

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

Financial Report

Year Ended 31 December 2017

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Directors' Report

The Directors of HSBC Bank Australia Limited (the "Company" or the "Bank") submit their report, together with the financial statements and related notes of the Company and its controlled entities (together the "consolidated entity") for the financial year ended 31 December 2017 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 Bradley AM	Non-Executive Chairman	
Carol Austin	Non-Executive Director	
Anthony Cripps	Non-Executive Director	Previously CEO until 2 April 2017
Guy Harvey-Samuel	Non-Executive Director	Resigned 1 April 2017
Mark Johnson	Non-Executive Director	Resigned 21 April 2017
Matthew Lobner	Non-Executive Director	Appointed 6 October 2017
Jayant Rikhye	Non-Executive Director	Resigned 25 October 2017
Jann Skinner	Non-Executive Director	Appointed 12 April 2017
Martin Tricaud	Chief Executive Officer	Appointed 3 April 2017

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, global liquidity and cash management, money market services, interest rate and foreign currency trading and services, capital markets services and financial advice.

The Company is an Australian unlisted public limited company.

The registered office and principal place of business of the consolidated entity is Level 36 International Tower One, 100 Barrangaroo Avenue, Sydney NSW 2000.

REVIEW OF OPERATIONS

In 2017, the consolidated entity reported a profit from its continuing operations before tax of \$409.9m, up from \$390.8m in 2016. Operating income before loan impairment charges increased by 6.6% primarily due to growth in net interest income from balance sheet growth despite the effects of the lower interest rate environment. Loan impairment charges fell across the year as specific corporate impairments reduced in 2017. The business invested heavily for growth in 2017 and for future growth as the business grew costs by 9.8% over the course of the year.

Total assets increased to \$32,248.1m driven by increases in customer advances and liquid asset holdings. Customer advances increased largely due to growth in the mortgage portfolio following a number of successful mortgage campaigns and the launch of mortgages into the broker channel.

DIVIDENDS

Dividends paid or declared by the Company to shareholders since the end of the previous financial year were \$157.5m including payments on the Tier 1 instruments (2016:\$129.9m). Dividend payments increased from 2016 in line with the Bank's dividend policy.

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

The Bank 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 period 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, to affect significantly the operations of the Company or consolidated entity, the results of those operations or the state of its affairs 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

Details of the amounts paid to PricewaterhouseCoopers ("PwC") 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 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 by the HSBC Group Audit Committee terms of reference on the agreed framework for engaging auditors for non-audit services; and
- none of the services undermine the general principles relating to auditor independence as set out in APES 110 *Code of Ethics for Professional Accountants*.

LEAD AUDITOR'S INDEPENDENCE DECLARATION

The lead auditor's independence declaration is set out on page 81 and forms part of the Directors' Report for the year ended 31 December 2017.

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 by them in their role as directors or officers of any entity, except where:

- the liability arises out of conduct involving a wilful breach of duty; or
- 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 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 them 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 or a close member of their family (hereinafter, a "Related Person") is a member, or with an entity in which the Director or a Related Person of any of them has a substantial interest, other than that disclosed in the financial statements.

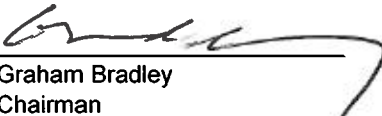
REGULATORY DISCLOSURES

Full details of the market disclosures and liquidity 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.

ROUNDING OFF OF AMOUNTS

The Company is of the kind referred to in an ASIC Legislative Instrument 2016/191, relating to the 'rounding off' of amounts in the Directors' Report and financial report. Amounts in this report and the accompanying financial statements have been rounded, where appropriate, to the nearest tenth of a million dollars except where otherwise stated.

The report is made with a resolution of the Directors.


Graham Bradley
Chairman


Martin Tricaud
Director and Chief Executive Officer

Dated at Sydney this 9th February 2018

Income Statements

For the year ended 31 December 2017

	Note	Consolidated		Company	
		2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
Interest income	4(i)	1,005.8	997.0	1,005.8	997.0
Interest expense	4(ii)	(298.6)	(325.0)	(298.6)	(325.0)
Net interest income		707.2	672.0	707.2	672.0
Fee and commission income	4(iv)	205.0	195.9	205.0	195.9
Fee and commission expense	4(iv)	(61.2)	(62.7)	(61.4)	(62.7)
Net fee and commission income		143.8	133.2	143.6	133.2
Net trading income	4(v)	65.7	57.9	65.7	57.9
Net loss from financial instruments designated at fair value	4(vi)	(1.4)	(1.1)	(1.4)	(1.1)
Net gain from disposal of financial investments	4(vii)	5.7	14.7	5.7	14.7
Other operating income	4(iii)	110.1	90.4	110.1	90.4
Net other operating income		180.1	161.9	180.1	161.9
Operating income before loan impairment charges and other credit risk provisions		1,031.1	967.1	1,030.9	967.1
Loan impairment charges, recoveries and other credit risk provisions	5	(33.8)	(41.2)	(33.8)	(41.2)
Net operating income		997.3	925.9	997.1	925.9
Operating expenses					
staff costs	6	(293.7)	(266.4)	(293.7)	(266.4)
premises and equipment	6	(58.0)	(50.8)	(58.0)	(50.8)
administrative expenses	6	(138.8)	(116.2)	(138.8)	(116.2)
other expenses	6	(96.9)	(101.7)	(96.9)	(101.7)
Total operating expenses		(587.4)	(535.1)	(587.4)	(535.1)
Profit before income tax		409.9	390.8	409.7	390.8
Income tax expense	8	(121.6)	(121.3)	(121.6)	(121.3)
Profit for the year		288.3	269.5	288.1	269.5
Attributable to equity holders of the parent		288.3	269.5	288.1	269.5

The notes on pages 14 to 76 are an integral part of these consolidated financial statements.

Statements of Comprehensive Income

For the year ended 31 December 2017

	Consolidated		Company	
	2017	2016	2017	2016
	\$'m	\$'m	\$'m	\$'m
Profit for the year	288.3	269.5	288.1	269.5
Other comprehensive income				
Items that may be reclassified to Profit and Loss				
Available for sale investments				
Fair value gains/(losses) taken to equity	12.4	(7.0)	12.4	(7.0)
Net amount transferred to Income Statement	(5.1)	0.3	(5.1)	0.3
Deferred tax on items taken directly to or transferred from equity	(1.8)	2.4	(1.8)	2.4
Cash flow hedges				
Net amount transferred to Income Statement	7.1	6.5	7.1	6.5
Effective portion of changes in fair value	(2.2)	(3.6)	(2.2)	(3.6)
Deferred tax on items taken directly to or transferred from equity	(1.4)	(1.1)	(1.4)	(1.1)
Other comprehensive income taken to equity during the year	9.0	(2.5)	9.0	(2.5)
Total comprehensive income for the year	297.3	267.0	297.1	267.0
Attributable to equity holders of the parent	297.3	267.0	297.1	267.0

The notes on pages 14 to 76 are an integral part of these consolidated financial statements.

Statements of Financial Position

As at 31 December 2017

	Note	Consolidated		Company	
		2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
Assets					
Cash and balances at central banks		1,541.1	1,186.1	1,541.1	1,186.1
Items in the course of collection from other banks		2.4	0.5	2.4	0.5
Derivatives	10	79.3	169.3	79.3	169.3
Loans and advances to banks	27(b)	63.3	98.6	63.3	98.5
Loans and advances to customers	9	22,546.1	20,394.0	22,546.1	20,394.0
Financial investments	11	6,838.0	7,897.5	6,838.0	7,897.5
Receivables from related entities	32	552.3	586.2	552.2	586.2
Other assets	15	441.6	587.1	440.2	586.2
Property, plant and equipment	12	28.2	21.9	28.2	21.9
Net deferred tax assets	16(a)	91.0	98.0	91.0	98.0
Intangible assets	14	64.8	63.6	64.8	63.6
Total Assets		32,248.1	31,102.8	32,246.8	31,101.8
Liabilities					
Deposits by banks		318.7	333.8	318.7	333.8
Items in the course of transmission to other banks		23.1	32.0	23.1	32.0
Sale and repurchase agreements - non trading		1,198.0	998.0	1,198.0	998.0
Trading liabilities	17	3.3	14.9	3.3	14.9
Financial liabilities designated at fair value	17	43.6	43.0	43.6	43.0
Derivatives	10	72.6	107.1	72.6	107.2
Customer accounts - amortised cost		25,242.0	24,160.9	25,242.0	24,160.9
Debt securities on issue	19	346.5	-	346.5	-
Provisions for liabilities and charges	18	6.2	7.1	6.2	7.1
Payables to related entities	32	2,229.0	2,776.3	2,229.0	2,776.0
Other liabilities	20	443.7	456.9	442.2	455.8
Employee benefits	21	84.4	73.9	84.4	73.9
Total liabilities		30,011.1	29,003.9	30,009.6	29,002.6
Net assets		2,237.0	2,098.9	2,237.2	2,099.2
Equity					
Share capital	22	811.0	811.0	811.0	811.0
Reserves	23	253.9	247.1	253.9	247.1
Retained earnings		1,172.1	1,040.8	1,172.3	1,041.1
Total equity		2,237.0	2,098.9	2,237.2	2,099.2

The notes on pages 14 to 76 are an integral part of these consolidated financial statements.

Statements of Changes in Equity

For the year ended 31 December 2017 - Consolidated

\$'m	Share capital	Available for sale reserve	Cashflow hedging reserve	Capital contribution reserve	Other capital reserve	Retained profits	Total
Balance at 1 January 2017	811.0	(1.8)	(7.8)	6.7	250.0	1,040.8	2,098.9
Profit for the year	-	-	-	-	-	288.3	288.3
Other comprehensive income, net of income tax							
Cash flow hedges							
Effective portion of changes in fair value	-	-	(3.6)	-	-	-	(3.6)
Net amount transferred to Income Statement	-	-	7.1	-	-	-	7.1
Available for sale assets							
Net change in fair value	-	10.5	-	-	-	-	10.5
Net amount transferred to Income Statement	-	(5.0)	-	-	-	-	(5.0)
Total other comprehensive income	-	5.5	3.5	-	-	-	9.0
Total comprehensive income for year	-	5.5	3.5	-	-	288.3	297.3
Transactions with owners, recorded directly in equity							
Contributions by and distributions to owners							
Share based payments	-	-	-	(2.2)	-	0.5	(1.7)
Dividends to equity holders	-	-	-	-	-	(157.5)	(157.5)
Total contributions by and distributions to owners	-	-	-	(2.2)	-	(157.0)	(159.2)
Balance at 31 December 2017	811.0	3.7	(4.3)	4.5	250.0	1,172.1	2,237.0

The notes on pages 14 to 76 are an integral part of these consolidated financial statements.

Statements of Changes in Equity (continued)

For the year ended 31 December 2016 - Consolidated

\$'m	Share capital	Available for sale reserve	Cashflow hedging reserve	Capital contribution reserve	Other capital reserve	Retained profits	Total
Balance at 1 January 2016	811.0	2.5	(9.6)	6.4	-	901.5	1,711.8
Profit for the year	-	-	-	-	-	269.5	269.5
Other comprehensive income, net of income tax							
Cash flow hedges							
Effective portion of changes in fair value	-	-	(4.8)	-	-	-	(4.8)
Net amount transferred to Income Statement	-	-	6.6	-	-	-	6.6
Available for sale assets							
Net change in fair value	-	(4.7)	-	-	-	-	(4.7)
Net amount transferred to Income Statement	-	0.4	-	-	-	-	0.4
Total other comprehensive income	-	(4.3)	1.8	-	-	-	(2.5)
Total comprehensive income for year	-	(4.3)	1.8	-	-	269.5	267.0
Transactions with owners, recorded directly in equity							
Contributions by and distributions to owners							
Issuance of other equity instruments	-	-	-	-	250.0	-	250.0
Share based payments	-	-	-	0.3	-	(0.3)	-
Dividends to equity holders	-	-	-	-	-	(129.9)	(129.9)
Total contributions by and distributions to owners	-	-	-	0.3	250.0	(130.2)	120.1
Balance at 31 December 2016	811.0	(1.8)	(7.8)	6.7	250.0	1,040.8	2,098.9

The notes on pages 14 to 76 are an integral part of these consolidated financial statements.

Statements of Changes in Equity (continued)

For the year ended 31 December 2017 - Company

\$'m	Share capital	Available for sale reserve	Cashflow hedging reserve	Capital contribution reserve	Other capital reserve	Retained profits	Total
Balance at 1 January 2017	811.0	(1.8)	(7.8)	6.7	250.0	1,041.1	2,099.2
Profit for the year	-	-	-	-	-	288.1	288.1
Other comprehensive income, net of income tax							
Cash flow hedges							
Effective portion of changes in fair value	-	-	(3.6)	-	-	-	(3.6)
Net amount transferred to Income Statement	-	-	7.1	-	-	-	7.1
Available for sale assets	-	-	-	-	-	-	-
Net change in fair value	-	10.5	-	-	-	-	10.5
Net amount transferred to Income Statement	-	(5.0)	-	-	-	-	(5.0)
Total other comprehensive income	-	5.5	3.5	-	-	-	9.0
Total comprehensive income for year	-	5.5	3.5	-	-	288.1	297.1
Transactions with owners, recorded directly in equity							
Contributions by and distributions to owners							
Share based payments	-	-	-	(2.2)	-	0.6	(1.6)
Dividends to equity holders	-	-	-	-	-	(157.5)	(157.5)
Total contributions by and distributions to owners	-	-	-	(2.2)	-	(156.9)	(159.1)
Balance at 31 December 2017	811.0	3.7	(4.3)	4.5	250.0	1,172.3	2,237.2

The notes on pages 14 to 76 are an integral part of these consolidated financial statements.

Statements of Changes in Equity (continued)

For the year ended 31 December 2016 - Company

\$'m	Share capital	Available for sale reserve	Cashflow hedging reserve	Capital contribution reserve	Other capital reserve	Retained profits	Total
Balance at 1 January 2016	811.0	2.5	(9.6)	6.4	-	901.7	1,712.0
Profit for the year	-	-	-	-	-	269.5	269.5
Other comprehensive income, net of income tax							
Cash flow hedges							
Effective portion of changes in fair value	-	-	(4.8)	-	-	-	(4.8)
Net amount transferred to Income Statement	-	-	6.6	-	-	-	6.6
Available for sale assets	-						
Net change in fair value	-	(4.7)	-	-	-	-	(4.7)
Net amount transferred to Income Statement	-	0.4	-	-	-	-	0.4
Total other comprehensive income	-	(4.3)	1.8	-	-	-	(2.5)
Total comprehensive income for year	-	(4.3)	1.8	-	-	269.5	267.0
Transactions with owners, recorded directly in equity							
Contributions by and distributions to owners							
Issuance of other equity instruments	-	-	-	-	250.0	-	250.0
Share based payments	-	-	-	0.3	-	(0.2)	0.1
Dividends to equity holders	-	-	-	-	-	(129.9)	(129.9)
Total contributions by and distributions to owners	-	-	-	0.3	250.0	(130.1)	120.2
Balance at 31 December 2016	811.0	(1.8)	(7.8)	6.7	250.0	1,041.1	2,099.2

The notes on pages 14 to 76 are an integral part of these consolidated financial statements.

Statements of Cash Flows

For the year ended 31 December 2017

	Note	Consolidated		Company	
		2017	2016	2017	2016
		\$'m	\$'m	\$'m	\$'m
Cash Flows from Operating Activities					
Interest received		1,035.7	955.4	1,035.7	955.4
Interest paid		(298.5)	(332.1)	(298.5)	(332.1)
Other income received		309.6	278.9	309.8	278.9
Other expenses paid		(601.4)	(350.9)	(601.7)	((350.9))
Loans and bills advanced		(2,342.8)	(1,563.0)	(2,342.9)	(1,563.0)
Net increase/(decrease) in deposits, repo and other borrowings		732.3	166.4	732.5	166.4
Net (increase)/decrease in trading assets		55.5	(97.2)	55.4	(97.2)
Net increase/(decrease) in trading liabilities		(11.6)	(26.7)	(11.6)	(26.7)
Net (increase)/decrease from movements in other assets/liabilities		122.3	(220.6)	122.4	(220.6)
Income tax paid		(128.0)	(114.0)	(128.0)	(114.0)
Net cash used in operating activities	29	(1,126.9)	(1,303.8)	(1,126.9)	(1,303.8)
Cash Flows from Investing Activities					
Purchases of investment securities		(1,695.7)	(5,649.9)	(1,695.7)	(5,649.9)
Purchase of property, plant and equipment		(13.7)	(11.4)	(13.7)	(11.4)
Proceeds/(payments) for intangible assets		(2.8)	(1.9)	(2.8)	(1.9)
Proceeds on sale of investments		2,778.5	3,479.3	2,778.5	3,479.3
Net cash used in investing activities		1,066.3	(2,183.9)	1,066.3	(2,183.9)
Cash Flows from Financing Activities					
Net increase/(decrease) in debt securities on issue		347.1	(0.2)	347.1	(0.2)
Dividends paid		(157.5)	(129.9)	(157.5)	(129.9)
Tier 1 issuance		-	250.0	-	250.0
Net cash provided by financing activities		189.6	119.9	189.6	119.9
Net increase/(decrease) in cash and cash equivalents held		129.0	(3,367.8)	129.0	(3,367.8)
Cash and cash equivalents at the beginning of the year		1,595.4	4,963.2	1,595.4	4,963.2
Cash and cash equivalents at the end of the year	29	1,724.4	1,595.4	1,724.4	1,595.4

The notes on pages 14 to 76 are an integral part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

1. REPORTING ENTITY

HSBC Bank Australia Limited is a company domiciled in Australia. The consolidated financial report of the Company for the year ended 31 December 2017 comprises the Company and its subsidiaries (together referred to as the “consolidated entity”). References to “HSBC” or “the HSBC Group” within this document mean HSBC Holdings plc together with its subsidiaries. The consolidated entity operates as a profit entity.

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 9 February 2018.

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 28.

c) Functional and Presentational Currency

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

Rounding

The Company is of the kind referred to in an ASIC Legislative Instrument 2016/191, relating to the ‘rounding off’ of amounts in the financial statements. Amounts in the financial statements have been rounded, where appropriate, to the nearest tenth of a million dollars except where 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) 'Sale and Repurchase Agreements' and is discussed further within note 10 'Derivatives' and note 28 '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:

- 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;
- 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
- 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, prepayments and default rates. For interest rate derivatives with collateralised counterparties and in significant currencies, the Bank 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 Australian Accounting Standards Board (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 and details of these can be found in note 18.

Goodwill impairment

The review of goodwill for impairment reflects management's best estimate of the future cash flows of the Cash-generating unit (CGUs) and the rates used to discount these cash flows, both of which are subject to uncertain factors as follows:

- the future cash flows of the CGUs are sensitive to the cash flows projected for the periods for which detailed forecasts are available and to assumptions regarding the long-term pattern of sustainable cash flows thereafter. Forecasts are compared with actual performance and verifiable economic data, but they reflect management's view of future business prospects at the time of the assessment; and
- the rates used to discount future expected cash flows can have a significant effect on their valuation and are based on the costs of capital assigned to individual CGUs. These variables are subject to fluctuations in external market rates and economic conditions beyond management's control and are subject to uncertainty requiring the exercise of significant judgement.

The accuracy of forecast cash flows is subject to a high degree of uncertainty in volatile market conditions. In such circumstances, management retests goodwill for impairment more frequently than once a year when indicators of impairment exist to ensure that the assumptions on which the cash flow forecasts are based continue to reflect current market conditions and management's best estimate of future business prospects and these can be found in note 14.

e) Changes in Accounting Policies

There are no new standards adopted during 2017 that have a material impact on the financial statements.

f) Future Accounting Developments

At 31 December 2017, a number of standards and interpretations, and amendments thereto, had been issued by the AASB, which are not effective for the Bank's consolidated financial statements as at 31 December 2017. The Bank's assessment of the impact of these new standards and interpretations is set out below.

AASB 9 'Financial Instruments'

AASB 9 'Financial Instruments' (AASB 9) is the comprehensive standard to replace AASB 139 'Financial Instruments: Recognition and Measurement' (AASB 139), and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting. It is effective for annual periods beginning on or after 1 January 2018.

Classification and measurement

The classification and measurement of financial assets will depend on how these are managed (the entity's business model) and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income ('FVOCI') or fair value through profit or loss ('FVPL'). The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of financial assets measured at amortised cost or fair value compared with AASB 139. However, based on an assessment of financial assets performed to date and expectations around changes to balance sheet composition, the Bank expects that the overall impact of any change will not be significant.

Notes to the Consolidated Financial Statements

2. BASIS OF PREPARATION (continued)

f) Future Accounting Developments (continued)

Impairment

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, and lease receivables, and certain loan commitments and financial guarantee contracts. At initial recognition, an impairment 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, an allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL').

Financial assets where 12-month ECL is recognised are in 'stage 1'; financial assets that are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment, so are considered to be in default or otherwise credit impaired, are in 'stage 3'. The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted, and should incorporate all available information relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of 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 AASB 139, and the resulting impairment charge will tend to be more volatile. AASB 9 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 AASB 139.

Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks. However they do not explicitly address macro hedge accounting strategies, which are particularly important for banks. As a result, AASB 9 includes an accounting policy choice to remain with AASB 139 hedge accounting. Based on the analysis performed to date, the Bank expects to exercise the accounting policy choice to continue AASB 39 hedge accounting and therefore is not currently planning to change hedge accounting, although it will implement the revised hedge accounting disclosures required by the related amendments to AASB 7 'Financial Instruments: Disclosures'.

Transitional impact

With the exception of the provisions relating to the presentation of gains and losses on financial liabilities designated at fair value, which were adopted from 1 January 2017, the requirements of AASB 9 'Financial Instruments' will be adopted from 1 January 2018. AASB 9 includes an accounting policy choice to remain with or continue AASB 139 hedge accounting, which HSBC Australia has exercised, although it will implement the revised hedge accounting disclosures required by the related amendments to AASB 7 'Financial Instruments: Disclosures'. 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. HSBC Australia does not intend to restate comparatives. Adoption of AASB 9 is expected to reduce net assets at 1 January 2018 by \$45.8m, due to increased impairment, with an immaterial impact on net assets from a classification and measurement changes.

AASB 15 'Revenue from Contracts with Customers'

The AASB has issued AASB 15 'Revenue from Contracts with Customers' and it is effective for annual periods beginning on or after 1 January 2018. AASB 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for performance obligations as they are satisfied. HSBC Australia will adopt the standard on its mandatory effective date, and the standard will be applied on a modified retrospective basis, recognising the cumulative effect, if any, of initially applying the standard as an adjustment to the opening balance of retained earnings. HSBC Australia has assessed the impact of AASB 15 and expects that the standard will have no significant effect, when applied, on the consolidated financial statements of HSBC Australia.

Notes to the Consolidated Financial Statements

2. BASIS OF PREPARATION (continued)

f) Future Accounting Developments (continued)

AASB 16 'Leases'

The AASB has issued AASB 16 'Leases' with an effective date for annual periods beginning on or after 1 January 2019. AASB 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under AASB 117 'Leases'. Lessees will recognise a 'right of use' asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease, and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as under AASB 117. HSBC Australia is currently assessing the impact of AASB 16, and it is not practicable to quantify the effect at the date of the publication of these financial statements. Existing operating lease commitments are set out in note 24.

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

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.

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.

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 reporting 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 financial instruments, excluding 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. However, as an exception to this, interest on debt securities issued by the Bank that are designated under the fair value option and derivatives managed in conjunction with those debt securities are included in interest expense. Interest on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

d) Non Interest Income

Fee income

Fee income is earned from a diverse range of services provided by the Bank 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

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 an ineffective portion of qualifying hedges, are also included in 'Net trading income'.

Net income from financial instruments designated at fair value

Net income from financial instruments designated at fair value comprises all gains and losses from changes in the fair value of such financial assets and financial liabilities, together with interest income and expense and dividend income attributable to those financial instruments. 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 which was with those debt securities, which is recognised in 'Interest expense' note 4(ii).

Dividend income

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

e) Financial Instruments Measured at Amortised Cost

Loans and advances to banks and customers, held-to-maturity investments and most financial liabilities are measured at amortised cost.

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.

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, 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 Bank'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 Bank 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)

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

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 Bank has incurred as a result of events occurring before the balance sheet date, which the Bank 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 Bank, those loans are removed from the Bank 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 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 Bank 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 Bank 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.
- when the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, the Bank 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 reporting 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)

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.

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.

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.

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 Bank 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 Bank 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 Bank 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 23(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 reporting 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, recoveries and other credit risk provisions' in the Income Statement and impairment losses for available-for-sale equity securities are recognised within 'Net loss from financial instruments' 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

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 Bank 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 initially recognised at fair value. Fair value is the price that would be received to sell an asset or be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, if there is a difference between the transaction price and the fair value of financial instruments whose fair value is based on a quoted price in an active market or a valuation technique that uses only data from observable markets, the Bank recognises the difference as a trading gain or loss at inception ('day 1 gain or loss'). In all other cases, the entire day 1 gain or loss is deferred and recognised in the Income Statement over the life of the transaction until the transaction matures or is closed out, the valuation inputs become observable or the Bank enters into an offsetting transaction. The fair value of financial instruments is generally measured on an individual basis. However, in cases where the Bank manages a group of financial assets and liabilities according to its net market or credit risk exposure, the fair value of the group of financial instruments is measured on a net basis but the underlying financial assets and liabilities are presented separately in the financial statements, unless they satisfy the AASBs offsetting criteria.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value are measured in accordance with the Bank's valuation methodologies, which are described in Note 28.

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 'Advances 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

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 on 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 Bank classifies them as either:

- hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedges'); or
- hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ('cash flow hedges').

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)

l) Derivatives and Hedge Accounting (continued)

Fair value hedge

Changes in the fair value of derivatives are recorded in the Income Statement, along with changes in the fair value of the hedged assets or liabilities attributable to the hedged risk. If a hedge relationship no longer meets the criteria for hedge accounting, hedge accounting is discontinued; the cumulative adjustment to the carrying amount of the hedged item is amortised to the Income Statement on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised, in which case it is recognised in the Income Statement immediately.

Cash flow hedge

The effective portion of 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 Bank 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'.

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

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 have expired; or when the consolidated entity has transferred its contractual rights 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

Recognition and measurement

Items of property, plant and equipment are stated at cost less accumulated depreciation 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.

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.

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 'premises and equipment. 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 reporting 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

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

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

Defined contribution plans

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

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 reporting 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.

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 plc is the grantor of its equity instruments for all share awards and share options across the HSBC Group. The credit to 'Other reserves' over the vesting period on expensing an award represents the effective capital contribution from HSBC Holdings plc. To the extent the Bank 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

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)

t) Employee Benefits (continued)

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 Bank; 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 and Subordinated Liabilities

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

x) Cash and Cash Equivalents

For the purpose of the Statement of Cash Flows, cash and 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 and Other Capital Instruments

Shares and other financial instruments are classified as equity when the Bank 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. The additional tier 1 capital instruments are perpetual subordinated loans on which coupon payments may be cancelled at the sole discretion of the Bank. The subordinated loans will be written down at the point of non-viability on the occurrence of a trigger event as defined in the banking (capital) rules. They rank higher than ordinary shares in the event of a wind-up.

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
4. NET OPERATING INCOME					
(i) Interest income					
Loans and advances to banks		22.6	23.2	22.6	23.2
Loans and advances to customers		830.4	793.6	830.4	793.6
Financial investments		140.2	153.2	140.2	153.2
Related corporations		12.3	26.7	12.3	26.7
Key management personnel		0.3	0.3	0.3	0.3
		<u>1,005.8</u>	<u>997.0</u>	<u>1,005.8</u>	<u>997.0</u>
Included within various captions under interest income for the year ended 31 December 2017 is a total of \$2.1m, (2016:\$6.6m) accrued on impaired financial assets.					
(ii) Interest expense					
Deposits by banks		3.4	5.5	3.4	5.5
Customer accounts		237.1	266.7	237.1	266.7
Repurchase agreements		17.7	17.3	17.7	17.3
Debt securities on issue		3.2	-	3.2	-
Related corporations		37.2	35.5	37.2	35.5
Total interest expense		<u>298.6</u>	<u>325.0</u>	<u>298.6</u>	<u>325.0</u>
Total interest expense		300.1	327.4	300.1	327.4
Less					
Interest expense classified as 'Net trading income'	4(v)	(0.1)	(0.9)	(0.1)	(0.9)
Interest expense classified as 'Net income/(loss) on financial instruments designated at fair value'	4(vi)	(1.4)	(1.5)	(1.4)	(1.5)
		<u>298.6</u>	<u>325.0</u>	<u>298.6</u>	<u>325.0</u>
(iii) Other operating income					
Recharge to related corporations		108.5	90.7	108.5	90.7
Loss on disposal of fixed assets		(0.4)	(1.0)	(0.4)	(1.0)
Other income		2.0	0.7	2.0	0.7
		<u>110.1</u>	<u>90.4</u>	<u>110.1</u>	<u>90.4</u>

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
4. NET OPERATING INCOME (continued)					
(iv) Fee and commission income					
Fees and commissions		182.2	178.2	182.2	178.2
Fee income on fiduciary activities		22.8	17.7	22.8	17.7
		<u>205.0</u>	<u>195.9</u>	<u>205.0</u>	<u>195.9</u>
Fee and commission expense					
Fees and commissions		58.5	56.7	58.7	56.7
Fees payable on fiduciary activities		2.7	6.0	2.7	6.0
		<u>61.2</u>	<u>62.7</u>	<u>61.4</u>	<u>62.7</u>
(v) Net trading income					
Trading income					
Exchange rates		64.9	59.2	64.9	59.2
Interest rates		0.2	(1.1)	0.2	(1.1)
		<u>65.1</u>	<u>58.1</u>	<u>65.1</u>	<u>58.1</u>
Gains/(losses) from hedging activities					
Fair value hedges					
Net gain/ on hedged items attributable to the hedged risk		1.7	13.3	1.7	13.3
Net gain/(loss) on hedging instruments		(1.0)	(12.6)	(1.0)	(12.6)
		<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>
Net interest income on trading activities					
Interest expense	4(ii)	(0.1)	(0.9)	(0.1)	(0.9)
		<u>(0.1)</u>	<u>(0.9)</u>	<u>(0.1)</u>	<u>(0.9)</u>
		<u>65.7</u>	<u>57.9</u>	<u>65.7</u>	<u>57.9</u>
(vi) Net loss from financial instruments designated at fair value					
Change in fair value of financial instruments designated at fair value		-	0.4	-	0.4
		<u>-</u>	<u>0.4</u>	<u>-</u>	<u>0.4</u>
Net interest income on financial instruments designated at fair value					
Interest expense	4(ii)	(1.4)	(1.5)	(1.4)	(1.5)
		<u>(1.4)</u>	<u>(1.5)</u>	<u>(1.4)</u>	<u>(1.5)</u>
Total net loss from financial instruments designated at fair value		<u>(1.4)</u>	<u>(1.1)</u>	<u>(1.4)</u>	<u>(1.1)</u>

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
4. NET OPERATING INCOME (continued)					
(vii) Net gain from disposal of financial investments					
Net gain from disposal of financial investments		5.7	14.7	5.7	14.7
		<u>5.7</u>	<u>14.7</u>	<u>5.7</u>	<u>14.7</u>
5. LOAN IMPAIRMENT CHARGES, RECOVERIES AND OTHER CREDIT RISK PROVISIONS					
Loan impairment charges					
New allowances		59.9	80.8	59.9	80.8
Reversal of allowances no longer required		(17.2)	(21.7)	(17.2)	(21.7)
Recoveries of amounts previously written off		(8.9)	(17.9)	(8.9)	(17.9)
		<u>33.8</u>	<u>41.2</u>	<u>33.8</u>	<u>41.2</u>
Individually assessed allowances charged		7.6	11.4	7.6	11.4
Collectively assessed allowances charged		26.2	29.8	26.2	29.8
Total loan impairment charges and other credit risk provisions		<u>33.8</u>	<u>41.2</u>	<u>33.8</u>	<u>41.2</u>
6. OPERATING EXPENSES					
Staff costs					
Wages and salaries		190.3	178.6	190.3	178.6
Bonuses		52.1	42.9	52.1	42.9
Retirement and termination benefits		21.2	17.7	21.2	17.7
Share-based payment transactions	32	4.4	3.7	4.4	3.7
Other		25.7	23.5	25.7	23.5
		<u>293.7</u>	<u>266.4</u>	<u>293.7</u>	<u>266.4</u>

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
6. OPERATING EXPENSES (continued)					
Premises and equipment					
Property rental		40.6	34.2	40.6	34.2
Equipment & other premise expense		12.2	11.8	12.2	11.8
Depreciation		5.4	5.5	5.4	5.5
Premise related provision		(0.2)	(0.7)	(0.2)	(0.7)
		<u>58.0</u>	<u>50.8</u>	<u>58.0</u>	<u>50.8</u>
Administrative expenses					
Marketing and communication		40.2	38.5	40.2	38.5
Legal and professional expenses		13.4	13.3	13.4	13.3
Printing and communication costs		14.6	12.7	14.6	12.7
Travel and entertainment		7.8	6.0	7.8	6.0
Auditor's remuneration		1.6	1.5	1.6	1.5
Fraud and operational losses		11.7	6.1	11.7	6.1
Contracted services and insurance		25.6	17.0	25.6	17.0
Other		23.8	25.2	23.8	25.2
		<u>138.7</u>	<u>120.3</u>	<u>138.7</u>	<u>120.3</u>
Other expenses					
Intercompany management fees	32	95.3	100.5	95.3	100.5
Amortisation of intangibles		1.6	1.2	1.6	1.2
		<u>96.9</u>	<u>101.7</u>	<u>96.9</u>	<u>101.7</u>
7. AUDITOR'S REMUNERATION		\$	\$	\$	\$
Auditor of the consolidated entity					
Audit services					
Audit and review of financial reports		916,139	817,580	916,139	817,580
Other assurance services					
Regulatory and other audit services		654,142	618,543	654,142	618,543
Other services					
Taxation services		-	14,000	-	14,000
		<u>1,570,281</u>	<u>1,450,123</u>	<u>1,570,281</u>	<u>1,450,123</u>

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
8. INCOME TAX EXPENSE					
Recognised in the Income Statement					
(a) Current tax expense					
Current year		(122.5)	(117.8)	(122.5)	(117.8)
Adjustments for prior years		5.2	(0.9)	5.2	(0.9)
		<u>(117.3)</u>	<u>(118.7)</u>	<u>(117.3)</u>	<u>(118.7)</u>
Deferred tax expense					
Origination and reversal of temporary differences		(0.1)	(3.6)	(0.1)	(3.6)
Adjustments for prior years		(4.2)	1.0	(4.2)	1.0
	16(b)	<u>(4.3)</u>	<u>(2.6)</u>	<u>(4.3)</u>	<u>(2.6)</u>
Total income tax expense in Income Statement		<u>(121.6)</u>	<u>(121.3)</u>	<u>(121.6)</u>	<u>(121.3)</u>
Attributable to Continuing operations		<u>(121.6)</u>	<u>(121.3)</u>	<u>(121.6)</u>	<u>(121.3)</u>
Numerical reconciliation between tax expense and pre-tax net profit					
Profit before income tax		<u>409.9</u>	<u>390.8</u>	<u>409.7</u>	<u>390.8</u>
Income tax using the domestic corporation tax rate of 30%		(122.9)	(117.2)	(122.9)	(117.2)
(Increase) / decrease in income tax expense due to:					
Non-deductible expenses		(0.9)	(4.2)	(0.9)	(4.2)
Other		1.2	-	1.2	-
		<u>(122.6)</u>	<u>(121.4)</u>	<u>(122.6)</u>	<u>(121.4)</u>
(Under) / over provided in prior years		1.0	0.1	1.0	0.1
Income tax expense on pre-tax net profit		<u>(121.6)</u>	<u>(121.3)</u>	<u>(121.6)</u>	<u>(121.3)</u>
(b) Deferred tax recognised directly in equity					
Relating to capital contribution reserve		0.5	(0.1)	0.5	(0.1)
Relating to available for sale and cash flow hedging reserves		(3.2)	1.3	(3.2)	1.3
	16(b)	<u>(2.7)</u>	<u>1.2</u>	<u>(2.7)</u>	<u>1.2</u>

Notes to the Consolidated Financial Statements

	Consolidated		Company	
	2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
9. LOANS AND ADVANCES TO CUSTOMERS AND IMPAIRMENT ALLOWANCES				
Gross amount of loans not individually impaired	22,438.9	20,288.2	22,438.9	20,288.2
Allowance for collective impairment	(29.2)	(35.4)	(29.2)	(35.4)
Carrying amount	22,409.7	20,252.8	22,409.7	20,252.8
Gross amount of impaired loans	209.8	221.7	209.8	221.7
Allowance for individual impairment	(64.9)	(71.1)	(64.9)	(71.1)
Allowance for collective impairment	(8.5)	(9.4)	(8.5)	(9.4)
Carrying amount	136.4	141.2	136.4	141.2
Total loans	22,546.1	20,394.0	22,546.1	20,394.0

Movements in Impairment Allowances

Allowance for individual impairment

Balance as at 1 January	71.1	97.4	71.1	97.4
Impairment charge for the year	7.6	11.4	7.6	11.4
Write off	(13.8)	(37.7)	(13.8)	(37.7)
Balance as at 31 December	64.9	71.1	64.9	71.0

Allowance for collective impairment

Balance as at 1 January	44.8	36.2	44.8	36.2
Impairment charge for the year	26.2	29.8	26.2	29.8
Write off	(33.3)	(21.2)	(33.3)	(21.2)
Balance as at 31 December	37.7	44.8	37.7	44.8

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 28.

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).

Notes to the Consolidated Financial Statements

10. DERIVATIVES (continued)

Use of derivatives

The consolidated entity transacts derivatives for two primary purposes: to create risk management solutions for clients; 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.

Derivatives 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. 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.

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 not expected to affect the Income Statement in 2018 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 reporting 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	
	2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
Assets				
Trading derivatives				
Third party				
Exchange rate	28.3	27.3	28.3	27.3
Interest rate	0.8	4.6	0.8	4.6
	29.1	31.9	29.1	31.9
Related entities				
Exchange rate	36.0	123.4	36.0	123.4
Interest rate	-	0.7	-	0.7
Equity	-	1.0	-	1.0
	36.0	125.1	36.0	125.1
Hedging derivatives				
Related entities				
Interest rate	11.2	9.3	11.2	9.3
	11.2	9.3	11.2	9.3
Derivatives matching fair value designated instruments				
Related entities				
Interest rate	3.0	3.0	3.0	3.0
	3.0	3.0	3.0	3.0
	79.3	169.3	79.3	169.3
Liabilities				
Trading derivatives				
Third party				
Exchange rate	23.0	32.2	23.0	32.3
Interest rate	0.1	2.5	0.1	2.5
	23.1	34.7	23.1	34.8
Related entities				
Exchange rate	30.3	39.1	30.3	39.1
Interest rate	0.8	2.7	0.8	2.7
	31.1	41.8	31.1	41.8
Hedging derivatives				
Related entities				
Interest rate	18.4	30.6	18.4	30.6
	18.4	30.6	18.4	30.6
	72.6	107.1	72.6	107.2

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 2017 were assets of \$10.1m (2016:\$8.0m) and liabilities of \$12.3m (2016:\$16.8m).

	Consolidated		Company	
	2017	2016	2017	2016
	\$'m	\$'m	\$'m	\$'m
Gains or losses arising from fair value hedges				
Gains / (losses)				
on hedging instruments	1.7	13.3	1.7	13.3
on the hedged items attributable to the hedged risk	(1.0)	(12.6)	(1.0)	(12.6)
	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>	<u>0.7</u>

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 2017, the fair values of outstanding derivatives designated as cash flow hedges were assets of \$1.1m (2016:\$1.3m) and liabilities of \$6.1m (2016:\$13.8m).

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 2017 is as follows:

	3 months or less \$'m	More than 3 months but less than 1 year \$'m	5 years or less but more than 1 year \$'m
Consolidated and Company			
At 31 December 2017			
Cash inflows exposures	600.0	100.0	100.0
Cash outflows exposures	(639.1)	(626.0)	(626.0)
Net cash inflows/(outflows)	(39.1)	(526.0)	(526.0)
At 31 December 2016			
Cash inflows exposures	600.0	600.0	100.0
Cash outflows exposures	(714.1)	(714.1)	(601.0)
Net cash inflows/(outflows)	(114.1)	(114.1)	(501.0)

	Note	Consolidated		Company	
		2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
11. FINANCIAL INVESTMENTS					
Available-for-sale securities at fair value					
Debt securities		5,827.1	7,490.4	5,827.1	7,490.4
Equities		4.0	2.8	4.0	2.8
Treasury and other eligible bills		1,006.9	404.3	1,006.9	404.3
		<u>6,838.0</u>	<u>7,897.5</u>	<u>6,838.0</u>	<u>7,897.5</u>
Analysis of available-for-sale securities by issuer					
Government securities and Australian Government agencies		5,161.7	5,511.1	5,161.7	5,511.1
Banks and Building Societies		1,676.3	2,386.4	1,676.3	2,386.4
		<u>6,838.0</u>	<u>7,897.5</u>	<u>6,838.0</u>	<u>7,897.5</u>

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
12. PROPERTY, PLANT AND EQUIPMENT					
Leasehold improvements at cost					
Balance at 1 January		61.5	63.2	61.5	63.2
Assets acquired		13.7	11.4	13.7	11.4
Assets disposed		(2.4)	(13.1)	(2.4)	(13.1)
Balance at 31 December		72.8	61.5	72.8	61.5
Furniture, fittings, office equipment at cost					
Balance at 1 January		30.8	58.5	30.8	58.5
Assets acquired		4.4	7.0	4.4	7.0
Assets disposed		(17.9)	(34.7)	(17.9)	(34.7)
Balance at 31 December		17.3	30.8	17.3	30.8
Leasehold improvements accumulated depreciation					
Balance at 1 January		(48.4)	(57.5)	(48.4)	(57.5)
Depreciation charge for the year		(2.9)	(3.1)	(2.9)	(3.1)
Disposals		2.4	12.2	2.4	12.2
Balance at 31 December		(48.9)	(48.4)	(48.9)	(48.4)
Furniture, fittings, office equipment accumulated depreciation					
Balance at 1 January		(22.0)	(54.3)	(22.0)	(54.3)
Depreciation charge for the year		(2.5)	(2.3)	(2.5)	(2.3)
Disposals		11.5	34.6	11.5	34.6
Balance at 31 December		(13.0)	(22.0)	(13.0)	(22.0)
Carrying amounts					
At 1 January		21.9	9.9	21.9	9.9
At 31 December		28.2	21.9	28.2	21.9

13. GROUP ENTITIES

Name of Entity	Note	2017 %	2016 %	Place of incorporation
Controlling Entity				
HSBC Bank Australia Limited		-	-	Australia
Controlled entities				
HSBC Custody Nominees (Australia) Limited		100	100	Australia
Lion Series 2009-1 Trust	(1)	-	-	Australia
ACN 087 652 113 Pty Limited		100	100	Australia
Midland Australia Pty Limited (<i>Deregistered in 2017</i>)		-	100	Australia

The Company established the Lion 2009-1 Trust in July 2009 to enable the creation of notes eligible for sale and repurchase 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	
		2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
14. INTANGIBLE ASSETS					
Goodwill					
Cost and carrying amount					
Balance at 1 January		58.7	58.7	58.7	58.7
Balance at 31 December		58.7	58.7	58.7	58.7
Internally generated software					
Cost					
Balance at 1 January		14.9	13.0	14.9	13.0
Addition		2.8	1.9	2.8	1.9
Balance at 31 December		17.7	14.9	17.7	14.9
Accumulated amortisation					
Balance at 1 January		(10.0)	(8.8)	(10.0)	(8.8)
Amortisation charge for the year		(1.6)	(1.2)	(1.6)	(1.2)
Balance at 31 December		(11.6)	(10.0)	(11.6)	(10.0)
Carrying amounts					
At 1 January		4.9	4.2	4.9	4.2
At 31 December		6.1	4.9	6.1	4.9
Total intangible assets		64.8	63.6	64.8	63.6

Segment allocation of Goodwill

In accordance with Australian Accounting Standard AASB138 'Intangible Assets', the consolidated entity's carrying amount of goodwill as at 31 December 2017 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.

Retail Banking and Wealth Management

Goodwill allocated to Retail Banking and Wealth Management arose from the company's acquisition in 2001 of NRMA Building Society Group Limited. The Retail Banking and Wealth Management units' impairment test is based on value in use calculations (VIU).

The VIU is calculated by discounting management's cash flow projections for the cash generating unit (CGU). The cash flow projections are based on the Board approved 5 year plan with cash flows in perpetuity extrapolated using a long term growth rate because of the long-term perspective within the Bank. The long-term growth rate of 2.7% reflects nominal GDP and inflation and is based on a 10 year historical average.

The discount rate of 7.2% is based on the cost of capital the HSBC Group allocates to investments in the countries within which the CGU operates.

The forecasts applied by management are not reliant on any one particular assumption and there are no reasonably possible changes in assumptions for that would result in an indication of impairment.

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 an acquisition from State Street generated a net profit after tax during the year ended 31 December 2017 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	
		2017	2016	2017	2016
		\$'m	\$'m	\$'m	\$'m
15. OTHER ASSETS					
Acceptances and endorsements		241.2	245.6	241.1	245.6
Prepayments and accrued income		126.5	147.8	125.2	146.9
Margins with exchange		45.5	139.7	45.5	139.7
Other assets		27.6	51.3	27.6	51.3
Assets held for resale		0.8	2.7	0.8	2.7
		<u>441.6</u>	<u>587.1</u>	<u>440.2</u>	<u>586.2</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

Both the Bank and the consolidated entity have no current tax assets or liabilities. In accordance with the tax consolidated legislation the immediate parent entity, HSBC Australia Holding Pty Limited as head entity of the consolidated Group for tax purposes 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	
	2017	2016	2017	2016	2017	2016
	\$'m	\$'m	\$'m	\$'m	\$'m	\$'m
Impairment allowances	30.7	34.9	(0.6)	-	30.1	34.9
Tangible fixed assets	15.4	16.3	-	-	15.4	16.3
Prepayments and accrued income	-	-	(0.9)	(0.7)	(0.9)	(0.7)
Other liabilities/ accrued expenses	31.4	29.6	(0.2)	(0.3)	31.2	29.3
Accruals and deferred income	12.2	12.3	-	-	12.2	12.3
Provision for liabilities and charges	1.9	2.1	-	-	1.9	2.1
Retained earnings	0.4	-	-	(0.1)	0.4	(0.1)
Cash flow hedging reserve	1.8	3.1	-	-	1.8	3.1
Available for sale securities reserve	-	0.8	(1.1)	-	(1.1)	0.8
Total tax assets/(liabilities)	93.8	99.1	(2.8)	(1.1)	91.0	98.0

b) Movement in temporary differences during the current year:

Consolidated and Company	Balance	Recognised in	Recognised in	Balance
	1 Jan 17	Income	Equity	31 Dec 17
	\$'m	\$'m	\$'m	\$'m
Impairment allowances	34.9	(4.8)	-	30.1
Tangible fixed assets	16.3	(0.9)	-	15.4
Prepayments and accrued income	(0.7)	(0.2)	-	(0.9)
Other liabilities/accrued expenses	29.3	1.9	-	31.2
Accruals and deferred income	12.3	(0.1)	-	12.2
Provision for liabilities and charges	2.1	(0.2)	-	1.9
Retained earnings	(0.1)	-	0.5	0.4
Cash flow hedging reserve	3.1	-	(1.3)	1.8
Available for sale securities reserve	0.8	-	(1.9)	(1.1)
	98.0	(4.3)	(2.7)	91.0

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 16	Income	Equity	31 Dec 16
	\$'m	\$'m	\$'m	\$'m
Impairment allowances	40.9	(6.0)	-	34.9
Tangible fixed assets	17.7	(1.4)	-	16.3
Prepayments and accrued income	(0.5)	(0.2)	-	(0.7)
Other liabilities/accrued expenses	28.5	0.8	-	29.3
Accruals and deferred income	8.8	3.5	-	12.3
Provision for liabilities and charges	1.4	0.7	-	2.1
Retained earnings	-	-	(0.1)	(0.1)
Cash flow hedging reserve	4.2	-	(1.1)	3.1
Available for sale securities reserve	(1.6)	-	2.4	0.8
	99.4	(2.6)	1.2	98.0

Note	Consolidated		Company	
	2017	2016	2017	2016
	\$'m	\$'m	\$'m	\$'m

17. TRADING LIABILITIES AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE

Trading liabilities

Customer accounts	3.3	14.9	3.3	14.9
	3.3	14.9	3.3	14.9

Financial liabilities designated at fair value

Debt securities on issue	43.6	43.0	43.6	43.0
	43.6	43.0	43.6	43.0

Notes to the Consolidated Financial Statements

Note	Consolidated		Company	
	2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m

18. PROVISIONS FOR LIABILITIES AND CHARGES

Balance at 1 January	7.1	4.7	7.1	4.7
New provisions	9.5	6.1	9.5	6.1
Release of provision	(1.6)	(1.8)	(1.6)	(1.8)
Provisions utilised	(8.7)	(1.9)	(8.7)	(1.9)
Balance at 31 December	6.2	7.1	6.2	7.1

Included within the amounts above is a provision which relates to certain compliance and customer remediation programs of the Bank. The Bank has provided for the cost of running these programs, together with anticipated remediation costs. Where probable, key assumptions in determining the remediation and program cost provisions include expected remediation rates and amounts and case complexity. These have been developed considering historical evidence, current information available and the exercise of judgement. The Bank considers that provisions held are adequate and represent our best estimate of the anticipated future costs.

19. DEBT SECURITIES ON ISSUE

Certificate of deposit	246.5	-	246.5	-
Bonds and medium-term notes	100.0	-	100.0	-
	346.5	-	346.5	-

20. OTHER LIABILITIES

Acceptances and endorsements	241.2	245.6	241.1	245.6
Accruals and deferred income	71.7	71.8	70.3	70.7
Settlement balances	92.2	98.7	92.2	98.7
Other liabilities	38.6	40.8	38.6	40.8
	443.7	456.9	442.2	455.8

21. EMPLOYEE BENEFITS

Liability for annual leave	13.8	12.5	13.8	12.5
Bonus payable	49.7	41.8	49.7	41.8
Liability for long service leave	20.9	19.6	20.9	19.6
Total employee benefits	84.4	73.9	84.4	73.9

Notes to the Consolidated Financial Statements

21. EMPLOYEE BENEFITS (continued)

Defined contribution plans

The Company and the consolidated entity makes contributions to the staff superannuation scheme; a defined contribution plan. The amount recognised as an expense was \$17.1m for the year ended 31 December 2017 (2016:\$15.9m).

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 and Sharematch are voluntary savings related share option plans for all eligible employees.

During 2017, \$4.4m (2016:\$3.7m) 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	
		2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m

22. CAPITAL

Issued Capital

685,250,305 Ordinary shares fully paid	811.0	811.0	811.0	811.0
	811.0	811.0	811.0	811.0

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.

Notes to the Consolidated Financial Statements

23. RESERVES AND DIVIDENDS

(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 been realised.

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.

Other capital reserve

This reserve represents the issuance of AUD250m of Tier 1 capital instruments. The Tier 1 capital instruments are perpetual subordinated loans on which coupon payments may be cancelled at the sole discretion of the Bank. The subordinated loans will be written down at the point of non-viability on the occurrence of a trigger event as defined by the Australian Prudential Regulation Authority (APRA) or the Hong Kong Monetary Authority (HKMA). They rank higher than ordinary shares in the event of a wind-up.

(b) Dividends

Dividends to shareholders of the parent company amounted to \$157.5m in 2017 (2016:\$129.9m).

	Company 2017		Company 2016	
	\$ per Share	Total \$'m	\$ per share	Total \$'m
<i>Ordinary shares</i>				
Dividend 1	0.076	52.4	0.028	19.3
Dividend 2	0.039	27.0	0.043	29.5
Dividend 3	0.052	35.3	0.050	34.0
Dividend 4	0.037	25.5	0.069	47.1
		140.2		129.9
<i>Tier 1 instruments</i>				
Dividend 1	-	8.7	-	-
Dividend 2	-	8.6	-	-
		17.3		-
Total		157.5		129.9

Notes to the Consolidated Financial Statements

	Consolidated		Company	
	2017	2016	2017	2016
	\$'m	\$'m	\$'m	\$'m
24. COMMITMENTS				
<i>Lease commitments</i>				
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	33.8	24.4	33.8	24.4
Payable between 1 and 5 years	108.5	73.3	108.5	73.3
Payable over 5 years	110.3	65.5	110.3	65.5
	<u>252.6</u>	<u>163.2</u>	<u>252.6</u>	<u>163.2</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.

Other commitments

Documentary credits and trade related transactions	288.9	752.6	288.9	752.6
Undrawn lending facilities	11,458.5	10,431.6	11,458.5	10,431.6
	<u>11,747.4</u>	<u>11,184.2</u>	<u>11,747.4</u>	<u>11,184.2</u>

25. CONTINGENT LIABILITIES

Contingent liabilities in respect of guarantees given	<u>1,131.3</u>	<u>1,279.0</u>	<u>1,131.3</u>	<u>1,279.0</u>
Letters of credit and other contingencies	<u>1,628.3</u>	<u>1,750.3</u>	<u>1,628.3</u>	<u>1,750.3</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.

26. FIDUCIARY ACTIVITIES

Funds under custody	<u>395,561.2</u>	<u>290,974.0</u>	<u>395,561.2</u>	<u>290,974.0</u>
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The Bank provides custody and clearing services to global custodians, fund managers and broker dealers.

Notes to the Consolidated Financial Statements

27. 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 formulates high-level risk management policies for the HSBC Group worldwide. The HSBC 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 Risk Committee ("RC") is mandated by the Board to oversee the management of risk within the Bank and of the Bank's risk appetite and future risk strategy, including capital and liquidity management strategy. The executive Risk Management Meeting ("RMM") 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.

(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 is undertaken by reducing existing client exposures and restricting new client exposures; and

Notes to the Consolidated Financial Statements

27. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Credit Risk Disclosures (continued)

- 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 RMM receive regular reports on credit exposures. These include information on large credit exposures, concentrations, industry exposures, levels of impairment provisioning and country exposures.

RMM 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 RMM are supported by a dedicated risk function headed by the Chief Risk Officer, who is a member of both EXCO and RMM and at an entity level reports to the Chief Executive Officer.

The RC has responsibility for oversight and advice to the Board on risk related matters. The key responsibilities of the RC in this regard include providing 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 Chief Risk Officer.

Notes to the Consolidated Financial Statements

27. 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, placings with 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	
	2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
Cash and balances at central banks	1,541.1	1,186.1	1,541.1	1,186.1
Items in course of collection from other banks	2.4	0.5	2.4	0.5
Derivatives	79.3	169.3	79.3	169.3
Loans and advances to banks	63.3	98.5	63.3	98.5
Loans and advances to customers	22,546.1	20,394.0	22,546.1	20,394.0
Financial investments				
Debt securities	5,827.1	7,490.4	5,827.1	7,490.4
Equities	4.0	2.8	4.0	2.8
Treasury and other eligible bills	1,006.9	404.3	1,006.9	404.3
Total financial investments	6,838.0	7,897.5	6,838.0	7,897.5
Other assets				
Acceptances and endorsements	241.2	245.6	241.2	245.6
Receivables from related parties	552.3	586.2	552.3	586.2
Accrued income	115.9	141.2	115.9	141.2
Other	84.5	200.3	84.5	200.3
Total other assets	993.8	1,173.3	993.8	1,173.3
Financial guarantees and contingent liabilities	10.2	16.5	10.2	16.5
Loan commitments and other credit related commitments	11,747.4	11,184.2	11,747.4	11,184.2
At 31 December	43,821.6	42,112.0	43,821.6	42,119.9

Notes to the Consolidated Financial Statements

27. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Credit Risk Disclosures (continued)

Credit quality of loans and advances

Five broad classifications describe 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	Expected loss %
Strong	A- and above	CRR1 to CRR2	0 – 0.169	EL1 to EL2	0 – 0.999
Good	BBB+ to BBB-	CRR3	0.170 – 0.740	EL3	1.000 – 4.999
Satisfactory	BB+ to B, and unrated	CRR4 to CRR5	0.741 – 4.914	EL4 to EL5	5.000 – 19.999
Sub-standard	B- to C	CRR6 to CRR8	4.915 – 99.999	EL6 to EL8	20.000 – 99.999
Impaired	Default	CRR9 to CRR10	100	EL9 to EL10	100+ or defaulted

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; and
- **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 HSBC 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 HSBC 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

27. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Credit Risk Disclosures (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 3.6% (2016:3.5%) 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 2017 was \$118.6m (2016:\$115.3m).

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 Bank'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

27. 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 Impaired \$'m	Impaired \$'m	Total \$'m
	Strong \$'m	Good \$'m	Satisfactory \$'m	Sub - Standard \$'m			
At 31 December 2017							
Cash and balances at central banks	1,541.1	-	-	-	-	-	1,541.1
Items in the course of collection from other banks	2.4	-	-	-	-	-	2.4
Derivatives	52.8	11.6	14.9	-	-	-	79.3
Loans and advances held at amortised cost - gross							
loans and advances to banks	63.1	0.2	-	-	-	-	63.3
loans and advances to customers	17,214.5	3,474.4	1,430.8	14.4	304.8	209.8	22,648.7
	<u>17,277.6</u>	<u>3,474.6</u>	<u>1,430.8</u>	<u>14.4</u>	<u>304.8</u>	<u>209.8</u>	<u>22,712.0</u>
Financial investments							
equities	4.0	-	-	-	-	-	4.0
treasury and other eligible bills	1,006.9	-	-	-	-	-	1,006.9
debt securities	5,827.1	-	-	-	-	-	5,827.1
	<u>6,838.0</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,838.0</u>
Other assets							
endorsements and acceptances	-	232.4	8.8	-	-	-	241.2
receivables from related parties	552.3	-	-	-	-	-	552.3
other	88.8	28.0	83.5	0.1	-	-	200.4
	<u>641.1</u>	<u>260.4</u>	<u>92.3</u>	<u>0.1</u>	<u>-</u>	<u>-</u>	<u>993.9</u>
Total	<u>26,353.0</u>	<u>3,746.6</u>	<u>1,538.0</u>	<u>14.5</u>	<u>304.8</u>	<u>209.8</u>	<u>32,166.7</u>

Notes to the Consolidated Financial Statements

27. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued) (b) Credit Risk Disclosures (continued)

	Neither Past Due Nor Impaired				Past due but not	Impaired	Total
	Strong	Good	Satisfactory	Sub - Standard	Impaired		
	\$'m	\$'m	\$m	\$'m	\$'m	\$'m	\$'m
At 31 December 2016							
Cash and balances at central banks	1,186.1	-	-	-	-	-	1,186.1
Items in the course of collection from other banks	0.5	-	-	-	-	-	0.5
Derivatives	146.6	9.2	13.5	-	-	-	169.3
Loans and advances held at amortised cost - gross							
loans and advances to banks	98.6	-	-	-	-	-	98.6
loans and advances to customers	14,973.3	3,675.8	1,185.1	105.9	348.1	221.7	20,509.9
	15,071.8	3,675.8	1,185.1	105.9	348.1	221.7	20,608.4
Financial investments							
treasury and other eligible bills	404.2	-	-	-	-	-	404.2
debt securities	7,490.4	-	-	-	-	-	7,490.4
	7,894.6	-	-	-	-	-	7,894.6
Other assets							
endorsements and acceptances	-	236.9	8.7	-	-	-	245.6
receivables from related parties	586.2	-	-	-	-	-	586.2
other	213.6	24.4	103.5	-	-	-	341.6
	799.8	261.3	112.2	-	-	-	1,173.4
Total	25,099.5	3,946.3	1,310.8	105.9	348.1	221.7	31,032.3

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	30-59 days	60-89 days	90-180 days	Over 180 days	Total
	\$'m	\$'m	\$'m	\$'m	\$'m	\$'m
At 31 December 2017						
Loans and advances held at amortised cost						
loans and advances to customers	261.1	32.0	11.7	-	-	304.8
	261.1	32.0	11.7	-	-	304.8
At 31 December 2016						
Loans and advances held at amortised cost						
loans and advances to customers	294.4	41.7	12.1	-	-	348.1
	294.4	41.7	12.1	-	-	348.1

Notes to the Consolidated Financial Statements

27. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Credit Risk Disclosures (continued)

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)

	2017 \$'m	2016 \$'m
Class of Asset		
Personal		
Mortgages	15,911.9	14,024.8
Other personal lending	1,071.1	1,047.7
Corporate and commercial		
Manufacturing	1,016.9	1,206.4
International trade and services	2,094.8	1,874.2
Commercial real estate and construction	1,157.1	1,199.4
Other commercial	1,120.6	1,015.4
Financial (non-bank financial institutions)	276.2	142.0
Total gross credit risks	22,648.7	20,509.9

Notes to the Consolidated Financial Statements

27. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(b) Credit Risk Disclosures (continued)

Renegotiated loans

Renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet its contractual payment obligations in full are classified as impaired, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment. For loans that are assessed for impairment on a collective basis, the evidence to support reclassification as no longer impaired typically comprises a history of payment performance against the original or revised terms, depending on the nature and volume of renegotiation and the credit risk characteristics surrounding the renegotiation. For loans that are assessed for impairment on an individual basis all available evidence is assessed on a case by case basis. The value of renegotiated loans in 2017 was \$44.4m (2016:\$48.9m).

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:

	Carrying amount outstanding	
	2017	2016
	\$'m	\$'m
Nature of Assets		
Residential property	0.8	2.7
	0.8	2.7

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. The Bank does not generally occupy repossessed properties for its business use.

(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 / or 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 a portfolio of highly liquid assets diversified by maturity which are held to enable the Bank to respond quickly and smoothly to unforeseen liquidity requirements.

The Board is ultimately responsible for determining the types and magnitude of liquidity risk that the Bank is able to take and ensuring that there is an appropriate organisation structure for managing this risk. Under authorities delegated by the Board, the Asset and Liability Committee (ALCO) is responsible for managing all Asset, Liability and Capital Management (ALCM) issues including liquidity and funding risk management.

Notes to the Consolidated Financial Statements

27. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(c) Liquidity and Funding Management Disclosures (continued)

Compliance with liquidity and funding requirements is monitored by HSBC Bank Australia ALCO who report to the HSBC Holdings plc ALCO on a regular basis. This process includes:

- maintaining compliance with relevant regulatory requirements of the HSBC Bank Australia;
- monitoring liquidity and funding ratios against internal and regulatory requirements;
- managing term funding profile where appropriate;
- maintaining debt financing plans where appropriate;
- 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.

Liquidity coverage ratio (LCR)

The LCR metric is designed to promote the short-term resilience of a bank's liquidity profile. It aims to ensure that a bank has sufficient unencumbered high-quality liquid assets ('HQLA') to meet its liquidity needs in a 30-calendar-day liquidity stress scenario. HQLA consist of cash or assets that can be converted into cash at little or no loss of value in markets.

The Bank manages to both APRA and HSBC Group European Bank Authority (EBA) based LCR models.

Net stable funding ratio (NSFR)

The NSFR requires institutions to maintain sufficient stable funding relative to required stable funding, and reflects a bank's long-term funding profile (funding with a term of more than a year). It is designed to complement the LCR. The Bank manages to a HSBC Group EBA based NSFR model but also monitors and reports using an APRA NSFR model (with APRA NSFR requirements becoming live in 2018).

Notes to the Consolidated Financial Statements

27. 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 \$'m	Due within 3 months \$'m	Due between 3 and 12 months \$'m	Due between 1 and 5 years \$'m	Due after 5 years \$'m	Total \$'m
At 31 December 2017						
Deposits by banks	318.7	-	-	-	-	318.7
Repurchase agreement by banks	1,198.0	-	-	-	-	1,198.0
Customer accounts	21,277.6	2,872.3	1,095.9	15.7	12.2	25,273.7
Trading liabilities	3.3	-	-	-	-	3.3
Items in the course of transmission to other banks	23.1	-	-	-	-	23.1
Debt securities on issue	-	0.5	251.6	101.6	-	353.7
Financial liabilities designated at fair value	-	1.1	1.1	48.1	-	50.2
Derivatives	54.2	1.1	1.0	16.3	-	72.6
Subordinated liabilities (related parties)	-	2.8	8.5	45.6	295.9	352.8
Other financial liabilities	2,021.1	137.2	-	2.3	-	2,160.6
	24,896.0	3,015.1	1,358.1	229.5	308.1	29,806.8
Financial guarantee contracts*	1,083.9	-	-	1.1	1.1	1,086.0
Loan commitments	8,725.6	3,017.2	-	-	-	11,742.8
	34,705.5	6,032.3	1,358.1	230.6	309.1	42,635.6
At 31 December 2016						
Deposits by banks	333.8	-	-	-	-	333.8
Repurchase agreement by banks	998.0	-	-	-	-	998.0
Customer accounts	19,656.2	3,271.2	1,236.7	19.8	13.1	24,197.0
Trading liabilities	14.9	-	-	-	-	14.9
Items in the course of transmission to other banks	32.0	-	-	-	-	32.0
Financial liabilities designated at fair value	-	0.6	1.6	8.8	41.7	52.7
Derivatives	76.6	5.9	2.5	22.1	-	107.1
Subordinated liabilities (related parties)	-	2.8	8.5	45.5	295.9	352.7
Other financial liabilities	2,766.1	250.7	-	2.0	-	3,018.8
	23,877.6	3,531.2	1,249.3	98.2	350.7	29,107.0
Financial guarantee contracts*	1,227.3	-	-	-	-	1,227.3
Loan commitments	8,455.5	2,723.8	-	0.1	-	11,179.4
	33,560.4	6,255.0	1,249.3	98.3	350.7	41,513.7

*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.

Notes to the Consolidated Financial Statements

27. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(c) Liquidity and Funding Management Disclosures (continued)

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.

(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 holding period assumes that all positions can be liquidated or the risk offset during that period. This may not fully reflect the market risk arising at times of severe illiquidity, when the holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and
- VaR is unlikely to reflect loss potential on exposures that only arise under significant market movements.

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.

Notes to the Consolidated Financial Statements

27. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(d) Market Risk Disclosures (continued)

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

	Total VaR		Trading VaR	
	Year Ended 31 December		Year Ended 31 December	
	2017	2016	2017	2016
	\$'m	\$'m	\$'m	\$'m
At 31 December	3.6	6.9	0.1	0.2
Average	4.9	5.6	0.1	0.2
Maximum	6.6	7.3	0.5	0.8
Minimum	3.3	4.4	0.0	0.0

Total VaR at 31 December 2017 was \$3.6m which decreased from the VaR of \$6.9m observed as at 31 December 2016. The decrease in VaR was due to the decrease in interest rate present value of a basis point (PVBP) from \$470k to \$81k as at 31 December 2017. As a result of the decrease in interest rate PVBP exposure through the course of 2017, the average VaR utilisation was \$4.9m, compared to the average VaR utilisation of \$5.6m in 2016.

Total Trading VaR at 31 December 2017 decreased to \$0.1m from \$0.2m due to the decrease in magnitude of the AUD interest rate PVBP exposure held in trading book.

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 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 non-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 to 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

27. 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 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 embedded optionality within certain investment product areas, such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts, and the re-pricing behaviour of managed rate products.

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 Bank ALCO. The transfer of market risk to books managed by Global Markets or supervised by the Bank's 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. Bank 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

27. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(e) Operational Risk Disclosures

Operational risk is the risk to achieving the Bank's strategy or objectives as a result of inadequate or failed internal processes, people and systems or from external events.

Responsibility for minimising operational risk lies with all the Bank's staff are required to manage the operational risks of the business and operational activities for which they are responsible.

Operational risk management framework

HSBC's Operational Risk Management Framework (ORMF) is the Bank's overarching approach for managing operational risk, the purpose of which is to:

- identify and manage the Bank's operational risks in an effective manner;
- remain within the operational risk appetite, which helps the organisation understand the level of risk it is willing to accept; and
- drive forward-looking risk awareness and assist management focus during 2018.

Business managers throughout the organisation are responsible for maintaining an acceptable level of internal control commensurate with the scale and nature of operations, and for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The ORMF helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

Three lines of defence (3LOD)

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.

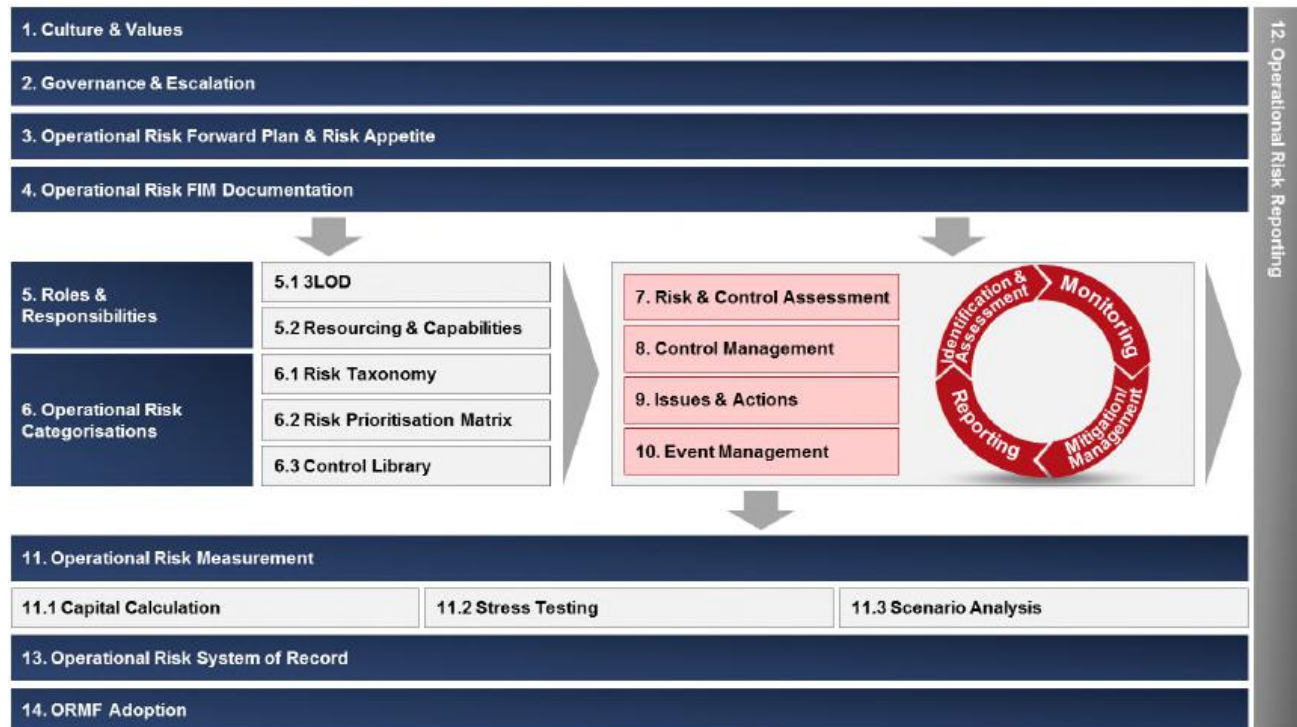
- the first line of defence is accountable for managing and monitoring operational risk in the business;
- the second line is responsible for providing risk oversight, challenge, advice and insights to the business; and
- the third line of defence independently assures that the Bank is managing operational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

Having a strong three lines of defence model in operation across the Bank enables the Bank to identify and effectively manage operational risks. A diagrammatic representation of the ORMF is presented below.

Notes to the Consolidated Financial Statements

27. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(e) Operational Risk Disclosures (continued)



Activity to strengthen our operational risk culture and to better embed the use of our ORMF continued in 2017. In particular, the Bank continues 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 the business understand the level of risk the Bank is willing to accept. Monitoring operational risk exposure against risk appetite on a regular basis and implementing the Bank's risk acceptance process drives risk awareness in a more forward-looking manner. It assists management in determining whether further action is required.

(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.

Notes to the Consolidated Financial Statements

27. ADDITIONAL FINANCIAL INSTRUMENT DISCLOSURES (continued)

(f) Capital Management (continued)

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 Bank, excluding non-controlled subsidiaries and subsidiaries with non financial operations and securitisation special purpose vehicles.

The Bank 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 principles 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 the Capital prudential standards incorporating Basel III capital reforms came into effect from 1 January 2013, electing to accelerate the 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. 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 designed 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 utilised. 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.

For fair values determined using valuation models, the control framework may include, as applicable, development or validation by independent support functions of:

- the logic within valuation models;
- the inputs to those models;
- any adjustments required outside the valuation models; and
- 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. Changes in fair value are generally subject to a profit and loss analysis process. This process disaggregates changes in fair value into three high level categories:

- portfolio changes, such as new transactions or maturing transactions;
- market movements, such as changes in foreign exchange rates or equity prices; and
- other such as changes in fair value adjustments.

To this end, the ultimate responsibility for the determination of fair values lies within the Finance function, which reports to the Chief Financial Officer, who 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:

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

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. In inactive markets, obtaining assurance that the transaction price provides evidence of fair value or determining the adjustments to transaction prices that are necessary to measure the fair value of the instrument requires additional work during the valuation process.

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.

Notes to the Consolidated Financial Statements

28. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

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. 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; and
- debt securities on issue (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 the instruments therefore includes the effect of own credit spread. Movements taken into reserves 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

28. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Consolidated	Valuation Techniques			Total Third Party \$'m	Amount with HSBC* \$'m	Total \$'m
	Level 1 \$'m	Level 2 \$'m	Level 3 \$'m			
At 31 December 2017						
<i>Assets</i>						
Derivatives	0.1	29.0	-	29.1	50.2	79.3
Financial investments	3,994.9	2,839.1	4.0	6,838.0	-	6,838.0
<i>Liabilities</i>						
Trading liabilities	-	3.3	-	3.3	-	3.3
Financial liabilities designated at fair value	-	43.6	-	43.6	-	43.6
Derivatives	-	23.2	-	23.2	49.4	72.6
At 31 December 2016						
<i>Assets</i>						
Derivatives	-	31.9	-	31.9	137.4	169.3
Financial investments	5,310.5	2,584.2	2.8	7,897.5	-	7,897.5
<i>Liabilities</i>						
Trading liabilities	-	14.9	-	14.9	-	14.9
Financial liabilities designated at fair value	-	43.0	-	43.0	-	43.0
Derivatives	0.1	34.7	0.1	34.8	72.4	107.2

*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 and all reside within level 2.

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	
		2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
29. NOTES TO THE STATEMENT OF CASH FLOWS					
(a) Reconciliation of Net Cash Flows used in Operating Activities to Profit for the year					
Profit for the year		288.3	269.5	288.1	269.5
Depreciation and amortisation		7.0	6.7	7.0	6.7
(Increase)/decrease in interest receivable		29.9	(41.6)	29.9	(41.6)
Increase/(decrease) in interest payable		0.1	(7.1)	0.1	(7.1)
Dividend income from controlled entities		-	-	-	-
Loan impairment charges		33.8	41.2	33.8	41.2
(Profit)/loss on the sale of investments		(5.7)	(14.7)	(5.7)	(14.7)
Increase/(decrease) in provisions		(0.9)	2.4	(0.9)	2.4
Increase/(decrease) in provision for employee entitlements		1.3	1.7	1.3	1.7
Increase/(decrease) in intercompany payable account		(6.4)	7.3	(6.4)	7.3
(Increase)/decrease in sundry debtors		(8.6)	-	(8.2)	-
Increase/(decrease) in sundry creditors		(21.5)	170.5	(21.5)	170.2
Changes in Operating Assets and Liabilities					
Net (increase)/decrease in trading assets		55.5	(97.2)	55.4	(97.1)
Net decrease in trading liabilities		(11.6)	(26.7)	(11.6)	(26.7)
Cash inflows/(outflows) from movements in other assets/liabilities		122.3	(219.2)	122.4	(218.9)
Net (Increase)/decrease in loans and bills advanced		(2,342.8)	(1,563.0)	(2,342.9)	(1,563.0)
Net increase in deposits and other borrowings		732.2	166.4	732.3	166.4
Net cash used in operating activities		<u>(1,126.9)</u>	<u>(1,303.8)</u>	<u>(1,126.9)</u>	<u>(1,303.7)</u>

(b) Reconciliation of Cash and Cash Equivalents

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	1,541.1	1,186.1	1,541.1	1,186.1
Placings with banks with remaining maturity 1 month or less	18.4	8.8	18.4	8.8
Securities purchased from related entities under agreements to resell	164.9	400.5	164.9	400.5
Total cash and cash equivalents	<u>1,724.4</u>	<u>1,595.4</u>	<u>1,724.4</u>	<u>1,595.4</u>

(c) Financing Facilities

At 31 December 2017 and 31 December 2016 there are no committed facilities.

Notes to the Consolidated Financial Statements

	Note	Consolidated		Company	
		2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
30. ASSETS PLEDGED AS SECURITY FOR LIABILITIES AND COLLATERAL ACCEPTED AS SECURITY FOR ASSETS					
Financial assets pledged as collateral		306.6	-	306.6	-
Fair value of the collateral permitted to sell or repledge in the absence of default		162.4	392.0	162.4	392.0
Fair value of collateral actually sold or repledged		-	-	-	-

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

31. 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	
	2017 \$'m	2016 \$'m	2017 \$'m	2016 \$'m
Carrying Amount of Asset				
Loans and advances to customers*	2,420.8	1,771.7	2,420.8	1,771.7
Total	2,420.8	1,771.7	2,420.8	1,771.7
Carrying Amount of Related Liability				
Sale and repurchase agreement	1,198.0	998.0	1,198.0	998.0
Total	1,198.0	998.0	1,198.0	998.0

*The Bank has performed a mortgage loan securitisation, whereby it has sold mortgage loans to the Lion Series 2009-1 Trust which funded its purchases through the issue of securities to the Bank and the Trust respectively. The Bank provides swaps and services (including servicing and trust management) to the Trust on an arms length basis in accordance with the APRA Prudential Guidelines (APS120 "Securitisation") and is entitled to the residual income from the notes. In addition the Bank provides a liquidity facility to the Lion Series 2009-1 Trust.

Notes to the Consolidated Financial Statements

32. RELATED PARTY DISCLOSURES

Controlling entities

The ultimate chief entity of the HSBC Group is HSBC Holdings plc, a company incorporated in England and Wales. The immediate parent entity in Australia is HSBC Australia Holdings Pty Ltd.

Ownership interest in related parties

Interests held in related parties are set out in Note 13.

	Consolidated		Company	
	2017	2016	2017	2016
	\$	\$	\$	\$
Amounts Receivable From or Payable To Related Parties				
Aggregate amounts receivable:				
Other related entities	387,386,357	185,675,233	387,386,357	185,675,233
Reverse repurchase agreement – other related entities	164,803,244	400,485,394	164,803,244	400,485,394
Aggregate amounts payable:				
Owing to parent in respect of tax	11,888,143	26,134,831	11,888,143	26,134,831
Other related entities	1,967,075,357	2,492,965,169	1,967,006,526	2,492,665,169
Subordinated liabilities – other related entities	250,000,000	250,000,000	250,000,000	250,000,000
Aggregate of Amounts Received or Receivable From or Paid or Payable to Related Parties during the year				
Interest revenue				
Other related entities	12,353,775	26,748,569	12,353,775	26,748,569
Key management personnel	337,000	269,000	337,000	269,000
Interest expense				
Other related entities	37,205,370	35,484,273	37,205,370	35,470,007
Management fees paid				
Other related entities	95,274,973	100,503,195	95,274,973	100,503,195
Management fees received				
Other related entities	108,501,215	90,736,059	108,501,215	90,736,059
Fee income				
Other related entities	5,825,126	4,564,468	5,825,126	4,564,468
Fee expense				
Other related entities	13,980,389	15,752,791	13,980,389	15,752,791
Employee benefits				
Share based payments	8,368,000	7,242,000	8,368,000	7,242,000
Dividend paid				
Controlling entity	157,520,692	129,920,000	157,520,692	129,920,000

Notes to the Consolidated Financial Statements

32. 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 \$1,234,803,558 (Consolidated) (2016:\$1,248,709,856), 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.

33. 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:

Martin Tricaud (Chief Executive Officer)

Appointed 3 April 2017

Non-Executive Directors:

Graham Bradley (Chairman)

Carol Austin

Anthony Cripps

Guy Harvey-Samuel

Mark Johnson

Matthew Lobner

Jayant Rikhye

Jann Skinner

Previously CEO until 2 April 2017

Resigned 1 April 2017

Resigned 21 April 2017

Appointed 6 October 2017

Resigned 25 October 2017

Appointed 12 April 2017

Company Secretary:

Robert Agati

Executives:

Gunalan Bhaskaran (Head of Regulatory Compliance)

Guy Dickinson (Head of Global Markets)

Sarah Duncan (Head of Financial Crime Compliance)

Graham Heunis (Head of Retail Banking and Wealth Management)

Emma Hider (Chief Financial Officer)

Steve Hughes (Head of Commercial Banking)

Brenton Hush (Chief Operating Officer)

Hamish Kelly (Head of Global Banking)

David Matthews (Head of Communications)

Noel McNamara (Chief Risk Officer)

Paul Murphy (Head of Human Resources)

Bridget Powell (General Counsel)

Gavin Powell (Head of Global Markets)

Vic Wolff (Head of Marketing)

Appointed 4 September 2017

Resigned 25 October 2017

Resigned 31 July 2017

Notes to the Consolidated Financial Statements

	Consolidated		Company	
	2017	2016	2017	2016
	\$	\$	\$	\$

33. KEY MANAGEMENT PERSONNEL DISCLOSURES (continued)

Transactions with Key Management Personnel

The key management personnel compensation included in 'staff costs' note 6 are as follows

Short term employee benefits				
Cash salary, fees and short-term compensated absences	6,167,785	5,835,812	6,167,785	5,835,812
Short-term cash profit-sharing and other bonuses	2,708,859	3,433,994	2,708,859	3,433,994
Non-monetary benefits	253,491	442,972	253,491	442,972
Other short-term employee benefits	456,052	297,539	456,052	297,539
	<u>9,586,188</u>	<u>10,010,317</u>	<u>9,586,188</u>	<u>10,010,317</u>
Post employment benefits				
Pension and superannuation benefits	296,249	327,916	296,249	327,916
Other post-employment benefits	57,799	55,395	57,799	55,395
	<u>354,049</u>	<u>383,310</u>	<u>354,049</u>	<u>383,310</u>
	<u>9,940,236</u>	<u>10,393,628</u>	<u>9,940,236</u>	<u>10,393,628</u>
Share based payments granted during the year	<u>1,939,055</u>	<u>842,060</u>	<u>1,939,055</u>	<u>842,060</u>

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 21).

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

	<u>10,677,083</u>	<u>10,790,002</u>	<u>10,677,083</u>	<u>10,790,002</u>
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Loan Repayments Received

	<u>593,990</u>	<u>468,168</u>	<u>593,990</u>	<u>468,168</u>
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Notes to the Consolidated Financial Statements

34. 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.

Notes to the Consolidated Financial Statements

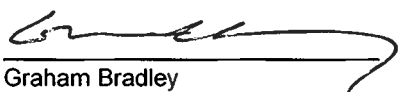
Directors' Declaration

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

- (a) the financial statements and notes set out on pages 6 to 76 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 2017, 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 Note 2(a).

Dated at Sydney this 9th February 2018

Signed in accordance with a resolution of the Directors:



Graham Bradley
Chairman



Martin Tricaud
Director



Independent auditor's report

To the members of HSBC Bank Australia Limited

Our opinion

In our opinion:

The accompanying financial report of HSBC Bank Australia Limited (the Company) and its controlled entities (together the Group) is in accordance with the *Corporations Act 2001*, including:

- (a) giving a true and fair view of the Company's and Group's financial positions as at 31 December 2017 and of their financial performance for the year then ended
- (b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

What we have audited

The Company and Group financial report comprises:

- the Consolidated and Company statements of financial position as at 31 December 2017
- the Consolidated and Company income statements for the year then ended
- the Consolidated and Company statements of comprehensive income for the year then ended
- the Consolidated and Company statements of changes in equity for the year then ended
- the Consolidated and Company statements of cash flows for the year then ended
- the notes to the financial statements, which include a summary of significant accounting policies
- the directors' declaration.

Basis for opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial report* section of our report.

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

Independence

We are independent of the Group in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

Other information

The directors are responsible for the other information. The other information comprises the information included in the Directors' Report, but does not include the financial report and our auditor's report thereon.

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

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

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

Responsibilities of the directors 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 *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial report

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

A further description of our responsibilities for the audit of the financial report is located at the Auditing and Assurance Standards Board website at: http://www.auasb.gov.au/auditors_responsibilities/ar3.pdf. This description forms part of our auditor's report.

Matters relating to the electronic presentation of the audited financial report

This auditor's report relates to the financial report of HSBC Bank Australia Limited for the year ended 31 December 2017 included on HSBC Group's web site. The directors of the Company are responsible for the integrity of HSBC Group's web site. We have not been engaged to report on the integrity of this web site. The auditor's report refers only to the financial report named above. It does not provide an opinion on any other information which may have been hyperlinked to/from the financial report. If users of this report are concerned with the inherent risks arising from electronic data communications they are advised to refer to the hard copy of the audited financial report to confirm the information included in the audited financial report presented on this web site.

PricewaterhouseCoopers

PricewaterhouseCoopers

A handwritten signature in blue ink, appearing to be 'E A Barron', with several horizontal lines extending to the right.

E A Barron
Partner

Sydney
9 February 2018



Auditor's Independence Declaration

As lead auditor for the audit of HSBC Bank Australia Limited for the year ended 31 December 2017, 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 blue ink, appearing to read 'E A Barron', with a circular flourish around the first part of the name.

E A Barron
Partner
PricewaterhouseCoopers

Sydney
9 February 2018