The Hongkong and Shanghai Banking Corporation Limited
Macau Branch

Disclosure of Financial Information
31 December 2016

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 2016, we continued our strategy to be the leading international bank in Macau. All lines of business including Commercial Banking, Retail Banking and Wealth Management and Global Markets recorded respectable performance. In particular, taking advantage of the trend of RMB internationalization, we have launched various RMB initiatives and increased our collaboration with HSBC China to deliver effective RMB solutions to our clients and this has led to a significant increase in revenue generation. Revenue and profit before tax grew by 6.2% and 9.5% respectively. We also achieved customer advances growth of 9.1% and net interest income increase of 10.1%. Net Trading Income surged by 36.1% as we successfully captured the business opportunities in the volatile FX markets.

In addition to the positive financial performance, we have also achieved significant progress in implementing our Global Standards to HSBC in Macau. We have strengthened our Financial Crime Compliance and Risk Management including the launch of the Anti-Bribery and Corruption policy, which provides baseline to mitigate the related risks.

In terms of infrastructure, we completed our branch refurbishment with a celebration ceremony held on 22 August 2016. The new branch facilities serve to improve customer experience, drive business growth and enhance brand awareness. The renovated office also offers a much better working environment for our staff.

On the people side, we have continued to focus on our strategy to make HSBC a better workplace. Strong efforts have been made to recruit, retain and engage staff. We continued to identify talents in the Bank and build a stronger management team for future business growth and sustainability.

Balance sheet as at 31 December 2016

(Expressed in thousands of Macau Patacas)

		2016	
	Amounts	*Reserves, depreciation and provision*	*Net amount*
	MOP'000	MOP'000	MOP'000
Assets			
Cash	302,730	-	302,730
Deposits at AMCM	402,336	-	402,336
Current deposits at other local credit institutions	122,643	-	122,643
Current deposits at other overseas credit institutions	308,171	-	308,171
Loans and advances	16,018,111	9,383	16,008,728
Placements to local credit institutions	2,559,139	-	2,559,139
Call and fixed deposits at overseas credit institutions	2,933,834	-	2,933,834
Debtors	48,725	-	48,725
Available-for-sale equity investments	250	-	250
Properties	93,500	-	93,500
Equipment	134,229	76,209	58,020
Internal and adjustment accounts	313,726	-	313,726
Total	23,237,394	85,592	23,151,802

Balance sheet as at 31 December 2016 (continued)
(Expressed in thousands of Macau Patacas)

	2016	
	Subtotal	*Total*
	MOP'000	MOP'000
Liabilities		
Current deposits	12,397,234	
Call deposits	8,632	
Fixed deposits	1,309,633	13,715,499
Funding from local credit institutions	91,784	
Funding from overseas credit institutions	8,486,756	
Cheques and bills payable	82,160	
Other liabilities	37,431	8,698,131
Internal and adjustment accounts		173,369
Provisions		193,476
Revaluation reserve	80,077	
Other reserves	7,444	87,521
Current profit		283,806
		23,151,802

Profit and loss account
for the year ended 31 December 2016
(Expressed in thousands of Macau Patacas)

Profit and loss account

Debit	*2016 Amount* MOP'000	*Credit*	*2016 Amount* MOP'000
Operating costs	64,642	Operating income	433,747
Personnel expenses		Income from banking services	125,029
Staff costs	75,624	Other operating income	92,578
Staff benefits	15,277	Other banking income	1,522
Supplies by third party	18,878		
Services provided by third party	110,947		
Other banking expenses	9,612		
Tax expenses	28		
Non operating expenses	1,312		
Depreciation expenses	8,777		
Provisions	27,130		
Operating profits	320,649		
Total	652,876	**Total**	652,876

Profit and loss account
for the year ended 31 December 2016 (continued)

(Expressed in thousands of Macau Patacas)

Profit and loss account

Debit	*2016 Amount* MOP'000	*Credit*	*2016 Amount* MOP'000
Loss related to prior years	3,760	Operating profit	320,649
Tax on profit	38,460	Income related to prior years	1,617
Profit	283,806	Provision	3,760
Total	326,026	**Total**	326,026

Cash flow statement for the year ended 31 December 2016

(Expressed in thousands of Macau Patacas)

	2016
	MOP'000
Operating activities	
Profit before taxation	322,266
Adjustments for:	
Depreciation	8,775
Impairment allowances on loans and advances	25,512
Interest income	(433,747)
Interest expense	64,642
Interest received	432,537
Interest paid	(63,934)
	356,051
Operating cash flows before changes in working capital	
Decrease in deposits at AMCM for the purpose of fulfilling minimum liquidity requirement	97,784
Decrease in placements to local credit institutions with original maturity of more than three months	372,550
Increase in call and fixed deposits at overseas credit institutions with original maturity of more than three months	(74,100)
Increase in gross loans and advances	(1,326,577)
Increase in internal and adjustment accounts (assets)	(4,325)
Increase in funding from credit institutions	2,295,577
Decrease in current, call and fixed deposits	(1,623,733)
Decrease in internal and adjustment accounts (liabilities)	(79,915)
Cash generated from operations	13,312
Taxation paid	(35,369)
Net cash generated from operating activities	(22,057)

Cash flow statement
for the year ended 31 December 2016 (continued)
(Expressed in thousands of Macau Patacas)

	2016
	MOP'000
Investing activities	
Purchase of properties and equipment	(56,052)
Net cash used in investing activities	(56,052)
Financing activity	
Profit remitted to head office	(258,752)
Net cash used in financing activity	(258,752)
Net decrease in cash and cash equivalents	(336,861)
Cash and cash equivalents at 1 January	5,090,144
Cash and cash equivalents at 31 December	4,753,283

Analysis of balances of cash and cash equivalents

Cash	302,730
Current deposits at other local credit institutions	122,643
Current deposits at other overseas credit institutions	308,171
Deposits at AMCM	402,336
Placements to local credit institutions	2,559,139
Call and fixed deposits at overseas credit institutions	2,933,834
Amount shown in the balance sheet	6,628,853
Less:	
Deposits at AMCM for the purpose of fulfilling minimum liquidity requirement	(229,661)
Placements to local credit institutions with original maturity over three months	(1,190,000)
Call and fixed deposits at overseas credit institutions with original maturity over three months	(455,909)
Cash and cash equivalents in the cash flow statement	4,753,283

Off-balance-sheet exposures
for the year ended 31 December 2016
(Expressed in thousands of Macau Patacas)

(a) *Contingent liabilities and commitments*

	Contractual amounts 2016 MOP'000
Financial guarantees	792,951
Performance guarantees	1,990,831
Trade related contingencies	508,796
Other commitments	9,580,9550

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 2016 (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:

	2016
	MOP'000
Exchange rate contracts	7,297,647

Derivatives arise from forward and swap transactions undertaken in the foreign exchange and equity markets. 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:

	2016	
	Assets	*Liabilities*
	MOP'000	MOP'000
Fair value		
– Exchange rate contracts	91,218	64,365

	2016
	MOP'000
Credit risk weighted amounts	
– Exchange rate contracts	85,892

Off-balance-sheet exposures
for the year ended 31 December 2016 (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 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;

- 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.

(i) Loans and receivables

Impairment losses on loans and receivables are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets). Receivables with a short duration are not discounted if the effect of discounting is immaterial.

The total allowance for credit losses consists of two components: individual impairment allowances and collective impairment allowances.

Accounting policies (continued)

(e) Impairment of assets (continued)

(i) Loans and receivables (continued)

The Branch first assesses whether objective evidence of impairment exists for financial assets that are individually significant, and collectively for financial assets that are not individually significant. If the Branch determines that no objective evidence of impairment exists for an individually assessed financial asset it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

The individual impairment allowance is based upon management's best estimate of the present value of the cash flows which are expected to be received discounted at the original effective interest rate. In estimating these cash flows, management makes judgments about the borrower's financial situation and the net realisable value of any underlying collateral or guarantees in favour of the Branch. Each impaired asset is assessed on its own merits.

In assessing the need for collective impairment allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, the Branch makes assumptions both to define the way the Branch models inherent losses and to determine the required input parameters, based on historical experience and current economic conditions. In determining the amount of provision, the Branch made references to the provisioning guidelines pursuant to AMCM notice No. 18/93.

The accuracy of the impairment allowances the Branch makes depends on how well the Branch can estimate future cash flows for individually assessed impairment allowances and the model assumptions and parameters used in determining collective impairment allowances. While this necessarily involves judgment, the Branch believes that the impairment allowances on loans and advances to customers are reasonable and supportable.

Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates that can be linked objectively to an event occurring after the write-down, will result in a change in the impairment allowances on loans and receivables and will be charged or credited to the profit and loss account. A reversal of impairment losses is limited to the loans and receivables' carrying amount that would have been determined had no impairment loss been recognised in prior years.

Accounting policies (continued)

(e) Impairment of assets (continued)

(i) Loans and receivables (continued)

Loans and receivables with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Branch has made concessions that it would not otherwise consider. Renegotiated loans and receivables are subject to ongoing monitoring to determine whether they remain impaired or past due.

When there is no reasonable prospect of recovery, the loan and related interest receivables are written off.

(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

Interest income 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 2016 MOP'000	*The Hongkong and Shanghai Banking Corporation, Hong Kong Branch 2016* MOP'000
Interest income	691	13,257
Interest expense	(20)	(57,122)
Fee and commission income	4,966	3,362
Fee and commission expense	(909)	(675)
Other operating income	723	-
Operating expenses	(22,656)	(71,599)
For the year ended 31 December	(17,205)	(112,777)

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 2016 MOP'000	*The Hongkong and Shanghai Banking Corporation, Hong Kong Branch 2016* MOP'000
Current deposits at other overseas credit institutions	242,748	64,020
Call and fixed deposits at overseas credit institutions	939,645	1,867,571
Internal and adjustment accounts (assets)	-	51,963
Funding from overseas credit institutions	(218,416)	(8,410,295)
Internal and adjustment accounts (liabilities)	-	(43,538)
As at 31 December	963,977	(6,470,279)

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:

	2016 MOP'000
Executive officers	5,087

Credit risk management

(Expressed in thousands of Macau Patacas)

The Branch's credit risk is primarily attributable to customer advances and debt investments issued by banks. 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.

Investments are normally in liquid securities issued by banks and quoted on a recognised stock exchange and with counterparties that have high credit ratings.

At the balance sheet date, the Branch's greatest concentration of credit risk on one market sector was 40.4% 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:

	2016		
Region	*Gross loans and advances and commitments* MOP'000	*Placements to local credit institutions* MOP'000	*Financial derivatives* MOP'000
Macau SAR	22,235,155	2,000,000	2,937,184
in which:			
– banks	-	-	-
– governments and public sectors	-	2,000,000	-
– others	22,235,155	-	2,937,184
Hong Kong SAR	-	-	4,360,462
in which:			
– banks	-	-	-
– governments and public sectors	-	-	-
– others	-	-	4,360,462
	22,235,155	2,000,000	7,297,646

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:

	2016	
	Gross loans and advances MOP'000	*Past due or impaired* MOP'000
Macau	14,015,039	299,887
Hong Kong	1,896,195	-
	15,911,234	299,887

Credit risk management (continued)

(Expressed in thousands of Macau Patacas)

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

	2016
	MOP'000
Industry distribution of exposures	
– Manufacturing	1,473,248
– Construction and public works	63,223
– Wholesale and retail trade	4,322,584
– Restaurants, hotels and similar	7,817
– Transport, warehouse and communications	39,099
– Information technology	4,624
– Individuals for house purchases	6,466,971
– Individuals for other purposes	706,748
– Others	2,933,797
	16,018,111

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 2016, the amounts of specific provision by industry sector are shown as follows:

	2016
	MOP'000
– Manufacturing	3,298
– Construction and public works	1,484
– Individuals for house purchases	3,116
– Individuals for other purposes	1,485
	9,383

Credit risk management (continued)

(Expressed in thousands of Macau Patacas)

(c) Analysis on assets and liabilities by remaining maturity

	2016						
	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	302,730	-	-	-	-	-	302,730
Deposits at AMCM	402,336	-	-	-	-	-	402,336
Current deposits at other local credit institutions	122,643	-	-	-	-	-	122,643
Current deposits at other overseas credit institutions	308,171	-	-	-	-	-	308,171
Loans and advances	104,772	4,480,720	1,136,734	4,790,491	5,496,011	-	16,008,728
Placements to local credit institutions	-	1,637,557	891,582	30,000	-	-	2,559,139
Call and fixed deposits at overseas credit institutions	691,037	2,242,797	-	-	-	-	2,933,834
Debtors	48,725	-	-	-	-	-	48,725
Available-for-sale equity investments	-	-	-	-	-	250	250
Properties	-	-	-	-	-	93,500	93,500
Equipment	-	-	-	-	-	58,020	58,020
Internal and adjustment accounts	162,561	5,601	2,528	6,111	7,904	129,021	313,726
Total assets	2,142,975	8,366,675	2,030,844	4,826,602	5,503,915	280,791	23,151,802
Liabilities							
Current and call deposits	12,405,866	-	-	-	-	-	12,405,866
Fixed deposits	-	1,180,784	128,849	-	-	-	1,309,633
Funding from credit institutions	121,452	121,343	103	8,335,642	-	-	8,578,540
Cheques and bills payable	82,160	-	-	-	-	-	82,160
Other liabilities	-	37,431	-	-	-	-	37,431
Internal and adjustment accounts	23,611	12,791	59,298	1,040	218	76,411	173,369
Provisions	1,267	54,152	13,738	57,896	66,423	-	193,476
Total liabilities	12,634,356	1,406,501	201,988	8,394,578	66,641	76,411	22,780,475
Net liquidity gap	(10,491,381)	6,960,174	1,828,856	(3,567,976)	5,437,274	204,380	371,327

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:

	2016
	MOP'000
Gross advances to customers that are past due	
– six months or less but over three months	61,157
– one year or less but over six months	-
– over one year	4,849
	66,006

	2016
	MOP'000
Value of collateral on past due loans and advance	
– six months or less but over three months	56,117
– one year or less but over six months	-
– over one year	1,597
	57,714

	2016
	MOP'000
Amount of specific provision made on past due loans and advance	
– six months or less but over three months	6,086
– one year or less but over six months	-
– over one year	3,297
	9,383

As at 31 December 2016, 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 2016 and 2015 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:

	2016 MOP'000
USD	41,925
HKD	(90,336)
Other currencies	679
Total	(47,732)

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:

	2016			
In thousand of MOP equivalent	*United States Dollars*	*Hong Kong Dollars*	*Other foreign currencies*	*Total*
Assets				
Cash and current deposits at credit institutions	7,261	262,781	255,134	525,176
Placements to local credit institutions	559,213	-	-	559,213
Call and fixed deposits at oversea credit institutions	887,983	419,079	1,512,039	2,819,101
Loans and advances	2,326,521	12,271,721	31,586	14,629,828
Internal and adjustment accounts	106,323	92,330	741	199,394
Spot assets	3,887,301	13,045,911	1,799,500	18,732,712
Liabilities				
Current, call and fixed deposits	(4,303,748)	(5,001,844)	(801,149)	(10,106,741)
Funding from credit institutions	(659,244)	(7,817,292)	(92,937)	(8,569,473)
Cheques and bills payable	-	(33,758)	-	(33,758)
Internal and adjustment accounts	(77,775)	(16,138)	(4,928)	(98,841)
Spot liabilities	(5,040,767)	(12,869,032)	(899,014)	(18,808,813)
Forward purchase	4,261,270	923,119	2,113,257	7,297,646
Forward sales	(3,065,880)	(1,190,333)	(3,013,064)	(7,269,277)
Net long non-structural position	41,924	(90,335)	679	(47,732)

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 2016:

(a)	The arithmetic mean of the minimum weekly amount of cash in hand that is required to be held	450,994
(b)	The arithmetic mean of the average weekly amount of cash in hand	652,720
(c)	The arithmetic mean of the specified liquid assets at the end of each month	10,408,682
(d)	The average ratio of specified liquid assets to total basic liabilities at the end of the month	65.9%
(e)	The arithmetic mean of its one-month liquidity ratio in the last week of each month	1035.1%
(f)	The arithmetic mean of its three-month liquidity ratio in the last week of each month	920.6%

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 2016 not provided for in the financial statements.

(b) Operating lease commitments

At 31 December 2016, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	2016 MOP'000
Within 1 year	1,988
After 1 year but within 5 year	500
	2,488

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

	2016
	%
Capital adequacy ratio at 31 December	
Tier 1 capital ratio	17.2
Total capital ratio	19.0

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 2016 HKD million
Share capital	114,359
Other equity instruments	14,737
Other reserves	85,886
Retained profits	413,024
Total shareholders' equity	628,006
Non-controlling interests	51,130
Total equity	679,136

(c) Consolidated assets, liabilities and profits position

	At 31 December 2016 HKD million
Total assets	7,548,952
Total liabilities	6,869,816
Loans and advances to customers	2,834,114
Deposits by banks	192,479
Customer accounts	4,900,004
Profit before taxation	102,707

(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 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 2016 comprises:

Executive directors

Stuart T Gulliver, *Chairman*
Peter Tung Shun Wong, *Deputy Chairman and Chief Executive*
Rose Wai Mun Lee

Non-executive directors

Laura May Lung Cha, GBS, *Deputy Chairman*
Zia Mody, *Deputy Chairman*
Graham John Bradley
Dr Christopher Wai Chee Cheng, GBS, OBE
Dr Raymond Kuo Fung Ch'ien, GBS, CBE
Irene Yun-lien Lee
Jennifer Xinzhe Li
Victor Tzar Kuoi Li
John Rober Slosar
Kevin Anthony Westley
Dr Rosanna Yick-Ming Wong, DBE
Marjorie Mun Tak Yang, GBS
Tan Sri Dr Francis Sock Ping Yeoh, CBE

EXTERNAL 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 2016 have been derived from the audited financial statements and the books and records of the Branch for the year ended on the same date. These summary financial statements, which comprise the balance sheet as at 31 December 2016 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 the books and records of the Branch, 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 Branch for the year ended 31 December 2016 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 28 April 2017.

The audited financial statements comprise the balance sheet as at 31 December 2016, and the income statement, statement of changes in equity 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 and the books and records of the Branch.

For a better understanding of the financial position of the Branch 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, 28 April 2017