The Hongkong and Shanghai Banking Corporation Limited
Macau Branch

Disclosure of Financial Information
31 December 2018

Report of the Branch management

Principal place of business and activities

The Hongkong and Shanghai Banking Corporation Limited, Macau Branch ("the Branch") is a branch of The Hongkong and Shanghai Banking Corporation Limited. It is domiciled in Macau and has its registered office and principal place of business at Avenida da Praia Grande, No.639, 1st Floor, HSBC Main Branch, Macau. The Hongkong and Shanghai Banking Corporation Limited ("the Bank") produces financial statements available for public use. The Branch is registered as a licensed bank under the Macau Financial System Act under the supervision of the Autoridade Monetaria de Macau ("AMCM").

Branch's activities in Macau

In 2018, we continued our strategy to be the leading international bank in Macau. Total Revenue grew by 16.5% whilst Profit Before Tax decreased by 43.9%, as a result of loan impairment on the Wholesale Banking portfolio. The improvement in Net Interest Margin contributed to a rise in Net Interest Income of 3.8%. As we successfully captured business opportunities in the volatile FX market, Net Trading Income rose by 10.6%.

Despite the challenging business conditions in 2018, we continued to pursue the opportunities arising from the trends of RMB internationalization, development of the Greater Bay Area and Belt-and-Road initiatives. We have increased our collaboration with our offices in the Greater China Region, including a number of visits to the offices in the Mainland, and a joint townhall with HSBC China, Hong Kong and Taiwan.

To continue our digitalization journey, we have upgraded the new Evolve online FX trading platform, with an onboarding rate of close to 100% of our corporate customers. 5 new self-service banking machines were installed to expand our channel distribution for cash deposits, and credit card and mortgage payments. Effort is now being put to enhance our public website and personal internet banking services.

For mortgages, we launched the Young Adult First Time Home Buyers Scheme to support the local young people to buy their own home. We also successfully completed an internal customer-centric Payment Review to improve customer experience on cross border payments. Travel related benefits and offers were introduced to strengthen the positioning of our credit card as travel companion card in Macau.

Report of the Branch management (continued)

Branch's activities in Macau (continued)

With respect of Financial Crime Compliance and Risk Management, we have streamlined the customer due diligence process and enhanced our internal Credit Workflow Tool to enable a better and faster customer experience as well as a simpler but safer lending journey. Besides we have completed all key Customer Due Diligence Programmes for a much better understanding of our customers.

On the people side, we continued to build our team by bringing in talents with diversified knowledge and experience. Strong efforts have been made to recruit, retain and engage staff. Staff benefits continued to be under constant review. We have enhanced our staff housing loan scheme and increased our maternity leave period from 10 to 14 weeks, and paternity leave from 5 to 10 days, both setting a new standard in Macau. In addition, we have implemented a flexible working policy to enable our staff to achieve a better work life balance.

Balance sheet as at 31 December 2018

(Expressed in thousands of Macau Patacas)

	2018		
	Amounts MOP'000	*Reserves, depreciation and provision* MOP'000	*Net amount* MOP'000
Assets			
Cash	428,588	-	428,588
Deposits at AMCM	432,786	-	432,786
Current deposits at other local credit institutions	35,470	-	35,470
Current deposits at other overseas credit institutions	362,718	-	362,718
Loans and advances	16,653,897	211,670	16,442,227
Placements to local credit institutions	2,806,384	-	2,806,384
Call and fixed deposits at overseas credit institutions	3,846,989	-	3,846,989
Debtors	53,132	-	53,132
Available-for-sale equity investments	250	-	250
Properties	105,780	-	105,780
Equipment	101,680	55,765	45,915
Internal and adjustment accounts	164,736	-	164,736
Total	24,992,410	267,435	24,724,975

Balance sheet as at 31 December 2018 (continued)
(Expressed in thousands of Macau Patacas)

	2018	
	Subtotal	*Total*
	MOP'000	MOP'000
Liabilities		
Current deposits	11,323,231	
Call deposits	63,449	
Fixed deposits	2,648,720	14,035,400
Funding from overseas credit institutions	9,922,642	
Cheques and bills payable	111,782	
Other liabilities	62,348	10,096,772
Internal and adjustment accounts		114,838
Provisions		209,334
Revaluation reserve	90,806	
Other reserves	8,701	99,507
Current profit		169,124
Total		24,724,975

Profit and loss account
for the year ended 31 December 2018
(Expressed in thousands of Macau Patacas)

Profit and loss account

Debit	*2018 Amount* MOP'000	*Credit*	*2018 Amount* MOP'000
Operating costs	181,021	Operating income	607,605
Personnel expenses		Income from banking services	120,819
Staff costs	104,827	Other operating income	110,620
Staff benefits	6,857	Other banking income	1,594
Supplies by third party	19,734		
Services provided by third party	119,192		
Other banking expenses	3,627		
Tax expenses	25		
Non operating expenses	423		
Depreciation expenses	17,524		
Provisions	196,256		
Operating profits	191,152		
Total	840,638	**Total**	840,638

Profit and loss account
for the year ended 31 December 2018 (continued)
(Expressed in thousands of Macau Patacas)

Profit and loss account

Debit	*2018 Amount* MOP'000	*Credit*	*2018 Amount* MOP'000
Loss related to prior years	3,571	Operating profit	191,152
Tax on profit	23,730	Income related to prior years	1,702
Profit	169,124	Provision	3,571
Total	196,425	**Total**	196,425

Cash flow statement
for the year ended 31 December 2018
(Expressed in thousands of Macau Patacas)

	2018
	MOP'000
Operating activities	
Profit before taxation	192,854
Adjustments for:	
Depreciation	17,524
Provision for bad and doubtful debts	194,554
Interest income	(607,605)
Interest expense	181,021
Interest received	605,057
Interest paid	(165,592)
	417,813
Operating cash flows before changes in working capital	
Change in deposits at AMCM for the purpose of fulfilling minimum liquidity requirement	23,303
Change in placements to local credit institutions with original maturity of more than three months	(60,000)
Change in call and fixed deposits at overseas credit institutions with original maturity of more than three months	208,201
Change in gross loans and advances	880,166
Change in internal and adjustment accounts (assets)	485,530
Change in funding from overseas credit institutions	(613,906)
Change in current, call and fixed deposits	(458,529)
Change in internal and adjustment accounts (liabilities)	(378,279)
Cash generated from operations	504,299
Taxation paid	(40,737)
Net cash generated from operating activities	463,562

Cash flow statement
for the year ended 31 December 2018 (continued)
(Expressed in thousands of Macau Patacas)

	2018
	MOP'000
Investing activities	
Purchase of properties and equipment	(13,251)
Net cash used in investing activities	(13,251)
Financing activity	
Profit remitted to head office	(303,162)
Net cash used in financing activity	(303,162)
Net increase in cash and cash equivalents	147,149
Cash and cash equivalents at 1 January	5,917,322
Cash and cash equivalents at 31 December	6,064,471

Analysis of balances of cash and cash equivalents

Cash	428,588
Current deposits at other local credit institutions	35,470
Current deposits at other overseas credit institutions	362,718
Deposits at AMCM	432,786
Placements to local credit institutions	2,806,384
Call and fixed deposits at overseas credit institutions	3,846,989
Amount shown in the statement of financial position	7,912,935
Less:	
- Deposits at AMCM for the purpose of fulfilling minimum liquidity requirement	(285,062)
- Placements to local credit institutions with original maturity over three months	(1,110,000)
- Call and fixed deposits at overseas credit institutions with original maturity over three months	(453,402)
Cash and cash equivalents in the cash flow statement	6,064,471

Off-balance-sheet exposures
for the year ended 31 December 2018
(Expressed in thousands of Macau Patacas)

(a) ***Contingent liabilities and commitments***

	Contractual amounts *2018* MOP'000
Financial guarantees	1,126,082
Performance guarantees	2,889,712
Trade related contingencies	642
Other commitments	8,456,154

Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. As the facilities may expire without being drawn upon, the contractual amounts do not represent expected future cash flows.

AMCM requires that general provision be maintained at 1% of the guarantees given by the credit institutions. Specific provisions on contingent credit are made when there is evidence that the guarantees given by the credit institutions are not fully recoverable.

(b) ***Derivatives***

Derivatives refer to financial contracts whose value depends on the value of one or more underlying assets or indices.

Off-balance-sheet exposures
for the year ended 31 December 2018 (continued)
(Expressed in thousands of Macau Patacas)

(b) ***Derivatives (continued)***

The following is a summary of the notional amounts of each significant type of derivative:

	2018
	MOP'000
Exchange rate contracts	4,928,690

Derivatives arise from forward transactions undertaken in the foreign exchange market. The notional amounts of these instruments indicate the volume of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

The fair values and credit risk weighted amounts of the aforesaid off-balance sheet exposures are as follows:

	2018	
	Assets	*Liabilities*
	MOP'000	MOP'000
Fair value		
– Exchange rate contracts	18,730	15,291

	2018
	MOP'000
Credit risk weighted amounts	
– Exchange rate contracts	51,675

Off-balance-sheet exposures for the year ended 31 December 2018 (continued)

(Expressed in thousands of Macau Patacas)

(b) Derivatives (continued)

Credit risk weighted amount refers to the amount as computed in accordance with AMCM Guideline Notice 013/93-AMCM on capital adequacy and depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 50% for exchange rate and interest rate contracts and from 0% to 100% for other derivative contracts.

The Branch did not enter into any bilateral netting arrangements during the year and accordingly these amounts are shown on a gross basis.

Accounting policies

(a) Statement of compliance

This disclosure of financial information has been prepared in accordance with the requirements as set out in the Guidelines on Disclosure of Financial Information issued by the AMCM.

These financial statements have been prepared in accordance with the requirements as set out in Decree-Law No. 32/93/M and the Macau Financial Reporting Standards ("MFRSs") issued under Administrative Regulation No. 25/2005 of Macau SAR.

(b) Basis of preparation of the financial statements

The Branch is part of The Hongkong and Shanghai Banking Corporation Limited and accordingly it is not a separate legal entity. These financial statements have been prepared from the books and records maintained by the Branch in Macau, which contain evidence of all transactions entered into by the Branch locally but do not necessarily reflect all transactions that may be applicable to the Branch.

The financial statements are presented in thousands of Macau Patacas ("MOP"). The measurement basis used in the preparation of the financial statements is historical cost except for leasehold lands and properties, AMCM monetary bill and derivative financial instruments, which are carried at fair value.

The preparation of financial statements under MFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised if the revision affects only that year, or in the year of the revision and future years if the revision affects both current and future years.

Accounting policies (continued)

(c) Financial instruments

(i) Initial recognition

The Branch classifies its financial instruments into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: held at fair value through profit or loss, loans and receivables, available-for-sale financial assets and other financial liabilities.

Financial instruments are measured initially at fair value, which normally will be equal to the transaction price, plus, in case of a financial asset or financial liability not held at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately.

The Branch recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. A regular way purchase or sale of financial assets is recognised using trade date accounting. From this date, any gains and losses arising from changes in fair value of the financial assets or financial liabilities are recorded.

(ii) Categorisation

Fair value through profit or loss

This category comprises derivatives that do not qualify for hedge accounting. These transactions are accounted for as trading instruments.

Financial assets and liabilities under this category are carried at fair value and are not allowed to be reclassified into or out of this category while held or issued. Changes in the fair value are included in the profit and loss account in the period in which they arise. Upon disposal or repurchase, the difference between the net sale proceeds or the net payment and the carrying value is included in the profit and loss account.

Accounting policies (continued)

(c) Financial instruments (continued)

(ii) Categorisation (continued)

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (a) those that the Branch intends to sell immediately or in the near term, which will be classified as held for trading; (b) those that the Branch, upon initial recognition, designates as held at fair value through profit or loss or as available-for-sale; or (c) those where the Branch may not recover substantially all of its initial investment, other than because of credit deterioration, which will be classified as available-for-sale. Loans and receivables mainly comprise balances with financial institutions and loans and advances to customers.

Loans and receivables are carried at amortised cost using the effective interest rate method, less impairment losses, if any (see accounting policy (e)).

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any other categories. They include financial assets intended to be held for an indefinite period of time, but which may be sold in response to needs for liquidity or changes in the market environment.

Available-for-sale financial assets are carried at fair value. Unrealised gains and losses arising from changes in fair value are recognised directly in the available-for-sale financial assets reserve except for foreign exchange gains and losses on monetary items such as debt securities and impairment losses which are recognised in the profit and loss account.

Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments are carried at cost less impairment losses, if any (see accounting policy (e)).

When available-for-sale financial assets are sold, the difference between the net sale proceeds and the carrying value, together with the accumulated fair value adjustments in the available-for-sale financial assets reserve are treated as gains or losses on disposal.

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Accounting policies (continued)

(c) Financial instruments (continued)

(ii) Categorisation (continued)

Other financial liabilities

Financial liabilities, other than trading liabilities and those designated as held at fair value through profit or loss, are measured at amortised cost using the effective interest rate method.

(iii) Fair value measurement principles

The fair value of financial instruments is based on their quoted market prices, where available, at the balance sheet date without any deduction for estimated future selling costs. Financial assets are priced at current bid prices, while financial liabilities are priced at current ask prices.

Where quoted market prices are not available and discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the balance sheet date applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the balance sheet date.

(iv) Derecognition

A financial asset is derecognised when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset together with substantially all the risks and rewards of ownership, have been transferred.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

Accounting policies (continued)

(d) Property, plant and equipment

(i) Land and buildings

Land and buildings held for own use are carried at their revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses.

Revaluations are performed by professional qualified valuers, on a market basis, with sufficient regularity to ensure that the net carrying amount does not differ materially from the fair value. Surpluses arising on revaluation are credited firstly to the profit and loss account, to the extent of any deficits arising on revaluation previously charged to the profit and loss account in respect of the same land and buildings, and are thereafter taken to the 'Property revaluation reserve'. Deficits arising on revaluation are first set off against any previous revaluation surpluses included in the 'Property revaluation reserve' in respect of the same land and buildings, and are thereafter recognised in the profit and loss account.

Buildings held for own use which are situated on leasehold land where it is possible reliably to separate the value of the building from the value of the leasehold land at inception of the lease are revalued by professional qualified valuers, on a depreciated replacement cost basis or surrender value, with sufficient regularity to ensure that the net carrying amount does not differ materially from the fair value.

Depreciation on land and buildings is calculated to write off the assets over their estimated useful lives as follows:

- freehold land is not depreciated; and

- leasehold land and buildings are depreciated over the shorter of their unexpired terms of the leases or their remaining useful lives.

Accounting policies (continued)

(d) Property, plant and equipment (continued)

(ii) Other equipment

Equipment, fixtures and fittings are stated at cost less any impairment losses. Depreciation is calculated on a straight-line basis to write-off the assets over their useful lives, which are generally between 4 and 10 years.

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

Gains or losses arising from the retirement or disposal of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the profit and loss account on the date of retirement or disposal.

(e) Impairment of assets

The carrying amount of the Branch's assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, the carrying amount is reduced to the estimated recoverable amount by means of a charge to the profit and loss account. The carrying value of loans and receivables is adjusted through use of an allowance account rather than a direct write off.

Accounting policies (continued)

(e) Impairment of assets (continued)

(i) Loans and receivables

Provisions for bad and doubtful debts are made in reference to the provisioning guidelines pursuant to AMCM Notice No.18/93 ("AMCM's Provisioning Guidelines"). The Branch assesses losses for impaired loans and advances when there is objective evidence that impairment of a loan or portfolio of loans has occurred. The Branch assesses on a case-by-case basis at each reporting date whether there is any objective evidence that a loan is impaired and an individual assessment performed to arrive at a specific provision for such loans. For loans where specific provisions are not individually provided, general provisions calculated on a collective basis to cover losses which have been incurred but not yet been identified are made. Such estimation is made with reference to the AMCM's Provisioning Guidelines.

(ii) Available-for-sale financial assets

When there is objective evidence that an available-for-sale financial asset is impaired, the cumulative loss that had been recognised directly in equity is removed from equity and is recognised in the profit and loss account. The amount of the cumulative loss that is recognised in the profit and loss account is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in the profit and loss account.

Impairment losses recognised in the profit and loss account in respect of available-for-sale equity securities are not reversed through the profit and loss account. Any subsequent increase in the fair value of such assets is recognised directly in equity.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in the profit and loss account.

Accounting policies (continued)

(e) Impairment of assets (continued)

(iii) Other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased:

- property, plant and equipment; and
- other assets

If any such indication exists, the asset's recoverable amount is estimated.

- Calculation of recoverable amount

  The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

- Recognition of impairment losses

  An impairment loss is recognised in the profit and loss account whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

- Reversals of impairment losses

  An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount.

  A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the profit and loss account in the year in which the reversals are recognised.

Accounting policies (continued)

(f) *Cash and cash equivalents*

Cash and cash equivalents comprise cash at bank and on hand, demand deposits and term deposits with maturities below three month, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(g) *Employee benefits*

(i) Short term employee benefits

Salaries, annual bonuses, paid annual leave, leave passage and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees of the Branch. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

(ii) Pension

The Branch operates two pension plans which include both a defined benefit and a defined contribution plan.

Costs in respect of defined contribution plans are charged as an expense over the period to which the employee service relates.

The costs recognised for funding defined benefit plans are determined using the projected unit credit method, with annual actuarial valuations performed on the plan. Actuarial differences that arise are recognised in reserves and presented in the statement of recognised income and expense in the period they arise. Past service costs are recognised immediately to the extent the benefits are vested, and are otherwise recognised on a straight-line basis over the average period until the benefits are vested. The current service costs and any past service costs together with the unwinding of the discount on the plan liabilities, less the expected return on plan assets are charged to operating expenses.

Accounting policies (continued)

(h) Income tax

(i) Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the profit and loss account except to the extent that it relates to items recognised directly in equity, in which case they are recognised in equity.

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

(iii) Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions that are currently not applicable to the Branch, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

(iv) Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if, and only if the Branch has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Branch intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on the same taxable entity.

Accounting policies (continued)

(i) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Branch has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(j) Revenue recognition

Provided it is probable that the economic benefits will flow to the Branch and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in the profit and loss account as follows:

(i) Interest income and interest expenses

Interest income and interest expenses for all interest-bearing financial instruments is recognised in the profit and loss account using the effective interest rate method.

The effective interest rate method is a method of calculating the amortised cost of a financial asset and of allocating the interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset. When calculating the effective interest rate, the Branch estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

For impaired loans, the accrual of interest income based on the original terms of the loan is discontinued, but any increase in the present value of impaired loans due to the passage of time is reported as interest income.

(ii) Fee and commission income

Fee and commission income is recognised when the corresponding services are provided.

Accounting policies (continued)

(k) Translation of foreign currencies

Foreign currency transactions during the year are translated into Macau Patacas at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Macau Patacas at the exchange rate ruling at the balance sheet date. Exchange gains and losses on these foreign currency translations are dealt with in the profit and loss account. Non-monetary assets denominated in foreign currencies that are stated at fair value are translated into Macau Patacas at the exchange rates ruling at the time the fair value was established.

(l) Related parties

(a) A person, or a close member of that person's family, is related to the Branch if that person:

   (i) has control or joint control over the Branch;

   (ii) has significant influence over the Branch; or

   (iii) is a member of the key management personnel of the Branch or the Branch's parent.

(b) An entity is related to the Branch if any of the following conditions applies:

   (i) The entity and the Branch are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

   (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

   (iii) Both entities are joint ventures of the same third party.

   (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

   (v) The entity is a post-employment benefit plan for the benefit of employees of either the Branch or an entity related to the Branch.

   (vi) The entity is controlled or jointly controlled by a person identified in (a).

   (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity.

Significant Related party transactions
(Expressed in thousands of Macau Patacas)

Material related party transactions

The Branch entered into the following material related party transactions.

(a) Transactions with group companies

During the year, the Branch entered into transactions with related parties in the ordinary course of its banking business including lending, acceptance and placement of inter-bank deposits, correspondent banking transactions and off-balance sheet transactions. The transactions were priced at the relevant market rates at the time of each transaction.

The amount of related-party transactions during the year and outstanding balances at the end of the year are set out below:

	Associates, other branches, subsidiaries, fellow subsidiaries 2018 MOP'000	*The Hongkong and Shanghai Banking Corporation, Hong Kong Branch 2018* MOP'000
Interest income	254	53,028
Interest expense	(10)	(142,954)
Fee and commission income	2,101	2,181
Fee and commission expense	(564)	(736)
Other operating income	1,133	372
Operating expenses	(33,926)	(63,637)
For the year ended 31 December	(31,012)	(151,746)

Significant Related party transactions (continued)

(Expressed in thousands of Macau Patacas)

Material related party transactions (continued)

(a) Transactions with group companies (continued)

	Associates, other branches, subsidiaries, fellow subsidiaries *2018* MOP'000	*The Hongkong and Shanghai Banking Corporation, Hong Kong Branch* *2018* MOP'000
Cash and current deposits at other overseas credit institutions	278,869	82,475
Call and fixed deposits at overseas credit institutions	65,678	3,613,575
Internal and adjustment accounts - assets	-	17,379
Funding from overseas credit institutions	(127,021)	(9,727,777)
Internal and adjustment accounts - liabilities	(68,303)	(71,667)
As at 31 December	149,223	(6,086,015)

No impairment allowance was made in respect of the above loans to and placements with related parties.

The Branch's immediate parent is The Hongkong and Shanghai Banking Corporation Limited, which is incorporated in Hong Kong and the Branch's ultimate parent is HSBC Holdings plc, which is incorporated in the United Kingdom. Both the immediate and ultimate parent companies produce consolidated financial statements for public use.

(b) Key management personnel

The remuneration of key management personnel, which is included in the staff cost, is as follows:

	2018 MOP'000
Executive officers	4,718

Credit risk management

(Expressed in thousands of Macau Patacas)

The Branch's credit risk is primarily attributable to customer advances. The Branch manages this risk as follows:

In respect of customer advances, individual credit evaluations are performed on all customers requiring credit. Normally, the Branch obtains collateral from customers.

At the balance sheet date, the Branch's greatest concentration of credit risk on one market sector was 31.9% of total customer advances.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet after deducting any impairment allowance and adjustment of mark to market value if applicable.

Credit risk management (continued)

(Expressed in thousands of Macau Patacas)

(a) Geographical distribution of credit risk exposures

The geographical distribution is based on the countries where the counterparties were operated or located after taking into account any transfer of risk. In general, such transfer of risk takes place if the claims are guaranteed by a party in a country which is different from that of the counterparty or if the claims are on an overseas branch of a bank whose head office is located in another country.

Exposures to individual countries or jurisdiction, groups of countries or regions within countries amounting to 10% or more of the relevant major types of credit exposures at balance sheet date are shown as follows:

	2018		
Region	*Gross loans and advances and commitments* MOP'000	*Placements to local credit institutions* MOP'000	*Financial derivatives* MOP'000
Macau SAR	22,748,563	2,806,384	2,108,179
in which:			
– banks	-	566,384	-
– governments and public sectors	-	2,240,000	-
– others	22,748,563	-	2,108,179
Hong Kong SAR	1,840,039	-	2,820,511
in which:			
– banks	-	-	-
– governments and public sectors	-	-	-
– others	1,840,039	-	2,820,511
	24,588,602	2,806,384	4,928,690

Credit risk management (continued)

(Expressed in thousands of Macau Patacas)

(a) Geographical distribution of credit risk exposures (continued)

Geographic region with higher than or equal to 10% of the total loans and advances to customers at balance sheet date are shown as follows:

	2018	
	Gross loans and advances MOP'000	*Past due or impaired* MOP'000
Macau	14,519,465	517,994
Hong Kong	1,683,143	22
	16,202,608	518,016

Credit risk management (continued)

(Expressed in thousands of Macau Patacas)

(b) Loans and advances to customers analysed by industry sector

	2018
	MOP'000
Industry distribution of exposures	
– Manufacturing	949,517
– Construction and public works	62,554
– Wholesale and retail trade	5,304,344
– Restaurants, hotels and similar	20,262
– Transport, warehouse and communications	34,883
– Information technology	4,152
– Individuals for house purchases	6,738,776
– Individuals for other purposes	491,659
– Others	3,047,750
	16,653,897

According to AMCM's requirements, a general provision is made at 1% of the aggregated balance of loans and advances (with overdue days less than 3 months), guarantees and contingent assets. As at 31 December 2018, the amounts of specific provision by industry sector are shown as follows:

	2018
	MOP'000
– Individuals for house purchases	1,863
– Individuals for other purposes	209,806
	211,669

Credit risk management (continued)

(Expressed in thousands of Macau Patacas)

(c) Analysis on assets and liabilities by remaining maturity

	2018						
	Repayable on demand MOP'000	*Due within 3 months* MOP'000	*Due between 3 and 12 months* MOP'000	*Due between 1 year and 5 years* MOP'000	*Due after 5 years* MOP'000	*No contractual maturity* MOP'000	*Total* MOP'000
Assets							
Cash	428,588	-	-	-	-	-	428,588
Deposits at AMCM	-	432,786	-	-	-	-	432,786
Current deposits at other local credit institutions	35,470	-	-	-	-	-	35,470
Current deposits at other overseas credit institutions	362,718	-	-	-	-	-	362,718
Loans and advances	259,186	4,476,515	1,125,967	4,970,508	5,610,051	-	16,442,227
Placements to local credit institutions	-	2,076,384	730,000	-	-	-	2,806,384
Call and fixed deposits at overseas credit institutions	164,305	3,656,513	22,652	3,519	-	-	3,846,989
Debtors	1,911	50,235	592	394	-	-	53,132
Available-for-sale equity investments	-	-	-	-	-	250	250
Properties	-	-	-	-	-	105,780	105,780
Equipment	-	-	-	-	-	45,915	45,915
Internal and adjustment accounts	78,412	82,596	215	3,513	-	-	164,736
Total assets	1,330,590	10,775,029	1,879,426	4,977,934	5,610,051	151,945	24,724,975
Liabilities							
Current and call deposits	11,386,680	-	-	-	-	-	11,386,680
Fixed deposits	-	2,192,486	456,234	-	-	-	2,648,720
Funding from credit institutions	148,701	390,331	91	9,382,011	1,508	-	9,922,642
Cheques and bills payable	111,782	-	-	-	-	-	111,782
Other liabilities	-	15,382	-	-	-	46,966	62,348
Internal and adjustment accounts	10,098	33,561	59,849	2,056	-	9,274	114,838
Provisions	3,316	57,374	14,302	63,113	71,229	-	209,334
Total liabilities	11,660,577	2,689,134	530,476	9,447,180	72,737	56,240	24,456,344
Net liquidity gap	(10,329,987)	8,085,895	1,348,950	(4,469,246)	5,537,314	95,705	268,631

Credit risk management (continued)

(Expressed in thousands of Macau Patacas)

(d) ***Analysis on past due assets***

The ageing analysis of advances to customers that are past due is as follows:

	2018
	MOP'000
Gross advances to customers that are past due	
– more than three months but less than six months	13,269
– more than six months but less than one year	240,358
– more than one year	13,617
	267,244

	2018
	MOP'000
Value of collateral on past due loans and advance	
– more than three months but less than six months	14,104
– more than six months but less than one year	20,291
– more than one year	13,298
	47,693

	2018
	MOP'000
Amount of specific provision made on past due loans and advance	
– more than three months but less than six months	581
– more than six months but less than one year	209,773
– more than one year	1,315
	211,669

As at 31 December 2018, there were no other assets that have been past due for bank and non-bank customers.

Market risk management

(Expressed in thousands of Macau Patacas)

Market risk

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

Interest rate risk management

(Expressed in thousands of Macau Patacas)

Interest rate risk

Interest rate risk arises principally from mismatches between the future yield on assets and our funding cost as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on optionality in certain product areas, for example mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand, for example current accounts.

As part of the Bank's Asset, Liability and Capital Management ('ALCM') structure, we have established the Asset and Liability Management Committee ('ALCO') and Balance Sheet Management ('BSM') at the Branch level. In order to manage this risk optimally, all interest rate risk is transferred to BSM.

The transfer of interest rate risk to books managed by BSM is usually achieved by a series of internal deals between the business units and these books. When the behavioural characteristics of a product differ from its contractual characteristics, the behavioural characteristics are assessed to determine the true underlying interest rate risk. Local ALCOs regularly monitor all such behavioural assumptions and interest rate risk positions, to ensure they comply with interest rate risk limits established by senior management.

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

Once interest rate risk has been consolidated in BSM, the net exposure is typically managed through the use of pre-designated market instruments within agreed limits.

We also monitor the sensitivity of projected net interest income under varying interest rate scenarios. We aim, through its management of interest rate risk, to mitigate the impact of prospective interest rate movements which could reduce future net interest income, whilst balancing the cost of such hedging activities on the current net revenue stream.

Operational risk management
(Expressed in thousands of Macau Patacas)

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

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

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

– operational risk management responsibility is assigned to senior management within the business operation;

– information systems are used to record the identification and assessment of operational risks and to generate appropriate, regular management reporting;

– assessments are undertaken of the operational risks facing each business and the risks inherent in its processes, activities and products. Risk assessment incorporates a regular review of identified risks to monitor significant changes;

– operational risk loss data is collected and reported to senior management. Aggregate operational risk losses are recorded and details of incidents above a materiality threshold are reported to the HSBC Group’s Audit Committee; and

– risk mitigation, including insurance, is considered where this is cost-effective.

Foreign exchange risk management

(Expressed in thousands of Macau Patacas)

Foreign currency risk

The Branch is exposed to currency risks primarily arising from financial instruments that are denominated in United States dollars ("USD") and other major currencies. As the USD is pegged to the Hong Kong dollar ("HKD") which is in turn pegged to Patacas, the Branch considers the risk of movements in exchange rates between the HKD and the USD, and to Patacas to be insignificant. In respect of financial instruments denominated in other currencies, the Branch ensures that the net exposure is kept to an acceptable level by buying or selling foreign currencies at spot rates where necessary to address short-term imbalances.

As most of the Branch's financial instruments at 31 December 2018 and 2017 were denominated in either HKD or USD, management does not consider there to be any significant currency risk associated with them.

The following table indicates the net long/(short) position of currencies other than MOP:

	2018 MOP'000
USD	10,077
HKD	(222,591)
Other currencies	(1,288)
Total	(213,802)

Foreign exchange risk management (continued)

(Expressed in thousands of Macau Patacas)

Foreign currency risk

Analysis on foreign currencies with net position constitute not less than 10% of the total net position in all currencies:

	2018			
In thousand of MOP equivalent	*United States Dollars*	*Hong Kong Dollars*	*Other foreign currencies*	*Total*
Assets				
Cash and current deposits at credit institutions	19,488	423,846	287,280	730,614
Placements to local credit institutions	483,984	82,400	-	566,384
Call and fixed deposits at oversea credit institutions	2,502,722	814,594	365,603	3,682,919
Loans and advances	1,545,000	12,711,908	48,405	14,305,313
Debtors	23	778	-	801
Internal and adjustment accounts	38,553	64,158	1,031	103,742
Spot assets	4,589,770	14,097,684	702,319	19,389,773
Liabilities				
Funding from credit institutions	(125,502)	(9,752,525)	(3,528)	(9,881,555)
Current, call and fixed deposits	(4,696,746)	(4,391,600)	(736,170)	(9,824,516)
Cheques and bills payable	-	(67,459)	-	(67,459)
Internal and adjustment accounts	(37,183)	(21,040)	(1,981)	(60,204)
Spot liabilities	(4,859,431)	(14,232,624)	(741,679)	(19,833,734)
Forward purchase	2,443,893	1,080,012	1,404,585	4,928,490
Forward sales	(2,164,155)	(1,167,663)	(1,366,513)	(4,698,331)
Net long/(short) non-structural position	10,077	(222,591)	(1,288)	(213,802)

Liquidity risk management

(Expressed in thousands of Macau Patacas)

The Branch's policy is to monitor its liquidity requirements and its compliance with lending covenants daily, including the terms of borrowings from other group entities, to ensure that it maintains sufficient reserves of cash, readily realisable marketable securities or committed lines of funding (from major financial institutions or other group companies) to satisfy its contractual and reasonably foreseeable obligations as they fall due.

As part of the Bank's Asset, Liability and Capital Management ("ALCM") structure, we have established the Asset and Liability Management Committee ("ALCO") at the Branch level. The terms of reference of ALCO includes the monitoring and control of liquidity and funding.

The following table summarizes the key quantitative indicators for liquidity risk for the year ended 31 December 2018:

(a)	The arithmetic mean of the minimum weekly amount of cash in hand that is required to be held	432,492
(b)	The arithmetic mean of the average weekly amount of cash in hand	771,216
(c)	The arithmetic mean of the specified liquid assets at the end of each month	15,259,006
(d)	The average ratio of specified liquid assets to total basic liabilities at the end of the month	79.1%
(e)	The arithmetic mean of its one-month liquidity ratio in the last week of each month	667.7%
(f)	The arithmetic mean of its three-month liquidity ratio in the last week of each month	505.1%

The above ratios and figures calculations are computed based on the data extracted from the weekly and monthly returns submitted to AMCM.

Other information

(Expressed in thousands of Macau Patacas)

(a) Capital commitments

There were no capital commitments outstanding at 31 December 2018 not provided for in the financial statements.

(b) Operating lease commitments

At 31 December 2018, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	2018
	MOP'000
Within 1 year	1,835
After 1 year but within 5 years	710
	2,545

Other information in relation to positions of Head Office, The Hongkong and Shanghai Banking Corporation Limited

(Expressed in Hong Kong dollars)

The Branch is one of the branches of The Hongkong and Shanghai Banking Corporation Limited ("the Bank") and therefore it is not required to prepare consolidated accounts. Unless otherwise stated, all information disclosed below is extracted from the corresponding information in the most recently available annual audited consolidated financial statements of the HSBC group of which the Branch is a member.

The audited consolidated financial statements can be accessed through various channels, including its website (http://www.hsbc.com.hk). For more comprehensive understanding of the financial position and results of operations of HSBC, the information disclosed below should be read in conjunction with the audited consolidated financial statements.

(a) Consolidated capital adequacy ratio

	2018
	%
Capital adequacy ratio at 31 December	
Tier 1 capital ratio	17.8
Total capital ratio	19.8

The capital ratios were contained in the 'Capital Adequacy Ratio' return submitted to the HKMA by The Hongkong and Shanghai Banking Corporation Limited on a consolidated basis that is specified by the HKMA under the requirements of section 3C(1) of the Banking (Capital) Rules.

Other information in relation to positions of Head Office, The Hongkong and Shanghai Banking Corporation Limited (continued)

(Expressed in Hong Kong dollars)

(b) Capital and reserves

	At 31 December 2018 HKD million
Share capital	172,335
Other equity instruments	35,879
Other reserves	114,949
Retained profits	429,595
Total shareholders' equity	752,758
Non-controlling interests	60,162
Total equity	812,920

(c) Consolidated assets, liabilities and profits position

	At 31 December 2018 HKD million
Total assets	8,263,454
Total liabilities	7,450,534
Loans and advances to customers	3,528,702
Deposits by banks	164,664
Customer accounts	5,207,666
Profit before taxation	134,583

(d) Shareholders with qualifying holdings

The Branch is one the branches of The Hongkong and Shanghai Banking Corporation Limited ("the Bank"). The ultimate holding company of the Bank is HSBC Holdings plc, which is incorporated in the United Kingdom. There are no shareholders with major holdings in HSBC Holdings plc ordinary shares.

Other information in relation to positions of Head Office, The Hongkong and Shanghai Banking Corporation Limited (continued)

(e) Board of Directors

The Board of Directors of the Bank at 31 December 2018 comprises:

John Michael Flint#, *Chairman*
Peter Tung Shun Wong, *Deputy Chairman and Chief Executive*
Laura May Lung Cha*, GBM, *Deputy Chairman*
Zia Mody*, *Deputy Chairman*
Graham John Bradley*
Louisa Wai Wan Cheang
Dr Christopher Wai Chee Cheng*, GBS, OBE
Dr Raymond Kuo Fung Ch'ien*, GBS, CBE
Yiu Kwan Choi*
Irene Yun-lien Lee*
Jennifer Xinzhe Li*
Victor Tzar Kuoi Li#
Bin Hwee Quek (née Chua)* , JP
Kevin Anthony Westley*, BBS
Marjorie Mun Tak Yang*, GBS
Tan Sri Dr Francis Sock Ping Yeoh*, CBE

* Independent non-executive Director
\# Non-executive Director

INDEPENDENT AUDITOR'S REPORT ON THE SUMMARY FINANCIAL STATEMENTS

TO THE MANAGEMENT OF THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED, MACAU BRANCH

The attached summary financial statements of The Hongkong and Shanghai Banking Corporation Limited, Macau Branch (the "Branch") for the year ended 31 December 2018 have been derived from the audited financial statements of the Branch for the year ended on the same date. These summary financial statements, which comprise the balance sheet as at 31 December 2018 and the income statement for the year then ended, are the responsibility of the management. Our responsibility is to express an opinion solely to you, as a body, as to whether the summary financial statements are consistent, in all material respects, with the audited financial statements, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We have audited the financial statements of the Company for the year ended 31 December 2018 in accordance with Auditing Standards and Technical Standards on Auditing issued by the Government of the Macao Special Administrative Region and have issued an auditor's report with an unqualified opinion on these financial statements dated 29 April 2019.

The audited financial statements comprise the statement of financial position as at 31 December 2018, and the statement of profit or loss and other comprehensive income, statement of changes in reserves and cash flow statement for the year then ended, and a summary of significant accounting policies and explanatory notes.

In our opinion, the summary financial statements are consistent, in all material respects, with the audited financial statements.

For a better understanding of the financial position of the Company and its operating results and of the scope of our audit, the attached summary financial statements should be read in conjunction with the audited financial statements and the independent auditor's report thereon.

Cheung Pui Peng Grace
Registered Auditor
PricewaterhouseCoopers

Macao, 29 April 2019