements with counterparties to purchase or sell the financial instruments, 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, the fair values are remeasured and gains and losses from changes therein are recognised in the income statement within 'Net trading income'.

## Notes to the Consolidated Financial Statements

### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### h) Financial Instruments Designated at Fair Value

A financial instrument, other than those held for trading, is classified in this category if it meets the criteria set out below, and is so designated by management on initial recognition. The group may designate financial instruments at fair value when the designation:

- eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities or recognising the gains and losses on them on different bases such as debt issuances that are managed in conjunction with financial assets or liabilities measured on a fair value basis; or
- relates to financial instruments containing one or more embedded derivatives that significantly modify cash flows resulting from those financial instruments, and which would otherwise be required to be accounted for separately; examples include certain debt issuances and debt securities held.

This fair value designation, once made, is irrevocable. Financial assets and financial liabilities are recognised when the group enters the contractual provisions of the arrangements with counterparties, which is generally on trade date, 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, the fair values are remeasured and gains and losses from changes therein are recognised in the income statement within 'Net income from financial instruments designated at fair value'.

#### i) 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 redeemed.

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 24(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 are recognised within 'Loan impairment charges and other credit risk provisions' in the income statement and impairment losses for available-for-sale equity securities are recognised within 'Gains less losses from financial investments' in the Income Statement. The impairment methodologies for available-for-sale financial assets are set out in more detail below.



## Notes to the Consolidated Financial Statements

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### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### i) Financial Investments (continued)

When assessing available-for-sale debt securities for objective evidence of impairment at the reporting date, the group considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. These events may include a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial reorganisation, or the disappearance of an active market for the debt security because of financial difficulties relating to the issuer.

These types of specific events and other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment of a debt security.

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;

#### j) Valuation of Financial Instruments

All financial instruments are recognised initially at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, sometimes the fair value will be based 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, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the group recognises a trading gain or loss on day 1, being the difference between the transaction price and the fair value. When significant unobservable parameters are used, the entire day 1 gain or loss is deferred and is recognised in the income statement over the life of the transaction until the transaction matures, is closed out, the valuation inputs become observable, or when the group enters into an offsetting transaction.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value are measured in accordance with the group's valuation methodologies, which are described in Note 29.



## Notes to the Consolidated Financial Statements

### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### k) Sale and Repurchase Agreements

Where securities are sold subject to a commitment to repurchase them at a predetermined price ('repos'), they remain on the statement of financial position 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 statement of financial position 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 statement of financial position. Cash collateral advanced or received is recorded as an asset or a liability respectively.

Securities borrowed are not recognised on the statement of financial position. 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'.

#### l) 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 derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models.

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 would meet the definition of a stand-alone derivative if they were contained in a separate contract; and the combined contract is not held for trading or designated at fair value. 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.

Gains and losses from changes in the fair value of derivatives, including the contractual interest, that do not qualify for hedge accounting are reported in 'Net trading income' except for derivatives managed in conjunction with financial instruments designated at fair value, where gains and losses are reported in 'Net income from financial instruments designated at fair value' together with the gains and losses on the economically hedged items. Where the derivatives are managed with debt securities in issue, the contractual interest is shown in 'Interest expense' together with the interest payable on the issued debt.

When derivatives are designated as hedges, the group 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 hedges').

##### (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'.

## Notes to the Consolidated Financial Statements

### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### I) Derivatives and Hedge Accounting (continued)

##### *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.

##### *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 other comprehensive income. Any gain or loss in fair value relating to an ineffective portion is recognised immediately in the Income Statement.

The accumulated gains and losses recognised in other comprehensive income 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 recognised in other comprehensive income are removed 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 group requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective both prospectively and retrospectively, on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed and the method adopted by an entity to assess hedge effectiveness will depend on its risk management strategy. For prospective effectiveness, the hedging instrument must be expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated, with the effectiveness range being defined as 80% to 125%. Hedge ineffectiveness is recognised in the income statement in 'Net trading income'.

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

##### (iii) Derivatives that do not qualify for hedging

Non-qualifying hedges are economic hedges entered into as part of documented interest rate management strategies for which hedge accounting is not applied. Changes in fair value of non-qualifying hedges do not alter the cash flows expected as part of the documented management strategies for both the non-qualifying hedge instruments and the related assets and liabilities.

## Notes to the Consolidated Financial Statements

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### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### m) 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.

#### n) Offsetting Financial Assets and Financial Liabilities

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

#### o) 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 ('CGUs') for the purpose of impairment testing, which is undertaken 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 CGU may be impaired, by comparing the recoverable amount of a CGU 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 CGU. If the recoverable amount of the CGU is less than the carrying value, an impairment loss is charged to the income statement. Any write-off in excess of the carrying value of goodwill is limited to the fair value of the individual assets and liabilities of the CGU.

Goodwill is stated at cost, less accumulated impairment losses, which are charged to the Income Statement (see note 14).

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.

## Notes to the Consolidated Financial Statements

### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### p) 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 12).

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.

#### q) Operating Leases

All leases are classified as operating leases. Where the consolidated entity is the lessee, the leased assets are not recognised on the statement of financial position. 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.

#### r) 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.

## Notes to the Consolidated Financial Statements

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### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### r) Income Tax (continued)

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.

In determining the amount of current and deferred tax the consolidated entity takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. The consolidated entity believes that its accruals for tax liabilities are adequate for all open years based on its assessment of many factors, including interpretations of tax laws and prior experience. This assessment relies on estimates and assumptions and may involve a series of judgements about future events. New information may become available that causes the consolidated entity to change its judgement regarding the adequacy of its existing tax liabilities; such changes to tax liabilities will impact tax expense in the period that the determination is made.

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.

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.

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.

## Notes to the Consolidated Financial Statements

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### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### s) 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 statement of financial position.

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.

#### t) 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 corporate bond rate.

##### (iii) Share-Based Payments

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 is recognised as an expense on a straight-line basis over the vesting period. The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately.

HSBC Holdings is the grantor of its equity instruments for all share awards and share options across the group. The credit to 'Other reserves' over the vesting period on expensing an award represents the effective capital contribution from HSBC Holdings. To the extent the group will be, or has been, required to fund a share-based payment arrangement, this capital contribution is reduced and the fair value of shares expected to be released to employees is recorded within 'Other liabilities'.

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.

## Notes to the Consolidated Financial Statements

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### 3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### t) Employee Benefits (continued)

##### (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.

#### u) Provisions for Liabilities and Charges

Provisions for liabilities and charges are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation arising from past events and a reliable estimate can be made of the amount of the obligation.

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the group; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

#### v) Financial Guarantees

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received or receivable. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations.

#### w) Debt Securities on Issue, Subordinated Liabilities, Deposits by Banks and Customers

Debt securities issued for trading purposes or designated at fair value are reported under the appropriate Statement of Financial Position captions. Other debt securities in issue and subordinated liabilities are measured at amortised cost using the effective interest method and are reported under 'Debt securities in issue' or 'Subordinated liabilities'.

#### x) 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 comprise cash and balances with banks maturing within one month, and treasury bills and certificates of deposit with less than three months' maturity from the date of acquisition.

#### y) Share Capital

Shares and other financial instruments are classified as equity when the group has the unconditional right to avoid transferring cash or other financial assets to the holder. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

## Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>4. BANKING OPERATING INCOME</b>					
<b>(i) Interest Income</b>					
Loans and advances to banks		10.8	10.0	10.8	10.0
Loans and advances to customers		776.9	834.7	776.9	834.7
Financial investments		141.9	125.5	141.9	125.5
Related corporations		49.6	79.6	49.6	79.6
Key management personnel		0.4	0.4	0.4	0.4
		<u>979.6</u>	<u>1,050.2</u>	<u>979.6</u>	<u>1,050.2</u>
Less:					
- Interest income classified as 'Net trading income'	4(v)	-	-	-	-
		<u>979.6</u>	<u>1,050.2</u>	<u>979.6</u>	<u>1,050.2</u>
Included within various captions under interest income for the year ended 31 December 2015 is a total of \$7.9m (2014:\$6.3m) accrued on impaired financial assets.					
<b>(ii) Interest Expense</b>					
Deposits by banks		5.0	5.9	5.0	5.9
Customer accounts		332.6	372.0	332.6	372.0
Repurchase agreement		2.7	-	2.7	-
Debt securities on issue		2.8	17.2	0.2	12.8
Subordinated liabilities		9.2	10.9	9.2	10.9
Related corporations		9.2	12.2	14.1	19.7
<b>Total interest expense</b>		<u>361.5</u>	<u>418.2</u>	<u>363.8</u>	<u>421.3</u>
<b>Total interest expense</b>		365.1	423.6	367.4	426.7
Less					
- Interest expense classified as 'Net trading income'	4(v)	(2.0)	(2.7)	(2.0)	(2.7)
- Interest expense classified as 'Net income/(loss)'	4(vi)	(1.6)	(2.7)	(1.6)	(2.7)
		<u>361.5</u>	<u>418.2</u>	<u>363.8</u>	<u>421.3</u>
<b>(iii) Other Operating Income</b>					
Dividend income		-	-	4.6	-
Related corporations		92.7	74.3	92.7	74.3
Other income		0.9	17.4	0.9	17.4
		<u>93.6</u>	<u>91.7</u>	<u>98.2</u>	<u>91.7</u>



## Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>4. BANKING OPERATING INCOME (continued)</b>					
<b>(iv) Fee and commission income</b>					
Fees and commissions		189.9	205.2	189.9	205.2
Fee income on fiduciary activities		13.6	11.0	13.9	11.4
		<u>203.5</u>	<u>216.2</u>	<u>203.8</u>	<u>216.6</u>
<b>Fee and commission expense</b>					
Fees and commissions		23.1	34.7	21.2	32.1
Fees payable on fiduciary activities		8.3	2.9	8.3	2.9
		<u>31.4</u>	<u>37.6</u>	<u>29.5</u>	<u>35.0</u>
<b>(v) Net trading income / (loss)</b>					
Trading income					
- Exchange rates		54.1	5.7	54.1	5.7
- Interest rates		1.4	1.8	1.4	1.8
		<u>55.5</u>	<u>7.5</u>	<u>55.5</u>	<u>7.5</u>
Gains / (losses) from hedging activities:					
Fair value Hedges:					
- Net gain/(loss) on hedged items attributable to the hedged risk		8.7	(4.1)	8.7	(4.1)
- Net gain/(loss) on hedging instruments		(8.7)	4.1	(8.7)	4.1
		<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net interest income on trading activities					
- Interest income		-	-	-	-
- Interest expense		(2.0)	(2.7)	(2.0)	(2.7)
		<u>(2.0)</u>	<u>(2.7)</u>	<u>(2.0)</u>	<u>(2.7)</u>
		<u>53.5</u>	<u>4.8</u>	<u>53.5</u>	<u>4.8</u>
<b>(vi) Net income / (loss) from financial instruments designated at fair value</b>					
Change in fair value of financial assets and liabilities designated at fair value		0.6	(0.2)	0.6	(0.2)
		<u>0.6</u>	<u>(0.2)</u>	<u>0.6</u>	<u>(0.2)</u>
Net interest income on financial instruments designated at fair value					
- Interest expense	4(ii)	(1.6)	(2.7)	(1.6)	(2.7)
		<u>(1.6)</u>	<u>(2.7)</u>	<u>(1.6)</u>	<u>(2.7)</u>
<b>Total net loss from financial instruments designated at fair value</b>		<u>(1.0)</u>	<u>(2.9)</u>	<u>(1.0)</u>	<u>(2.9)</u>

## Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>4. BANKING OPERATING INCOME (continued)</b>					
<b>(vii) Net gains/(loss) from disposal of financial investments</b>					
Net gain/(loss) on disposal of available for sale securities		7.7	0.1	7.7	0.1
		<u>7.7</u>	<u>0.1</u>	<u>7.7</u>	<u>0.1</u>
<b>5 LOAN IMPAIRMENT CHARGES, RECOVERIES AND OTHER CREDIT RISK PROVISIONS</b>					
Loan impairment charges:					
- New allowances		128.3	92.8	128.3	92.8
- Reversal of allowances no longer required		(33.7)	(15.7)	(33.7)	(15.7)
- Recoveries of amounts previously written off		(25.3)	(20.8)	(20.2)	(19.3)
Provision charge for commitments, guarantees and similar obligations		0.0	(2.2)	0.0	(2.2)
		<u>69.3</u>	<u>54.1</u>	<u>74.4</u>	<u>55.6</u>
- Individually assessed allowances charged		48.0	15.8	53.1	17.2
- Collectively assessed allowances charged		21.3	40.5	21.3	40.5
- Other credit risk provisions		-	(2.2)	-	(2.1)
Total loan impairment charges and other credit risk provisions		<u>69.3</u>	<u>54.1</u>	<u>74.4</u>	<u>55.6</u>
<b>6. OPERATING EXPENSES</b>					
<b>Staff costs</b>					
Wages and salaries		176.4	172.7	176.4	172.7
Bonuses		49.3	40.5	49.3	40.5
Retirement and termination benefits		18.4	15.8	18.4	15.8
Share-based payment transactions	22(b)	4.6	4.2	4.6	4.2
Other		23.1	21.5	23.1	21.5
		<u>271.8</u>	<u>254.7</u>	<u>271.8</u>	<u>254.7</u>

## Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>6. OPERATING EXPENSES (continued)</b>					
<b>Premises and equipment</b>					
Property rental		35.0	34.4	35.0	34.4
Hire of equipment		3.8	3.4	3.8	3.4
Repairs and maintenance		1.1	2.2	1.1	2.2
EDP costs		2.5	1.7	2.5	1.7
Utilities		2.5	2.9	2.5	2.9
Depreciation		7.4	8.2	7.4	8.2
Premise related provision		1.7	-	1.7	-
Other		3.0	2.1	3.0	2.1
		<u>57.0</u>	<u>54.9</u>	<u>57.0</u>	<u>54.9</u>
<b>Administrative expenses</b>					
Advertising and marketing		48.4	57.5	48.4	57.5
Legal and professional fees		9.3	7.1	9.3	7.1
Communications		4.4	4.2	4.4	4.2
Business information costs		6.2	5.2	6.2	5.1
Printing and stationery		7.8	9.7	7.8	9.7
Travel and entertainment		7.4	8.1	7.4	8.1
Auditor's remuneration	7	1.3	1.6	1.3	1.6
Insurance		2.7	2.1	2.7	2.1
Losses from fraud		3.7	4.2	3.6	4.1
Contracted services		13.7	13.2	13.7	13.2
Errors and losses		1.5	1.1	1.5	1.1
Charitable donation		2.8	0.4	2.8	0.4
Other		15.2	10.0	15.2	10.0
		<u>124.4</u>	<u>124.4</u>	<u>124.3</u>	<u>124.2</u>
<b>Other expenses</b>					
Intercompany management fees	33	105.3	87.1	105.3	87.1
Provision for contingent liabilities and charges		-	(0.9)	-	(0.9)
Amortisation of intangibles		1.0	0.1	1.0	0.1
		<u>106.3</u>	<u>86.3</u>	<u>106.3</u>	<u>86.3</u>
<b>7. AUDITOR'S REMUNERATION</b>		\$	\$	\$	\$
<b>Audit services</b>					
Auditor of the consolidated entity					
Audit and review of financial reports		797,571	817,580	797,571	817,580
Regulatory and other audit services		441,071	637,535	441,071	637,535
		<u>1,238,642</u>	<u>1,455,115</u>	<u>1,238,642</u>	<u>1,455,115</u>
<b>Other services</b>					
Auditor of the consolidated entity					
Taxation services		-	73,035	-	73,035
Other assurance services		40,000	73,313	-	73,313
		<u>40,000</u>	<u>146,348</u>	<u>-</u>	<u>146,348</u>

## Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>8. INCOME TAX EXPENSE</b>					
<b>Recognised in the Income Statement</b>					
<b>(a) Current tax expense</b>					
Current year		(108.6)	(102.8)	(107.0)	(102.4)
Adjustments for prior years		1.6	(1.8)	1.6	(1.8)
		<u>(107.0)</u>	<u>(104.6)</u>	<u>(105.4)</u>	<u>(104.2)</u>
<b>Deferred tax expense</b>					
Origination and reversal of temporary differences		13.3	3.3	13.3	3.3
Adjustments for prior years		(0.8)	2.0	(0.8)	2.0
	16(b)	<u>12.5</u>	<u>5.3</u>	<u>12.5</u>	<u>5.3</u>
Total income tax expense in Income Statement		<u>(94.5)</u>	<u>(99.3)</u>	<u>(92.9)</u>	<u>(98.9)</u>
Attributable to:					
Continuing operations		(94.5)	(99.3)	(92.9)	(98.9)
		<u>(94.5)</u>	<u>(99.3)</u>	<u>(92.9)</u>	<u>(98.9)</u>
<b>Numerical reconciliation between tax expense and pre-tax net profit</b>					
Profit for the period		220.7	230.6	221.8	229.6
Total income tax expense		<u>94.5</u>	<u>99.3</u>	<u>92.9</u>	<u>98.9</u>
Profit excluding income tax		315.2	329.9	314.7	328.5
Income tax using the domestic corporation tax rate of 30%		<u>(94.6)</u>	<u>(99.0)</u>	<u>(94.4)</u>	<u>(98.5)</u>
(Increase) / decrease in income tax expense due to:					
Non-deductible expenses		(0.7)	(0.9)	(0.7)	(1.0)
Non-taxable revenue		-	0.4	1.4	0.4
		<u>(95.3)</u>	<u>(99.5)</u>	<u>(93.7)</u>	<u>(99.1)</u>
(Under) / over provided in prior years		0.8	0.2	0.8	0.2
Income tax expense on pre-tax net profit		<u>(94.5)</u>	<u>(99.3)</u>	<u>(92.9)</u>	<u>(98.9)</u>
<b>(b) Deferred tax recognised directly in equity</b>					
Relating to capital contribution reserve		(0.3)	(0.3)	(0.3)	(0.3)
Relating to available for sale and cash flow hedging reserves		6.2	2.4	6.2	2.4
	16(b)	<u>5.9</u>	<u>2.1</u>	<u>5.9</u>	<u>2.1</u>

## Notes to the Consolidated Financial Statements

	Consolidated		Company	
	2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>9. LOANS AND ADVANCES TO CUSTOMERS AND IMPAIRMENT ALLOWANCES</b>				
Gross amount of loans not individually impaired	18,724.8	16,794.4	18,724.8	16,794.4
Allowance for collective impairment	(27.9)	(40.5)	(27.9)	(40.5)
Carrying amount	18,696.9	16,753.9	18,696.9	16,753.9
Gross amount of impaired loans	246.0	157.9	246.0	157.9
Allowance for individual impairment	(97.4)	(53.1)	(97.4)	(53.1)
Allowance for collective impairment	(8.3)	(8.3)	(8.3)	(8.3)
Carrying amount	140.3	96.5	140.3	96.5
Total Loans	18,837.2	16,850.4	18,837.2	16,850.4

### Movements in Impairment Allowances

#### Allowance for individual impairment

Balance opening	53.0	92.2	53.0	92.2
Impairment charge for the year	48.0	16.0	48.0	16.0
Transfer from provision for contingent liabilities	-	3.0	-	3.0
Net write off	(3.6)	(58.2)	(3.6)	(58.2)
Balance closing	97.4	53.0	97.4	53.0

#### Allowance for collective impairment

Balance opening	48.8	52.9	48.8	52.9
Impairment charge for the year	21.3	40.5	21.3	40.5
Net write off	(33.9)	(44.6)	(33.9)	(44.6)
Balance closing	36.2	48.8	36.2	48.8

## 10. 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 statement of financial position as separate totals of assets and liabilities. A description of how the fair value of derivatives is derived is set out in Note 29.

## Notes to the Consolidated Financial Statements

### 10. DERIVATIVES (continued)

Derivative assets and liabilities on different transactions are only offset 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 3(l).

#### 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.

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.

#### 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.

The cash flows of the above hedging derivatives are expected to affect the income statement in 2015 and beyond.

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.

## Notes to the Consolidated Financial Statements

### 10. 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	
	2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>Assets:</b>				
<b>Trading derivatives</b>				
Third party				
- Exchange rate	23.4	33.9	23.4	33.9
- Interest rate	4.6	3.7	4.6	3.7
	<u>28.0</u>	<u>37.6</u>	<u>28.0</u>	<u>37.6</u>
Related entities				
- Exchange rate	19.1	53.6	19.1	53.6
- Interest rate	0.7	0.9	0.7	0.9
- Equity	1.7	3.4	1.7	3.4
	<u>21.5</u>	<u>57.9</u>	<u>21.5</u>	<u>57.9</u>
<b>Hedging derivatives</b>				
Related entities				
- Interest rate	3.5	0.5	3.5	0.5
	<u>3.5</u>	<u>0.5</u>	<u>3.5</u>	<u>0.5</u>
<b>Derivatives matching fair value designated instruments</b>				
Related entities				
- Interest rate	3.0	2.8	3.0	2.8
	<u>3.0</u>	<u>2.8</u>	<u>3.0</u>	<u>2.8</u>
	<u>56.0</u>	<u>98.8</u>	<u>56.0</u>	<u>98.8</u>
<b>Liabilities:</b>				
<b>Trading derivatives</b>				
Third party				
- Exchange rate	28.3	42.6	28.3	42.6
- Interest rate	0.8	0.8	0.8	0.8
	<u>29.1</u>	<u>43.4</u>	<u>29.1</u>	<u>43.4</u>
Related entities				
- Exchange rate	19.5	34.3	19.5	34.3
- Interest rate	3.8	2.9	3.8	2.9
- Equity	0.2	0.2	0.2	0.2
	<u>23.5</u>	<u>37.4</u>	<u>23.5</u>	<u>37.4</u>
<b>Hedging derivatives</b>				
Related entities				
- Interest rate	38.4	42.3	38.4	42.3
	<u>38.4</u>	<u>42.3</u>	<u>38.4</u>	<u>42.3</u>
<b>Derivatives matching fair value designated instruments</b>				
Related entities				
- Interest rate	-	-	-	-
	<u>91.0</u>	<u>123.1</u>	<u>91.0</u>	<u>123.1</u>

## Notes to the Consolidated Financial Statements

### 10. DERIVATIVES (continued)

#### 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.

The fair values of outstanding derivatives designated as fair value hedges at 31 December 2015 were assets of \$3.3m (2014:\$0.0m) and liabilities of \$22.9m (2014:\$27.4m).

	Consolidated		Company	
	2015	2014	2015	2014
	\$'m	\$'m	\$'m	\$'m
<b>Gains or losses arising from fair value hedges</b>				
Gains / (losses):				
- on hedging instruments	8.7	(4.1)	8.7	(4.1)
- on the hedged items attributable to the hedged risk	(8.7)	4.1	(8.7)	4.1
	0.0	0.0	0.0	0.0

#### 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. 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.

At 31 December 2015, the fair values of outstanding derivatives designated as cash flow hedges were assets of \$0.2m (2014:\$0.5m) and liabilities of \$15.5m (2014:\$14.9m).



## Notes to the Consolidated Financial Statements

### 10. DERIVATIVES (continued)

#### Cash flow hedges (continued)

The schedule of forecast principal balances on which the expected interest cash flows arise as at 31 December 2015 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
<b>Consolidated and Company</b>			
<b>At 31 December 2015</b>			
Cash inflows exposures	-	-	-
Cash outflows exposures	(759.1)	(741.1)	(714.1)
Net cash outflows	(759.1)	(741.1)	(714.1)
<b>At 31 December 2014</b>			
Cash inflows exposures	100.0	100.0	-
Cash outflows exposures	(744.1)	(744.1)	(609.1)
Net cash Inflows / (outflows)	(644.1)	(644.1)	(609.1)

## Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>11. FINANCIAL INVESTMENTS</b>					
Available-for-sale securities at fair value					
- Debt securities		4,562.3	3,418.6	4,562.3	3,418.6
- Treasury and other eligible bills		1,147.8	246.6	1,147.8	246.6
		<u>5,710.1</u>	<u>3,665.2</u>	<u>5,710.1</u>	<u>3,665.2</u>
Available-for-sale securities					
- Which may not be repledged or resold or are not subject to repledge or resale by counterparties		5,710.1	3,665.2	5,710.1	3,665.2
- Which may be repledged or resold or are subject to repledge or resale by counterparties		-	-	-	-
		<u>5,710.1</u>	<u>3,665.2</u>	<u>5,710.1</u>	<u>3,665.2</u>
Analysis of available for sale securities by issuer:					
- Government securities and Australian government agencies		4,192.5	1,386.4	4,192.5	1,386.4
- Banks and building societies		1,517.6	2,278.8	1,517.6	2,278.8
		<u>5,710.1</u>	<u>3,665.2</u>	<u>5,710.1</u>	<u>3,665.2</u>
<b>12. PROPERTY, PLANT &amp; EQUIPMENT</b>					
Leasehold improvements at cost					
Balance at 1 January		62.2	62.4	62.2	62.4
Assets acquired		1.0	1.0	1.0	1.0
Assets disposed		-	(1.2)	-	(1.2)
Balance at 31 December		<u>63.2</u>	<u>62.2</u>	<u>63.2</u>	<u>62.2</u>
Furniture, fittings, office equipment at cost					
Balance at 1 January		57.6	62.8	57.6	62.8
Assets acquired		0.9	1.6	0.9	1.6
Assets disposed		-	(6.8)	-	(6.8)
Balance at 31 December		<u>58.5</u>	<u>57.6</u>	<u>58.5</u>	<u>57.6</u>
Leasehold improvements accumulated depreciation					
Balance at 1 January		(53.4)	(49.8)	(53.4)	(49.8)
Depreciation charge for the year		(4.1)	(4.7)	(4.1)	(4.7)
Disposals		-	1.1	-	1.1
Balance at 31 December		<u>(57.5)</u>	<u>(53.4)</u>	<u>(57.5)</u>	<u>(53.4)</u>
Furniture, fittings, office equipment accumulated depreciation					
Balance at 1 January		(51.2)	(54.9)	(51.2)	(54.9)
Depreciation charge for the year		(3.1)	(3.5)	(3.1)	(3.5)
Disposals		-	7.2	-	7.2
Balance at 31 December		<u>(54.3)</u>	<u>(51.2)</u>	<u>(54.3)</u>	<u>(51.2)</u>
<b>Carrying amounts</b>					
At 1 January		15.2	20.5	15.2	20.5
At 31 December		<u>9.9</u>	<u>15.2</u>	<u>9.9</u>	<u>15.2</u>

## Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>13. GROUP ENTITIES</b>					
<b>Name of Entity</b>	<b>Note</b>	<b>2015 %</b>	<b>2014 %</b>	<b>Place of incorporation</b>	
<b>Controlling Entity:</b>					
HSBC Bank Australia Limited				Australia	
<b>Controlled entities:</b>					
HSBC Custody Nominees (Australia) Limited		100	100	Australia	
HSBC Finance Holdings (Australia) Pty Ltd		100	100	Australia	
Midland Australia Pty Limited		100	100	Australia	
ACN 087 652 113 Pty Ltd		100	100	Australia	
Lion Series 2007-1 Trust	(1)	-	-	Australia	
Lion Series 2009-1 Trust	(2)	-	-	Australia	

- (1) 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. Further details are contained in Note 34.
- (2) 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	
	2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>14. INTANGIBLE ASSETS</b>				
<b>GOODWILL</b>				
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
<b>INTERNALLY DEVELOPED SOFTWARE</b>				
Cost				
Opening balance at 1 January	12.6	13.4	12.6	13.4
Addition	0.4	4.8	0.4	4.8
Disposals	-	(5.6)	-	(5.6)
Closing Balance at 31 December	13.0	12.6	13.0	12.6
Accumulated Amortisation				
At 1 January	(7.8)	(13.2)	(7.8)	(13.2)
Amortisation charge for the year	(1.0)	(0.2)	(1.0)	(0.2)
Disposals	-	5.6	-	5.6
Accumulated amortisation at 31 December	(8.8)	(7.8)	(8.8)	(7.8)
Carrying amounts				
At 1 January	4.8	0.2	4.8	0.2
At 31 December	4.2	4.8	4.2	4.8
<b>TOTAL INTANGIBLE ASSETS</b>	<b>62.9</b>	<b>63.5</b>	<b>62.9</b>	<b>63.5</b>

### Segment allocation of Goodwill

In accordance with Australian Accounting Standard AASB 138: Intangible Assets, the consolidated entity's carrying amount of goodwill as at 31 December 2015 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

### 14. 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 2015 by calculating a PE value, with industry average price earning's ratio for retail banks of 9 to 14 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 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 2015 that exceeded the carrying amounts of the 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	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>15. OTHER ASSETS</b>					
Acceptances and endorsements		168.2	129.9	168.2	129.9
Prepayments and accrued income		104.7	80.5	104.0	79.6
Other assets		53.5	109.6	53.5	109.6
Assets held for resale		2.9	-	2.9	-
		<u>329.3</u>	<u>320.0</u>	<u>328.6</u>	<u>319.1</u>

Assets held for resale mainly comprised assets acquired by repossession of collateral for realisation.

## Notes to the Consolidated Financial Statements

### 16. 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 entity 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	
	2015	2014	2015	2014	2015	2014
	\$'m	\$'m	\$'m	\$'m	\$'m	\$'m
Impairment allowances	40.9	30.7	-	-	40.9	30.7
Tangible fixed assets depreciation	17.7	17.5	-	-	17.7	17.5
Prepayments and accrued income	0.1	0.1	(0.6)	(0.2)	(0.5)	(0.1)
Other liabilities/accrued expenses	28.8	27.0	(0.3)	(0.2)	28.5	26.8
Accruals and deferred income	8.8	8.7	-	-	8.8	8.7
Provision for liabilities and charges	1.4	0.7	-	-	1.4	0.7
Retained earnings	-	0.3	-	-	-	0.3
Cash flow hedging reserve	4.2	3.8	-	-	4.2	3.8
Available for sale securities reserve	-	-	(1.6)	(7.4)	(1.6)	(7.4)
Total tax assets/(liabilities)	101.9	88.8	(2.5)	(7.8)	99.4	81.0

- b) Movement in temporary differences during the last year:

Consolidated and Company	Balance 1 Jan 15	Recognised in Income	Recognised in Equity	Balance 31 Dec 15
	\$'m	\$'m	\$'m	\$'m
Impairment allowances	30.7	10.2	-	40.9
Tangible fixed assets depreciation	17.5	0.2	-	17.7
Prepayments and accrued income	(0.1)	(0.4)	-	(0.5)
Other liabilities/accrued expenses	26.8	1.7	-	28.5
Accruals and deferred income	8.7	0.1	-	8.8
Provision for liabilities and charges	0.7	0.7	-	1.4
Retained earnings	0.3	-	(0.3)	-
Cash flow hedging reserve	3.8	-	0.4	4.2
Available for sale securities reserve	(7.4)	-	5.8	(1.6)
	81.0	12.5	5.9	99.4

## Notes to the Consolidated Financial Statements

### 16. TAX ASSETS AND LIABILITIES (continued)

#### b) Movement in temporary differences during the last year

Consolidated and Company	Balance	Recognised in	Recognised in	Balance
	1 Jan 14	Income	Equity	31 Dec 14
	\$'m	\$'m	\$'m	\$'m
Impairment allowances	8.7	22.0	-	30.7
Tangible fixed assets depreciation	16.6	0.9	-	17.5
Prepayments and accrued income	0.1	(0.2)	-	(0.1)
Other liabilities/accrued expenses	27.3	(0.5)	-	26.8
Accruals and deferred income	12.0	(3.3)	-	8.7
Provision for liabilities and charges	14.3	(13.6)	-	0.7
Capital contribution reserve	0.6	-	(0.6)	-
Retained earnings	-	-	0.3	0.3
Cash flow hedging reserve	0.6	-	3.2	3.8
Available for sale securities reserve	(6.6)	-	(0.8)	(7.4)
	73.6	5.3	2.1	81.0

	Note	Consolidated		Company	
		2015	2014	2015	2014
		\$'m	\$'m	\$'m	\$'m

### 17. TRADING LIABILITIES & FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE

#### TRADING LIABILITIES

Bonds and medium-term notes	8.6	13.2	8.6	13.2
Customer accounts	33.0	73.1	33.0	73.1
	41.6	86.3	41.6	86.3

#### FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE

Debt Securities on issue	43.2	43.5	43.2	43.5
	43.2	43.5	43.2	43.5

## Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>18. SUBORDINATED LIABILITIES</b>					
Subordinated debt due November 2020, callable from November 2015		-	200.0	-	200.0
		-	200.0	-	200.0

Regulatory approval was required from the Australian Prudential Regulation Authority ("APRA"), Financial Services Authority ("FSA") and Hong Kong Monetary Authority ("HKMA") before the subordinated debt was called and repaid in November 2015. New Basel compliant debt was issued to a related entity, and is disclosed within other liabilities.

### 19. DEBT SECURITIES ON ISSUE

Certificate of deposit	-	19.9	-	19.9
Bonds and medium-term notes	-	135.0	-	-
	-	154.9	-	19.9

### 20. PROVISIONS FOR LIABILITIES AND CHARGES

Balance at 1 January	2.3	47.7	2.3	47.7
New provisions	4.3	1.9	4.3	1.9
Release of provision	(0.2)	(4.4)	(0.2)	(4.4)
Provisions utilised	(1.7)	(40.9)	(1.7)	(40.9)
Other	-	(2.0)	-	(2.0)
Balance at 31 December	4.7	2.3	4.7	2.3

Final payments on the Bell litigation occurred in 2014.



## Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>21. OTHER LIABILITIES</b>					
Acceptances and endorsements		168.2	129.9	168.2	129.9
Accruals and deferred income		71.5	73.7	70.7	72.5
Other liabilities		54.4	127.9	54.6	128.0
		<u>294.1</u>	<u>331.5</u>	<u>293.5</u>	<u>330.4</u>

### 22. EMPLOYEE BENEFITS

Liability for annual leave	11.5	11.6	11.5	11.6
Bonus payable	45.3	40.7	45.3	40.7
Payable to related entity with respect to share based payments	7.2	8.3	7.2	8.3
Liability for long service leave	17.9	17.5	17.9	17.5
Total employee benefits	<u>81.9</u>	<u>78.1</u>	<u>81.9</u>	<u>78.1</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 \$15.9m for the year ended 31 December 2015 (2014:\$15.2m).

#### 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.

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

During 2015, \$4.7m (2014:\$4.2m) 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.

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>23. CAPITAL</b>					
Issued Capital					
685,250,305 Ordinary shares fully paid		811.0	811.0	811.0	811.0
		<u>811.0</u>	<u>811.0</u>	<u>811.0</u>	<u>811.0</u>

## Notes to the Consolidated Financial Statements

### 23. CAPITAL (Continued)

#### Ordinary Shares

The 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 creditors and are fully entitled to any proceeds of liquidation.

The Company does not have authorised capital or par value in respect of its issued shares.

### 24. RESERVES AND RETAINED EARNINGS

#### (a) Reserves

##### 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 \$123.4m in 2015 (2014:\$111.8m).

	Company 2015		Company 2014	
	\$ per Share	Total \$'m	\$ per share	Total \$'m
<i>Ordinary shares</i>				
Dividend 1	0.047	32.3	0.042	28.8
Dividend 2	0.038	26.2	0.044	30.0
Dividend 3	0.043	29.7	0.042	29.0
Dividend 4	0.051	35.2	0.035	24.0
		<u>123.4</u>		<u>111.8</u>

## Notes to the Consolidated Financial Statements

	Consolidated		Company	
	2015	2014	2015	2014
	\$'m	\$'m	\$'m	\$'m
<b>25. COMMITMENTS</b>				
<b>(a) Lease Commitments</b>				
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	21.6	27.7	21.6	27.7
Payable between 1 and 5 years	49.2	55.9	49.2	55.9
Payable over 5 years	66.1	82.5	66.1	82.5
	<u>136.9</u>	<u>166.1</u>	<u>136.9</u>	<u>166.1</u>

The consolidated entity leases property under operating leases expiring from one to twelve 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>(b) Other Commitments</b>				
Documentary credits and trade related transactions	411.4	610.6	411.4	610.6
Undrawn lending facilities	10,526.3	9,446.3	10,526.3	9,446.3
	<u>10,937.7</u>	<u>10,056.9</u>	<u>10,937.7</u>	<u>10,056.9</u>

## 26. CONTINGENT LIABILITIES

Contingent liabilities in respect of guarantees given	<u>1,174.1</u>	<u>1,035.0</u>	<u>1,174.1</u>	<u>1,035.0</u>
Letters of credit and other contingencies	<u>1,607.4</u>	<u>1,483.9</u>	<u>1,607.4</u>	<u>1,483.9</u>

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.

Various members of the banking industry are facing a series of class actions over exception fees that were charged to customers. As at the date of this report, only one of these cases has gone to judgment with the original judgment in the Plaintiff's favour overturned on appeal. The Plaintiff has been granted leave to appeal certain elements to the High Court. HSBC Bank Australia is not subject to any action and, in any event, it is not practicable for the Directors to reliably measure any additional contingent liability. Any further disclosures might be prejudicial to the Bank.

## 27. FIDUCIARY ACTIVITIES

Funds under custody	<u>207,228.0</u>	<u>169,596.3</u>	<u>207,228.0</u>	<u>169,596.3</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

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### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES

#### (a) Risk Management

The consolidated entity's activities involve the analysis, evaluation, acceptance and management of financial risks. The principal financial risks are:

- credit risk;
- liquidity risk;
- market risk (including foreign exchange and interest rate risks);
- operational risk; and
- capital management

The HSBC Group Head Office formulates high-level risk management policies for the HSBC Group worldwide. The group's risk management policies and procedures are subject to a high degree of oversight and guidance to ensure that all types of risk are systematically identified, measured, analysed and actively managed. In addition, internal audit is responsible for the independent review of risk management and the control environment.

The Bank's Risk Committee ("RC") 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 ("RMC") exercises oversight of the Bank's risk framework.

For the following credit, market 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 separately monitored for both the Company and consolidated entity.

## Notes to the Consolidated Financial Statements

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### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (b) 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 direct lending and trade finance business but also from certain other products such as guarantees and derivatives, and from the Bank's holding of debt and other securities.

Credit risk generates the largest regulatory capital requirement of the risks incurred. The Bank has standards, policies and procedures dedicated to controlling and monitoring risk from all such activities. The Bank's principal credit risk management procedures and policies, which follow policies established by HSBC Group Head Office, include the following:

- Formulating credit policies which are consistent with the HSBC Group credit policy and documenting these in detail in dedicated manuals.
- Establishing and maintaining the Bank's large credit exposure policy. This policy delineates the Bank's maximum exposures to individual customers, customer groups and other risk concentrations.
- Establishing and complying with lending guidelines on the HSBC group's attitude towards, and appetite for, lending to specified market sectors and industries.
- Undertaking an objective assessment of risk. All commercial non-bank credit facilities originated by the Bank in excess of designated limits are subject to review prior to the facilities being committed to customers.
- Controlling exposures to banks and other financial institutions. The Bank's credit and settlement risk limits to counterparties in the finance and government sectors are designed to optimise the use of credit availability and avoid excessive risk concentration.
- Managing exposures to debt securities by establishing controls in respect of the liquidity of securities held for trading and setting issuer limits for financial investments. Separate portfolio limits are established for asset-backed securities and similar instruments.
- Controlling cross-border exposures to manage country and cross-border risk through the imposition of country limits with sub-limits by maturity and type of business.
- Controlling exposures to selected industries. When necessary, restrictions are imposed on new business are capped.
- Maintaining and developing risk ratings in order to categorise exposures meaningfully and facilitate focused management of the attendant risks. Rating methodology is based upon a wide range of financial analytics, together with market data-based tools, which are core inputs to the assessment of counterparty risk. Although automated risk-rating processes are increasingly used for the larger facilities, ultimate responsibility for setting risk grades rests in each case with the final approving executive. Risk grades are reviewed frequently and amendments, where necessary, are implemented promptly.

Both the HSBC Group Head Office and the consolidated entity's RMC receive regular reports on credit exposures. These include information on large credit exposures, concentrations, industry exposures, levels of impairment provisioning and country exposures.

RMC has the responsibility for risk approval authorities and approving definitive risk policies and controls. It monitors risk inherent to the financial services business, receives reports, determines action to be taken and reviews the efficacy of the risk management framework.

The Executive Committee ("EXCO") and RMC are supported by a dedicated risk function headed by the Chief Risk Officer, who is a member of both EXCO and RMC and reports to the Chief Executive Officer.

The RC has responsibility for oversight and advice to the Board on risk matters. The key responsibilities of the RC in this regard include preparing advice to the Board on the overall risk appetite tolerance and strategy within the group and seeking such assurance as it may deem appropriate that account has been taken of the current and prospective macroeconomic and financial environment. The RC is also responsible for the periodic review of the effectiveness of the internal control and risk management frameworks and advising the Board on all high level risk matters.

The RC approves the appointment and removal of the consolidated entity's Chief Risk Officer.

## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (b) Credit Risk Disclosures (continued)

##### *Credit exposure*

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

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

#### Maximum Exposure to Credit Risk

	Consolidated		Company	
	2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
Cash and balances at central banks	2,224.9	763.8	2,224.9	763.8
Items in course of collection from other banks	2.8	4.5	2.8	4.5
Derivatives	56.0	98.8	56.0	98.8
Loans and advances to banks	121.4	179.5	121.4	179.5
Loans and advances to customers	18,837.2	16,850.4	18,837.2	16,850.4
Financial investments - Debt securities	4,562.3	3,418.6	4,562.3	3,418.6
- Treasury and other eligible bill	1,147.8	246.6	1,147.8	246.6
Total financial investments	5,710.1	3,665.2	5,710.1	3,665.2
Other assets				
- Acceptances and endorsements	168.2	129.9	168.2	129.9
- Receivables from related parties	2,927.3	3,844.5	2,927.3	3,844.5
- Accrued income	98.3	75.7	98.3	75.7
- Other	62.8	109.5	62.8	109.5
Total other assets	3,256.6	4,159.6	3,256.6	4,159.6
Financial guarantees and contingent liabilities	1,174.1	1,035.0	1,174.1	1,035.0
Loan commitments and other credit related commitments	10,937.7	10,056.9	10,937.7	10,056.9
At 31 December	42,320.8	36,813.7	42,320.8	36,813.7

## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (b) Credit Risk Disclosures (continued)

##### *Credit quality of loans and advances*

Five 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	Debt securities and other bills	Wholesale lending and derivatives		Retail Lending	
	External credit rating	Internal credit rating	12 month probability of default %	Internal credit rating <sup>1</sup>	Expected loss %
<b>Strong</b>	A- and above	CRR <sup>2</sup> 1 to CRR2	0 – 0.169	EL <sup>3</sup> 1 to EL2	0 – 0.999
<b>Good</b>	BBB+ to BBB-	CRR3	0.170 – 0.740	EL3	1.000 – 4.999
<b>Satisfactory</b>	BB+ to B, and unrated	CRR4 to CRR5	0.741 – 4.914	EL4 to EL5	5.000 – 19.999
<b>Sub-standard</b>	B- to C	CRR6 to CRR8	4.915 – 99.999	EL6 to EL8	20.000 – 99.999
<b>Impaired</b>	Default	CRR9 to CRR10	100	EL9 to EL10	100+ or defaulted <sup>4</sup>

CRR ('Customer Risk Rating') fall within the following categories:

- **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.
- **Good:** Exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.
- **Satisfactory:** Exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minor following the adoption of recovery processes.
- **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.
- **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 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 CRR 10-grade scale maps to a more granular underlying 23-grade scale of obligor probability of default. These scales are used Group-wide for all individually significant customers, depending on which Basel II approach is adopted for the assets in question. The EL ('Expected Loss') 10-grade scale for retail business summarises a more granular 29-grade scale combining obligor and facility/product risk factors in a composite measure, used Group-wide. The external ratings cited above have for clarity of reporting been assigned to the quality classifications defined for internally-rated exposures.

The basis of reporting reflects risk rating systems under the HSBC Group's Basel II programme and to extend the range of financial instruments covered in the presentation of portfolio quality.

## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (b) Credit Risk Disclosures (continued)

##### *Credit Quality of Loans and Advances (continued)*

Impairment is not measured for financial instruments held in trading portfolios or designated at fair value, as assets in such portfolios are managed according to movements in fair value, and the fair value movement is taken directly through the income statement.

##### **Collateral and Other Credit Enhancements**

###### *Loans and advances*

Although collateral can be an important mitigant of credit risk, it is HSBC Group's practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured. However, for other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of default the Bank may use the collateral as a source of repayment.

Depending on its form, collateral can have a significant financial effect in mitigating the Bank's exposure to credit risk.

The Bank may also manage its risk by employing other types of collateral and credit risk enhancements, such as second charges, other liens and unsupported guarantees, but the valuation of such mitigants is less certain and their financial effect has not been quantified.

The collateral types are as follows:

- in the personal sector, mortgages over residential properties (mortgage loans where the loan has a greater than 80% loan to value, the level at which lender mortgage insurance is required on origination, represent 5.5% (2014: 6.2%) of total mortgage loan portfolio);
- 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 2015 was \$51.6m (2014: \$77.8m).

##### **Derivatives**

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

##### **Other Credit Risk Exposures**

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

Government, bank and other financial institution issued securities may benefit from additional credit enhancement, notably through government guarantees that reference these assets. Corporate issued debt securities are primarily unsecured. Debt securities issued by banks and financial institutions include asset-backed securities ('ABS's) and similar instruments, which are supported by underlying pools of financial assets.

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



## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (b) Credit Risk Disclosures (continued)

##### Distribution of Financial Instruments by Credit Quality (gross)

	Neither Past Due Nor Impaired				Past due but not		Total \$'m
	Strong \$'m	Good \$'m	Satisfactory \$'m	Sub - Standard \$'m	Impaired \$'m	Impaired \$'m	
<b>At 31 December 2015</b>							
Cash and balances at central banks	2,224.9	-	-	-	-	-	2,224.9
Items in the course of collection from	2.9	-	-	-	-	-	2.9
Derivatives	32.7	5.1	18.2	-	-	-	56.0
Loans and advances held at amortised cost - gross							
- loans and advances to banks	121.5	-	-	-	-	-	121.5
- loans and advances to customers	13,763.9	3,047.9	1,557.8	47.0	308.2	246.0	18,970.8
	13,885.4	3,047.9	1,557.8	47.0	308.2	246.0	19,092.3
Financial investments							
- treasury and other eligible bills	1,147.8	-	-	-	-	-	1,147.8
- debt securities	4,562.3	-	-	-	-	-	4,562.3
	5,710.1	-	-	-	-	-	5,710.1
Other assets							
- endorsements and acceptances	-	161.4	4.1	2.7	-	-	168.2
- receivables from related parties	2,927.3	-	-	-	-	-	2,927.3
- other	71.7	11.1	78.3	0.1	-	-	161.2
	2,999.0	172.5	82.4	2.8	-	-	3,256.7
<b>Total</b>	<b>24,855.0</b>	<b>3,225.5</b>	<b>1,658.4</b>	<b>49.8</b>	<b>308.2</b>	<b>246.0</b>	<b>30,342.9</b>
<b>At 31 December 2014</b>							
Cash and balances at central banks	763.8	-	-	-	-	-	763.8
Items in the course of collection from	4.5	-	-	-	-	-	4.5
Derivatives	66.8	9.1	22.9	-	-	-	98.8
Loans and advances held at amortised cost - gross							
- loans and advances to banks	159.9	-	19.6	-	-	-	179.5
- loans and advances to customers	12,112.3	2,383.7	1,636.2	124.2	537.9	157.9	16,952.2
	12,272.2	2,383.7	1,655.8	124.2	537.9	157.9	17,131.7
Financial investments							
- treasury and other eligible bills	246.6	-	-	-	-	-	246.6
- debt securities	3,418.6	-	-	-	-	-	3,418.6
	3,665.2	-	-	-	-	-	3,665.2
Other assets							
- endorsements and acceptances	0.3	122.7	6.9	-	-	-	129.9
- receivables from related parties	3,844.5	-	-	-	-	-	3,844.5
- other	107.7	12.8	64.5	0.2	-	-	185.2
	3,952.5	135.5	71.4	0.2	-	-	4,159.6
<b>Total</b>	<b>20,725.0</b>	<b>2,528.3</b>	<b>1,750.1</b>	<b>124.4</b>	<b>537.9</b>	<b>157.9</b>	<b>25,823.6</b>

## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (b) Credit Risk Disclosures (continued)

##### Ageing Analysis of Past Due but not Impaired Financial Instruments

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
<b>At 31 December 2015</b>						
Loans and advances held at amortised cost						
- loans and advances to customers	251.1	41.6	15.4	-	-	308.2
	251.1	41.6	15.4	-	-	308.2
<b>At 31 December 2014</b>						
Loans and advances held at amortised cost						
- loans and advances to customers	492.8	32.4	11.7	1.0	-	537.9
	492.8	32.4	11.7	1.0	-	537.9

##### 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.

##### Loans and Advances by Industries (gross)

	2015 \$'m	2014 \$'m
<b>2015</b>		
<b>Class of Asset</b>		
Personal		
- Mortgages	12,726.4	11,171.5
- Other Personal lending	993.6	994.6
Corporate and commercial		
- Manufacturing	1,234.0	781.0
- International trade and services	1,888.8	1,801.1
- Commercial Real Estate and construction	1,179.5	1317.0
- Other Commercial	870.4	707.8
Financial (non-bank financial institutions)	78.1	176.5
Total gross credit risks	18,970.8	16,952.2

## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (b) Credit Risk Disclosures (continued)

##### *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 judgements 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 2015 was \$34.5m (2014:\$22.3m).

#### **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:

	<b>Consolidated</b>	
	<b>Carrying amount obtained in:</b>	
	<b>2015</b>	<b>2014</b>
	<b>\$'m</b>	<b>\$'m</b>
<b>Nature of Assets</b>		
Residential property	2.9	-
	-	-

Repossessed assets are non-financial assets acquired in exchange for loans in order to achieve an orderly realisation, and are reported in the statement of financial position 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

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (c) Liquidity and Funding Management Disclosures

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 complemented with external wholesale and intra-group term funding along with a portfolio of highly liquid assets diversified by 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.

It is the responsibility of local management to ensure compliance with local regulatory requirements and limits set by the HSBC Group/regional head office. Liquidity is managed on a daily basis by local treasury functions.

Compliance with liquidity and funding requirements is monitored by the Asset and Liability Management Committee ('ALCO') which report to the HSBC Group's regional Office on a regular basis. This process includes:

- maintaining compliance with relevant regulatory requirements of the operating entity
- projecting cash flows under various stress scenarios (including APRA "Name Crisis") and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet liquidity and advances to core funding 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;
- managing contingent liquidity commitment exposures within pre-determined limits;
- maintaining debt financing plans;
- monitoring of 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 crises, while minimising adverse long-term implications for the business.

#### *Core deposits*

A key assumption of the internal framework is the categorisation of customer deposits into core and non-core based on the Bank's expectation of the behaviour of these deposits during a liquidity stress. This characterisation takes into account the inherent liquidity risk categorisation of the operating entity originating the deposit plus three filters around the nature of the customer, the size and pricing of the deposit. No deposit is considered to be core in its entirety unless it is contractually collateralising a loan. The core deposit base in each operating entity is considered to be a long-term source of funding and therefore is assumed not to be withdrawn in the liquidity stress scenario that the Bank uses to calculate its principal liquidity risk metrics. The inherent liquidity risk categorisation of the operating entity is determined by the HSBC Group considering political, economic and regulatory factors within the operating entities' host country, and factors specific to the entity itself, such as the local market, market share and balance sheet strength.

## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (c) Liquidity and Funding Management Disclosures (continued)

The three filters considered in assessing whether a deposit is core are:

- price: any deposit priced significantly above market or benchmark rates is generally treated as entirely non-core;
- size: depositors with total funds above certain monetary thresholds are excluded. Thresholds are established by considering the business line and inherent liquidity risk categorisation; and
- line of business: the element of any deposit remaining after the application of the price and size filter is assessed on the basis of the line of business to which the deposit is associated. The proportion of any customer deposit that can be considered core under this filter is between 45% and 85%.

Repurchase transactions and bank deposits cannot be categorised as core deposits.

The exclusion of deposits, as non-core, due to deposit size or through line of business filters, is referred to as “haircutting”.

A number of principal measures are used to manage liquidity risk, as described below.

#### *Advances to core funding ratio*

The HSBC Group liquidity and funding risk management framework (“LFRF”) employs two key measures to define, monitor and control the liquidity and funding risk of each of the HSBC Group’s operating entities. The advances to core funding ratio is used to monitor the structural long-term funding position, and the stressed coverage ratio, incorporating HSBC Group-defined stress scenarios, is used to monitor the resilience to severe liquidity stresses.

Core customer deposits are an important source of funds to finance lending to customers, and mitigate against reliance on short-term wholesale funding. Limits are placed on operating entities to restrict their ability to increase loans and advances to customers without corresponding growth in core customer deposits or long-term debt funding with a residual maturity beyond one year. This measure is referred to as the ‘advances to core funding’ ratio.

Advances to core funding ratio limits are set by the HSBC Group Risk Management Meeting for the most significant operating entities, and by the HSBC Group ALCO for smaller operating entities, and are monitored by Asset Liability & Capital Management (“ALCM”) teams. The ratio describes current 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. In general, customer loans are assumed to be renewed and are included in the numerator of the advances to core funding ratio, irrespective of the contractual maturity date. Reverse repurchase arrangements are excluded from the advances to core funding ratio.

#### *Stressed coverage ratios*

Stressed coverage ratios, using localised assumptions based on the HSBC Group approach to forecasting under various “stress” scenarios, are tabulated below and derived from stressed cash flow scenario analyses and express the stressed cash inflows as a percentage of stressed cash outflows over one-month and three-month time horizons.

The stressed cash inflows include:

- inflows (net of assumed haircuts) expected to be generated from the realisation of liquid assets; and
- contractual cash inflows from maturing assets that are not already reflected as a use of liquid assets.

In line with the approach adopted for the advances to core funding ratio, customer loans are, in general, assumed not to generate any cash inflows under stress scenarios and are therefore excluded from the numerator of the stressed coverage ratios, irrespective of the contractual maturity date.

A stressed coverage ratio of 100% or higher reflects a positive cumulative cash flow under the stress scenario being monitored. HSBC Group operating entities are required to maintain a ratio of 100% or greater out to three months under the combined market-wide and HSBC-specific stress scenario defined by the inherent risk categorisation of the operating entity concerned.

Advances to core funding ratios and the stressed one-month and three-month coverage ratios for the consolidated entity are provided in the following table based on month end figures:

## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (c) Liquidity and Funding Management Disclosures (continued)

	Advances to core funding		Stressed one month coverage		Stressed three month coverage	
	Year Ended 31 December		Year Ended 31 December		Year Ended 31 December	
	2015	2014	2015	2014	2015	2014
	%	%	%	%	%	%
<b>Year End</b>	<b>92.6%</b>	<b>99.0%</b>	<b>121.8%</b>	<b>113.2%</b>	<b>111.1%</b>	<b>110.4%</b>
Maximum	99.0%	105.7%	127.1%	113.7%	113.7%	110.4%
Minimum	82.7%	99.0%	111.0%	108.6%	103.8%	102.6%
Average	91.1%	102.0%	118.6%	111.3%	108.3%	107.0%

#### *Stressed scenario analysis*

We use a number of standard HSBC group stress scenarios designed to model:

- combined market-wide and HSBC-specific liquidity crisis scenarios; and
- market-wide liquidity crisis scenarios.

The appropriateness of the assumptions for each scenario is reviewed regularly and formally approved by the HSBC Group Risk Management Meeting and the Board annually as part of the liquidity and funding risk appetite approval process.

Stressed cash outflows are determined by applying a standard set of prescribed stress assumptions to the group's cash flow model. The HSBC Group's framework prescribes the use of two market-wide scenarios and three further combined market-wide and HSBC-specific stress scenarios of increasing severity. In addition to the HSBC Group standard stress scenarios, individual operating entities are required to design their own scenarios to reflect specific local market conditions, products and funding bases.

The three combined market-wide and HSBC-specific scenarios model a more severe scenario than the two market-wide scenarios. The relevant combined market-wide and HSBC-specific stress scenario that an operating entity manages to is based upon its inherent liquidity risk categorisation.

#### *Liquid assets*

The estimated liquidity value (after assumed haircuts) of assets categorised by the Bank as liquid that are used for the purposes of calculating the three-month stressed coverage ratios, as defined under the LFRF were are \$11,559.1m (2014: \$7,963.6m).

Any unencumbered asset held as a consequence of a reverse repo transaction with a residual contractual maturity within the stressed coverage ratio time period and unsecured interbank loans maturing within three months are not included in liquid assets, as these assets are reflected as contractual cash inflows.

Liquid assets are held and managed by the Balance Sheet Management function, primarily for the purpose of managing liquidity risk, in line with the LFRF..

## Notes to the Consolidated Financial Statements

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### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (c) Liquidity and Funding Management Disclosures (continued)

Stressed scenario analysis and the numerator of the coverage ratio include the assumed cash inflows that would be generated from the realisation of liquid assets, after applying the appropriate stressed haircut. These assumptions are made based on management's expectation of when an asset is deemed to be realisable.

Liquid assets are unencumbered assets that meet the Bank's definition of liquid assets and are either held outright or as a consequence of a reverse repo transaction with a residual contractual maturity beyond the time horizon of the stressed coverage ratio being monitored.

The Bank's framework defines the asset classes that can be assessed as high quality and realisable within one month and between one month and three months. ALCO has to be satisfied that any asset which may be treated as liquid in accordance with the Bank's liquid asset policy will remain liquid under the stress scenario being managed to.

Inflows from the utilisation of liquid assets within one month can generally only be based on confirmed withdrawable central bank deposits or the sale or repo of government and semi-government exposures generally restricted to those denominated in the sovereign's domestic currency. High quality ABSs and covered bonds are also included but inflows assumed for these assets are capped.

Inflows after one month are also reflected for high quality non-financial and non-structured corporate bonds and equities within the most liquid indices.

#### *Sources of funding*

The Bank's primary sources of funding are customer current accounts and customer savings deposits payable on demand or at short notice. The Bank issues wholesale securities (secured and unsecured) to supplement customer deposits and change the currency mix, maturity profile or location of the Bank's liabilities.

The level of customer accounts continued to exceed the level of loans and advances to customers. The positive funding gap was predominantly deployed into liquid assets; cash and balances with central banks and financial investments, as required by the LFRF.

The Bank also accesses wholesale funding markets by issuing senior secured and unsecured debt securities (publically and privately) and borrowing from the secured repo markets against high quality collateral, in order to align asset and liability maturities and currencies and to maintain a presence in local wholesale markets.

#### *Liquidity behaviouralisation*

Liquidity behaviouralisation is applied to reflect the Bank's assessment of the expected period for which the Bank is confident that it will have access to its liabilities, even under a severe liquidity stress scenario, and the expected period for which the Bank must assume that it will need to fund its assets. Behaviouralisation is applied when the contractual terms do not reflect the expected behaviour. Liquidity behaviouralisation is reviewed and approved by ALCO in compliance with policies set by the HSBC Group Risk Management Meeting.

#### *Contingent liquidity risk*

The Bank provides customers with committed and standby facilities. These facilities increase the funding requirements of the Bank when customers drawdown. The liquidity risk associated with the potential drawdown on non-cancellable committed facilities is factored into the Bank's stressed scenarios and limits are set for these facilities.

#### *Management of cross-currency liquidity and funding risk*

The liquidity and funding risk framework also considers the ability of the Bank to continue to access foreign exchange markets under stress when a surplus in one currency is used to meet a deficit in another currency, for example, by the use of the foreign currency swap markets. The Bank also monitors stressed coverage ratios and advances to core funding ratios for non-local currencies.

## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (c) Liquidity and Funding Management Disclosures (continued)

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

	On demand	Due within 3	Due between 3	Due between 1	Due after 5
	\$'m	months	and 12 months	and 5 years	years
	\$'m	\$'m	\$'m	\$'m	\$'m
<b>At 31 December 2015</b>					
Deposits by banks	360.5	-	-	-	-
Repurchase agreement by banks	990.4	-	-	-	-
Customer accounts	18,726.9	3,756.8	1,249.2	27.9	11.3
Trading liabilities	41.6	-	-	-	-
Items in the course of transmission to other banks	25.0	-	-	-	-
Debt securities on issue – trading liabilities	-	-	0.1	9.1	-
Financial liabilities designated at fair value	-	0.6	1.6	8.8	43.9
Derivatives	52.5	8.4	8.2	21.9	-
Subordinated liabilities (related parties)	-	3.2	9.7	51.8	315.3
Other financial liabilities	2,922.9	171.2	0.3	2.1	-
	23,119.8	3,940.2	1,269.1	121.6	370.5
Financial guarantee contracts	1,130.6	-	-	-	-
Loan commitments	8,677.4	2,255.5	-	0.1	-
	32,927.8	6,195.8	1,269.1	121.7	370.5
<b>At 31 December 2014</b>					
Deposits by banks	342.3	-	-	-	-
Customer accounts	17,063.1	4,120.6	1,171.3	47.5	12.2
Trading liabilities	86.3	-	-	-	-
Items in the course of transmission to other banks	26.2	-	-	-	-
Debt securities on issue	-	10.1	69.3	99.2	-
Financial liabilities designated at fair value	-	0.5	1.6	8.8	46.1
Derivatives	80.8	5.9	7.8	28.7	-
Subordinated liabilities	-	2.8	208.3	-	-
Other financial liabilities	741.0	135.3	5.2	2.5	-
	18,339.7	4,275.2	1,463.5	186.7	58.3
Financial guarantee contracts	1,004.3	-	-	-	-
Loan commitments	7,664.0	2,293.3	-	-	-
	27,008.0	6,568.5	1,463.5	186.7	58.3

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

The balances in the above table will not agree directly to the balances in the consolidated Statement of Financial Position 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.

Cash flows payable in respect of customer accounts are primarily contractually repayable on demand or at short notice. In practice, however, short-term deposit balances remain stable as inflows and outflows broadly match and a significant portion of loan commitments and guarantee contracts expire without being drawn upon. The Bank's approach to managing liquidity risk is set out above.



## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (d) Market Risk Disclosures

Market risk is the risk that movements in foreign exchange rates, interest rates, credit spreads, or equity and commodity prices will result in profits or losses to the Bank. Market risk arises on financial instruments which are measured at fair value and those which are measured at amortised cost. The objective of market risk management is to control market risk exposures to achieve an optimal return while maintaining risk at acceptable levels.

The Bank monitors market risk separately for trading portfolios and non-trading portfolios. Trading portfolios include positions arising from market-making in exchange rate and interest rate as well as in debt securities. Trading risks arise either from customer-related business or from market-making proprietary position-taking.

The management of market risk is principally undertaken in Global Markets through risk limits approved by the HSBC group's Executive Committee. Wholesale and Market Risk, a unit within the Risk function, develops risk management policies and measurement techniques.

Risk limits are determined for each location and, within location, for each portfolio. Limits are set by product and risk type with market liquidity being a principal factor in determining the level of limits set. Limits are set using a combination of risk measurement techniques, including position limits, sensitivity limits, as well as value at risk limits at a portfolio level. Similarly, option risks are controlled through full revaluation limits in conjunction with limits on the underlying variables that determine each option's value.

#### Value at risk ("VaR")

VaR is a technique which estimates the potential losses that could occur on risk positions taken due to movements in market rates and prices over a specified time horizon and to a given level of confidence (99% for the Bank). The use of VaR is integrated in the risk management of market risk in the Bank and VaR is calculated for all trading-intent positions regardless of how those exposures are capitalised. Where there is not an approved internal model, the appropriate local rules to capitalise exposures are used. The Bank's models are based predominantly on historical simulation. VaR is calculated at a 99% confidence level for a one-day holding period. 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 a 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% 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.

The Bank recognises these limitations by augmenting the VaR limits with other position and sensitivity limit structures, as well as with stress testing, both on individual portfolios and on a consolidated basis. The Bank's stress testing regime provides senior management with an assessment of the impact of extreme events on the market risk exposures of the Bank.

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

## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (d) Market Risk Disclosures (continued)

	Total VaR		Trading VaR	
	Year Ended 31 December		Year Ended 31 December	
	2015	2014	2015	2014
	\$'m	\$'m	\$'m	\$'m
At 31 December	6.0	1.7	0.7	0.1
Average	4.1	2.7	0.3	0.1
Maximum	6.6	5.4	0.7	0.2
Minimum	1.6	1.5	0.0	0.0

Total VaR at 31 December 2015 was \$6.0m which increased from the VaR of \$1.7m observed as at 31 December 2014. The increase in VaR was due to the increase in AUD interest rate present value of a basis point (PVBP) from \$67k to \$267k as at 31 December 2015. As a result of the increase in interest rate PVBP exposure through the course of 2015, the average VaR utilisation was \$4.1m, compared to the average VaR utilisation of \$2.7m in 2014.

Total Trading VaR at 31 December 2015 increased to \$0.7m from \$0.1m due to the increase in AUD interest rate PVBP.

#### *Market risk linkages to the accounting Statement of Financial Position*

##### **Trading assets and liabilities**

The Bank's trading assets and liabilities are in substantially all cases originated by GB&M. As described in note 3(g), the assets and liabilities are classified as held for trading if they have been acquired or incurred principally for the purpose of selling or repurchasing in the near term, or 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 assets and liabilities are treated as traded risk for the purposes of market risk management, other than a limited number of exceptions, primarily in Global Banking where the short-term acquisition and disposal of the assets are linked to other non-trading related activities such as loan origination.

##### **Financial liabilities designated at fair value**

Financial liabilities designated at fair value are primarily fixed-rate securities issued by for funding purposes. As described in note 3(h), an accounting mismatch would arise if the debt securities were accounted for at amortised cost because the derivatives which economically hedge market risks on the securities would be accounted for at fair value with changes recognised in the income statement. The market risks of these liabilities are treated as non-traded risk, the principal risks being interest rate and/or foreign exchange risks.

##### **Derivative assets and liabilities**

As described in note 10, the Bank undertakes derivative activity for three primary purposes; to create risk management solutions for clients, to manage the portfolio risks arising from client business and to manage and hedge the Bank's own risks. Most of the Bank's derivative exposures arise from sales and trading activities within GB&M and are treated as traded risk for market risk management purposes. Within derivative assets and liabilities there are portfolios of derivatives which are not risk managed on a trading intent basis and are treated as non-traded risk for VaR measurement purposes. These arise when the derivative was entered into in order to manage risk arising from non-traded exposures. These include non-qualifying hedging derivatives, and derivatives qualifying for fair value and cash flow hedge accounting. The use of on-qualifying hedges whose primary risks relate to interest rate and foreign exchange exposure is described in note 3(l). Details of derivatives in fair value and cash flow hedge accounting relationships are given in Note 10 on the Financial Statements. The Bank's primary risks in respect of these instruments relate to interest rate and foreign exchange risks.

## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (d) Market Risk Disclosures (continued)

##### Loans and advances to customers

The primary risk on assets within loans and advances to customers is the credit risk of the borrower. The risk of these assets is treated as non-trading risk for market risk management purposes.

##### Financial investments

Financial investments include assets held on an available-for-sale and held-to-maturity basis. An analysis of the Bank's holdings of these securities by accounting classification and issuer type is shown in note 11. The majority of these securities are mainly held within Balance Sheet Management in GB&M. The positions which are originated in order to manage structural interest rate and liquidity risk are treated as non-trading risk for the purposes of market risk management.

##### Trading

The Bank's control of market risk is based on restricting individual operations to trading within a list of permissible instruments authorised for each site by Wholesale and Market Risk, and enforcing rigorous new product approval procedures. In particular, trading in the more complex derivative products is concentrated in offices with appropriate levels of product expertise and robust control systems.

In addition, at both portfolio and position levels, market risk in trading portfolios is monitored and controlled using a complementary set of techniques such as VaR and present value of a basis point, together with stress and sensitivity testing and concentration limits. These techniques quantify the impact on capital of defined market movements.

##### Non-trading portfolios

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.

In order to manage this risk optimally, market risk in non-trading portfolios is transferred to Global Markets or to separate books managed under the supervision of the local Asset and Liability Management Committee ('ALCO'). The transfer of market risk to books managed by Global Markets 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. Local ALCOs regularly monitor all such behavioural assumptions and interest rate risk positions, to ensure they comply with interest rate risk limits established by senior management.

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 Markets or ALCO-managed books, the net exposure is typically managed through the use of interest rate swaps within agreed limits.

The Bank also monitors the sensitivity of projected net interest income under varying interest rate scenarios. The Bank 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.

A large part of the Bank's exposure to changes in net interest income arising from movements in interest rates relates to its core deposit franchise. The Bank's core deposit franchise is exposed to changes in the value of the deposits raised and spreads against wholesale funds. The value of core deposits increases as interest rates rise and decreases as interest rates fall. This risk is, however, asymmetrical in a very low interest rate environment as there is limited room to lower deposit pricing in the event of interest rate reductions.

## Notes to the Consolidated Financial Statements

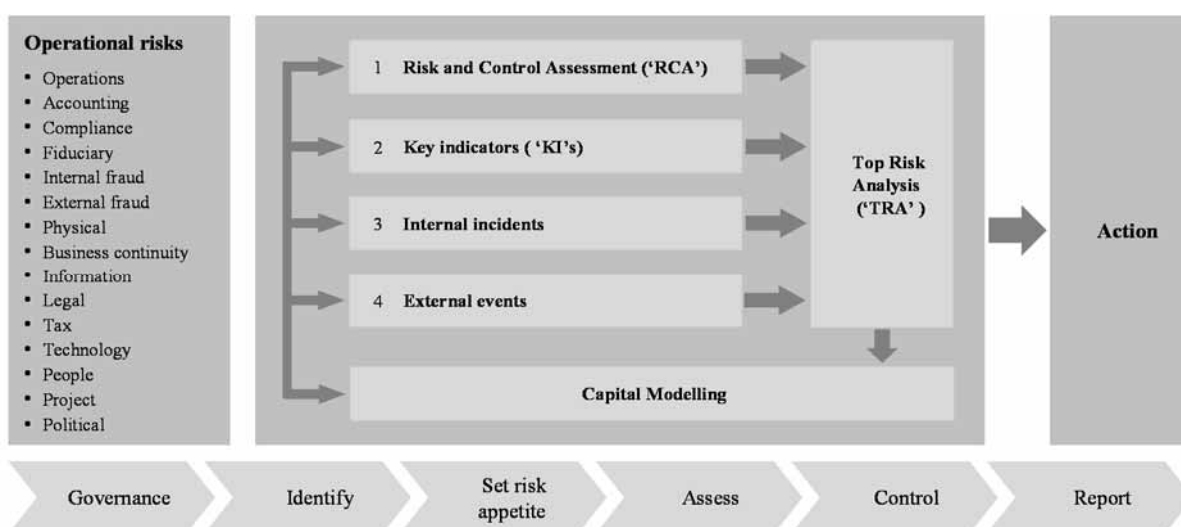
### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (e) Operational Risk Disclosures

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk (along with accounting, tax, security and fraud, people, systems, projects, operations and organisational change risk). It arises from day to day operations or external events, and is relevant to every aspect of our business.

#### Operational risk management framework

The HSBC Group Operational Risk function and the operational risk management framework ('ORMF') assist business management in discharging their responsibilities. The ORMF defines minimum standards and processes, and the governance structure for operational risk and internal control across the HSBC Group.



#### Three lines of defence

The Three Lines of Defence model is essential to delivering strong risk management within the bank. It defines who is responsible to do what to identify, assess, measure, manage, monitor, and mitigate operational risks, encouraging collaboration and enabling efficient coordination of risk and control activities.

- The first line of defence is accountable for managing and monitoring operational risk in the business.
- The second line is responsible for providing risk oversight, challenge, advice and insights to the business.
- The third line of defence independently assures that the Bank is managing operational risk effectively.

Having a strong Three Lines of Defence model in operation across the bank enables us to identify and effectively manage operational risks. A diagrammatic representation of the ORMF is presented above.

Activity to strengthen our operational risk culture and to better embed the use of our ORMF continued in 2015. In particular, we continued to streamline our operational risk management processes, procedures and tool sets to provide more forward-looking risk insights and more effective operation of the ORMF.

Articulating our risk appetite for material operational risks helps business understand the level of risk our organisation is willing to accept. Monitoring operational risk exposure against risk appetite on a regular basis and implementing our risk acceptance process drives risk awareness in a more forward-looking manner. It assists management in determining whether further action is required.

## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (f) Capital Management

The Bank's approach to capital management is driven by its strategic and organisational requirements, taking into account the regulatory, economic and commercial environment in which it operates.

It is the Bank's objective to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times.

There is an annual Bank capital plan which is approved by the Board. The plan is drawn up with the objective of maintaining both an appropriate amount of capital and an optimal mix between the different components of capital. In accordance with HSBC Group's Capital Management Framework, capital generated in excess of planned requirements is returned to the shareholder, normally by way of dividends.

The principal forms of capital are included in the following balances on the consolidated Statement of Financial Position: share capital, retained profits, other reserves, and subordinated liabilities. Capital also includes the general reserve for credit losses.

#### *Externally imposed capital requirements*

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 group uses the standardised approach to credit risk, operational risk and market risk.

During the year, the Bank and the consolidated entity complied with all of the externally imposed capital requirements by APRA.

#### *Basel III*

In December 2010, the Basel Committee issued two documents: 'A global regulatory framework for more resilient banks and banking systems' and 'International framework for liquidity risk measurement, standards and monitoring', which together are commonly referred to as 'Basel III'. In June 2011, the Basel Committee issued a revision to the former document setting out the finalised capital treatment for counterparty credit risk in bilateral trades.

The Basel III rules set out the minimum common equity tier 1 (CET1) requirement of 4.5% and additional capital conservation buffer requirement of 2.5%, to be phased in sequentially from 1 January 2013, becoming fully effective on 1 January 2019. Any additional countercyclical capital buffer requirements will also be phased in, starting in 2016 to a maximum level of 2.5% effective on 1 January 2019, although individual jurisdictions may choose to implement larger countercyclical capital buffers. In addition to the criteria detailed in the Basel III proposals, the Basel Committee issued further minimum requirements in January 2011 to ensure that all classes of capital instruments fully absorb losses at the point of non-viability before taxpayers are exposed to loss. Instruments issued on or after 1 January 2013 may only be included in regulatory capital if the new requirements are met. The capital treatment of securities issued prior to this date will be phased out over a 10-year period commencing on 1 January 2013.

APRA announced final Basel III capital reforms in September 2013, and in the main adopted the core principals and transitional guidelines announced by the Basel Committee on Banking Supervision (BCBS) to strengthen the capital framework whilst maintaining its supervisory discretion on specific capital adjustments. APRA revised Capital prudential standards incorporating Basel III capital reforms came into effect from 1 January 2013, electing to accelerate implementation timetable in some requirements in recognition that Australian ADIs capital levels are sound and above the revised thresholds.

## Notes to the Consolidated Financial Statements

### 28. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

#### (f) Capital Management (continued)

##### *Leverage Ratio*

Basel III introduces a simple non risk-based leverage ratio as a complementary measure to the risk-based capital requirements to limit excessive leverage on the part of banks. The Basel Committee's implementation timetable provides for a "parallel run" of the leverage ratio from 2015 until 2017, with the ratio becoming a binding requirement from 2018. APRA's current proposal is to follow the Basel Committee suggestion of using 3% as a "testing minimum" ratio, subject to review during the parallel run period.

### 29. 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).

#### *Control framework*

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

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is used. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the Bank will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors that are considered in this regard are, inter alia:

- the extent to which prices may be expected to represent genuine traded or tradable prices;
- the degree of similarity between financial instruments;
- the degree of consistency between different sources;
- the process followed by the pricing provider to derive the data;
- the elapsed time between the date to which the market data relates and the balance sheet date; and
- the manner in which the data was sourced.

For fair values determined using a valuation model, the control framework may include, as applicable, development or validation by independent support functions of: (i) the logic within valuation models; (ii) the inputs to those models; (iii) any adjustments required outside the valuation models; and (iv) where possible, model outputs. Valuation models are subject to a process of due diligence and calibration before becoming operational and are calibrated against external market data on an on-going basis.

To this end, ultimate responsibility for the determination of fair values lies within Product control, which reports functionally to the Chief Financial officer. Finance establishes the accounting policies and procedures governing valuation, and is responsible for ensuring that these comply with all relevant accounting standards.

#### *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.



## Notes to the Consolidated Financial Statements

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### (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:

- Debt securities, Treasury and eligible bills (level 1, level 2): 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.
- Derivatives (level 2): 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 (level 2) – designated at fair value: In certain circumstances, the Bank 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 their instruments therefore includes the effect of own credit spread. Gains and losses arising from changes in the credit spread of liabilities issued by the Bank reverse over the contractual life of the debt.

## Notes to the Consolidated Financial Statements

### 29. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

- Issued structured notes and certain hybrid instrument liabilities are included within trading liabilities (level 3), and marked at fair value. The credit spread applied to these instruments is derived from the spreads at which the Bank issues structured notes. These market spreads are significantly tighter than credit spreads observed in vanilla debt or credit default swap markets

Consolidated	Valuation Techniques			Total Third Party \$'m	Amount with HSBC* \$'m	Total \$'m
	Level 1 \$'m	Level 2 \$'m	Level 3 \$'m			
<b>At 31 December 2015</b>						
<i>Assets</i>						
Trading assets	-	-	-	-	-	-
Derivatives	0.1	28.0	-	28.1	27.9	56.0
Available for sale investments	3,471.2	2,238.9	-	5,710.1	-	5,710.1
<i>Liabilities</i>						
Trading liabilities	-	34.0	7.6	41.6	-	41.6
Financial liabilities designated at fair value	-	43.2	-	43.2	-	43.2
Derivatives	0.1	28.8	0.2	29.1	61.9	91.0
<b>At 31 December 2014</b>						
<i>Assets</i>						
Trading assets	-	-	-	-	-	-
Derivatives	0.5	36.5	0.7	37.7	61.1	98.8
Available for sale investments	1,691.7	1,973.5	-	3,665.2	-	3,665.2
<i>Liabilities</i>						
Trading liabilities	-	71.4	14.9	86.3	-	86.3
Financial liabilities designated at fair value	-	43.5	-	43.5	-	43.5
Derivatives	0.4	42.2	0.8	43.4	79.7	123.1

\*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.

The Level 3 trading liabilities that are 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.

#### **Fair Value of Financial Instruments not Carried at Fair Value**

Aside from the assets outlined in the table above, the carrying values are a reasonable approximation of fair values.



## Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>30. NOTES TO THE STATEMENT OF CASH FLOWS</b>					
<b>(a) Reconciliation of Net Cash Flows Provided by Operating Activities to Operating Profit after Income Tax</b>					
Profit for the period		220.7	230.6	221.8	229.6
Depreciation and amortisation		8.4	8.3	8.4	8.3
(Increase)/decrease in interest receivable		(20.4)	14.3	(20.4)	14.3
Increase/(decrease) in interest payable		(6.6)	(2.1)	(6.8)	(2.1)
Dividend income from controlled entities		-	-	(4.6)	-
Loan impairment charges		69.3	54.1	74.4	55.6
Profit/(loss) on the sale of investments		(7.7)	(0.1)	(7.7)	(0.1)
Increase/(decrease) in deferred taxes		(12.6)	(7.7)	(12.6)	(7.7)
Increase/(decrease) in provisions		2.4	(44.4)	2.4	(44.4)
Increase/(decrease) in provision for employee entitlements		0.3	3.2	0.3	3.2
Increase/(decrease) in intercompany payable account		(11.1)	(18.9)	(12.6)	(19.3)
Increase/(decrease) in sundry creditors		(28.3)	76.4	(27.8)	76.0
<b>Changes in Operating Assets and Liabilities</b>					
Net Increase/ (decrease) in trading assets		10.7	2.2	10.7	2.2
Net decrease in trading liabilities		(44.7)	(25.9)	(44.7)	(25.9)
Cash inflows / (outflows) from movements in other assets/liabilities		2.5	80.5	2.5	80.5
Net Increase / (decrease) in Loans and bills advanced		(1,846.3)	2.3	(1,851.4)	0.8
Net increase in deposits and other borrowings		4,637.4	560.8	4,502.6	522.7
Net Cash provided by operating activities		<u>2,974.0</u>	<u>933.6</u>	<u>2,834.5</u>	<u>893.7</u>

## Notes to the Consolidated Financial Statements

Note	Consolidated		Company	
	2015 \$'m	2014 \$'m	2015 \$'m	2014 \$'m
<b>30. NOTES TO THE STATEMENT OF CASH FLOWS (continued)</b>				
<b>(b) Reconciliation of Cash and Cash Equivalents</b>				
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 Statement of Financial Position as follows:				
Cash and balances at central banks	2,224.9	763.8	2,224.9	763.8
Placings with banks with remaining maturity 1 month or less	2.9	0.3	2.9	0.3
Securities purchased from related entities under agreements to resell	2,735.4	3,503.5	2,735.4	3,503.5
Total cash and cash equivalents	<u>4,963.2</u>	<u>4,267.6</u>	<u>4,963.2</u>	<u>4,267.6</u>

### (c) Financing Facilities

At 31 December 2015 there are no committed facilities. At 31 December 2014, the consolidated entity had an unused committed standby facility of \$1,705.0m from a related corporation.

The total external subordinated liabilities on issue at 31 December 2015 were \$0.0m (2014:\$200.0m).

## 31. 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 \$2,783.9m (2014: \$3,519.6m), and by the Company of \$2,783.9m (2014: \$3,519.6m). The fair value of such collateral actually sold or repledged by the consolidated entity and Company was nil (2014:\$nil).

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

### 32. SECURITISATIONS AND OTHER STRUCTURED TRANSACTIONS

The consolidated entity enters into transactions from time to time by which it transfers recognised financial assets directly to 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 Statement of Financial Position to the extent of the bank's continuing involvement.

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

	Consolidated		Company	
	2015	2014	2015	2014
	\$'m	\$'m	\$'m	\$'m
<b>Carrying Amount of Asset</b>				
Loans and advances to customers (1)	1,209.2	132.2	1,209.2	132.2
<b>Total</b>	<b>1,209.2</b>	<b>132.2</b>	<b>1,209.2</b>	<b>132.2</b>
<b>Carrying Amount of Related Liability</b>				
Debt Securities on issue (2)	-	132.2	-	-
Related Parties	-	-	-	132.2
Sale and Repurchase Agreement	990.4	-	990.4	-
<b>Total</b>	<b>990.4</b>	<b>132.2</b>	<b>992.2</b>	<b>132.2</b>

- (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 to external investors (Lion Series 2007-1 Trust) and the Bank (Lion Series 2009-1 Trust) respectively. 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. In addition the Bank provides a liquidity facility to the Lion Series 2009-1 Trust.

The mortgage loans within the Lion Series 2007-1 Trust 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 Lion Series 2007-1 Trust's Series Notice specifies that, when the total balance of the securitised mortgage pool falls below 10% of the initial securitised mortgage pool, the Bank as the Trust Manager can choose to initiate the exercise of the Call option to redeem all notes issued. On 30 November 15 the Call option was triggered because the securitised mortgage pool total balance fell to \$100.23m. As a result, the Bank bought back all securitised mortgages from the Trust and on 15 December 15 all the notes issued by the Trust were redeemed in full.

## Notes to the Consolidated Financial Statements

### 33. 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 13.

	Consolidated		Company	
	2015	2014	2015	2014
	\$	\$	\$	\$
<b>Amounts Receivable From or Payable To Related Parties</b>				
Aggregate amounts receivable:				
Other related entities	191,908,649	340,980,855	191,908,649	340,980,855
Reverse repurchase agreement – other related entities	2,735,447,233	3,503,524,362	2,735,447,233	3,503,524,362
Aggregate amounts payable:				
Owing to Parent in respect of tax	21,983,903	21,657,723	21,983,903	21,657,723
Other related entities	2,751,316,097	499,542,277	2,751,016,097	635,642,277
Subordinated liabilities – other related entities	250,000,000	-	250,000,000	-
<b>Aggregate of Amounts Received or Receivable From or Paid or Payable to Related Parties during the year</b>				
Interest revenue:				
Other related entities	49,612,230	79,554,449	49,612,230	79,554,449
Key management personnel	396,000	451,633	396,000	451,633
Interest expense:				
Other related entities	9,180,884	12,267,877	14,056,700	19,725,881
Management fees paid:				
Other related entities	105,313,272	87,132,508	105,313,272	87,132,508
Management fees received:				
Other related entities	92,665,405	74,346,514	92,665,405	74,346,514
Fee income:				
Other related entities	6,777,223	13,460,867	6,777,223	13,460,867
Fee expense:				
Other related entities	3,188,571	4,310,217	3,188,571	4,310,217
Dividend income:				
Wholly owned subsidiaries	-	-	4,637,275	-
Dividend paid:				
Controlling entities	123,340,000	111,850,000	123,340,000	111,850,000

## Notes to the Consolidated Financial Statements

### 33. 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 \$1,271,386,390 (Consolidated) (2014:\$53,615,355), 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 HSBC Group. Otherwise these services are charged on a time and cost basis.

### 34. 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:

Anthony W Cripps (Chief Executive Officer)

Michael J Arnold (Chief Financial Officer)

Resigned 30 October 2015

#### Non-Executive Directors:

Graham J Bradley (Chairman)

Carol J Austin

Guy D Harvey-Samuel

Mark G Johnson

Richard G Humphry

Jayant Rikhye

Resigned 25 October 2015

#### Company Secretary:

Robert Agati

Bridget Powell (General Counsel)

#### Executives:

Gunalan Bhaskaran (Head of Regulatory Compliance)

John Fogarty (Head of Regulatory and Financial Crime Compliance)

James Dynon (Head of Capital Financing)

Sean Henderson (Head of Capital Financing)

Kate Epworth (Head of Communications)

Graham Heunis (Head of Retail Banking and Wealth Management)

Emma Hider (Chief Financial Officer)

James Hogan (Head of Commercial Banking)

Brenton Hush (Chief Operating Officer)

Charlotte Middleton (Chief Risk Officer)

Paul Murphy (Head of Human Resources)

Francine Biddulph (Head of Human Resources)

Gavin Powell (Head of Global Markets)

Chris Russell (Head of Global Banking)

Vic Wolff (Head of Marketing)

Appointed 01 December 2015

Resigned 22 December 2015

Appointed 14 September 2015

Resigned 25 August 2015

Resigned 06 December 2015

Appointed 06 November 2015

Resigned 21 December 2015

Appointed 01 April 2015

Resigned 18 January 2015

Resigned 31 December 2015

## Notes to the Consolidated Financial Statements

	Consolidated		Company	
	2015	2014	2015	2014
	\$	\$	\$	\$
<b>34. KEY MANAGEMENT PERSONNEL DISCLOSURES (continued)</b>				
<b>Transactions with Key Management Personnel</b>				
The key management personnel compensations included in 'staff costs' (see note 6) are as follows:				
Short term employee benefits				
Cash salary, fees and short-term compensated absences	7,037,060	6,387,514	7,037,060	6,387,514
Short-term cash profit-sharing and other bonuses	3,379,026	3,510,499	3,379,026	3,510,499
Non-monetary benefits	858,853	827,559	858,853	827,559
Other short-term employee benefits	572,349	587,464	572,349	587,464
	<u>11,847,288</u>	<u>11,313,036</u>	<u>11,847,288</u>	<u>11,313,036</u>
Post employment benefits				
Pension and superannuation benefits	283,736	552,255	283,736	552,255
Other post-employment benefits	54,093	57,189	54,093	57,189
	<u>337,830</u>	<u>609,444</u>	<u>337,830</u>	<u>609,444</u>
	<u>12,185,117</u>	<u>11,922,480</u>	<u>12,185,117</u>	<u>11,922,480</u>
Share based payments granted during the year	759,138	1,024,648	759,138	1,024,648

### 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 employee share ownership programmes (see note 22).

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\*

7,502,341	9,818,304	7,502,341	9,818,304
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### Loan Repayments Received

4,494,695	507,102	4,494,695	507,102
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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

### 35. 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	2015			2014		
	Due within one year \$'m	Due after one year \$'m	Total \$'m	Due within one year \$'m	Due after one year \$'m	Total \$'m
<b>Assets</b>						
Cash and balances at central bank	2,224.9	-	2,224.9	763.8	-	763.8
Items in the course of collection from other banks	2.9	-	2.9	4.5	-	4.5
Loan and advances to banks	2.9	118.6	121.5	19.8	159.7	179.5
Loans and advances to customers	2,641.4	16,195.8	18,837.2	2,567.1	14,283.3	16,850.4
Financial investments	2,272.6	3,437.5	5,710.1	2,056.6	1,608.6	3,665.2
Other assets	3,256.5	0.1	3,256.6	4,163.9	0.6	4,164.5
<b>Liabilities</b>						
Deposits by banks	360.5	-	360.5	342.3	-	342.3
Repurchase agreements by bank	990.4	-	990.4	-	-	-
Customer accounts	23,678.8	35.1	23,713.9	22,295.2	53.0	22,348.2
Items in the course of transmission to other banks	25.0	-	25.0	26.2	-	26.2
Debt securities on issue	-	-	-	55.9	99.0	154.9
Financial liabilities designated at fair value	-	43.2	43.2	-	43.5	43.5
Other liabilities	3,066.3	251.1	3,317.4	850.6	2.1	852.7
Employee benefits	75.1	6.8	81.9	72.1	6.0	78.1
Subordinated liabilities	-	-	-	200.0	-	200.0

### 36. 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


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

- (a) the financial statements and notes set out on pages 6 to 79 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 2015, 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 Note2(a).

Dated at Sydney this 2 day of February 2016.

Signed in accordance with a resolution of the Directors:

  
\_\_\_\_\_  
Graham J Bradley  
Chairman

  
\_\_\_\_\_  
Anthony W Cripps  
Director





## **Independent auditor's report to the members of HSBC Bank Australia Limited**

### ***Report on the financial report***

We have audited the accompanying financial report of HSBC Bank Australia Limited (the company), which comprises the Statements of Financial Position as at 31 December 2015, the Income Statements, Statements of Comprehensive Income, Statements of Changes in Equity and Statements of Cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration for both the company and the HSBC Bank Australia Group (the consolidated entity). The consolidated entity comprises the company and the entities it controlled at 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 2, the directors also state, in accordance with 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. Those 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 believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

### ***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 Limited is in accordance with the *Corporations Act 2001*, including:
  - (i) giving a true and fair view of the company's and consolidated entity's financial position as at 31 December 2015 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 consolidated financial report also complies with International Financial Reporting Standards as disclosed in Note 2.

*PricewaterhouseCoopers*

PricewaterhouseCoopers

A handwritten signature in black ink, appearing to read 'E A Barron', with a stylized flourish extending to the right.

E A Barron  
Partner

Sydney  
12 February 2016



## Auditor's Independence Declaration

As lead auditor for the audit of HSBC Bank Australia Limited for the year ended 31 December 2015, I declare that to the best of my knowledge and belief, there have been:

- a) no contraventions of the auditor independence requirements of 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.

This declaration is in respect of HSBC Bank Australia Limited and the entities it controlled during the period.

A handwritten signature in black ink, appearing to read 'E A Barron', with a horizontal line extending to the right.

E A Barron  
Partner  
PricewaterhouseCoopers

Sydney  
12 February 2016