HSBC Bank Australia Ltd

A.B.N. 48 006 434 162

Annual Report and Accounts 2018

HSBC

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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 2018 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 (resigned 26 October 2018)

Matthew Lobner, Non-executive Director

Kenneth Ng, Non-executive Director (appointed 26 October 2018)

Jann Skinner, Non-executive Director

Martin Tricaud, Chief Executive Officer

Principal activities

The principal activities of the consolidated entity during the financial year were the provision of financial services comprising of 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 2018, the consolidated entity reported a profit from its continuing operations before income tax of $434.9m, up from $409.9m in 2017. Operating income before loan impairment charges increased by 7.5% primarily due to growth in loans and advances to customers, particularly within the mortgage portfolio. Operating costs were higher as the business invested heavily for future growth.

Total assets increased to $37,824.7m 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 expansion of the broker channel for mortgages.

Dividends

Dividends paid or declared by the Company to shareholders since the end of the previous financial year were $123.3m including payments on the Tier 1 instruments (2017: $157.5m). Dividend payments were 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 61 for the year ended 31 December 2018.

Indemnification and insurance of Directors and officers

During the financial year, the consolidated entity paid premiums in respect of contracts insuring all the directors, executive officers and those acting in a capacity of an officer of the Company and its controlled entities against any liability incurred by them in their role as directors or executive 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 11 February 2019

Financial statements

Income statements

for the year ended 31 December 2018

		Consolidated		Company	
		2018	2017	**2018**	2017
	Notes	**$m**	$m	**$m**	$m
Interest income	*4(i)*	**1,127.4**	1,005.8	**1,127.4**	1,005.8
Interest expense	*4(ii)*	**(383.6)**	(298.6)	**(383.6)**	(298.6)
Net interest income		**743.8**	707.2	**743.8**	707.2
Fee and commission income	*4(iv)*	**202.6**	205.0	**202.6**	205.0
Fee and commission expense	*4(v)*	**(63.0)**	(61.2)	**(63.0)**	(61.4)
Net fee and commission income		**139.6**	143.8	**139.6**	143.6
Net trading income	*4(vi)*	**89.2**	65.7	**89.2**	65.7
Net loss from financial instruments designated at fair value	*4(vii)*	**(1.6)**	(1.4)	**(1.6)**	(1.4)
Change in fair value of other financial instruments mandatorily measured at fair value through profit or loss	*4(viii)*	**0.2**	–	**0.2**	–
Net gain from disposal of financial assets measured at fair value through other comprehensive income	*4(ix)*	**8.2**	5.7	**8.2**	5.7
Other operating income	*4(iii)*	**129.0**	110.1	**129.0**	110.1
Net other operating income		**225.0**	180.1	**225.0**	180.1
Operating income before change in expected credit losses and and other credit risk provisions		**1,108.4**	1,031.1	**1,108.4**	1,030.9
Net change in expected credit losses and other credit risk provisions	*5*	**(39.0)**	(33.8)	**(39.0)**	(33.8)
Net operating income		**1,069.4**	997.3	**1,069.4**	997.1
Operating expenses					
– employee compensation and benefits	*6*	**(317.6)**	(293.7)	**(317.6)**	(293.7)
– premises and equipment	*6*	**(62.4)**	(58.0)	**(62.4)**	(58.0)
– general and administrative expenses	*6*	**(131.6)**	(138.8)	**(131.6)**	(138.8)
– other expenses	*6*	**(122.9)**	(96.9)	**(122.9)**	(96.9)
Total operating expenses		**(634.5)**	(587.4)	**(634.5)**	(587.4)
Profit before income tax		**434.9**	409.9	**434.9**	409.7
Income tax expense	*8*	**(133.2)**	(121.6)	**(133.2)**	(121.6)
Profit for the year		**301.7**	288.3	**301.7**	288.1
Attributable to equity holders of the parent		**301.7**	288.3	**301.7**	288.1

The notes on pages 10 to 57 are an integral part of these consolidated financial statements.

Statements of comprehensive income

for the year ended 31 December 2018

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Profit for the year	**301.7**	288.3	**301.7**	288.1
Other comprehensive income				
Items that may be reclassified to Income statement:				
Financial assets measured at fair value through other comprehensive income				
– fair value gains recognised in other comprehensive income	**4.5**	12.4	**4.5**	12.4
– net amount transferred to Income statement	**(8.1)**	(5.1)	**(8.1)**	(5.1)
– deferred tax on items taken directly to or transferred from equity	**0.9**	(1.8)	**0.9**	(1.8)
Cash flow hedges				
– net amount transferred to Income statement	**–**	7.1	**–**	7.1
– effective portion of changes in fair value	**2.5**	(2.2)	**2.5**	(2.2)
– deferred tax on items taken directly to or transferred from equity	**(0.7)**	(1.4)	**(0.7)**	(1.4)
Changes in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	**0.5**	–	**0.5**	–
Total other comprehensive income	**(0.4)**	9.0	**(0.4)**	9.0
Total comprehensive income for the year	**301.3**	297.3	**301.3**	297.1
Attributable to equity holders of the parent	**301.3**	297.3	**301.3**	297.1

The notes on pages 10 to 57 are an integral part of these consolidated financial statements.

Statements of financial position

As at 31 December 2018

	Notes	Consolidated 2018 $m	Consolidated 2017 $m	Company 2018 $m	Company 2017 $m
Assets					
Cash and balances at central banks		**1,750.0**	1,541.1	**1,750.0**	1,541.1
Items in the course of collection from other banks		**1.9**	2.4	**1.9**	2.4
Other financial assets mandatorily measured at fair value through profit or loss		**3.9**	–	**3.9**	–
Derivatives	10	**157.7**	79.3	**157.7**	79.3
Loans and advances to banks	27	**45.5**	63.3	**45.5**	63.3
Loans and advances to customers	27	**25,212.3**	22,546.1	**25,212.3**	22,546.1
Financial assets measured at fair value through other comprehensive income	11	**9,304.0**	6,838.0	**9,304.0**	6,838.0
Receivables from related entities	33	**655.1**	552.3	**655.1**	552.2
Other assets	15	**471.9**	441.6	**470.2**	440.4
Property, plant and equipment	12	**35.8**	28.2	**35.8**	28.2
Net deferred tax assets	16	**114.9**	91.0	**114.9**	91.0
Intangible assets	14	**71.7**	64.8	**71.7**	64.8
Total assets		**37,824.7**	32,248.1	**37,823.0**	32,246.8
Liabilities					
Deposits by banks		**380.3**	318.7	**380.3**	318.7
Items in the course of transmission to other banks		**27.4**	23.1	**27.4**	23.1
Sale and repurchase agreements – non-trading		**1,462.4**	1,198.0	**1,462.4**	1,198.0
Trading liabilities	17	**–**	3.3	**–**	3.3
Financial liabilities designated at fair value	17	**43.0**	43.6	**43.0**	43.6
Derivatives	10	**138.0**	72.6	**138.0**	72.6
Customer accounts – amortised cost		**28,705.6**	25,242.0	**28,705.6**	25,242.0
Debt securities on issue	19	**433.8**	346.5	**433.8**	346.5
Provisions for liabilities and charges	18	**16.6**	6.2	**16.6**	6.2
Payables to related entities	33	**3,773.0**	2,229.0	**3,773.0**	2,229.0
Other liabilities	20	**382.5**	443.7	**380.8**	442.2
Employee benefits	21	**93.2**	84.4	**93.2**	84.4
Total liabilities		**35,455.8**	30,011.1	**35,454.1**	30,009.6
Net assets		**2,368.9**	2,237.0	**2,368.9**	2,237.2
Equity					
Share capital	22	**811.0**	811.0	**811.0**	811.0
Reserves	23	**252.9**	253.9	**252.9**	253.9
Retained earnings		**1,305.0**	1,172.1	**1,305.0**	1,172.3
Total equity		**2,368.9**	2,237.0	**2,368.9**	2,237.2

The notes on pages 10 to 57 are an integral part of these consolidated financial statements.

Statement of changes in equity – consolidated

for the year ended 31 December 2018

	Share capital	Own credit spread reserve	FVOCI reserve	Cash flow hedging reserve	Capital contribution reserve	Other capital reserve	Retained profits	Total
	$m	$m	$m	$m	$m	$m	$m	$m
At 1 Jan 2018	**811.0**	**(0.4)**	**3.9**	**(4.3)**	**4.9**	**250.0**	**1,125.7**	**2,190.8**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**301.7**	**301.7**
Other comprehensive income (net of income tax)								
Cash flow hedges								
– effective portion of changes in fair value	**–**	**–**	**–**	**1.8**	**–**	**–**	**–**	**1.8**
– net amount transferred to Income statement	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Financial assets measured at fair value through other comprehensive income								
– net change in fair value	**–**	**–**	**4.5**	**–**	**–**	**–**	**–**	**4.5**
– net amount transferred to Income statement	**–**	**–**	**(7.2)**	**–**	**–**	**–**	**–**	**(7.2)**
Changes in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	**–**	**0.5**	**–**	**–**	**–**	**–**	**–**	**0.5**
Total other comprehensive income	**–**	**0.5**	**(2.7)**	**1.8**	**–**	**–**	**–**	**(0.4)**
Total comprehensive income for year	**–**	**0.5**	**(2.7)**	**1.8**	**–**	**–**	**301.7**	**301.3**
Transactions with owners, recorded directly in equity								
Contributions by and distributions to owners								
Share based payments	**–**	**–**	**–**	**–**	**(0.8)**	**–**	**0.9**	**0.1**
Dividends to equity holders	**–**	**–**	**–**	**–**	**–**	**–**	**(123.3)**	**(123.3)**
Total contributions by and distributions to owners	**–**	**–**	**–**	**–**	**(0.8)**	**–**	**(122.4)**	**(123.2)**
At 31 Dec 2018	**811.0**	**0.1**	**1.2**	**(2.5)**	**4.1**	**250.0**	**1,305.0**	**2,368.9**
At 1 Jan 2017	811.0	–	(1.8)	(7.8)	6.7	250.0	1,040.8	2,098.8
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
Financial assets measured at fair value								
– 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)
At 31 Dec 2017	811.0	–	3.7	(4.3)	4.5	250.0	1,172.1	2,237.0
Balance at 1 Jan 2018	811.0	–	3.7	(4.3)	4.5	250.0	1,172.1	2,237.0
Changes on initial application of AASB 9	–	(0.4)	0.2	–	0.4	–	(46.4)	(46.2)
Restated balance at 1 Jan 2018	811.0	(0.4)	3.9	(4.3)	4.9	250.0	1,125.7	2,190.8

The notes on pages 10 to 57 are an integral part of these consolidated financial statements.

Statement of changes in equity – company

for the year ended 31 December 2018

	Share capital	Own credit spread reserve	FVOCI reserve	Cash flow hedging reserve	Capital contribution reserve	Other capital reserve	Retained profits	Total
	$m	$m	$m	$m	$m	$m	$m	$m
At 1 Jan 2018	**811.0**	**(0.4)**	**3.9**	**(4.3)**	**4.9**	**250.0**	**1,125.9**	**2,191.0**
Profit for the year	–	–	–	–	–	–	301.7	301.7
Other comprehensive income (net of income tax)								
Cash flow hedges								
– effective portion of changes in fair value	–	–	–	1.8	–	–	–	1.8
– net amount transferred to Income statement	–	–	–	–	–	–	–	–
Financial assets measured at fair value through other comprehensive income								
– net change in fair value	–	–	4.5	–	–	–	–	4.5
– net amount transferred to Income statement	–	–	(7.2)	–	–	–	–	(7.2)
Changes in fair value of financial liabilities designated at fair value upon initial recognition arising from changes in own credit risk	–	0.5	–	–	–	–	–	0.5
Total other comprehensive income	–	0.5	(2.7)	1.8	–	–	–	(0.4)
Total comprehensive income for year	–	0.5	(2.7)	1.8	–	–	301.7	301.3
Transactions with owners, recorded directly in equity								
Contributions by and distributions to owners		–						
Share based payments	–	–	–	–	(0.8)	–	0.7	(0.1)
Dividends to equity holders	–	–	–	–	–		(123.3)	(123.3)
Total contributions by and distributions to owners	–	–	–	–	(0.8)	–	(122.6)	(123.4)
At 31 Dec 2018	**811.0**	**0.1**	**1.2**	**(2.5)**	**4.1**	**250.0**	**1,305.0**	**2,368.9**
At 1 Jan 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)
At 31 Dec 2017	811.0	–	3.7	(4.3)	4.5	250.0	1,172.3	2,237.2
Balance at 1 Jan 2018	811.0	–	3.7	(4.3)	4.5	250.0	1,172.3	2,237.2
Changes on initial application of AASB9	–	(0.4)	0.2	–	0.4	–	(46.4)	(46.2)
At 1 Jan 2018	811.0	(0.4)	3.9	(4.3)	4.9	250.0	1,125.9	2,191.0

The notes on pages 10 to 57 are an integral part of these consolidated financial statements.

Statements of cash flows

for the year ended 31 December 2018

		Consolidated		Company	
		2018	2017	**2018**	2017
	Note	**$m**	$m	**$m**	$m
Cash flows from operating activities					
Interest received		**1,113.6**	1,035.7	**1,113.6**	1,035.7
Interest paid		**(377.1)**	(298.5)	**(377.1)**	(298.5)
Other income received		**362.8**	309.6	**363.2**	309.8
Other expenses paid		**(619.3)**	(601.4)	**(619.8)**	(601.7)
Loans and bills advanced		**(2,976.8)**	(2,342.8)	**(2,976.4)**	(2,342.9)
Net increase/(decrease) in deposits, repo and other borrowings		**5,277.8**	732.3	**5,277.9**	732.5
Net (increase)/decrease in trading assets		**(13.0)**	55.5	**(13.0)**	55.4
Net increase/(decrease) in trading liabilities		**(3.3)**	(11.6)	**(3.3)**	(11.6)
Net (increase)/decrease from movements in other assets/liabilities		**(45.4)**	122.3	**(45.9)**	122.4
Income tax paid		**(130.0)**	(128.0)	**(130.0)**	(128.0)
Net cash from / (used in) operating activities	*29*	**2,589.3**	(1,126.9)	**2,589.3**	(1,126.9)
Cash flows from investing activities					
Purchases of investment securities		**(9,058.2)**	(3,118.7)	**(9,058.2)**	(3,118.7)
Purchase of property, plant and equipment		**(10.1)**	(13.7)	**(10.1)**	(13.7)
Payments for intangible assets		**(9.4)**	(2.8)	**(9.4)**	(2.8)
Proceeds from sale and maturity of investments		**6,596.0**	4,201.5	**6,596.0**	4,201.5
Net cash (used in) / from investing activities		**(2,481.7)**	1,066.3	**(2,481.7)**	1,066.3
Cash flows from financing activities					
Net increase/(decrease) in debt securities issue		**86.7**	347.1	**86.7**	347.1
Dividends paid		**(123.3)**	(157.5)	**(123.3)**	(157.5)
Net cash (used in) / provided by financing activities		**(36.6)**	189.6	**(36.6)**	189.6
Net increase/(decrease) in cash and cash equivalents held		**71.1**	129.0	**71.1**	129.0
Cash and cash equivalents at the beginning of the year		**1,724.4**	1,595.4	**1,724.4**	1,595.4
Cash and cash equivalents at the end of the year	*29*	**1,795.5**	1,724.4	**1,795.5**	1,724.4

The notes on pages 10 to 57 are an integral part of these 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 2018 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 11 February 2019.

(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 fair value through other comprehensive income ('FVOCI'). 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

In determining Expected Credit Loss ('ECL'), management is required to exercise judgement in defining what is considered to be a significant increase in credit risk and in making assumptions and estimates to incorporate relevant information about past events, current conditions and forecasts of economic conditions. Judgement has been applied in determining the lifetime and point of initial recognition of revolving facilities. The probability of default ('PD'), loss given default ('LGD') and exposure at default ('EAD') models, which support these determinations are reviewed regularly in light of differences between loss estimates and actual loss experience, but given that AASB 9 requirements have only just been applied, there has been little time available to make these comparisons. Therefore, the underlying models and their calibration, including how they react to forward-looking economic conditions, remain subject to review and refinement. This is particularly relevant for lifetime PDs, which have not been previously used in regulatory modelling, and for the incorporation of 'Upside scenarios', which have not generally been subject to experience gained through stress testing.

The exercise of judgement in making estimations requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas. Many of the factors have a high degree of interdependency and there is no single factor to which loan impairment allowances as a whole are sensitive. Note 27 outlines the assumptions underlying the Central scenario and information about how scenarios are developed in relation to the HSBC Group's top and emerging risks and its judgements, informed by consensus forecasts of professional industry forecasters. The sensitivity of ECL to different economic scenarios is illustrated by recalculating the ECL for selected portfolios as if 100% weighting had been assigned to each scenario.

Application of the Bank's methodology for loan impairment is set out in statement of significant accounting policies note 3. However, for stage 3 impaired 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.

Valuation of financial instruments

The consolidated entity's accounting policy for valuation of financial instruments is included in note 3k '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 is 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).

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 units ('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 two new accounting standards adopted during 2018 that have an impact on the financial statements.

The Bank has adopted the requirements of AASB 9 from 1 January 2018, 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. AASB 9 includes an accounting policy choice to remain with AASB 139 hedge accounting, which HSBC has exercised. The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application. As permitted by AASB 9, HSBC has not restated comparatives. Adoption reduced net assets at 1 January 2018 by $46.4m as set out in note 36.

In addition, the Bank has adopted the requirements of AASB 15 'Revenue from contracts with customers' and a number of interpretations and amendments to standards which have had an insignificant effect on the consolidated financial statements of the Bank.

Changes in accounting policy

While not necessarily required by the adoption of AASB 9, the following voluntary changes in accounting policy and presentation have been made as a result of reviews carried out in conjunction with its adoption. The effect of presentational changes at 1 January 2018 is included in the reconciliation set out in note 36 and comparatives have not been restated.

- The Bank has considered market practices for the presentation of certain financial liabilities which contain both deposit and derivative components. The bank has concluded that a change in accounting policy and presentation from 'trading customer accounts and other debt securities in issue' would be appropriate, since it would better align with the presentation of similar financial instruments by peers and therefore provide more relevant information about the effect of these financial liabilities on our financial position and performance. As a result, rather than being classified as held for trading, the Bank will designate these financial liabilities as at fair value through profit or loss since they are managed and their performance evaluated on a fair value basis. A further consequence of

this change in presentation is that the effects of changes in the liabilities' credit risk will be presented in 'Other comprehensive income' with the remaining effect presented in profit or loss in accordance with HSBC Group accounting policy adopted in 2017 (following the adoption of the requirements in AASB 9 relating to the presentation of gains and losses on financial liabilities designated at fair value).

- Cash collateral, margin and settlement accounts have been reclassified from 'Trading assets' and 'Loans and advances to banks and customers' to 'Prepayments, accrued income and other assets' and from 'Trading liabilities' and 'Deposits by banks' and 'Customer accounts' to 'Accruals, deferred income and other liabilities'. The change in presentation for financial assets is in accordance with AASB 9 and the change in presentation for financial liabilities is considered to provide more relevant information, given the change in presentation for the financial assets. The change in presentation for financial liabilities has had no effect on measurement of these items and therefore on retained earnings or profit for any period.

(f) Future accounting developments

At 31 December 2018, 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 2018. The Bank's assessment of the impact of this new standard and interpretations is set out below.

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 ('ROU') asset and a corresponding financial liability on the Statement of financial position. 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. At 1 January 2019, the Bank expects to adopt the standard using a modified retrospective approach where the cumulative effect of initially applying the standard is recognised as an adjustment to the opening balance of retained earnings and comparatives are not restated. The implementation is expected to increase assets (ROU assets) by $241.1m and increase financial liabilities by $236.7m with no effect on net assets or retained earnings. Existing operating lease commitments are set out in note 24.

3 Statement of significant account 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.

(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

The Bank generates fee income from services provided at a fixed price over time, such as account service and card fees, or when the Bank delivers a specific transaction at a point in time such as broking services and import/export services. With the exception of certain fund management and performance fees, all other fees are generated at a fixed price. Fund management and performance fees can be

variable depending on the size of the customer portfolio and HSBC's performance as fund manager. Variable fees are recognised when all uncertainties are resolved. Fee income is generally earned from short term contracts with payment terms that do not include a significant financing component.

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

The Bank recognises fees earned on transaction-based arrangements at a point in time when we have fully provided the service to the customer. Where the contract requires services to be provided over time, income is recognised on a systematic basis over the life of the agreement. Where the Bank offers a package of services that contains multiple non-distinct performance obligations, such as those included in account service packages, the promised services are treated as a single performance obligation. If a package of services contains distinct performance obligations, such as those including both account and insurance services, the corresponding transaction price is allocated to each performance obligation based on the estimated stand-alone selling prices.

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

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

- 'Net income from financial instruments held for trading or managed on a fair value basis': This is comprised of the net trading income, which includes all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with the related interest income, expense and dividends; and it also includes all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets and liabilities measured at fair value through profit or loss.
- 'Dividend income' is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders approve the dividend for unlisted equity securities.
- 'Changes in fair value of long-term debt and related derivatives': Interest paid on the external long-term debt and interest cash flows on related derivatives is presented in interest expense.
- 'Changes in fair value of other financial instruments mandatorily measured at fair value through profit or loss': This includes interest on instruments which fail the solely payments of principal and interest ('SPPI') test.

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).

(e) Financial instruments measured at amortised cost

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

Non-trading reverse repurchase, repurchase and similar agreements

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

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

(f) Impairment of amortised cost and FVOCI financial assets

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

Credit impaired (stage 3)

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

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

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due, even where regulatory rules permit default to be defined based on 180 days past due. Therefore the definitions of credit impaired and default are aligned as far as possible so that stage 3 represents all loans which are considered defaulted or otherwise credit impaired. Interest income is recognised by applying the effective interest rate to the amortised cost amount, i.e. gross carrying amount less ECL allowance.

Write-off

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

Renegotiation

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

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

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

Loan modifications that are not credit impaired

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

Significant increase in credit risk (stage 2)

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

For wholesale portfolios, the quantitative comparison assesses default risk using a lifetime probability of default which encompasses a wide range of information including the obligor’s customer risk rating (‘CRR’), macroeconomic condition forecasts and credit transition probabilities. Significant increase in credit risk is measured by comparing the average the probability of default (‘PD’) for the remaining term estimated at origination with the equivalent estimation at reporting date. For origination CRRs up to 3.3, a significant increase in credit risk is considered to have occurred when the PD increase exceeds the below thresholds. For CRRs greater than 3.3 which are not impaired, a significant increase in credit risk is considered to have occurred when the origination PD has doubled. The significance of changes in PD was informed by expert credit risk judgement, referenced to historical credit migrations and to relative changes in external market rates. The quantitative measure of significance varies depending on the credit quality at origination as follows:

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

For loans originated prior to the implementation of IFRS 9, the origination PD does not include adjustments to reflect expectations of future macroeconomic conditions since these are not available without the use of hindsight. In the absence of this data, origination PD must be approximated assuming through-the-cycle (‘TTC’) PDs and TTC migration probabilities, consistent with the instrument’s underlying modelling approach and the CRR at origination. For these loans, the quantitative comparison is supplemented with additional

CRR deterioration-based thresholds as set out in the table below:

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

Further information about the 23-grade scale used for CRR can be found on page 40.

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

For retail portfolios, default risk is assessed using a reporting date 12-month PD derived from credit scores which incorporate all available information about the customer. This PD is adjusted for the effect of macroeconomic forecasts for periods longer than 12 months and is considered to be a reasonable approximation of a lifetime PD measure. Retail exposures are first segmented into homogeneous portfolios, generally by product and brand. Within each portfolio, the stage 2 accounts are defined as accounts with an adjusted 12-month PD greater than the average 12-month PD of loans in that portfolio 12 months before they become 30 days past due. The expert credit risk judgement is that no prior increase in credit risk is significant. This portfolio-specific threshold identifies loans with a PD higher than would be expected from loans that are performing as originally expected and higher than what would have been acceptable at origination. It therefore approximates a comparison of origination to reporting date PDs.

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

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

Movement between stages

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

Measurement of ECL

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

In general, the Bank calculates ECL using three main components, a PD, a loss given default ('LGD') and the exposure at default ('EAD').

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

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

The Bank leverages the Basel II internal ratings based ('IRB') framework where possible, with recalibration to meet the differing AASB 9 requirements set out in the table below:

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

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

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

Period over which ECL is measured

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

Forward-looking economic inputs

The Bank will in general apply three forward-looking global economic scenarios determined with reference to external forecast distributions, the consensus economic scenario approach. This approach is considered sufficient to calculate unbiased expected loss in most economic environments. They represent a 'most likely outcome' (the central scenario) and two, less likely, 'outer' scenarios on either side of the central, referred to as an upside and a downside scenario respectively. The central scenario is used in the annual operating planning process and, with regulatory modifications, will also be used in enterprise-wide stress tests. The upside and downside are constructed following a standard process supported by a scenario narrative reflecting the Group's current top and emerging risks. The relationship between the outer scenarios and central scenario will generally be fixed with the central scenario being assigned a weighting of 80% and the upside and downside scenarios 10% each, with the difference between the central and outer scenarios in terms of economic severity being informed by the spread of external forecast distributions among professional industry forecasts. The outer scenarios are economically plausible, internally consistent states of the world and will not necessarily be as severe as scenarios used in stress testing. The period of forecast is five years, after which the forecasts will revert to a view based on average past experience. The central forecast and spread between the central and outer scenarios is grounded on the expected gross domestic product.

In general, the consequences of the assessment of credit risk and the resulting ECL outputs will be probability-weighted using the standard probability weights. This probability weighting may be applied directly or the effect of the probability-weighting determined on a periodic basis, at least annually, and then applied as an adjustment to the outcomes resulting from the central economic forecast. The central economic forecast is updated quarterly.

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

(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'.

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

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

- the use of the designation removes or significantly reduces an accounting mismatch; and
- where the financial liability contains one or more non-closely related embedded derivatives.

Designated financial liabilities are recognised when the Bank enters into contracts with counterparties, which is generally on settlement date, and are normally derecognised when extinguished. Subsequent changes in fair values are recognised in the Income statement in 'Net loss from financial instruments designated at fair value through profit or loss'.

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

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

(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 offsetting criteria in note 3(n).

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.

(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'.

Fair value hedge

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

Cash flow hedge

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

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 derivatives entered into as economic hedges of assets and liabilities for which hedge accounting is not applied.

(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.

(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.

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 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.

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.

(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.

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.

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'.

(w) 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.

(x) 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.

4 Net operating income

	Notes	Consolidated		Company	
		2018	2017	**2018**	2017
		$m	$m	**$m**	$m
(i) Interest income					
Loans and advances to banks		**26.2**	22.6	**26.2**	22.6
Loans and advances to customers		**925.6**	830.4	**925.6**	830.4
Financial assets measured at FVOCI		**169.6**	140.2	**169.6**	140.2
Related corporations		**5.7**	12.3	**5.7**	12.3
Key management personnel		**0.3**	0.3	**0.3**	0.3
		1,127.4	1,005.8	**1,127.4**	1,005.8
Included within various captions under interest income for the year ended 31 December 2018 is nil (2017:$2.1m) accrued on impaired financial assets.					
(ii) Interest expense					
Deposits by banks		**3.4**	3.4	**3.4**	3.4
Customer accounts		**291.2**	237.1	**291.2**	237.1
Repurchase agreements		**21.2**	17.7	**21.2**	17.7
Debt securities on issue		**11.7**	3.2	**11.7**	3.2
Related corporations		**57.5**	37.2	**57.5**	37.2
Other interest		**0.2**	–	**0.2**	–
Total interest expense		**385.2**	300.1	**385.2**	300.1
Less					
Interest expense classified as 'Net trading income'	*4(vi)*	**–**	(0.1)	**–**	(0.1)
Interest expense classified as 'Net income/(loss) on financial instruments designated at fair value'	*4(vii)*	**(1.6)**	(1.4)	**(1.6)**	(1.4)
Interest expense		**383.6**	298.6	**383.6**	298.6
(iii) Other operating income					
Recharge to related corporations		**126.3**	108.5	**126.3**	108.5
Other income		**2.7**	1.6	**2.7**	1.6
		129.0	110.1	**129.0**	110.1
(iv) Fee and commission income					
Fees and commissions		**185.6**	182.2	**185.6**	182.2
Fee income on fiduciary activities		**17.0**	22.8	**17.0**	22.8
		202.6	205.0	**202.6**	205.0
(v) Fee and commission expense					
Fees and commissions		**62.4**	58.5	**62.4**	58.7
Fees payable on fiduciary activities		**0.6**	2.7	**0.6**	2.7
		63.0	61.2	**63.0**	61.4
(vi) Net trading income					
Exchange rates		**89.5**	64.9	**89.5**	64.9
Interest rates		**(0.1)**	0.2	**(0.1)**	0.2
		89.4	65.1	**89.4**	65.1
Gains/(losses) from hedging activities					
Fair value hedges					
Net gain/(loss) on hedged items attributable to the hedged risk		**(12.1)**	1.7	**(12.1)**	1.7
Net gain/(loss) on hedging instruments		**11.9**	(1.0)	**11.9**	(1.0)
		(0.2)	0.7	**(0.2)**	0.7
Net interest income on trading activities					
Interest expense	*4(ii)*	**–**	(0.1)	**–**	(0.1)
		–	(0.1)	**–**	(0.1)
Total net trading income		**89.2**	65.7	**89.2**	65.7
(vii) Net loss from financial instruments designated at fair value					
Net interest income on financial instruments designated at fair value					
Interest expense	*4(ii)*	**(1.6)**	(1.4)	**(1.6)**	(1.4)
Total net loss from financial instruments designated at fair value		**(1.6)**	(1.4)	**(1.6)**	(1.4)
(viii) Change in fair value of other financial instruments mandatorily measured at fair value through profit or loss					
Change in fair value of other financial instruments mandatorily measured at fair value through profit or loss		**0.2**	–	**0.2**	–
		0.2	–	**0.2**	–
(ix) Net gain from disposal of financial assets measured at FVOCI					
Net gain from disposal of financial assets measured at FVOCI		**8.2**	5.7	**8.2**	5.7
		8.2	5.7	**8.2**	5.7

5 Net change in expected credit losses and and other credit risk provisions

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Loans and advances to banks and customers				
New allowances net of allowance releases	**48.5**	42.7	**48.5**	42.7
Recoveries of amounts previously written off	**(6.7)**	(8.9)	**(6.7)**	(8.9)
Loan commitments and guarantees	**(0.2)**	–	**(0.2)**	–
Other financial assets	**(2.6)**	–	**(2.6)**	–
Net change in expected credit losses and other credit impairment charges	**39.0**	33.8	**39.0**	33.8

	Consolidated	Company
	2017	2017
	$m	$m
Loan impairment charges		
New allowances	59.9	59.9
Reversal of allowances no longer required	(17.2)	(17.2)
Recoveries of amounts previously written off	(8.9)	(8.9)
	33.8	33.8
Individually assessed allowances charged	7.6	7.6
Collectively assessed allowances charged	26.2	26.2
Total loan impairment charges and other credit risk provisions	33.8	33.8

6 Operating expenses

		Consolidated		Company	
		2018	2017	**2018**	2017
	Note	**$m**	$m	**$m**	$m
Employee compensation and benefits					
Wages and salaries		**209.2**	190.3	**209.2**	190.3
Bonuses		**58.6**	52.1	**58.6**	52.1
Retirement and termination benefits		**19.5**	21.2	**19.5**	21.2
Share-based payment transactions	*33*	**3.8**	4.4	**3.8**	4.4
Other		**26.5**	25.7	**26.5**	25.7
		317.6	293.7	**317.6**	293.7
Premises and equipment					
Property rental		**43.2**	40.6	**43.2**	40.6
Equipment and other premise expense		**13.6**	12.2	**13.6**	12.2
Depreciation		**5.5**	5.4	**5.5**	5.4
Premise related provision		**0.1**	(0.2)	**0.1**	(0.2)
		62.4	58.0	**62.4**	58.0
General administrative expenses					
Marketing and communication		**42.6**	40.2	**42.6**	40.2
Legal and professional expenses		**16.4**	13.4	**16.4**	13.4
Printing and communication costs		**13.1**	14.6	**13.1**	14.6
Travel and entertainment		**8.5**	7.8	**8.5**	7.8
Auditor's remuneration		**2.0**	1.5	**2.0**	1.5
Fraud and operational losses		**4.7**	11.7	**4.7**	11.7
Contracted services		**28.7**	25.6	**28.7**	25.6
Other		**15.6**	24.0	**15.6**	24.0
		131.6	138.8	**131.6**	138.8
Other expenses					
Intercompany management fees	*33*	**120.5**	95.3	**120.5**	95.3
Amortisation of intangibles		**2.4**	1.6	**2.4**	1.6
		122.9	96.9	**122.9**	96.9

7 Auditor's remuneration

	Consolidated		Company	
	2018	2017	**2018**	2017
	$	$	**$**	$
Auditor of the consolidated entity				
Audit services				
Audit and review of financial reports	**1,124,456**	916,139	**1,124,456**	916,139
Other assurance services				
Regulatory and other audit services	**834,662**	654,142	**834,662**	654,142
At 31 Dec	**1,959,118**	1,570,281	**1,959,118**	1,570,281

8 Income tax expense

		Consolidated		Company	
		2018	2017	**2018**	2017
	Note	**$m**	$m	**$m**	$m
Recognised in the Income statement					
(a) Current tax expense					
Current year		**(135.9)**	(122.5)	**(135.9)**	(122.5)
Adjustments for prior years		**(0.9)**	5.2	**(0.9)**	5.2
		(136.8)	(117.3)	**(136.8)**	(117.3)
Deferred tax expense					
Origination and reversal of temporary differences		**4.3**	(0.1)	**4.3**	(0.1)
Adjustments for prior years		**(0.7)**	(4.2)	**(0.7)**	(4.2)
	16	**3.6**	(4.3)	**3.6**	(4.3)
Total income tax expense in Income statement		**(133.2)**	(121.6)	**(133.2)**	(121.6)
Attributable to Continuing operations		**(133.2)**	(121.6)	**(133.2)**	(121.6)
Numerical reconciliation between tax expense and pre-tax net profit					
Profit before income tax		**434.9**	409.9	**434.9**	409.7
Income tax using the corporation tax rate of 30%		**(130.5)**	(122.9)	**(130.5)**	(122.9)
(Increase)/decrease in income tax expense due to:					
– non-deductible expenses		**(1.1)**	(0.9)	**(1.1)**	(0.9)
– other		**–**	1.2	**–**	1.2
		(131.6)	(122.6)	**(131.6)**	(122.6)
(Under)/over provided in prior years		**(1.6)**	1.0	**(1.6)**	1.0
Income tax expense		**(133.2)**	(121.6)	**(133.2)**	(121.6)
(b) Deferred tax recognised directly in equity					
Relating to capital contribution reserve		**0.2**	0.5	**0.2**	0.5
Relating to financial assets measured at FVOCI and cash flow hedging reserves		**0.2**	(3.2)	**0.2**	(3.2)
	16	**0.4**	(2.7)	**0.4**	(2.7)

9 Loans and advances to customers and impairment allowances

	Consolidated	Company
	2017	2017
	$m	$m
Gross amount of loans not individually impaired	22,438.9	22,438.9
Allowance for collective impairment	(29.2)	(29.2)
Carrying amount	22,409.7	22,409.7
Gross amount of impaired loans	209.8	209.8
Allowance for individual impairment	(64.9)	(64.9)
Allowance for collective impairment	(8.5)	(8.5)
Carrying amount	136.4	136.4
Total loans	22,546.1	22,546.1
Movements in Impairment allowances		
Allowance for individual impairment		
Balance as at 1 Jan	71.1	71.1
Impairment charge for the year	7.6	7.6
Write off	(13.8)	(13.8)
Balance as at 31 Dec	64.9	64.9
Allowance for collective impairment		
Balance as at 1 Jan	44.8	44.8
Impairment charge for the year	26.2	26.2
Write off	(33.3)	(33.3)
Balance as at 31 Dec	37.7	37.7

The above disclosure relates only to 2017 and any 2018 disclosures are included in note 27b.

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).

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 9. 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.

Derivative 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 2019 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.

Offsetting

Offsetting can occur in the following instances:

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

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

The bank has $2,046.0m in repurchase agreements with enforceable netting arrangements, $112.1m in derivatives and $55.1m in customer accounts.

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.

Fair values of third party and inter-company derivatives' open positions by product contract type

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Assets				
Trading derivatives				
Third party				
– exchange rate	**45.2**	28.3	**45.2**	28.3
– interest rate	**2.8**	0.8	**2.8**	0.8
	48.0	29.1	**48.0**	29.1
Related entities				
– exchange rate	**92.7**	36.0	**92.7**	36.0
– interest rate	**3.0**	3.0	**3.0**	3.0
	95.7	39.0	**95.7**	39.0
Hedging derivatives				
Related entities				
– interest rate	**14.0**	11.2	**14.0**	11.2
	14.0	11.2	**14.0**	11.2
At 31 Dec	**157.7**	79.3	**157.7**	**79.3**
Liabilities				
Trading derivatives				
Third party				
– exchange rate	**65.5**	23.0	**65.5**	23.0
– interest rate	**–**	0.1	**–**	0.1
	65.5	23.1	**65.5**	23.1
Related entities				
– exchange rate	**42.7**	30.3	**42.7**	30.3
– interest rate	**3.0**	0.8	**3.0**	0.8
	45.7	31.1	**45.7**	31.1
Hedging derivatives				
Related entities				
– interest rate	**26.8**	18.4	**26.8**	18.4
At 31 Dec	**138.0**	72.6	**138.0**	72.6

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 2018 were assets of $14.0m (2017:$10.1m) and liabilities of $23.4m (2017:$12.3m).

Gains or losses arising from fair value hedges

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Gains or losses arising from fair value hedges				
Gains/(losses)				
– on hedging instruments	**(12.1)**	1.7	**(12.1)**	1.7
– on hedged items attributable to the hedged risked	**11.9**	(1.0)	**11.9**	(1.0)
31 Dec	**(0.2)**	0.7	**(0.2)**	0.7

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 2018, the fair values of outstanding derivatives designated as cash flow hedges were assets of $0.0m (2017: $1.1m) and liabilities of $3.4m (2017: $6.1m).

The schedule of forecast principal balances on which the expected interest cash flows arise as at 31 December 2018 is as follows:

Forecast principal balances on which interest cash flows are expected to arise – consolidated and company

	3 months or less	**More than 3 months but less than 1 year**	**5 years or less but more than 1 year**
	$m	**$m**	**$m**
At 31 Dec 2018			
Cash inflows exposures	**100.0**	**–**	**–**
Cash outflows exposures	**(426.0)**	**(426.0)**	**(150.0)**
Net cash inflows/(outflows)	**(326.0)**	**(426.0)**	**(150.0)**
At 31 Dec 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)

11 Financial assets measured at FVOCI

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Analysis of financial assets measured at FVOCI by security type				
– debt securities	**6,719.3**	5,827.1	**6,719.3**	5,827.1
– equities	**4.0**	4.0	**4.0**	4.0
– treasury and other eligible bills	**2,580.7**	1,006.9	**2,580.7**	1,006.9
	9,304.0	6,838.0	**9,304.0**	6,838.0
Analysis of financial assets measured at FVOCI by security issuer				
– government securities and Australian Government agencies	**7,718.4**	5,161.7	**7,718.4**	5,161.7
– banks and building societies	**1,585.6**	1,676.3	**1,585.6**	1,676.4
	9,304.0	6,838.0	**9,304.0**	6,838.1

12 Property, plant and equipment

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Leasehold improvements at cost				
Balance at 1 Jan	**72.8**	61.5	**72.8**	61.5
Assets acquired	**10.1**	13.7	**10.1**	13.7
Assets disposed	**(2.6)**	(2.4)	**(2.6)**	(2.4)
Balance at 31 Dec	**80.3**	72.8	**80.3**	72.8
Furniture, fittings, office equipment at cost				
Balance at 1 Jan	**17.3**	30.8	**17.3**	30.8
Assets acquired	**3.0**	4.4	**3.0**	4.4
Assets disposed	**(0.3)**	(17.9)	**(0.3)**	(17.9)
Balance at 31 Dec	**20.0**	17.3	**20.0**	17.3
Leasehold improvements accumulated depreciation				
Balance at 1 Jan	**(48.9)**	(48.4)	**(48.9)**	(48.4)
Depreciation charge for the year	**(3.7)**	(2.9)	**(3.7)**	(2.9)
Disposals	**2.5**	2.4	**2.5**	2.4
Balance at 31 Dec	**(50.1)**	(48.9)	**(50.1)**	(48.9)
Furniture, fittings, office equipment accumulated depreciation				
Balance at 1 Jan	**(13.0)**	(22.0)	**(13.0)**	(22.0)
Depreciation charge for the year	**(1.7)**	(2.5)	**(1.7)**	(2.5)
Disposals	**0.3**	11.5	**0.3**	11.5
Balance at 31 Dec	**(14.4)**	(13.0)	**(14.4)**	(13.0)
Carrying amounts				
At 1 Jan	**28.2**	21.9	**28.2**	21.9
At 31 Dec	**35.8**	28.2	**35.8**	28.2

13 Group entities

	Note	**2018**	2017	Place of
		%	%	incorporation
Controlling entity				
HSBC Bank Australia Limited		**—**	—	Australia
Controlled entities				
HSBC Custody Nominees (Australia) Limited		**100**	100	Australia
ACN 087 652 113 Pty Limited		**100**	100	Australia
Lion Series 2009-1 Trust	(1)	**100**	100	Australia

(1) 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.

14 Intangible assets

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Goodwill				
Cost and carrying amount				
Balance at 1 Jan	**58.7**	58.7	**58.7**	58.7
Balance at 31 Dec	**58.7**	58.7	**58.7**	58.7
Internally generated software				
Cost				
Balance at 1 Jan	**17.7**	14.9	**17.7**	14.9
Addition	**9.3**	2.8	**9.3**	2.8
Balance at 31 Dec	**27.0**	17.7	**27.0**	17.7
Accumulated amortisation				
Balance at 1 Jan	**(11.6)**	(10.0)	**(11.6)**	(10.0)
Amortisation charge for the year	**(2.4)**	(1.6)	**(2.4)**	(1.6)
Balance at 31 Dec	**(14.0)**	(11.6)	**(14.0)**	(11.6)
Carrying amounts				
At 1 Jan	**6.1**	4.9	**6.1**	4.9
At 31 Dec	**13.0**	6.1	**13.0**	6.1
Total intangible assets	**71.7**	64.8	**71.7**	64.8

Segment allocation of goodwill

In accordance with Australian Accounting Standard AASB 138 'Intangible Assets', the consolidated entity's carrying amount of goodwill as at 31 December 2018 is disclosed for each segment of business.

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
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

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 unit's impairment test is based on value in use calculations ('VIU').

The VIU is calculated by discounting management's cash flow projections for the 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 7.6% 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 VIU 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 2018 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.

15 Other assets

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Acceptances and endorsements	**168.8**	241.1	**168.8**	241.1
Prepayments and accrued income	**133.9**	126.5	**132.1**	125.2
Margins with exchange	**137.6**	45.5	**137.6**	45.5
Other assets	**30.5**	27.7	**30.6**	27.8
Assets held for resale	**1.1**	0.8	**1.1**	0.8
Total	**471.9**	441.6	**470.2**	440.4

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

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 Holdings 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

Deferred tax assets and liabilities

	Deferred tax assets		Deferred tax liabilities		Net deferred tax assets	
	2018	2017	**2018**	2017	**2018**	2017
	$m	$m	**$m**	$m	**$m**	$m
Consolidated and Company						
Impairment allowances	**48.7**	30.7	**(1.3)**	(0.6)	**47.4**	30.1
Tangible fixed assets	**16.0**	15.4	**–**	–	**16.0**	15.4
Prepayments and accrued income	**–**	–	**(0.9)**	(0.9)	**(0.9)**	(0.9)
Other liabilities/accrued expenses	**4.3**	31.4	**(0.4)**	(0.2)	**3.9**	31.2
Accruals and deferred income	**41.5**	12.2	**–**	–	**41.5**	12.2
Provision for liabilities and charges	**5.1**	1.9	**–**	–	**5.1**	1.9
Retained earnings	**0.6**	0.4	**–**	–	**0.6**	0.4
Cash flow hedging reserve	**1.1**	1.8	**–**	–	**1.1**	1.8
Financial assets measured at FVOCI securities reserve	**–**	–	**(0.1)**	(1.1)	**(0.1)**	(1.1)
Own credit spread reserve	**0.3**	–	**–**	–	**0.3**	–
Total tax assets/(liabilities)	**117.6**	93.8	**(2.7)**	(2.8)	**114.9**	91.0

Movement in temporary differences

	1 Jan 2018	**AASB 9 transitional adjustment**	**AASB 9 Balance 1 Jan 18**	**Recognised in income**	**Recognised in equity**	**31 Dec 2018**	1 Jan 2017	Recognised in income	Recognised in equity	31 Dec 2017
	$m	**$m**	**$m**	**$m**	**$m**	**$m**	$m	$m	$m	$m
Consolidated and Company										
Impairment allowances	**30.1**	**16.5**	**46.6**	**0.8**	**–**	**47.4**	34.9	(4.8)	–	30.1
Tangible fixed assets	**15.4**	**–**	**15.4**	**0.6**	**–**	**16.0**	16.3	(0.9)	–	15.4
Prepayments and accrued income	**(0.9)**	**–**	**(0.9)**	**–**	**–**	**(0.9)**	(0.7)	(0.2)	–	(0.9)
Other liabilities/accrued expenses	**3.3**	**–**	**3.3**	**0.6**	**–**	**3.9**	5.3	(2.0)	–	3.3
Accruals and deferred income	**40.1**	**–**	**40.1**	**1.4**	**–**	**41.5**	36.3	3.8	–	40.1
Provision for liabilities and	**1.9**	**3.3**	**5.2**	**(0.1)**	**–**	**5.1**	2.1	(0.2)	–	1.9
Retained earnings	**0.4**	**–**	**0.4**	**–**	**0.2**	**0.6**	(0.1)	–	0.5	0.4
Cash flow hedging reserve	**1.8**	**–**	**1.8**	**–**	**(0.7)**	**1.1**	3.1	–	(1.3)	1.8
FVOCI securities reserve	**(1.1)**	**0.1**	**(1.0)**	**–**	**0.9**	**(0.1)**	0.8	–	(1.9)	(1.1)
Own credit spread reserve	**–**	**–**	**–**	**0.3**	**–**	**0.3**	–	–	–	–
	91.0	**19.9**	**110.9**	**3.6**	**0.4**	**114.9**	98.0	(4.3)	(2.7)	91.0

17 Trading liabilities and financial liabilities designated at fair value

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Trading liabilities				
Customer accounts	**–**	3.3	**–**	3.3
	–	3.3	**–**	3.3
Financial liabilities designated at fair value				
Debt securities on issue	**43.0**	43.6	**43.0**	43.6
	43.0	43.6	**43.0**	43.6

18 Provisions for liabilities and charges

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
At 1 Jan	**6.2**	7.1	**6.2**	7.1
AASB 9 Transition	**11.1**	–	**11.1**	–
New provisions	**7.8**	9.5	**7.8**	9.5
Release of provision	**(9.9)**	(1.6)	**(9.9)**	(1.6)
Provisions utilised	**1.4**	(8.7)	**1.4**	(8.7)
Balance at 31 Dec	**16.6**	6.2	**16.6**	6.2

Provisions contain the ECL provision for off balance sheet items of $13.1m see note 27 and other provisions, which are individually insignificant, in respect of remediation activities, restructurings, and litigation.

19 Debt securities on issue

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Certificate of deposit	**183.8**	246.5	**183.8**	246.5
Bonds and medium-term notes	**250.0**	100.0	**250.0**	100.0
	433.8	346.5	**433.8**	346.5

20 Other liabilities

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Acceptances and endorsements	**168.8**	241.1	**168.8**	241.1
Accruals and deferred income	**76.8**	71.7	**75.1**	70.3
Settlement balances	**89.2**	92.2	**89.2**	92.2
Other liabilities	**100.3**	38.7	**100.3**	38.6
	435.1	443.7	**433.4**	442.2

21 Employee benefits

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Liability for annual leave	**14.9**	13.8	**14.9**	13.8
Bonus payable	**56.2**	49.7	**56.2**	49.7
Liability for long service leave	**22.1**	20.9	**22.1**	20.9
	93.2	84.4	**93.2**	84.4

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 $18.9m for the year ended 31 December 2018 (2017:$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 2018, $3.8m (2017: $4.4m) 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.

22 Capital

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
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.

23 Reserves and dividends

(a) Reserves

Financial assets measured at FVOCI securities reserve

The FVOCI securities reserve includes the cumulative net change in the fair value of FVOCI 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.

Own Credit Spread Reserve

This reserve represents the own credit spread component of the fair value movement for financial liabilities designated at fair value.

Other capital reserve

This reserve represents the issuance of $250m 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

	2018		2017	
	Per share	**Total**	Per share	Total
	$	**$m**	$	$m
Ordinary shares				
Dividend 1	**0.057**	**39.0**	0.076	52.4
Dividend 2	**0.030**	**20.9**	0.039	27.0
Dividend 3	**0.035**	**24.0**	0.052	35.3
Dividend 4	**0.033**	**22.4**	0.037	25.5
		106.3		140.2
Tier 1 instruments				
Dividend 1	**–**	**8.4**	–	8.7
Dividend 2	**–**	**8.6**	–	8.6
		17.0		17.3
		123.3		**157.5**

24 Commitments

Lease commitments

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
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	**37.2**	33.8	**37.2**	33.8
Payable between 1 and 5 years	**104.0**	108.5	**104.0**	108.5
Payable over 5 years	**69.8**	110.3	**69.8**	110.3
	211.0	252.6	**211.0**	252.6

The consolidated entity leases property under operating leases expiring from one to 12 years. Leases generally provide the consolidated entity with a right of renewal at which time all terms are renegotiated.

Other commitments

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Documentary credits and trade related transactions	**159.8**	288.9	**159.8**	288.9
Undrawn lending facilities	**10,813.8**	11,458.5	**10,813.8**	11,458.5
	10,973.6	11,747.4	**10,973.6**	11,747.4

25 Contingent liabilities

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Contingent liabilities in respect of guarantees given	**1,077.9**	1,131.3	**1,077.9**	1,131.3
Letters of credit and other contingencies	**1,801.0**	1,628.3	**1,801.0**	1,628.3

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.

The Bank is party to legal proceedings and regulatory matters in a number of jurisdictions arising out of its normal business operations. Apart from the matters described below, HSBC considers that none of these matters are material. The recognition of provisions is determined in accordance with the accounting policies set out in note 1. While the outcome of legal proceedings and regulatory matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of these matters as at 31 December 2018 note 18. Where an individual provision is material, the fact that a provision has been made is stated and quantified, except to the extent doing so would be seriously prejudicial. Any provision recognised does not constitute an admission of wrongdoing or legal liability.

Regulatory

Regulators and other bodies continue to progress various reviews involving the financial services sector. The nature of these reviews can be wide-ranging and, in Australia, currently include investigations into potential misconduct in credit and financial services. These regulatory bodies may make findings that the Bank has engaged in misconduct including breaches of law or conduct that falls below community standards and expectations. Any findings made may result in litigation, fines, penalties, revocation, suspension or variation of conditions of relevant regulatory licences or other enforcement or administrative action being taken by regulators or other bodies.

Litigation

There are ongoing court proceedings, claims and possible claims for and against the Company. Contingent liabilities exist in respect of actual and potential claims and proceedings, including those listed below. An assessment of the Company's likely loss has been made on a case-by-case basis for the purpose of the financial statements but cannot always be reliably estimated. Where appropriate, specific provisions have been made note 18.

In August 2016, HSBC Bank Australia Limited and other panel banks were named as defendants in two putative class actions filed in the New York District Court on behalf of persons who transacted in products related to the BBSW benchmark rates. The complaints allege, among other things, misconduct related to these benchmark rates in violation of US antitrust, commodities and racketeering laws, and state law. The defendants moved to dismiss the BBSW case in February 2017 and filed a renewed motion to dismiss on standing and capacity to sue grounds in February 2018. These motions were upheld in November 2018.

26 Fiduciary activities

	Consolidated	
	2018	2017
	$m	$m
Funds under custody	**398,505.6**	395,561.2

The Bank provides custody and clearing services to global custodians, fund managers and broker dealers.

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 Bank 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 assets measured at FVOCI. 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
- 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 consolidated entity 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.

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 assets measured at FVOCI.

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.

Summary of credit risk

The disclosure below presents the gross carrying/nominal amount of financial instruments to which the impairment requirements in AASB 9 are applied and the associated allowance for ECL. Due to the forward-looking nature of AASB 9, the scope of financial instruments on which ECL are recognised is greater than the scope of AASB 139. The following tables analyse loans by industry sector and represent the concentration of exposures on which credit risk is managed.

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

	At 31 Dec 2018	
	Gross carrying/nominal amount	Allowance for ECL
	$m	$m
Loans and advances to customers at amortised cost		
Personal	20,716.6	(86.3)
– mortgages	19,634.1	(7.2)
– other personal (including credit cards)	1,082.5	(79.1)
Corporate and commercial	4,526.8	(76.0)
Non-bank financial institutions	131.5	(0.3)
Loans and advances to banks at amortised cost	45.5	–
Other financial assets measured at amortised cost	2,211.9	(0.2)
– cash and balances at central banks	1,750.0	–
– items in the course of collection from other banks	1.9	–
– reverse repurchase agreements – non-trading	–	–
– other financial assets held at amortised cost	460.0	(0.2)
Total gross carrying amount on-balance sheet	27,632.3	(162.8)
Loans and other credit related commitments	8,481.8	(8.3)
– personal	6,309.9	(0.4)
– corporate and commercial	1,645.5	(7.6)
– financial	526.4	(0.3)
Financial guarantee and similar contracts	1,026.3	(4.8)
– personal	20.1	(0.2)
– corporate and commercial	868.0	(4.4)
– financial	138.2	(0.2)
Total nominal amount off-balance sheet	9,508.1	(13.1)
At 31 Dec 2018	37,140.4	(175.9)

	Fair value	Memorandum allowance for ECL
	$m	$m
Debt instruments measured at FVOCI	9,299.9	(0.2)

The following table provides an overview of the consolidated entity's credit risk by stage and industry, and the associated ECL coverage. The financial assets recorded in each stage have the following characteristics:

- Stage 1: Unimpaired and without significant increase in credit risk on which a 12-month allowance for ECL is recognised.
- Stage 2: A significant increase in credit risk has been experienced since initial recognition on which a lifetime ECL is recognised.
- Stage 3: Objective evidence of impairment, and are therefore considered to be in default or otherwise credit impaired on which a lifetime ECL is recognised.
- POCI: Purchased or originated at a deep discount that reflects the incurred credit losses on which a lifetime ECL is recognised.

Summary of credit risk (excluding debt instruments measured at FVOCI) by stage distribution and ECL sector

	Gross carrying/nominal				Allowance for ECL				ECL coverage %			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	$m	$m	$m	$m	$m	$m	$m	$m	%	%	%	%
Loans and advances to customers at amortised cost	22,924.0	2,221.2	229.7	25,374.9	(30.4)	(35.4)	(96.8)	(162.6)	(0.1)	(1.6)	(42.1)	(0.6)
– personal	19,043.1	1,527.5	146.0	20,716.6	(26.7)	(25.2)	(34.4)	(86.3)	(0.1)	(1.7)	(23.5)	(0.4)
– corporate and commercial	3,751.8	691.3	83.7	4,526.8	(3.5)	(10.1)	(62.4)	(76.0)	(0.1)	(1.5)	(74.6)	(1.7)
– non-bank financial institutions	129.1	2.4	–	131.5	(0.2)	(0.1)	–	(0.3)	(0.2)	(4.2)	–	(0.2)
Loans and advances to banks at amortised cost	45.4	0.1	–	45.5	–	–	–	–	–	–	–	–
Other financial assets measured at amortised cost	2,207.2	3.6	1.1	2,211.9	(0.1)	(0.1)	–	(0.2)	–	(2.8)	–	–
Loans and other credit-related commitments	8,399.6	82.2	–	8,481.8	(5.4)	(2.9)	–	(8.3)	(0.1)	(3.5)	–	(0.1)
– personal	6,295.7	14.1	–	6,309.8	–	(0.4)	–	(0.4)	–	(2.8)	–	–
– corporate and commercial	1,577.6	67.9	–	1,645.5	(5.1)	(2.5)	–	(7.6)	(0.3)	(3.7)	–	(0.5)
– financial	526.3	0.2	–	526.5	(0.3)	–	–	(0.3)	(0.1)	–	–	(0.1)
Financial guarantee and similar contracts	886.3	136.7	3.3	1,026.3	(1.2)	(1.9)	(1.7)	(4.8)	(0.1)	(1.4)	(51.5)	(0.5)
– personal	19.5	–	0.6	20.1	–	–	(0.2)	(0.2)	–	–	(33.3)	(1.0)
– corporate and commercial	729.0	136.3	2.7	868.0	(1.0)	(1.9)	(1.5)	(4.4)	(0.1)	(1.4)	(55.6)	(0.5)
– financial	137.8	0.4	–	138.2	(0.2)	–	–	(0.2)	(0.1)	–	–	(0.1)
At 31 Dec 2018	34,462.5	2,443.8	234.1	37,140.4	(37.1)	(40.3)	(98.5)	(175.9)	(0.1)	(1.7)	(42.0)	(0.5)

Unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when they are 30 days past due and are transferred from stage 1 to stage 2. The disclosure below presents the ageing of stage 2 financial assets by those less than 30 and greater than 30 days past due and therefore presents those financial assets classified as stage 2 due to ageing (30 days past due) and those identified at an earlier stage (less than 30 days past due).

Stage 2 and days past due analysis

	Gross carrying amount			Allowance for ECL			ECL coverage %		
		Of which:	*Of which:*		*Of which:*	*Of which:*		*Of which:*	*Of which:*
	Stage 2	***1 to 29 DPD***	***30 and > DPD***	**Stage 2**	***1 to 29 DPD***	***30 and > DPD***	**Stage 2**	***1 to 29 DPD***	***30 and > DPD***
	$m	**$m**	**$m**	**$m**	**$m**	**$m**	**%**	**%**	**%**
Loans and advances to customers at amortised cost	**2,221.2**	**145.0**	**46.3**	**(35.4)**	**–**	**–**	**(1.6)**	**—**	**—**
– personal	**1,527.5**	**145.0**	**46.1**	**(25.2)**	**–**	**–**	**(1.7)**	**—**	**—**
– corporate and commercial	**691.3**	**–**	**–**	**(10.1)**	**–**	**–**	**(1.5)**	**—**	**—**
– non-bank financial institutions	**2.4**	**–**	**0.2**	**(0.1)**	**–**	**–**	**(4.2)**	**—**	**—**
Loans and advances to banks at amortised cost	**0.1**	**–**	**–**	**—**	**–**	**–**	**—**	**—**	**—**
Other financial assets measured at amortised cost	**3.6**	**–**	**–**	**(0.1)**	**–**	**—**	**(2.8)**	**—**	**—**
Loan and other credit-related commitments	**82.2**	**–**	**–**	**(2.9)**	**–**	**–**	**(3.5)**	**—**	**—**
– personal	**14.1**	**–**	**–**	**(0.4)**	**–**	**–**	**(2.8)**	**—**	**—**
– corporate and commercial	**67.9**	**–**	**–**	**(2.5)**	**–**	**–**	**(3.7)**	**—**	**—**
– financial	**0.2**	**–**	**–**	**–**	**–**	**–**	**—**	**—**	**—**
Financial guarantee and similar contracts	**136.7**	**–**	**–**	**(1.9)**	**–**	**–**	**(1.4)**	**—**	**—**
– personal	**–**	**–**	**–**	**–**	**–**	**–**	**—**	**—**	**—**
– corporate and commercial	**136.3**	**–**	**–**	**(1.9)**	**–**	**–**	**(1.4)**	**—**	**—**
– financial	**0.4**	**–**	**–**	**–**	**–**	**–**	**—**	**—**	**—**
At 31 Dec 2018	**2,443.8**	**145.0**	**46.3**	**(40.3)**	**–**	**—**	**(1.7)**	**—**	**—**

Measurement uncertainty and sensitivity analysis of ECL

Expected credit loss impairment allowances recognised in the financial statements reflect the effect of a range of possible economic outcomes, calculated on a probability-weighted basis, based on the economic scenarios described below. The recognition and measurement of ECL involves the use of significant judgement and estimation. It is necessary to formulate multiple forward-looking economic forecasts and incorporate them into the ECL estimates. HSBC uses a standard framework to form economic scenarios to reflect assumptions about future economic conditions, supplemented with the use of management judgement, which may result in using alternative or additional economic scenarios and/or management adjustments.

Methodology

HSBC has adopted the use of three scenarios, representative of our view of forecast economic conditions, sufficient to calculate unbiased expected loss in most economic environments. They represent a 'most likely outcome' (the Central scenario), and two, less likely 'outer' scenarios, referred to as the Upside and Downside scenarios. Each outer scenario is consistent with a probability of 10%, while the Central scenario is assigned the remaining 80%, according to the decision of HSBC's senior management. This weighting scheme is deemed appropriate for the unbiased estimation of ECL in most circumstances. Key scenario assumptions are set using the average of forecasts of external economists, helping to ensure that the AASB 9 scenarios are unbiased and maximise the use of independent information. The central, upside and downside scenarios selected with reference to external forecast distributions using the above approach are termed the 'consensus economic scenarios'.

For the Central scenario, HSBC sets key assumptions such as GDP growth, inflation, unemployment and policy interest rates, using either the average of external forecasts (commonly referred to as consensus forecasts) for most economies, or market prices. An external provider's global macro model, conditioned to follow the consensus forecasts, projects the other paths required as inputs to credit models. This external provider is subject to HSBC's risk governance framework, with oversight by a specialist internal unit.

The Upside and Downside scenarios are designed to be cyclical, in that GDP growth, inflation and unemployment usually revert back

to the Central scenario after the first three years for major economies. We determine the maximum divergence of GDP growth from the Central scenario using the 10th and the 90th percentile of the entire distribution of forecast outcomes for major economies. While key economic variables are set with reference to external distributional forecasts, HSBC also aligns the overall narrative of the scenarios to the macroeconomic risks described in HSBC's 'Top and emerging risks'. This ensures that scenarios remain consistent with the more qualitative assessment of these risks. We project additional variable paths using the external provider's global macro model.

We apply the following to generate the three economic scenarios:

To generate the three scenarios, the following are applied:

- Economic risk assessment – HSBC has developed a shortlist of the upside and downside economic and political risks most relevant to HSBC and the AASB 9 measurement objective.
- Scenario generation – For the central scenario, HSBC obtains a predefined set of economic forecasts from the average taken from the consensus forecast survey of professional forecasters. Paths for the two outer scenarios are benchmarked to the central scenario and reflect the economic risk assessment. Scenario probabilities reflect management judgement and are informed by data analysis of past recessions, transitions in and out of recession, and the current economic outlook. The key assumptions made, and the accompanying paths, represent our 'best estimate' of a scenario at a specified probability. Suitable narratives are developed for the central scenario and the paths of the two outer scenarios.

- Variable enrichment – HSBC expands each scenario through enrichment of variables. This includes the production of more than 400 variables that are required to calculate ECL. The external provider expands these scenarios by using as inputs the agreed scenario narratives and the variables aligned to these narratives. Scenarios, once expanded, continue to be benchmarked to the latest events and information. Late-breaking events could lead to the revision of scenarios to reflect management judgement.

The upside and downside scenarios are generated at year-end and are only updated during the year if economic conditions change significantly. The central scenario is generated every quarter. In quarters where only the central scenario is updated, wholesale outer scenarios are adjusted such that the relationship between the central scenario and outer scenarios in the quarter is consistent with that observed at the last full scenario generation. In retail, three scenarios are run annually to establish the effect of non-linearity for each portfolio. This effect is then applied in each quarter with the understanding that the non-linearity of response to economic conditions should not change, unless a significant change in economic conditions occurs. HSBC recognises that the consensus economic scenario approach, using three scenarios, will be insufficient in certain economic environments. Additional analysis may be requested at management's discretion, including the production of extra scenarios. Details on the management overlay are on page 38.

Central scenario

HSBC's central scenario is characterised by steady growth over the forecast period 2018–2023. Global GDP growth is expected to be 3% on average over the period which is marginally higher than the average growth rate over 2011–2016. GDP growth rate is forecast at 3.2% in 2018 and 3.1% in 2019. The elevated growth rates through 2018–19 are considered temporary in nature, and global growth reverts to a trend rate of 2.9% by the third year of the five-year projection. Unemployment rates displayed considerable positive cyclical momentum in 2018 across our key markets and such momentum is expected to continue to underpin labour market performance in the forecast period. Central scenario forecasts of the unemployment rate are stable and, for some markets, at historical lows.

Central scenario (Average 2019-2023)

	Australia
GDP growth rate (%)	**2.6%**
Inflation (%)	**2.4%**
Unemployment (%)	**5.2%**
House price growth (%)	**3.3%**

Upside scenario

Globally, real GDP growth rises in the first two years of the upside scenario before converging to the central scenario. Improved confidence, accommodative monetary policy, fiscal expansion and diminished political risk are the key themes that support the upside scenario.

Upside scenario (Average 2019-2023)

	Australia
GDP growth rate (%)	**3.0%**
Inflation (%)	**2.5%**
Unemployment (%)	**4.7%**
House price growth (%)	**4.5%**

Downside scenario

Globally, real GDP growth declines for two years in the downside scenario before recovering to the central scenario. House price growth either stalls or contracts, and equity markets correct abruptly. The global slowdown in demand drives commodity prices lower and inflation falls. Central banks remain accommodative. This is consistent with the risk themes of rising protectionism, central bank policy uncertainty, mainland China choosing to rebalance at a faster pace, and an absence of fiscal support.

Downside scenario (Average 2019-2023)

	Australia
GDP growth rate (%)	**2.3%**
Inflation (%)	**2.2%**
Unemployment (%)	**5.6%**
House price growth (%)	**1.4%**

How economic scenarios are reflected in the wholesale calculation of ECL

HSBC has developed a globally consistent methodology for the application of forward economic guidance ('FEG') in the calculation of ECL. This involves the incorporation of FEG into the estimation of the term structure of PD and loss given default ('LGD'). For PDs, HSBC considers the correlation of FEG to default rates for a particular industry in a country. For LGD calculations, we consider the correlation of FEG to collateral values and realisation rates for a particular country and industry. PDs and LGDs are estimated for the entire term structure of each instrument. For stage 3 impaired loans, LGD estimates take into account independent recovery valuations provided by external consultants where available, or internal forecasts corresponding to anticipated economic conditions and individual company conditions. In estimating the ECL on impaired loans that are considered individually not to be significant, HSBC incorporates FEG via the application of a scalar. The scalar reflects the ratio of the probability-weighted outcome to the Central scenario outcome for non-stage 3 populations.

How economic scenarios are reflected in the retail calculation of ECL

The impact of FEG on PD is modelled at a portfolio level. Historical relationships between observed default rates and macroeconomic variables are integrated into ECL by using economic response models. The impact of FEG on PD is modelled over a period equal to the remaining maturity of underlying asset(s). The impact on LGD is modelled for mortgage portfolios by forecasting future loan-to-value ('LTV') profiles for the remaining maturity of the asset, by using national-level forecasts of the house price index ('HPI') and applying the corresponding LGD expectation.

Effect of multiple economic scenarios on ECL

The ECL recognised in the financial statements reflect the effect on expected credit losses of a range of possible outcomes, calculated on a probability-weighted basis, based on the economic scenarios described above, including management overlays where required. The probability-weighted amount is typically a higher number than would result from using only the Central (most likely) economic scenario. Expected losses typically have a non-linear relationship to the many factors which influence credit losses, such that more favourable macroeconomic factors do not reduce defaults as much as less favourable macroeconomic factors increase defaults. The probability-weighted ECL are 3% higher than the ECL prepared using only Central scenario assumptions, reflecting the relatively stable and benign economic outlook across most markets.

A management overlay of $3.5m has been included in the 31 December 2018 ECL, adding to the result from the consensus economic scenarios; $(10.1)m of this relates to wholesale, and $13.6m to retail. The wholesale overlay was raised as the latest robust TDR calculated is as at the end of January 2017. Since the then the portfolio has not had a single default and the calculated TDR of 400bps from the model was deemed to be in excess of current performance. The retail overlays are an adjustment to capture the new behaviour scorecard which is not reflected in the current model, correction to account for loan to value ratio ('LVR') movements from origination on the mortgage portfolio and finally an overlay for personal loans currently using the cards ECL model.

ECL based exposures at 31 Dec 2018

	Retail	Wholesale	Total
Central scenario	81.3	28.3	109.6
Upside scenario	76.7	23.2	99.9
Downside scenario	88.6	35.5	124.1

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers

The disclosure below provides a reconciliation of the consolidated entity's gross carrying/nominal amount and allowances for loans and advances to banks and customers including loan commitments and financial guarantees. The reconciliation excludes the movement in other financial assets measured at amortised cost and debt instruments measured at FVOCI. The 31 December 2018 gross carrying amount and allowance for ECL for these financial instruments is presented in the 'Summary of financial instruments to which the impairment requirements in AASB 9 are applied' disclosure on page 35.

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

	Non-credit impaired				Credit impaired					
	Stage 1		Stage 2		Stage 3		POCI		Total	
	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL
	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m
At 1 Jan 2018	**21,441.3**	**(32.9)**	**1,602.3**	**(20.7)**	**137.2**	**(29.2)**	**–**	**–**	**23,180.8**	**(82.8)**
Transfers of financial instruments:										
– Transfers from Stage 1 to Stage 2	(1,516.2)	5.9	1,516.2	(5.9)	–	–	–	–	–	–
– Transfers from Stage 2 to Stage 1	1,414.3	(22.2)	(1,414.3)	22.2	–	–	–	–	–	–
– Transfers to Stage 3	(19.3)	0.2	(103.7)	18.5	123.0	(18.7)	–	–	–	–
– Transfers from Stage 3	–	–	21.5	(1.3)	(21.5)	1.3	–	–	–	–
– Net remeasurement of ECL arising from transfer of stage	–	10.7	–	(12.5)	–	(8.3)	–	–	–	(10.1)
New financial assets originated or purchased	6,721.9	(6.9)	–	–	–	–	–	–	6,721.9	(6.9)
Net new lending and changes to risk parameters (model inputs)	(345.4)	13.4	144.6	(29.4)	82.3	(45.9)	–	–	(118.5)	(61.9)
Changes to model used for ECL calculation	–	–	–	–	–	–	–	–	–	–
Asset derecognised (including final repayments)	(2,338.3)	4.9	(224.9)	3.4	(131.0)	23.0	–	–	(2,694.2)	31.3
Assets written off	–	–	–	–	(43.4)	43.4	–	–	(43.4)	43.4
Credit related modifications that resulted in derecognition	–	–	–	–	–	–	–	–	–	–
Others / Foreign exchange	–	–	–	–	–	–	–	–	–	–
At 31 Dec 2018	**25,358.3**	**(26.9)**	**1,541.7**	**(25.7)**	**146.6**	**(34.4)**	**–**	**–**	**27,046.6**	**(87.0)**
ECL release/(charge) for the period		(22.1)		38.5		31.2		–		47.6
Recoveries		–		–		(6.8)		–		(6.8)
Others		10.9		(23.9)		12.4		–		(0.6)
Total ECL charge for the period		**(11.2)**		**14.6**		**36.8**		**–**		**40.2**

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

	Non-credit impaired				Credit impaired				Total	
	Stage 1		Stage 2		Stage 3		POCI			
	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL
	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m
At 1 Jan 2018	**9,686.8**	**(14.4)**	**613.4**	**(5.7)**	**92.9**	**(65.4)**	**–**	**–**	**10,393.1**	**(85.5)**
Transfers of financial instruments:										
– Transfers from Stage 1 to Stage 2	**(1,577.9)**	**3.0**	**1,577.9**	**(3.0)**	**–**	**–**	**–**	**–**	**–**	**–**
– Transfers from Stage 2 to Stage 1	**1,133.3**	**(7.7)**	**(1,133.3)**	**7.7**	**–**	**–**	**–**	**–**	**–**	**–**
– Transfers to Stage 3	**(29.0)**	**–**	**–**	**–**	**29.0**	**–**	**–**	**–**	**–**	**–**
– Transfers from Stage 3	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
– Net remeasurement of ECL arising from transfer of stage	**–**	**5.0**	**–**	**(6.1)**	**–**	**–**	**–**	**–**	**–**	**(1.1)**
Changes due to modifications not derecognised	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
New financial assets originated or purchased	**5,729.6**	**(6.0)**	**–**	**–**	**–**	**–**	**–**	**–**	**5,729.6**	**(6.0)**
Net new lending and changes to risk parameters (model inputs)	**(3,422.5)**	**8.3**	**535.6**	**(10.1)**	**(7.5)**	**4.2**	**–**	**–**	**(2,894.4)**	**2.4**
Changes to model used for ECL calculation	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Asset derecognised (including final repayments)	**(4,699.8)**	**1.4**	**(619.0)**	**2.4**	**(28.5)**	**–**	**–**	**–**	**(5,347.3)**	**3.8**
Assets written off	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Credit related modifications that resulted in derecognition	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Others / Foreign exchange	**–**	**–**	**–**	**–**	**0.5**	**(2.7)**	**–**	**–**	**0.5**	**(2.7)**
At 31 Dec 2018	**6,820.5**	**(10.4)**	**974.6**	**(14.8)**	**86.4**	**(63.9)**	**–**	**–**	**7,881.5**	**(89.1)**
ECL release/(charge) for the period		**(8.7)**		**13.8**		**(4.2)**		**–**		**0.9**
Recoveries		**–**		**–**		**–**		**–**		**–**
Modification gains or (losses) on contractual cash flows that did not result in derecognition		**–**		**–**		**–**		**–**		**–**
Others		**2.1**		**(5.1)**		**1.0**		**–**		**(2.0)**
Total ECL charge for the period		**(6.6)**		**8.7**		**(3.2)**		**–**		**(1.1)**

Credit quality of loans and advances

HSBC assesses the credit quality of all financial instruments that are subject to credit risk. The credit quality of financial instruments is a point in time assessment of the probability of default of financial instruments, whereas AASB 9 stages 1 and 2 are determined based on relative deterioration of credit quality since initial recognition. Accordingly, for non-credit impaired financial instruments there is no direct relationship between the credit quality assessment and AASB 9 stages 1 and 2, though typically the lower credit quality bands exhibit a higher proportion in stage 2.

Quality classification definitions

- 'Strong' exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default.
- 'Good' exposures demonstrate a good capacity to meet financial commitments, with low default risk.
- 'Satisfactory' exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default
- 'Sub-standard' exposures require varying degrees of special attention and default risk is of greater concern.
- 'Credit-impaired' exposures have been assessed as impaired.

The five credit quality classifications defined above each encompass a range of granular internal credit rating grades assigned to wholesale and retail lending businesses and the external ratings attributed by external agencies to debt securities, as shown in the table below. Under AASB 139 retail lending credit quality was disclosed based on expected-loss percentages. Under AASB 9 retail lending credit quality is now disclosed based on a 12-month probability-weighted PD. The credit quality classifications for wholesale lending are unchanged and are based on internal credit risk ratings.

Credit 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	12-month probability weighted PD%
Quality classification					
Strong	**A- and above**	**CRR1 to CRR2**	**0 – 0.169**	**Band 1 and 2**	**0.000-0.500**
Good	**BBB+ to BBB-**	**CRR3**	**0.170 – 0.740**	**Band 4**	**0.501-1.500**
Satisfactory	**BB+ to B and unrated**	**CRR4 to CRR5**	**0.741 – 4.914**	**Band 4 and 5**	**1.501-20.000**
Sub–standard	**B- to C**	**CRR6 to CRR8**	**4.915 – 99.999**	**Band 6**	**20.001-99.999**
Impaired	**Default**	**CRR9 to CRR10**	**100**	**Band 7**	**100.00**

Distribution of financial instruments to which the impairment requirements in AASB 9 are applied, by credit quality and stage allocation

	Gross carrying/notional amount							
	Strong	Good	Satisfactory	Sub-standard	Credit impaired	Total	Allowance for ECL	Net
	$m	$m	$m	$m	$m	$m	$m	$m
Loans and advances to customers at amortised cost	**16,836.7**	**6,212.9**	**1,966.2**	**129.4**	**229.7**	**25,374.9**	**(162.6)**	**25,212.3**
– stage 1	**16,748.0**	**5,156.1**	**1,000.8**	**19.0**	**–**	**22,923.9**	**(30.4)**	**22,893.5**
– stage 2	**88.7**	**1,056.8**	**965.4**	**110.4**	**–**	**2,221.3**	**(35.5)**	**2,185.8**
– stage 3	**–**	**–**	**–**	**–**	**229.7**	**229.7**	**(96.7)**	**133.0**
– POCI	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Loans and advances to banks at amortised cost	**45.3**	**0.1**	**0.1**	**–**	**–**	**45.5**	**–**	**45.5**
– stage 1	**45.3**	**0.1**	**–**	**–**	**–**	**45.4**	**–**	**45.4**
– stage 2	**–**	**–**	**0.1**	**–**	**–**	**0.1**	**–**	**0.1**
– stage 3	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
– POCI	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Other financial assets measured at amortised cost	**2,087.6**	**77.4**	**45.8**	**–**	**1.1**	**2,211.9**	**(0.2)**	**2,211.7**
– stage 1	**2,085.6**	**75.7**	**45.8**	**–**	**–**	**2,207.1**	**(0.1)**	**2,207.0**
– stage 2	**2.0**	**1.7**	**–**	**–**	**–**	**3.7**	**(0.1)**	**3.6**
– stage 3	**–**	**–**	**–**	**–**	**1.1**	**1.1**	**–**	**1.1**
– POCI	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Loan and other credit-related commitments	**4,798.7**	**3,123.6**	**484.1**	**75.4**	**–**	**8,481.8**	**(8.4)**	**8,473.4**
– stage 1	**4,788.7**	**3,077.2**	**481.0**	**52.7**	**–**	**8,399.6**	**(5.5)**	**8,394.1**
– stage 2	**10.0**	**46.4**	**3.1**	**22.7**	**–**	**82.2**	**(2.9)**	**79.3**
– stage 3	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
– POCI	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Financial guarantees and similar contracts	**260.9**	**450.9**	**281.2**	**29.9**	**3.4**	**1,026.3**	**(4.8)**	**1,021.5**
– stage 1	**234.6**	**430.4**	**219.7**	**1.5**	**–**	**886.2**	**(1.2)**	**885.0**
– stage 2	**26.3**	**20.5**	**61.5**	**28.4**	**–**	**136.7**	**(2.0)**	**134.7**
– stage 3	**–**	**–**	**–**	**–**	**3.4**	**3.4**	**(1.6)**	**1.8**
– POCI	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Debt instruments at FVOCI	**9,299.9**	**–**	**–**	**–**	**–**	**9,299.9**	**(0.2)**	**9,299.7**
– stage 1	**9,299.9**	**–**	**–**	**–**	**–**	**9,299.9**	**(0.2)**	**9,299.7**
– stage 2	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
– stage 3	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
– POCI	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
At 31 Dec 2018	**33,329.1**	**9,864.9**	**2,777.4**	**234.7**	**234.2**	**46,440.3**	**(176.2)**	**46,264.1**

Total retail lending by stage distribution

	Gross carrying amount					Allowance for ECL				
	Stage 1	Stage 2	Stage 3	POCIFA	Total	Stage 1	Stage 2	Stage 3	POCIFA	Total
	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m
By portfolio										
First lien residential mortgages	**18,172.4**	**1,381.1**	**80.6**	**–**	**19,634.1**	**(2.8)**	**(1.0)**	**(3.4)**	**–**	**(7.2)**
Other personal lending	**870.7**	**146.4**	**65.4**	**–**	**1,082.5**	**(23.9)**	**(24.2)**	**(31.0)**	**–**	**(79.1)**
– other	**162.1**	**33.6**	**0.1**	**–**	**195.8**	**(2.4)**	**(0.8)**	**(0.1)**	**–**	**(3.3)**
– credit cards	**708.6**	**112.8**	**65.3**	**–**	**886.7**	**(21.5)**	**(23.4)**	**(30.9)**	**–**	**(75.8)**
At 31 Dec 2018	**19,043.1**	**1,527.5**	**146.0**	**–**	**20,716.6**	**(26.7)**	**(25.2)**	**(34.4)**	**–**	**(86.3)**

Total wholesale lending by stage distribution

	Gross carrying amount				Allowance for ECL			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	$m	$m	$m	$m	$m	$m	$m	$m
Corporate and commercial	**3,751.8**	**691.3**	**83.7**	**4,526.8**	**(3.5)**	**(10.1)**	**(62.4)**	**(76.0)**
– agriculture, forestry and fishing	**33.1**	**–**	**–**	**33.1**	**–**	**–**	**–**	**–**
– mining and quarrying	**66.2**	**–**	**25.6**	**91.8**	**(0.1)**	**–**	**(7.9)**	**(8.0)**
– manufacture	**330.0**	**553.6**	**–**	**883.6**	**(0.5)**	**(9.2)**	**–**	**(9.7)**
– electricity, gas, steam and air-conditioning supply	**0.1**	**–**	**–**	**0.1**	**–**	**–**	**–**	**–**
– water supply, sewerage, waste management and remediation	**3.2**	**–**	**–**	**3.2**	**–**	**–**	**–**	**–**
– construction	**26.2**	**0.7**	**–**	**26.9**	**–**	**–**	**–**	**–**
– wholesale and retail trade, repair of motor vehicles and motorcycles	**1,487.7**	**23.1**	**38.0**	**1,548.8**	**(1.0)**	**–**	**(37.8)**	**(38.8)**
– transportation and storage	**86.0**	**–**	**–**	**86.0**	**–**	**–**	**–**	**–**
– accommodation and food	**37.9**	**–**	**–**	**37.9**	**–**	**–**	**–**	**–**
– publishing, audiovisual and broadcasting	**159.3**	**5.1**	**–**	**164.4**	**(0.1)**	**–**	**–**	**(0.1)**
– real estate	**741.0**	**56.2**	**–**	**797.2**	**(0.8)**	**(0.1)**	**–**	**(0.9)**
– professional, scientific and technical activities	**448.4**	**8.3**	**–**	**456.7**	**(0.3)**	**(0.5)**	**–**	**(0.8)**
– administrative and support services	**136.0**	**41.7**	**–**	**177.7**	**(0.5)**	**(0.3)**	**–**	**(0.8)**
– education	**9.6**	**–**	**–**	**9.6**	**–**	**–**	**–**	**–**
– health and care	**173.7**	**–**	**–**	**173.7**	**(0.2)**	**–**	**–**	**(0.2)**
– other services	**13.4**	**2.6**	**20.1**	**36.1**	**–**	**–**	**(16.7)**	**(16.7)**
– activities of households	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Non-bank financial institutions	**129.1**	**2.4**	**–**	**131.5**	**(0.2)**	**(0.1)**	**–**	**(0.3)**
Loans and advances to banks	**45.4**	**0.1**	**–**	**45.5**	**–**	**–**	**–**	**–**
At 31 Dec 2018	**3,926.3**	**693.8**	**83.7**	**4,703.8**	**(3.7)**	**(10.2)**	**(62.4)**	**(76.3)**

Renegotiated loans and forbearance

The following table shows the gross carrying amounts of the Bank's holdings of renegotiated loans and advances to customers by industry sector and by stages. Wholesale renegotiated loans are classified as stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, observed over a minimum one-year period, and there are no other indicators of impairment. Personal renegotiated loans are deemed to remain credit impaired until repayment or derecognition.

Renegotiated loans and advances to customers at amortised cost by stage distribution

	Stage 1	Stage 2	Stage 3	POCI	Total
	$m	$m	$m	$m	$m
Gross carrying amount					
Personal					
– first lien residential mortgages	**–**	**–**	**30.6**	**–**	**30.6**
– other personal lending	**–**	**–**	**37.4**	**–**	**37.4**
Wholesale					
– corporate and commercial	**–**	**–**	**63.6**	**–**	**63.6**
– non-bank financial institutions	**–**	**–**	**–**	**–**	**–**
At 31 Dec 2018	**–**	**–**	**131.6**	**–**	**131.6**
Allowance for ECL					
Personal					
– first lien residential mortgages	**–**	**–**	**(0.9)**	**–**	**(0.9)**
– other personal lending	**–**	**–**	**(25.1)**	**–**	**(25.1)**
Wholesale					
– corporate and commercial	**–**	**–**	**(45.7)**	**–**	**(45.7)**
– non-bank financial institutions	**–**	**–**	**–**	**–**	**–**
At 31 Dec 2018	**–**	**–**	**(71.7)**	**–**	**(71.7)**

The value of renegotiated loans in 2017 was $44.4m.

Selected 2017 credit risk disclosures

The disclosures below were included in our 2017 external reports and do not reflect the adoption of AASB 9. As these tables are not directly comparable to the current 2018 credit risk tables, which are disclosed on an AASB 9 basis, these 2017 disclosures have been shown below and not adjacent to 2018 tables.

Maximum exposure to credit risk

	Consolidated 2017 $m	Company 2017 $m
Cash and balances at central banks	1,541.1	1,541.1
Items in course of collection from other banks	2.4	2.4
Derivatives	79.3	79.3
Loans and advances to banks	63.3	63.3
Loans and advances to customers	22,546.1	22,546.1
Financial assets measured at FVOCI		
Debt securities	5,827.1	5,827.1
Equities	4.0	4.0
Treasury and other eligible bills	1,006.9	1,006.9
Total financial assets measured at FVOCI	6,838.0	6,838.0
Other assets		
Acceptances and endorsements	241.2	241.2
Receivables from related parties	552.3	552.3
Accrued income	115.9	115.9
Other	84.5	84.5
Total other assets	993.8	993.8
Financial guarantees and contingent liabilities	10.2	10.2
Loan commitments and other credit related commitments	11,747.4	11,747.4
At 31 Dec	43,821.6	43,821.6

Distribution of financial instruments by credit quality (gross) - Consolidated and Company

	Neither past due nor impaired				Past due but not impaired	Impaired	Total
	Strong	Good	Satisfactory	Sub-standard			
	$m	$m	$m	$m	$m	$m	$m
At 31 Dec 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	17,277.6	3,474.6	1,430.8	14.4	304.8	209.8	22,712.0
– 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
Financial Investments	6,838.0	—	—	—	—	—	6,838.0
– Equities	4	—	—	—	—	—	4
– Treasury and other eligible bills	1,006.9	—	—	—	—	—	1,006.9
– Debt securities	5,827.1	—	—	—	—	—	5,827.1
Other assets	641.1	260.4	92.3	0.1	—	—	993.9
– Endorsements and acceptances	—	232.4	8.8	—	—	—	241.2
– Receivables from related parties	552.3	—	—	—	—	—	552.3
– Other	88.8	28	83.5	0.1	—	—	200.4
Total	26,353.0	3,746.6	1,538.0	14.5	304.8	209.8	32,166.7

Gross loans and advances by industry sector - Consolidated and Company

	2017 $m
Class of Asset	
Personal	
Mortgages	15,911.9
Other personal lending	1,071.1
Corporate and commercial	
Manufacturing	1,016.9
International trade and services	2,094.8
Commercial real estate and construction	1,157.1
Other commercial	1,120.6
Financial (non-bank financial institutions)	276.2
Total gross credit risks	22,648.7

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:

	2017
	$m
Nature of assets	
Residential property	0.8
	0.8

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.

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 Dec 2017						
Loans and advances held at amortised cost						
– loans and advances to customers	261.1	32.0	11.7	—	—	304.8

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 6.6% 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 2018 was $109.5m (2017:$118.6m).

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 ('ABSs') and similar instruments, which are supported by underlying pools of financial assets.

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.

(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 coordinated 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 responsible for determining the liquidity risk appetite for the Bank 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.

Compliance with liquidity and funding requirements is monitored by HSBC Bank Australia ALCO who also 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 Banking 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 both APRA and HSBC Group EBA-based NSFR models.

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

	On demand	Due within 3 months	Due between 3 and 12 months	Due between 1 and 5 years	Due after 5 years	Total
	$m	$m	$m	$m	$m	$m
Deposits by banks	**948.8**	**1,437.6**	**–**	**–**	**–**	**2,386.4**
Customer accounts	**23,935.4**	**3,353.4**	**465.4**	**989.3**	**13.3**	**28,756.8**
Repurchase agreements – non-trading	**1,464.3**	**1,390.6**	**–**	**–**	**–**	**2,854.9**
Financial liabilities designated at fair value	**–**	**–**	**–**	**48.1**	**–**	**48.1**
Derivatives	**111.2**	**–**	**2.6**	**25.2**	**–**	**139.0**
Debt securities in issue	**–**	**102.2**	**83.1**	**250.6**	**–**	**435.9**
Subordinated liabilities (related parties)	**–**	**–**	**–**	**–**	**503.8**	**503.8**
Other financial liabilities	**366.0**	**299.2**	**1.2**	**–**	**27.4**	**693.8**
Statement of financial postion	**26,825.7**	**6,582.9**	**552.3**	**1,313.3**	**544.5**	**35,818.7**
Loan and other credit-related commitments	**10,973.6**	**–**	**–**	**–**	**–**	**10,973.6**
Financial guarantees and similar contracts	**1,042.5**	**–**	**–**	**–**	**–**	**1,042.5**
At 31 Dec 2018	**38,841.8**	**6,582.9**	**552.3**	**1,313.3**	**544.5**	**47,834.8**
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
Statement of financial position	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
At 31 Dec 2017	34,705.5	6,032.3	1,358.1	230.6	309.1	42,635.6

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

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

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

(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.

Total and trading VaR for the consolidated entity

	Total VaR		Trading VaR	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Average	**5.6**	4.9	**0.1**	0.1
Maximum	**8.3**	6.6	**0.3**	0.5
Minimum	**2.8**	3.3	**–**	–
At 31 Dec	**3.1**	3.6	**0.2**	0.1

Total VaR at 31 December 2018 was $3.1m which decreased from the VaR of $3.6m observed as at 31 December 2017. The reduction in VaR was due to the lower swaps risks and the reduced volatility in the Government bonds market.

Total Trading VaR at 31 December 2018 increased to $0.2m from $0.1m due to a slight increase in the FX swap interest rate risks (from 13k to 15k).

Trading assets and liabilities

The Bank's trading assets and liabilities are in substantially all cases originated by Global Banking and Markets ('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 ('GB') 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.

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 assets measured at FVOCI

Financial assets measured at FVOCI 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 repricing 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, while 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.

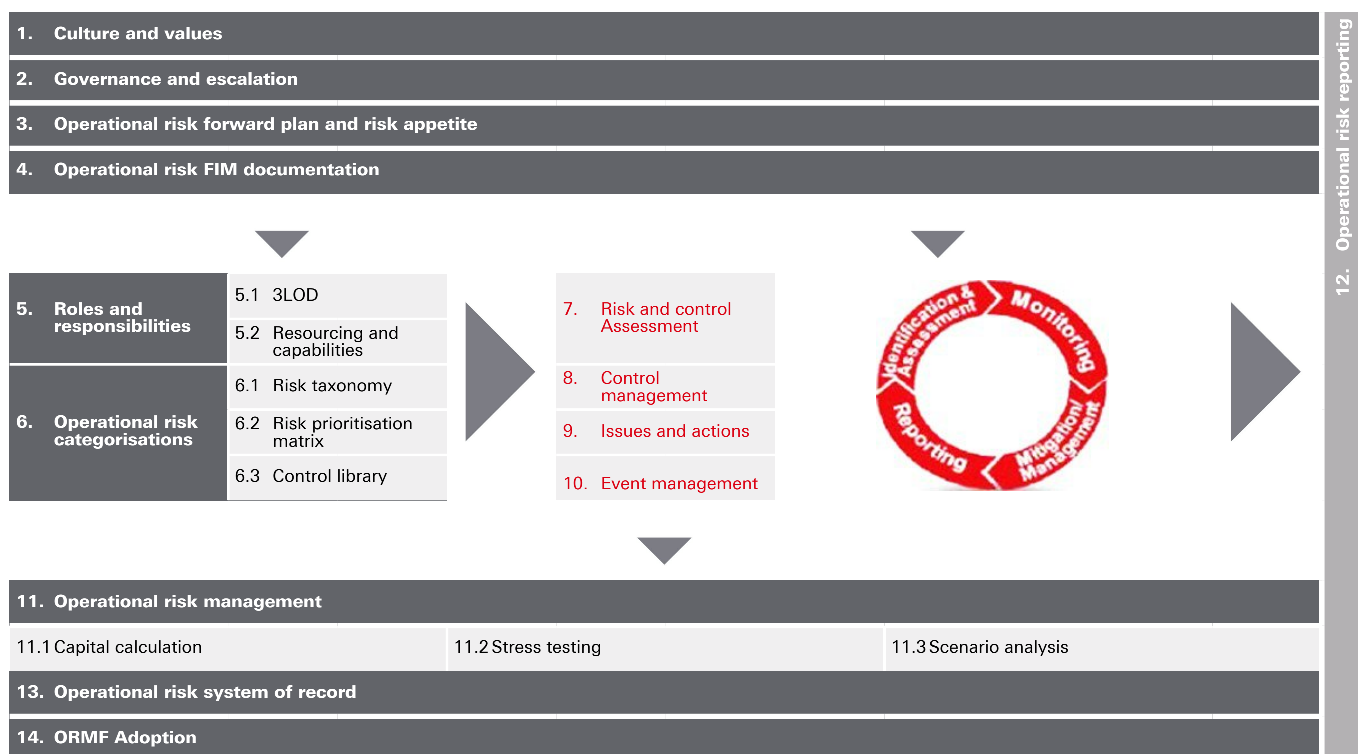
(e) Operational risk disclosures

HSBC Group defines operational risk as 'the risk to achieving your strategy or objectives as a result of inadequate or failed internal processes, people and systems, or from external events'.

In order to manage operational risks, HSBC Group has an Operational Risk Management Framework ('ORMF'), which includes adoption of the Three Lines of Defence risk governance framework:

- The First Line of Defence owns the operational risks. They are responsible for identifying, recording, reporting and managing risks, and ensuring that the right controls and assessments are in place to mitigate these risks. Most of HSBC's people are in the First Line of Defence, including Risk Owners, Control Owners and Business Risk & Control Managers ('BRCMs').
- The Second Line of Defence sets policy and guidelines for managing operational risk, and provides advice and guidance on effective risk management. The Second Line are risk management specialists comprising Risk Stewards and the Operational Risk Function.
- The Third Line of Defence is Internal Audit who independently monitor that HSBC Group is managing operational risk effectively.

Within the ORMF, there are the following 14 components:



Non-Financial Risk ('NFR') Transformation

NFR is one of the broadest types of risk and can affect the bank in a number of different ways – everything from compliance and IT failures, to misconduct and cyber-crime fails under the banner of NFR. Building on the success of the Operational Risk Transformation Programme, the main scope of the NFR roadmap is the further enhance our capability and broaden the ORMF to other NFR types. The roadmap will be managed through a portfolio of programmes, which sit across the Group. It will be delivered over the next three years – providing a global coordinated approach to meeting more immediate regulatory requirements while delivering longer term improved risk management capability across the bank. The NFR roadmap consists of a portfolio of 10 programmes as outlined:

- ORMF embedding, use and adoption – embedding and evidencing the ORMF in day-to-day risk management;
- integrate and align – employing the ORMF as the single way of identifying, assessing and managing non-financial risk;
- reporting and analysis – delivering insight to decision making through comprehensive integrated information;
- regulatory mapping – supporting the Bank to prove compliance with relevant material regulations;
- capital scenarios, stress testing and appetite – enable the business to own and control non-financial risk capital as an integral part of managing risk;
- control monitoring testing and assurance – enhancing and reducing the cost of control through delivery of an enterprise-wide control framework;
- process mapping to ORMF – optimising business operations through managing risks and control in critical end-to-end business processes;
- Three Lines of Defence – clarifying and establishing roles and responsibilities that drive appropriate risk management leadership and behaviour;
- simplify policy – simplifying and streamlining consistent policy framework providing transparency of compliance; and
- increase maturity and expand ORMF – ORMF to cover other NFR risk types (eg model risk, 3rd party risks). Control library framework includes controls from financial risk and NFR.

(f) Capital management

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

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

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

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

Externally imposed capital requirements

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

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

- Level 1 – Bank; and
- Level 2 – consists of the consolidated 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 while 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.

28 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 financial assets measured at FVOCI (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 movement, 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.

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 creditworthiness of the over-the-counter derivatives counterparties; and
- 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 follows:

- 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's 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.

Financial instruments carried at fair value (consolidated)

	Valuation Techniques					
	Level 1	Level 2	Level 3	Total Third Party	Amount with HSBC*	Total
	$m	$m	$m	$m	$m	$m
At 31 Dec 2018						
Assets						
Derivatives	**0.1**	**47.9**	**–**	**48.0**	**109.7**	**157.7**
Financial assets measured at FVOCI	**6,351.6**	**2,948.4**	**4.0**	**9,304.0**	**–**	**9,304.0**
Liabilities						
Financial liabilities designated at fair value	**–**	**43.0**	**–**	**43.0**	**–**	**43.0**
Derivatives	**0.3**	**65.2**	**–**	**65.5**	**72.5**	**138.0**
At 31 Dec 2017						
Assets						
Derivatives	0.1	29.0	–	29.1	50.2	79.3
Financial assets measured at FVOCI	3,994.9	2,839.1	4.0	6,838.0	–	6,838.0
Liabilities						
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

* *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 and liabilities outlined in the table above, the carrying values are a reasonable approximation of fair values. The movement between level 1 and level 2 was $668.8m and AUD1,833.8m between level 2 and level 1.

29 Notes to the Statement of cash flows

Reconciliation of net cash flows from / (used) in operating activities to profit for the year

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Profit for the year	**301.7**	288.3	**301.7**	288.1
Depreciation and amortisation	**7.9**	7.0	**7.9**	7.0
(Increase)/decrease in interest receivable	**(13.8)**	29.9	**(13.8)**	29.9
Increase/(decrease) in interest payable	**6.5**	0.1	**6.5**	0.1
Loan impairment charges	**39.0**	33.8	**39.0**	33.8
(Profit)/loss on the sale of investments	**(8.2)**	(5.7)	**(8.2)**	(5.7)
Increase/(decrease) in provisions	**10.4**	(0.9)	**10.4**	(0.9)
Increase/(decrease) in provision for employee entitlements	**1.2**	1.3	**1.2**	1.3
Increase/(decrease) in intercompany payable account	**3.2**	(6.4)	**3.2**	(6.4)
(Increase)/decrease in sundry debtors	**6.4**	(8.6)	**6.9**	(8.2)
Increase/(decrease) in sundry creditors	**(4.3)**	(21.5)	**(4.9)**	(21.5)
Changes in operating assets and liabilities				
Net (increase)/decrease in trading assets	**(13.0)**	55.5	**(13.0)**	55.4
Net decrease in trading liabilities	**(3.3)**	(11.6)	**(3.3)**	(11.6)
Cash inflows/(outflows) from movements in other assets/liabilities	**(45.4)**	122.3	**(45.9)**	122.4
Net (increase)/decrease in loans and bills advanced	**(2,976.8)**	(2,342.8)	**(2,976.4)**	(2,342.9)
Net increase in deposits and other borrowings	**5,277.8**	732.2	**5,277.9**	732.3
Net cash from / (used) in operating activities	**2,589.3**	(1,126.9)	**2,589.3**	(1,126.9)

Cash and cash equivalents at the end of the financial year as shown in the Statements of cash flows are reconciled to the related items in the Statements of financial position as follows:

Reconciliation of cash and cash equivalents

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Cash and balances at central banks	**1,750.0**	1,541.1	**1,750.0**	1,541.1
Placings with banks with remaining maturity 3 months or less	**45.5**	18.4	**45.5**	18.4
Securities purchased from related entities under agreements to resell	**–**	164.9	**–**	164.9
Total cash and cash equivalents	**1,795.5**	1,724.4	**1,795.5**	1,724.4

Financing facilities

At 31 December 2018 and 31 December 2017 there are no committed facilities.

30 Assets pledged as security for liabilities and collateral accepted as security for assets

	Consolidated		Company	
	2018	2017	**2018**	2017
	$m	$m	**$m**	$m
Financial assets pledged as collateral	**1,390.4**	306.6	**1,390.4**	306.6
Fair value of the collateral permitted to sell or repledge in the absence of default	**–**	162.4	**–**	162.4
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.

The amount of assets pledged to secure liabilities may be greater than the book value of assets utilised as collateral. For example, in the case of securitisations and covered bonds, the amount of liabilities issued plus mandatory over-collateralisation is less than the book value of the pool of assets available for use as collateral. This is also the case where assets are placed with a custodian or a settlement agent which has a floating charge over all the assets placed to secure any liabilities under settlement accounts.

These transactions are conducted under terms that are usual and customary to collateralised transactions including, where relevant, standard securities lending and borrowing, repurchase agreements and derivative margining. The Bank places both cash and non-cash collateral in relation to derivative transactions.

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.

Carrying amount of the assets not derecognised and their associated liabilities

		Consolidated		Company	
		2018	2017	**2018**	2017
	Note	**$m**	$m	**$m**	$m
Carrying amount of asset					
Loans and advances to customers	*	**2,442.3**	2,420.8	**2,442.3**	2,420.8
Total		**2,442.3**	2,420.8	**2,442.3**	2,420.8
Carrying amount of related liability					
Sale and repurchase agreement		**1,462.4**	1,198.0	**1,462.4**	1,198.0
Total		**1,462.4**	1,198.0	**1,462.4**	1,198.0

* *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.*

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

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

	Due not more than 1 month	Due within 3 months	Due between 3 and 12 months	Due between 1 and 5 years	Due after 5 years	Total
	$m	$m	$m	$m	$m	$m
Financial assets						
Cash and balances at central banks	1,750.0	–	–	–	–	1,750.0
Items in the course of collection from other banks	1.9	–	–	–	–	1.9
Other financial assets mandatorily measured through profit or loss	3.9	–	–	–	–	3.9
Derivatives	143.7	–	–	14.0	–	157.7
Loans and advances to banks	700.6	–	–	–	–	700.6
Loans and advances to customers	2,532.8	913.9	956.0	3,696.0	17,113.6	25,212.3
Reverse repurchase agreements – non-trading	–	–	–	–	–	–
Financial assets measured through other comprehensive income	199.9	1,472.6	1,668.8	5,852.1	110.6	9,304.0
Accrued income and other financial assets	154.6	299.7	21.7	0.1	0.1	476.2
Total financial assets at 31 Dec 2018	5,487.4	2,686.2	2,646.5	9,562.2	17,224.3	37,606.6
Non financial assets	–	–	–	–	218.1	218.1
Total assets at 31 Dec 2018	5,487.4	2,686.2	2,646.5	9,562.2	17,442.4	37,824.7
Financial liabilities						
Deposits by banks	2,289.0	–	–	–	–	2,289.0
Customer accounts	25,442.9	1,814.3	446.1	989.0	13.3	28,705.6
Repurchase agreements – non-trading	2,852.8	–	–	–	–	2,852.8
Items in the course of transmission to other banks	27.4	–	–	–	–	27.4
Trading liabilities	–	–	–	–	–	–
Financial liabilities designated at fair value	–	–	–	43.0	–	43.0
Derivatives	111.2	–	2.5	24.3	–	138.0
Debt securities in issue	1.0	99.7	83.1	250.0	–	433.8
Accruals and other financial liabilities	395.3	97.3	9.6	–	–	502.2
Subordinated liabilities	–	–	–	–	250.0	250.0
Total financial liabilities at 31 Dec 2018	31,119.6	2,011.3	541.3	1,306.3	263.3	35,241.8
Non financial liabilities	–	–	–	–	214.0	214.0
Total liabilities at 31 Dec 2018	31,119.7	2,011.3	541.3	1,306.2	477.3	35,455.8
Off-balance sheet commitments given						
Loan and other credit-related commitments	10,944.2	–	–	–	–	10,944.2

Maturity analysis of assets, liabilities and off-balance sheet commitments (continued)

	Due not more than 1 month	Due within 3 months	Due between 3 and 12 months	Due between 1 and 5 years	Due after 5 years	Total
	$m	$m	$m	$m	$m	$m
Financial assets						
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
Trading assets	–	–	–	–	–	–
Financial assets designated at fair value	–	–	–	–	–	–
Derivatives	79.3	–	–	–	–	79.3
Loans and advances to banks	18.4	44.9	–	–	–	63.3
Loans and advances to customers	2,679.9	1,158.0	1,235.2	3,707.3	13,765.8	22,546.2
Reverse repurchase agreements – non-trading	–	–	–	–	–	–
Financial investments	274.9	909.9	926.5	4,722.7	4.0	6,838.0
Accrued income and other financial assets	637.6	159.3	19.6	0.3	0.7	817.5
Financial assets at 31 Dec 2017	5,233.6	2,272.1	2,181.3	8,430.3	13,770.5	31,887.8
Non financial assets	–	–	–	–	360.3	360.3
Total assets at 31 Dec 2017	5,233.6	2,272.1	2,181.3	8,430.3	14,130.8	32,248.1
Financial Liabilities						
Deposits by banks	2,297.7	–	–	–	–	2,297.7
Customer accounts	22,379.3	1,754.8	1,082.4	14.4	11.1	25,242.0
Repurchase agreements – non-trading	1,198.0	–	–	–	–	1,198.0
Trading liabilities	3.3	–	–	–	–	3.3
Financial liabilities designated at fair value	–	–	–	–	43.6	43.6
Derivatives	72.6	–	–	–	–	72.6
Debt securities in issue	–	–	246.5	100.0	–	346.5
Accruals and other financial liabilities	368.0	137.0	3.8	0.5	0.2	509.5
Subordinated liabilities	–	–	–	–	250.0	250.0
Total financial liabilities at 31 Dec 2017	26,318.9	1,891.8	1,332.7	114.9	304.9	29,963.2
Non financial liabilities	–	–	–	–	47.9	47.9
Total liabilities at 31 Dec 2017	26,318.9	1,891.8	1,332.7	114.9	352.8	30,011.1
Off-balance sheet commitments given						
Loan and other credit-related commitments	8,699.0	3,017.2	–	–	–	11,716.2

33 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.

Amounts receivable from or payable to related parties

	Consolidated		Company	
	2018	2017	**2018**	2017
	$	$	**$**	$
Aggregate amounts receivable				
Other related entities	**655,117,849**	387,386,357	**655,117,849**	387,386,357
Reverse repurchase agreement – other related entities	**–**	164,803,244	**–**	164,803,244
Aggregate amounts payable				
Owing to parent in respect of tax	**18,033,816**	11,888,143	**18,033,816**	11,888,143
Other related entities	**3,504,960,283**	1,967,075,357	**3,504,960,283**	1,967,006,526
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

	Consolidated		Company	
	2018	2017	**2018**	2017
	$	$	**$**	$
Interest revenue				
Other related entities	**5,704,920**	12,353,775	**5,704,920**	12,353,775
Key management personnel	**256,041**	337,000	**256,041**	337,000
Interest expense				
Other related entities	**57,400,393**	37,205,370	**57,400,393**	37,205,370
Management fees paid				
Other related entities	**120,474,489**	95,274,973	**120,474,489**	95,274,973
Management fees received				
Other related entities	**126,310,619**	108,501,215	**126,310,619**	108,501,215
Fee income				
Other related entities	**8,241,954**	5,825,126	**8,241,954**	5,825,126
Fee expense				
Other related entities	**12,245,236**	13,980,389	**12,245,236**	13,980,389
Employee benefits				
Share based payments	**7,585,470**	8,368,000	**7,585,470**	8,368,000
Dividend paid				
Controlling entity	**123,334,452**	157,520,692	**123,334,452**	157,520,692

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 arm's length under normal commercial terms and conditions.

Loans and lease receivables outstanding as at balance date included $1,202,654,867 (Consolidated) (2017: $1,234,803,558), which were guaranteed by The Hongkong and Shanghai Banking Corporation Limited and other related corporations under normal commercial terms and conditions.

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

34 Key management personnel disclosures

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

Executive Directors		
Martin Tricaud	Chief Executive Officer	
Non-executive Directors		
Graham Bradley	Chairman	
Carol Austin		
Anthony Cripps		Resigned 26 October 2018
Matthew Lobner		
Kenneth Ng		Appointed 26 October 2018
Jann Skinner		
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	Resigned 2 December 2018
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	
Rani Mina	General Counsel	Appointed 1 May 2018
Paul Murphy	Head of Human Resources	
Jessica Power	Head of Retail Banking and Wealth Management	Appointed 3 December 2018
Vic Wolff	Head of Marketing	

The key management personnel compensation included in 'employee compensation and benefits' note 6 are as follows.

Transactions with key management personnel

	Consolidated		Company	
	2018	2017	**2018**	2017
	$	$	**$**	$
Short-term employee benefits				
Cash salary, fees and short-term compensated absences	**6,167,096**	6,167,785	**6,167,096**	6,167,785
Short-term cash profit-sharing and other bonuses	**5,172,353**	2,708,859	**5,172,353**	2,708,859
Non-monetary benefits	**500,919**	253,491	**500,919**	253,491
Other short-term employee benefits	**385,515**	456,052	**385,515**	456,052
	12,225,883	9,586,188	**12,225,883**	9,586,188
Post-employment benefits				
Pension and superannuation benefits	**284,970**	296,249	**284,970**	296,249
Other post-employment benefits	**52,921**	57,799	**52,921**	57,799
	337,891	354,049	**337,891**	354,049
	12,563,774	9,940,236	**12,563,774**	9,940,236
Share based payments granted during the year	**2,832,405**	1,939,055	**2,832,405**	1,939,055

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 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

	Consolidated		Company	
	2018	2017	**2018**	2017
	$	$	**$**	$
The aggregate amount of loans to key management personnel of any entity in the consolidated entity	**10,510,976**	10,677,083	**10,510,976**	10,677,083
Loan repayments received	**1,936,219**	593,990	**1,936,219**	593,990

35 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.

36 AASB 9 transition

On 1 January 2018, HSBC Australia implemented the requirements of AASB 9 'Financial Instruments'. The transition requirements of AASB 9 have necessitated a review of the designation of financial instruments at fair value. AASB requires that the designation is revoked where there is no longer an accounting mismatch at 1 January 2018 and permits designations to be revoked or additional designations created at 1 January 2018 if there are accounting mismatches at that date. The table below provides information relevant to understanding the impact of the new accounting standard on the Bank's Statement of financial position at 1 January 2018.

Reconciliation of consolidated balance sheet at 31 December 2017 and 1 January 2018

				AASB 9 reclassification to						
	AASB 39 measurement category	AASB 9 measurement category	AASB 39 carrying amount at 31 Dec 2017 $m	Other changes in classific-ation $m	Fair value through profit or loss $m	Fair value through other compre-hensive income $m	Amortised cost $m	Carrying amount post reclassific-ation $m	AASB 9 remeasure-ment including expected credit losses $m	AASB 9 carrying amount at 1 Jan 2018 $m
Assets										
Cash and balances at central banks	**Amortised cost**	**Amortised cost**	**1,541.1**	**–**	**(0.1)**	**–**	**–**	**1,541.0**	**–**	**1,541.0**
Items in the course of collection from other banks	**Amortised cost**	**Amortised cost**	**2.4**	**–**	**–**	**–**	**–**	**2.4**	**–**	**2.4**
Financial assets designated and otherwise mandatorily measured at fair value through profit or loss	**FVPL**	**FVPL**	**–**	**–**	**3.1**	**–**	**–**	**3.1**	**–**	**3.1**
Derivatives	**FVPL**	**FVPL**	**79.3**	**–**	**–**	**–**	**–**	**79.3**	**–**	**79.3**
Loans and advances to banks	**Amortised cost**	**Amortised cost**	**63.3**		**–**	**–**	**–**	**63.3**	**–**	**63.3**
Loans and advances to customers	**Amortised cost**	**Amortised cost**	**22,546.1**	**–**	**(3.1)**	**–**	**–**	**22,543.0**	**(54.8)**	**22,488.2**
Receivables from related entities	**Amortised cost**	**Amortised cost**	**552.3**	**–**	**(0.1)**	**–**	**–**	**552.2**	**–**	**552.2**
Financial investments	**FVOCI (Available for sale – debt instruments)**	**FVOCI**	**6,834.0**	**–**	**–**	**–**	**–**	**6,834.0**	**–**	**6,834.0**
	FVOCI (Available for sale – equity instruments)	**FVOCI**	**4.0**	**–**	**–**	**–**	**–**	**4.0**	**–**	**4.0**
	Amortised cost	**Amortised cost**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Other assets	**Amortised cost**	**Amortised cost**	**441.6**	**–**	**–**	**–**	**–**	**441.6**	**(0.1)**	**441.5**
Property, plant and equipment	**N/A**	**N/A**	**28.2**	**–**	**–**	**–**	**–**	**28.2**	**–**	**28.2**
Goodwill and intangible assets	**N/A**	**N/A**	**64.8**	**–**	**–**	**–**	**–**	**64.8**	**–**	**64.8**
Deferred tax assets	**N/A**	**N/A**	**91.0**	**–**	**–**	**–**	**–**	**91.0**	**19.9**	**110.9**
Total assets			32,248.1	–	(0.2)	–	–	32,247.9	(35.0)	32,212.9

Reconciliation for consolidated balance sheet at 31 December 2017 and 1 January 2018 (continued)

	AASB 39 measurement category	AASB 9 measurement category	AASB 39 carrying amount at 31 Dec 2017	AASB 9 reclassification to: Other changes in classification	Fair value through profit or loss	Fair value through other comprehensive income	Amortised cost	Carrying amount post reclassification	AASB 9 remeasurement including expected credit losses	AASB 9 carrying amount at 1 Jan 2018
			$m	$m	$m	$m	$m	$m	$m	$m
Liabilities										
Deposits by banks	Amortised cost	Amortised cost	318.7		–	–	–	318.7	–	318.7
Customer accounts	Amortised cost	Amortised cost	25,242.0	–	–	–	–	25,242.0	–	25,242.0
Repurchase agreements – non-trading	Amortised cost	Amortised cost	1,198.0	–	–	–	–	1,198.0	–	1,198.0
Items in the course of transmission to other banks	Amortised cost	Amortised cost	23.1	–	–	–	–	23.1	–	23.1
Trading liabilities	FVPL	FVPL	3.3	(3.3)	–	–	–	–	–	–
Financial liabilities designated at fair value	FVPL	FVPL	43.6	3.3	–	–	–	46.9	–	46.9
Derivatives	FVPL	FVPL	72.6	–	–	–	–	72.6	–	72.6
Debt securities in issue	Amortised cost	Amortised cost	346.5	–	–	–	–	346.5	–	346.5
Provisions	N/A	N/A	6.2	–	–	–	–	6.2	11.1	17.3
Payables to related entities	Amortised cost	Amortised cost	2,229.0	–	–	–	–	2,229.0	–	2,229.0
Other liabilities	N/A	N/A	443.7	(0.1)	–	–	–	443.6	–	443.6
Employee benefits	N/A	N/A	84.4	–	–	–	–	84.4	–	84.4
Total liabilities			30,011.1	(0.1)	–	–	–	30,011.0	11.1	30,022.1

	AASB 39 carrying amount at 31 Dec 2017	AASB 9 reclassification	Carrying amount post reclassification	AASB 9 remeasurement including expected credit losses	Carrying amount at 1 Jan 2018
Footnote	$m	$m	$m	$m	$m
Equity					
Share capital	811.0	–	811.0	–	811.0
Other equity instruments	250.0	–	250.0	–	250.0
Other reserves	3.9	–	3.9	0.2	4.1
Retained earnings	1,172.1	–	1,172.1	(46.4)	1,125.7
Total equity	2,237.0	–	2,237.0	(46.2)	2,190.8

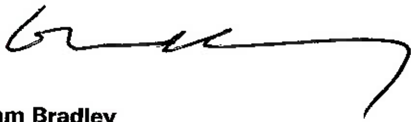
Directors' declaration

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

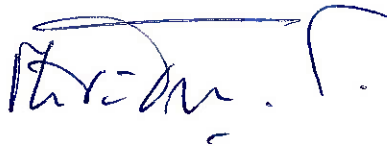
- the financial statements and notes set out on pages 4 to 57 are in accordance with the Corporations Act 2001, including:
  - giving a true and fair view of the financial position of the Company and the consolidated entity as at 31 December 2018, and of their performance, as represented by the results of their operations and their cash flows, for the year ended on that date; and
  - complying with Australian Accounting Standards and the Corporations Regulations 2001; and
- 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
- the financial report also complies with International Financial Reporting Standards as disclosed in note 2(a).

Dated at Sydney this 11 February 2019.

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 consolidated entity) is in accordance with the *Corporations Act 2001*, including:

(a) giving a true and fair view of the Company's and consolidated entity's financial positions as at 31 December 2018 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 financial report comprises:

- the Consolidated and Company statements of financial position as at 31 December 2018
- 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 Company and the consolidated entity 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.

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Other information

The directors are responsible for the other information. The other information comprises the information included in the Directors' report for the year ended 31 December 2018, 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 the *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 Company and the consolidated entity 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 Company or the consolidated entity 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.

PricewaterhouseCoopers

E A Barron
Partner

Sydney
11 February 2019

Auditor's Independence Declaration

As lead auditor for the audit of HSBC Bank Australia Limited for the year ended 31 December 2018, 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 year.

E A Barron
Partner
PricewaterhouseCoopers

Sydney
11 February 2019

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HSBC Bank Australia Ltd

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