

Interim Financial Statements 2015

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Presentation of Information

This document comprises the Interim Financial Statements 2015 for HSBC Bank Middle East Limited ('the bank') and its subsidiary undertakings (together 'the group'). It contains Condensed Financial Statements, together with the Auditor's review report. References to 'HSBC' or 'the HSBC Group' within this document mean HSBC Holdings plc together with its subsidiaries.

In accordance with IAS 34 the Interim Report is intended to provide an update on the *Annual Report and Accounts 2014* and therefore focusses on events during the first six months of 2015 rather than duplicating information previously reported.

Condensed Financial Statements (unaudited)

Consolidated income statement for the half-year to 30 June 2015

	Half-year to	
	30 June 2015 US\$000	30 June 2014 US\$000
Interest income	611,641	643,866
Interest expense	(80,780)	(93,715)
Net interest income	530,861	550,151
Fee income	310,104	328,216
Fee expense	(27,895)	(38,471)
Net fee income	282,209	289,745
Trading income excluding net interest income	153,240	185,968
Net interest expense on trading activities	(8,922)	(7,899)
Net trading income	144,318	178,069
Net income/(expense) from financial instruments designated at fair value.....	2,088	(4,809)
Gains less losses from financial investments	3,775	1,762
Dividend income	2,189	8,746
Other operating income	32,640	26,137
Net operating income before loan impairment (charges)/recoveries and other credit risk provisions	998,080	1,049,801
Loan impairment (charges)/recoveries and other credit risk provisions 4	(30,471)	50,031
Net operating income	967,609	1,099,832
Employee compensation and benefits	(316,681)	(303,326)
General and administrative expenses	(209,394)	(215,803)
Depreciation and impairment of property, plant and equipment	(9,048)	(9,776)
Amortisation and impairment of intangible assets	(5,816)	(6,075)
Total operating expenses	(540,939)	(534,980)
Operating profit	426,670	564,852
Share of profit in associates	3,457	1,261
Profit before tax	430,127	566,113
Tax expense	(65,980)	(90,694)
Profit for the period	364,147	475,419
Profit attributable to shareholders of the parent company	355,541	467,368
Profit attributable to non-controlling interests	8,606	8,051

The accompanying notes on pages 8 to 19 form an integral part of these condensed financial statements.

Condensed Financial Statements (unaudited) (continued)**Consolidated statement of comprehensive income for the half-year to 30 June 2015**

	Half-year to	
	30 June 2015 US\$000	30 June 2014 US\$000
Profit for the period	364,147	475,419
Other comprehensive income		
Items that will be reclassified subsequently to profit or loss when specific conditions are met		
Available for sale investments:	(12,017)	8,273
– fair value (losses)/gains	(11,731)	8,495
– fair value gains transferred to income statement on disposal	(6,136)	(642)
– amounts transferred to the income statement in respect of impairment losses	5,733	-
– income taxes	117	420
Cash flow hedges:	8,017	(2,614)
– fair value gains/(losses)	28,711	(3,408)
– fair value gains transferred to income statement	(19,882)	-
– income taxes	(812)	794
Exchange differences and other	(30,941)	9,318
Items that will not be reclassified subsequently to profit or loss		
Remeasurement of defined benefit asset/liability:	(2,942)	(8,364)
– before income taxes	(2,942)	(10,537)
– income taxes	-	2,173
Other comprehensive (expense)/income for the period, net of tax	(37,883)	6,613
Total comprehensive income for the period	326,264	482,032
Total comprehensive income for the period attributable to:		
– shareholders of the parent company	318,294	473,665
– non-controlling interests	7,970	8,367
	326,264	482,032

The accompanying notes on pages 8 to 19 form an integral part of these condensed financial statements.

Condensed Financial Statements (unaudited) (continued)**Consolidated statement of financial position at 30 June 2015**

	Notes	30 June 2015 US\$000	31 December 2014 US\$000
ASSETS			
Cash and balances at central banks		1,730,704	952,640
Items in the course of collection from other banks		53,502	71,711
Trading assets	9	196,697	465,454
Derivatives	9	1,125,939	1,178,406
Loans and advances to banks		8,871,288	9,244,193
Loans and advances to customers	3,4	27,901,170	25,925,735
Reverse repurchase agreements – non-trading		334,889	18,533
Financial investments	9	8,095,198	10,397,639
Prepayments, accrued income and other assets		1,359,725	1,321,891
Current tax assets		3,455	1,127
Interests in associates		54,645	55,555
Intangible assets		42,975	47,449
Deferred tax assets		193,926	201,551
Total assets		49,964,113	49,881,884
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks		2,956,123	2,483,030
Customer accounts		31,583,459	32,083,757
Items in the course of transmission to other banks		442,531	458,068
Trading liabilities	9	1,579,294	1,684,135
Financial liabilities designated at fair value	6,9	857,390	860,293
Derivatives	9	1,099,801	1,208,456
Debt securities in issue	7	3,415,771	3,174,957
Accruals and deferred income and other liabilities		2,180,359	2,025,672
Current tax liabilities		86,467	146,782
Provisions		15,464	27,961
Deferred tax liabilities		4,355	5,276
Total liabilities		44,221,014	44,158,387
Equity			
Called up share capital		931,055	931,055
Other reserves		(43,508)	(9,110)
Retained earnings		4,452,674	4,393,142
Total equity attributable to shareholders of the parent company		5,340,221	5,315,087
Non-controlling interests		402,878	408,410
Total equity		5,743,099	5,723,497
Total equity and liabilities		49,964,113	49,881,884

The accompanying notes on pages 8 to 19 form an integral part of these condensed financial statements.

M M Al Tuwaijri, Chief Executive Officer and Deputy Chairman

Condensed Financial Statements (unaudited) (continued)**Consolidated statement of cash flows for the half-year to 30 June 2015**

	Half-year to	
	30 June 2015 US\$000	30 June 2014 US\$000
Cash flows from operating activities		
Profit before tax	430,127	566,113
Adjustments for:		
– non-cash items included in profit before tax	21,558	(10,759)
– change in operating assets	(1,673,757)	(796,526)
– change in operating liabilities	349,254	986,058
– elimination of exchange differences ¹	127,160	(22,798)
– net gain from investing activities	(9,873)	(5,944)
– net gain on disposal of businesses	(1,732)	–
– share of profit in associates	(3,457)	(1,261)
– dividends received from associates	3,363	–
– contributions paid to defined benefit pension plans	–	(692)
– tax paid	(121,982)	(116,878)
Net cash generated (used in)/from operating activities	<u>(879,339)</u>	<u>597,313</u>
Cash flows from investing activities		
Purchase of financial investments	(5,658,468)	(6,869,746)
Proceeds from the sale and maturity of financial investments	7,091,261	7,065,144
Purchase of property, plant and equipment	(14,336)	(5,187)
Proceeds from the sale of property, plant and equipment	9,991	6,064
Purchase of intangible assets	(1,360)	(1,605)
Net cash outflow from disposal of businesses	(6,993)	–
Net cash generated from investing activities	<u>1,420,095</u>	<u>194,670</u>
Cash flows from financing activities		
Dividends paid to ordinary shareholders	(295,000)	(220,000)
Dividends paid to non-controlling interests	(14,031)	(9,678)
Net cash used in financing activities	<u>(309,031)</u>	<u>(229,678)</u>
Net increase in cash and cash equivalents	231,725	562,305
Cash and cash equivalents at 1 January	9,444,465	7,888,728
Effect of exchange rate changes on cash and cash equivalents	<u>(86,779)</u>	<u>13,641</u>
Cash and cash equivalents at 30 June	<u>9,589,411</u>	<u>8,464,674</u>

1 Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on a line-by-line basis, as details cannot be determined without unreasonable expense.

The accompanying notes on pages 8 to 19 form an integral part of these condensed financial statements.

Consolidated statement of changes in equity for the half-year to 30 June 2015

	Half-year to 30 June 2015									
	Called up share capital US\$000	Retained earnings US\$000	Other reserves				Merger reserve US\$000	Total share- holders' equity US\$000	Non- controlling interests US\$000	Total equity US\$000
Available- for-sale fair value reserve US\$000			Cash flow hedging reserve US\$000	Foreign exchange reserve US\$000	Other reserve US\$000					
At 1 January 2015	931,055	4,393,142	62,333	(6,512)	(52,509)	2,930	(15,352)	5,315,087	408,410	5,723,497
Profit for the period	-	355,541	-	-	-	-	-	355,541	8,606	364,147
Other comprehensive income (net of tax)	-	(3,105)	(11,533)	8,017	(30,630)	4	-	(37,247)	(636)	(37,883)
Available-for-sale investments	-	-	(11,518)	-	-	-	-	(11,518)	(499)	(12,017)
Cash flow hedges	-	-	-	8,017	-	-	-	8,017	-	8,017
Remeasurement of defined benefit asset/liability	-	(2,942)	-	-	-	-	-	(2,942)	-	(2,942)
Exchange differences and other	-	(163)	(15)	-	(30,630)	4	-	(30,804)	(137)	(30,941)
Total comprehensive income for the period	-	352,436	(11,533)	8,017	(30,630)	4	-	318,294	7,970	326,264
Dividends paid to shareholders	-	(295,000)	-	-	-	-	-	(295,000)	(14,031)	(309,031)
Cost of share-based payment arrangements	-	-	-	-	-	-	-	-	-	-
Other movements	-	2,096	46	-	-	(302)	-	1,840	529	2,369
At 30 June 2015	931,055	4,452,674	50,846	1,505	(83,139)	2,632	(15,352)	5,340,221	402,878	5,743,099

The accompanying notes on pages 8 to 19 form an integral part of these condensed financial statements.

	Half-year to 30 June 2014									
	Other reserves									
	Called up share capital US\$000	Retained earnings US\$000	Available- for-sale fair value reserve US\$000	Cash flow hedging reserve US\$000	Foreign exchange reserve US\$000	Other reserve US\$000	Merger reserve US\$000	Total share- holders' equity US\$000	Non- controlling interests US\$000	Total equity US\$000
At 1 January 2014	931,055	4,319,879	74,797	4,629	(22,121)	1,545	(15,352)	5,294,432	403,679	5,698,111
Profit for the period	–	467,368	–	–	–	–	–	467,368	8,051	475,419
Other comprehensive income (net of tax)	–	(8,053)	8,305	(2,614)	8,603	56	–	6,297	316	6,613
Available-for-sale investments	–	–	8,302	–	–	–	–	8,302	(29)	8,273
Cash flow hedges	–	–	–	(2,614)	–	–	–	(2,614)	–	(2,614)
Remeasurement of defined benefit asset/liability	–	(8,364)	–	–	–	–	–	(8,364)	–	(8,364)
Exchange differences and other	–	311	3	–	8,603	56	–	8,973	345	9,318
Total comprehensive income for the period	–	459,315	8,305	(2,614)	8,603	56	–	473,665	8,367	482,032
Dividends paid to shareholders	–	(220,000)	–	–	–	–	–	(220,000)	(9,678)	(229,678)
Cost of share-based payment arrangements	–	125	–	–	–	–	–	125	–	125
Other movements	–	(3,155)	362	125	–	1,439	–	(1,229)	(302)	(1,531)
At 30 June 2014	931,055	4,556,164	83,464	2,140	(13,518)	3,040	(15,352)	5,546,993	402,066	5,949,059

The accompanying notes on pages 8 to 19 form an integral part of these interim consolidated condensed financial statements.

Notes on the Condensed Financial Statements (unaudited)

1 Basis of preparation and significant accounting policies

(a) Compliance with International Financial Reporting Standards

The interim condensed financial statements of the group have been prepared in accordance with IAS 34 'Interim Financial Reporting' ('IAS 34') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the European Union ('EU'). These interim consolidated financial statements should be read in conjunction with the Annual Report and Accounts 2014.

At 30 June 2015, there were no unendorsed standards effective for the half year ended 30 June 2015 affecting these interim consolidated financial statements, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group.

Standards adopted during the period ended 30 June 2015

There were no new standards adopted during the period ended 30 June 2015.

During the period ended 30 June 2015, the group applied a number of interpretations and amendments to standards which have had an insignificant effect on these interim consolidated financial statements.

(b) Uses of estimates and judgements

Management believes that the group's critical accounting estimates and judgements are those which relate to the impairment of loans and advances, the valuation of financial instruments, provisions and the valuation of intangible assets recognised in business combinations. There was no change in the current period to the critical accounting estimates and judgements applied in 2014, which are stated in the Annual Report and Accounts 2014.

(c) Composition of group

There were no material changes in the composition of the group in the half year to 30 June 2015. Further explanation on minor disposals is provided in Note 10.

(d) Future accounting developments

Information on future accounting developments and their potential effect on the financial statements of the group are provided in the Annual Report and Accounts 2014.

(e) Going concern

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the group and parent company have the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows and capital resources.

(e) Accounting policies

The accounting policies adopted by the group for these interim consolidated financial statements are consistent with those described in the Annual Report and Accounts 2014. The methods of computation applied by the group for these interim consolidated financial statements are consistent with those applied for the Annual Report and Accounts 2014.

2 Dividends

Dividends to shareholders of the parent company

	Half year to 30 June 2015		Half year to 30 June 2014	
	US\$ per share	Total US\$000	US\$ per share	Total US\$000
Dividends declared on ordinary shares	0.3168	295,000	0.2369	220,000

During the period a fourth interim dividend for 2014 of US\$135 million was declared on 10 February 2015 (paid 27 February 2015) and the first interim dividend for 2015 of US\$160 million was declared on 7 May 2015 (paid 11 May 2015).

The Directors declared a second interim dividend of US\$120 million in respect of the financial year ending 31 December 2015 on 24 July 2015 (paid 29 July 2015). No liability is recognised in the financial statements in respect of this dividend.

Notes on the Condensed Financial Statements (unaudited) (continued)

3 Concentration of loans and advances

Loans and advances to banks were widely distributed across major institutions.

Gross loans and advances to customers by industry sector

	Gross loans and advances to customers			
	30 June 2015		31 December 2014	
	Total US\$000	As a % of total gross loans %	Total US\$000	As a % of total gross loans %
Personal				
Residential mortgages	2,640,641	9.12	2,646,139	9.73
Other personal	3,491,107	12.06	3,413,934	12.56
	6,131,748	21.18	6,060,073	22.29
Corporate and commercial				
Commercial, industrial and international trade	10,982,352	37.94	10,413,972	38.31
Commercial real estate	698,669	2.41	576,765	2.12
Other property related	1,589,801	5.49	1,570,660	5.78
Government	1,468,184	5.07	1,443,252	5.31
Other commercial	5,249,217	18.13	3,854,086	14.18
	19,988,223	69.04	17,858,735	65.70
Financial				
Non-bank financial institutions	2,830,632	9.78	3,263,773	12.01
Total gross loans and advances to customers	28,950,603	100.00	27,182,581	100.00
Impaired loans				
- as a percentage of gross loans and advances to customers	5.09%		6.38%	
Total impairment allowances				
- as a percentage of gross loans and advances to customers	3.62%		4.62%	

4 Loan impairment charge/(recoveries) and other credit risk provisions

	Half-year to	
	30 June 2015 US\$000	30 June 2014 US\$000
Loan impairment charges on loans and advances		
- new allowances net of allowance releases	48,550	(31,312)
- recoveries of amounts previously written off	(17,029)	(24,012)
	31,521	(55,324)
Impairment (releases)/charges on debt securities and other credit risk provisions	(1,050)	5,293
	30,471	(50,031)

Movement in impairment allowances on loans and advances to customers and banks

	Banks		Customers	
	Individually assessed US\$000	Individually assessed US\$000	Collectively assessed US\$000	Total US\$000
At 1 January 2015	18,280	1,017,484	239,362	1,275,126
Amounts written off	-	(205,805)	(54,238)	(260,043)
Recoveries of amounts previously written off	-	1,248	15,781	17,029
Charge to income statement	-	20,976	10,545	31,521
Foreign exchange and other movements	(28)	4,643	(563)	4,052
At 30 June 2015	18,252	838,546	210,887	1,067,685

Notes on the Condensed Financial Statements (unaudited) (continued)

	Banks		Customers		Total US\$000
	Individually assessed US\$000	Individually assessed US\$000	Collectively assessed US\$000		
At 1 January 2014	18,317	1,053,512	365,096	1,436,925	
Amounts written off	–	(31,040)	(41,022)	(72,062)	
Recoveries of amounts previously written off	–	5,329	18,683	24,012	
Release to income statement	–	(48,547)	(6,777)	(55,324)	
Foreign exchange and other movements	(3)	16,545	(5,224)	11,318	
At 30 June 2014.....	<u>18,314</u>	<u>995,799</u>	<u>330,756</u>	<u>1,344,869</u>	

5 Segment analysis

The basis used to identify the group's reporting segments are discussed in the *Annual Report and Accounts 2014*.

Profit/(loss) for the period

	UAE US\$000	Oman US\$000	Qatar US\$000	Rest of Middle East US\$000	Intra-group items US\$000	Total US\$000
Half year to 30 June 2015						
Net interest income	359,064	62,598	43,208	65,991	-	530,861
Net fee income	187,709	17,648	36,958	39,894	-	282,209
Net trading income	102,102	8,730	21,035	12,451	-	144,318
Other income	68,161	6,853	2,092	(187)	(36,227)	40,692
Net operating income before loan impairment (charges)/recoveries and other credit risk provisions.....	717,036	95,829	103,293	118,149	(36,227)	998,080
Loan impairment (charges)/recoveries and other credit risk provisions	(25,714)	(3,017)	(3,533)	1,793	-	(30,471)
Net operating income.....	691,322	92,812	99,760	119,942	(36,227)	967,609
Total operating expenses.....	(404,766)	(71,876)	(45,279)	(55,245)	36,227	(540,939)
Operating profit.....	286,556	20,936	54,481	64,697	-	426,670
Share of profit in associates.....	3,457	-	-	-	-	3,457
Profit before tax	<u>290,013</u>	<u>20,936</u>	<u>54,481</u>	<u>64,697</u>	-	<u>430,127</u>
By global business:						
Retail Banking and Wealth Management ...	82,674	634	3,758	5,251	-	92,317
Commercial Banking	75,737	14,135	14,857	35,792	-	140,521
Global Banking and Markets	155,253	6,743	35,917	23,828	-	221,741
Global Private Banking	(609)	-	-	(81)	-	(690)
Other ¹	(23,042)	(576)	(51)	(93)	-	(23,762)
Profit before tax	<u>290,013</u>	<u>20,936</u>	<u>54,481</u>	<u>64,697</u>	-	<u>430,127</u>

Notes on the Condensed Financial Statements (unaudited) (continued)

	UAE US\$000	Oman US\$000	Qatar US\$000	Rest of Middle East US\$000	Intra-group items US\$000	Total US\$000
Half year to 30 June 2014						
Net interest income	344,293	60,123	46,356	99,379	-	550,151
Net fee income	186,063	16,006	34,704	52,972	-	289,745
Net trading income	129,969	8,918	20,706	18,476	-	178,069
Other income	58,940	3,574	2,054	3,091	(35,823)	31,836
Net operating income before loan impairment (charges)/recoveries and other credit risk provisions.....	719,265	88,621	103,820	173,918	(35,823)	1,049,801
Loan impairment (charges)/recoveries and other credit risk provisions	24,077	(2,224)	6,235	21,943	-	50,031
Net operating income.....	743,342	86,397	110,055	195,861	(35,823)	1,099,832
Total operating expenses.....	(367,390)	(68,762)	(44,200)	(90,451)	35,823	(534,980)
Operating profit.....	375,952	17,635	65,855	105,410	-	564,852
Share of profit in associates.....	1,261	-	-	-	-	1,261
Profit before tax	377,213	17,635	65,855	105,410	-	566,113
By global business:						
Retail Banking and Wealth Management ...	82,249	14	9,340	2,194	-	93,797
Commercial Banking	131,527	9,476	21,237	54,019	-	216,259
Global Banking and Markets	199,515	8,440	35,277	49,500	-	292,732
Global Private Banking	279	-	-	-	-	279
Other ¹	(36,357)	(295)	1	(303)	-	(36,954)
Profit before tax	377,213	17,635	65,855	105,410	-	566,113

1 The main items reported in the 'Other' category are Head Office operations costs and movements in fair value of own debt.

Balance sheet information

	UAE US\$000	Oman US\$000	Qatar US\$000	Rest of Middle East US\$000	Intra-group items US\$000	Total US\$000
At 30 June 2015						
Loans and advances to customers (net)	19,416,614	3,420,518	2,142,390	2,921,648	-	27,901,170
Interest in associates	54,645	-	-	-	-	54,645
Total assets	34,920,449	6,178,167	4,946,665	5,841,742	(1,922,910)	49,964,113
Customer accounts.....	19,897,210	5,029,750	2,916,110	3,740,389	-	31,583,459
Total liabilities	30,004,559	5,363,249	4,941,357	5,834,759	(1,922,910)	44,221,014
At 31 December 2014						
Loans and advances to customers (net)	18,105,409	3,019,436	1,842,314	2,958,576	-	25,925,735
Interest in associates	55,555	-	-	-	-	55,555
Total assets	34,199,384	5,895,023	4,932,274	6,664,348	(1,809,145)	49,881,884
Customer accounts.....	19,779,987	4,792,644	3,070,940	4,440,186	-	32,083,757
Total liabilities	29,321,723	5,067,495	4,921,929	6,656,385	(1,809,145)	44,158,387

Net operating income by global business

	RBWM US\$000	CMB US\$000	GB&M US\$000	GPB US\$000	Other ² US\$000	Inter Segment US\$000	Total US\$000
At 30 June 2015							
Net operating income ¹	339,097	323,379	337,409	191	34,231	(36,227)	998,080
At 30 June 2014							
Net operating income ¹	343,488	342,085	372,373	706	26,972	(35,823)	1,049,801

1 Net operating income before loan impairment charges and other credit risk provisions.

2 The main items reported in the 'Other' category are Head Office operations costs and movements in fair value of own debt.

Notes on the Condensed Financial Statements (unaudited) (continued)

6 Financial liabilities designated at fair value

	30 June 2015 US\$000	31 December 2014 US\$000
Financial liabilities designated at fair value.....	<u>857,390</u>	<u>860,293</u>

At 30 June 2015, the accumulated amount of change in fair value attributable to changes in credit risk was a loss of US\$5.8 million (30 June 2014: US\$8.5 million loss).

7 Debt securities in issue

	30 June 2015		31 December 2014	
	Carrying amount US\$000	Fair value US\$000	Carrying amount US\$000	Fair value US\$000
Medium term notes	4,843,235	4,838,150	4,672,945	4,674,037
Non-equity preference shares	<u>950,000</u>	<u>876,429</u>	950,000	889,108
	5,793,235	5,714,579	5,622,945	5,563,145
Of which debt securities in issue reported as				
trading liabilities	(1,520,074)	(1,520,074)	(1,587,695)	(1,587,695)
financial liabilities designated at fair value (Note 6)	<u>(857,390)</u>	<u>(857,390)</u>	<u>(860,293)</u>	<u>(860,293)</u>
	<u>3,415,771</u>	<u>3,337,115</u>	3,174,957	3,115,157

8 Risk Management

The group's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk.

The interim consolidated financial statements do not include all risk management information and disclosures required in the annual financial statements: they should be read in conjunction with the Annual Report and Accounts 2014

There have been no material changes to our policies and practices regarding risk management and governance as described in the Annual Report and Accounts 2014.

9 Fair values of financial instruments

The accounting policies, control framework and the hierarchy used to determine fair values at 30 June 2015 are consistent with those applied in the Annual Report and Accounts 2014.

Financial instruments carried at fair value

	Valuation techniques			Total US\$000
	Level 1 Quoted market price US\$000	Level 2 Using observable inputs US\$000	Level 3 With significant unobservable inputs US\$000	
At 30 June 2015				
Recurring fair value measurements				
Assets				
Trading assets	–	196,697	–	196,697
Derivatives	–	1,122,342	3,597	1,125,939
Financial investments: available-for-sale	–	7,990,932	104,266	8,095,198
Liabilities				
Trading liabilities	–	1,579,294	–	1,579,294
Financial liabilities designated at fair value	857,390	–	–	857,390
Derivatives	–	1,082,183	17,618	1,099,801

Notes on the Condensed Financial Statements (unaudited) (continued)

	Valuation techniques			Total US\$000
	Level 1	Level 2	Level 3	
	Quoted market price	Using observable inputs	With significant unobservable inputs	
	US\$000	US\$000	US\$000	
At 31 December 2014				
Recurring fair value measurements				
Assets				
Trading assets	–	465,454	–	465,454
Derivatives	–	1,175,898	2,508	1,178,406
Financial investments: available-for-sale	–	10,281,291	116,348	10,397,639
Liabilities				
Trading liabilities	–	1,684,135	–	1,684,135
Financial liabilities designated at fair value	860,293	–	–	860,293
Derivatives	–	1,197,057	11,399	1,208,456

Movement in Level 3 financial instruments

The following table provides a reconciliation of the movement between opening and closing balances of Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs:

	Assets			Liabilities
	Available- for-sale US\$000	Held for Trading US\$000	Derivatives US\$000	Derivatives US\$000
At 1 January 2015	116,348	–	2,508	11,399
Total gains or losses recognised in profit or loss:				
- Gains less losses from financial investments	(4,124)	–	–	–
- Trading income excluding net interest income	–	–	1,089	6,219
Total gains or losses recognised in other comprehensive income				
- Available-for-sale investments: fair value losses	(6,236)	–	–	–
- Exchange differences	–	–	–	–
Purchases	38	–	–	–
Sales	(1,760)	–	–	–
Transfers in	–	–	–	–
At 30 June 2015	104,266	–	3,597	17,618
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held on 30 June 2015				
- Gains less losses from financial investments	(4,124)	–	–	–
- Trading income excluding net interest income	–	–	3,597	(17,618)
	(4,124)	–	3,597	(17,618)
At 1 January 2014	159,362	–	1,394	2,680
Total gains recognised in profit or loss:				
- Gains less losses from financial investments	7,261	–	–	–
- Trading income excluding net interest income	–	–	1,114	8,719
Total losses recognised in other comprehensive income:				
- Available-for-sale investments: fair value losses	(8,488)	–	–	–
- Exchange differences	(17)	–	–	–
Purchases	–	–	–	–
Sales	(42,007)	–	–	–
Transfers in	237	–	–	–
At 31 December 2014	116,348	–	2,508	11,399
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held on 30 June 2015				
- Gains less losses from financial investments	–	–	–	–
- Trading income excluding net interest income	–	–	2,508	(11,399)
	–	–	2,508	(11,399)

Notes on the Condensed Financial Statements (unaudited) (continued)

For assets and liabilities classified as held for trading, realised and unrealised gains and losses are presented in the income statement under 'Trading income excluding net interest income'.

Realised gains and losses from available-for-sale securities are presented under 'Gains less losses from financial investments' in the income statement while unrealised gains and losses are presented in 'Fair value gains/(losses) taken to equity' within 'Available-for-sale investments' in other comprehensive income.

Effects of changes in significant unobservable assumptions to reasonably possible alternatives

The fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data. The following table shows the sensitivity of fair values to reasonably possible alternative assumptions:

Sensitivity of fair values to reasonable possible alternative assumptions

	Reflected in profit/(loss)		Reflected in other comprehensive income	
	Favourable changes US\$000	Unfavourable changes US\$000	Favourable changes US\$000	Unfavourable changes US\$000
At 30 June 2015				
Derivatives/trading assets/trading liabilities ¹	–	–	–	–
Financial investments: available-for-sale	–	–	5,213	(5,213)
At 31 December 2014				
Derivatives/trading assets/trading liabilities ¹	–	–	–	–
Financial investments: available-for-sale	–	–	5,828	(11,636)

1 Derivatives, trading assets and trading liabilities are presented as one category to reflect the manner in which these financial instruments are risk-managed.

Sensitivity of fair values to reasonably possible alternative assumptions by Level 3 instrument type

	Reflected in profit or loss		Reflected in equity	
	Favourable changes US\$000	Unfavourable changes US\$000	Favourable changes US\$000	Unfavourable changes US\$000
At 30 June 2015				
Private equity including strategic investments	–	–	5,202	(5,202)
Other derivatives.....	–	–	–	–
Other portfolio.....	–	–	11	(11)
At 31 December 2014				
Private equity including strategic investments	–	–	5,806	(11,624)
Other derivatives.....	–	–	–	–
Other portfolio.....	–	–	22	(22)

Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable parameters using statistical techniques. When parameters are not amenable to statistical analysis, quantification of uncertainty is judgmental.

When the fair value of a financial instrument is affected by more than one unobservable assumption, the above table reflects the most favourable or most unfavourable change from varying the assumptions individually.

In respect of private equity investments, in many of the methodologies, the principal assumption is the valuation multiple to be applied to the main financial indicators. This may be determined with reference to multiples for comparable listed companies and includes discounts for marketability.

For other derivatives, principal assumptions concern the value to be attributed to future volatility of asset values and the future correlation between asset values.

Notes on the Condensed Financial Statements (unaudited) (continued)

10 Business Disposals

Sale of the group's banking operations in Jordan

On 20 January 2014, the group announced an agreement to sell the group's banking operations in Jordan at the net asset value of the business on the completion date. On 19 June 2014 the group completed the disposal for total cash consideration of JOD1.8 million (US\$2.6 million) which resulted in no gain or loss on disposal.

Sale of the group's banking operations in Pakistan

On 9 May 2014, the group announced an agreement to sell the group's banking operations in Pakistan at a purchase price based on a discount to the net asset value of the business on the completion date. On 17 October 2014 the group completed the disposal which resulted in a loss on disposal of US\$27.0 million.

Sale of the group's subsidiary banking operations in India and Pakistan

On 16 April 2014, the group's subsidiary, HSBC Bank Oman S.A.O.G ('HBON') announced an agreement to sell its banking operations in India to Doha Bank QSC ("Doha Bank"). On 31 March 2015 HBON completed the disposal at sale consideration (net of tax) of OMR7.1m (US\$18.4 million) and recorded a gain on disposal of OMR0.8m (US\$2.2 million) in 2015.

On 25 June 2015 HBON announced that it had entered into an agreement to sell its banking business in Pakistan to Meezan Bank Limited. The transaction is subject to shareholders' and regulatory approvals and is expected to be completed during the second half of 2015.

11 Credit quality of financial instruments

The five credit quality classifications set out and defined in the *Annual Report and Accounts 2014* describe the credit quality of the group's lending, debt securities portfolios and derivatives. These classifications each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending businesses, as well as the external ratings attributed by external agencies to debt securities. There is no direct correlation between internal and external ratings at granular level, except to the extent each falls within a single quality classification.

Notes on the Condensed Financial Statements (unaudited) (continued)

The following tables set out the group's distribution of financial instruments by measures of credit quality.

	30 June 2015							
	Neither past due nor impaired				Past due but not impaired	Impaired	Impairment allowances	Total
	Strong US\$000	Good US\$000	Satisfactory US\$000	Sub-standard US\$000	US\$000	US\$000	US\$000	US\$000
Cash and balances at central banks	1,628,004	71,031	–	31,669	–	–	–	1,730,704
Items in the course of collection from other banks	759	–	52,743	–	–	–	–	53,502
Trading assets	123,766	13,803	54,534	4,594	–	–	–	196,697
– treasury and other eligible bills	–	–	2,979	–	–	–	–	2,979
– debt securities	58,258	13,803	37,082	4,594	–	–	–	113,737
– loans and advances to banks	65,508	–	–	–	–	–	–	65,508
– loans and advances to customers	–	–	14,473	–	–	–	–	14,473
Derivatives	127,024	174,372	814,415	10,128	–	–	–	1,125,939
Loans and advances held at amortised cost	19,081,224	10,327,497	5,224,310	1,187,577	525,096	1,494,439	(1,067,685)	36,772,458
– loans and advances to banks	6,916,643	1,526,250	289,565	136,596	–	20,486	(18,252)	8,871,288
– loans and advances to customers	12,164,581	8,801,247	4,934,745	1,050,981	525,096	1,473,953	(1,049,433)	27,901,170
Reverse repurchase agreements non-trading	79,809	255,080	–	–	–	–	–	334,889
Financial investments	411,871	–	7,543,600	–	–	–	–	7,955,471
– treasury and other similar bills	–	–	2,090,341	–	–	–	–	2,090,341
– debt securities	411,871	–	5,453,259	–	–	–	–	5,865,130
Other assets	74,336	317,950	671,537	92,295	21,456	2,896	–	1,180,470
– endorsements and acceptances	69,637	317,323	504,867	92,295	20,931	2,896	–	1,007,949
– accrued income and other	4,699	627	166,670	–	525	–	–	172,521
Total financial instruments	21,526,793	11,159,733	14,361,139	1,326,263	546,552	1,497,335	(1,067,685)	49,350,130

Notes on the Condensed Financial Statements (unaudited) (continued)

	31 December 2014							
	Neither past due nor impaired				Past due but not impaired US\$000	Impaired US\$000	Impairment allowances US\$000	Total US\$000
	Strong US\$000	Good US\$000	Satisfactory US\$000	Sub-standard US\$000				
Cash and balances at central banks	858,536	61,162	-	32,942	-	-	-	952,640
Items in the course of collection from other banks	-	-	71,711	-	-	-	-	71,711
Trading assets	192,195	13,257	242,095	17,874	-	-	-	465,421
– treasury and other eligible bills	-	-	175,141	-	-	-	-	175,141
– debt securities	119,532	13,257	65,411	17,874	-	-	-	216,074
– loans and advances to banks	72,663	-	-	-	-	-	-	72,663
– loans and advances to customers	-	-	1,543	-	-	-	-	1,543
Derivatives	123,829	230,301	763,388	60,888	-	-	-	1,178,406
Loans and advances held at amortised cost	17,683,131	9,292,490	6,108,289	1,096,222	511,045	1,753,877	(1,275,126)	35,169,928
– loans and advances to banks	6,900,832	1,549,089	648,835	143,183	-	20,534	(18,280)	9,244,193
– loans and advances to customers	10,782,299	7,743,401	5,459,454	953,039	511,045	1,733,343	(1,256,846)	25,925,735
Reverse repurchase agreements non-trading..	18,533	-	-	-	-	-	-	18,533
Financial investments	241,014	25,347	9,957,941	-	-	-	-	10,224,302
– treasury and other similar bills	-	25,113	2,047,721	-	-	-	-	2,072,834
– debt securities	241,014	234	7,910,220	-	-	-	-	8,151,468
Other assets	125,394	268,367	660,646	59,487	30,353	5,305	-	1,149,552
– endorsements and acceptances	80,255	267,705	509,799	59,487	29,689	5,305	-	952,240
– accrued income and other	45,139	662	150,847	-	664	-	-	197,312
Total financial instruments	19,242,632	9,890,924	17,804,070	1,267,413	541,398	1,759,182	(1,275,126)	49,230,493

12 Contingent liabilities, contractual commitments and guarantees

	At 30 June 2015 US\$000	At 31 December 2014 US\$000
Guarantees and other contingent liabilities		
Guarantees	14,451,519	13,384,450
Commitments		
Documentary credits and short-term trade-related transactions	761,334	884,959
Undrawn formal standby facilities, credit lines and other commitments to lend	20,032,702	20,066,056
	20,794,036	20,951,015

The above table discloses the nominal principal amounts of contingent liabilities, commitments and guarantees. They are mainly credit-related instruments which include both financial and non financial guarantees and commitments to extend credit. Nominal principal amounts represent the amounts at risk should contracts be fully drawn upon and clients default. As a significant proportion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not representative of future liquidity requirements.

Notes on the Condensed Financial Statements (unaudited) (continued)

Guarantees and other commitments

The principal types of guarantees generally provided in the normal course of the group's banking business, and other contractual commitments, are consistent with those detailed in the *Annual Report and Accounts 2014*.

13 Legal proceedings and regulatory matters

The group is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions arising out of its normal business operations.

The review undertaken at the direction of the Jersey Financial Services Commission (the "Commission") into the bank's adherence to Jersey anti-money laundering requirements and international sanctions legislation has concluded. The Commission is currently reviewing the report. Notification of the final outcome is awaited.

No material adverse impact on the financial position of the group is expected to arise from these proceedings.

Anti-money laundering and sanctions-related

In October 2010, HSBC Bank USA entered into a consent cease and desist order with the Office of the Comptroller of the Currency (the 'OCC') and the indirect parent of that company, HSBC North America Holdings Inc. ('HNAH'), entered into a consent cease and desist order with the Federal Reserve Board (the 'FRB') (the 'Orders'). These Orders required improvements to establish an effective compliance risk management programme across HSBC's US businesses, including risk management related to US Bank Secrecy Act ('BSA') and anti-money laundering ('AML') compliance. Steps continue to be taken to address the requirements of the Orders.

In December 2012, HSBC Holdings, HNAH and HSBC Bank USA entered into agreements with US and UK government agencies regarding past inadequate compliance with the BSA, AML and sanctions laws. Among those agreements, HSBC Holdings and HSBC Bank USA entered into a five-year deferred prosecution agreement with the DoJ, the US Attorney's Office for the Eastern District of New York, and the US Attorney's Office for the Northern District of West Virginia (the 'US DPA'); HSBC Holdings entered into a two-year deferred prosecution agreement with the New York County District Attorney (the 'DANY DPA'); and HSBC Holdings consented to a cease and desist order and HSBC Holdings and HNAH consented to a civil money penalty order with the FRB. In addition, HSBC Bank USA entered into a civil money penalty order with FinCEN and a separate civil money penalty order with the OCC. HSBC Holdings also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions and an undertaking with the UK Financial Conduct Authority ('FCA'), to comply with certain forward-looking AML and sanctions-related obligations.

Under these agreements, HSBC Holdings and HSBC Bank USA made payments totalling US\$1.9bn to US authorities and are continuing to comply with ongoing obligations. In July 2013, the US District Court for the Eastern District of New York approved the US DPA and retained authority to oversee implementation of that agreement. Under the agreements with the DoJ, FCA, and the FRB, an independent monitor (who is, for FCA purposes, a 'skilled person' under Section 166 of the Financial Services and Markets Act) is evaluating and regularly assessing the effectiveness of HSBC's AML and sanctions compliance function and HSBC's progress in implementing its remedial obligations under the agreements. HSBC Holdings fulfilled all of the requirements imposed by the DANY DPA which expired at the end of the two-year period of that agreement in December 2014. If HSBC Holdings and HSBC Bank USA fulfil all of the requirements imposed by the US DPA, the DoJ charges against those entities will be dismissed at the end of the five-year period of that agreement. The DoJ may prosecute HSBC Holdings or HSBC Bank USA in relation to the matters that are the subject of the US DPA if HSBC Holdings or HSBC Bank USA breaches the terms of the US DPA.

HSBC Bank USA also entered into a separate consent order with the OCC requiring it to correct the circumstances and conditions as noted in the OCC's then most recent report of examination, and imposing certain restrictions on HSBC Bank USA directly or indirectly acquiring control of, or holding an interest in, any new financial subsidiary, or commencing a new activity in its existing financial subsidiary, unless it receives prior approval from the OCC. HSBC Bank USA also entered into a separate consent order with the OCC requiring it to adopt an enterprise-wide compliance programme.

Notes on the Condensed Financial Statements (unaudited) (continued)

These settlements with US and UK authorities have led to private litigation, and do not preclude further private litigation relating to HSBC's compliance with applicable BSA, AML and sanctions laws or other regulatory or law enforcement actions for BSA, AML, sanctions or other matters not covered by the various agreements.

In November 2014, a complaint was filed in the US District Court for the Eastern District of New York on behalf of representatives of US persons killed or injured in Iraq between April 2004 and November 2011. The complaint was filed against HSBC Holdings, HSBC Bank plc, HSBC Bank USA and HSBC Bank Middle East, as well as other non-HSBC banks and the Islamic Republic of Iran (together, the 'Defendants') The plaintiffs allege that the Defendants conspired to violate the federal US Anti-Terrorism Act of 2001, by altering or falsifying payment messages involving Iran, Iranian parties and Iranian banks for transactions processed through the US. Plaintiffs filed an amended complaint in April 2015. Defendants filed a motion to dismiss in May 2015. The motion will be fully briefed in August 2015.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of this matter, including the timing or any possible impact on HSBC, which could be significant.

14 Events after the balance sheet

On 24 July 2015 the Directors declared a second interim dividend of US\$120 million in respect of the financial year ending 31 December 2015.

15 Interim Report 2015 and statutory accounts

The information in this Interim Report 2015 is unaudited and does not constitute statutory accounts within the meaning of Article 105(1) of the Companies (Jersey) 1991, as amended. The Interim Report 2015 was approved by the Board of Directors on 3 August 2015. The Annual Report and Accounts for the year ended 31 December 2014 have been delivered to the Registrar of Companies in Jersey in accordance with Article 108 of the Companies (Jersey) 1991, as amended. The auditor has reported on those accounts. Its report was (i) unqualified; (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report; (iii) and did not contain a statement under Article 113B(3) of the Companies (Jersey) 1991, as amended.

Independent Review Report by PricewaterhouseCoopers CI LLP to HSBC Bank Middle East Limited

Our conclusion

We have reviewed the interim consolidated condensed financial statements of HSBC Bank Middle East Limited for the half-year ended 30 June 2015. Based on our review, nothing has come to our attention that causes us to believe that the interim consolidated condensed financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, "Interim Financial Reporting", as adopted by the European Union.

This conclusion is to be read in the context of what we say in the remainder of this report.

What we have reviewed

The interim consolidated condensed financial statements, which are prepared by HSBC Bank Middle East Limited, comprise:

- the consolidated condensed statement of financial position as at 30 June 2015;
- the consolidated condensed income statement and consolidated condensed statement of comprehensive income for the period then ended;
- the consolidated condensed statement of cash flows for the period then ended;
- the consolidated condensed statement of changes in equity for the period then ended; and
- the notes to the interim consolidated condensed financial statements.

As disclosed in note 1, the financial reporting framework of HSBC Bank Middle East Limited is International Financial Reporting Standards (IFRSs) as adopted by the European Union.

The interim consolidated condensed financial statements included in the interim financial report have been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting", as adopted by the European Union.

What a review of interim consolidated condensed financial statements involves

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim consolidated condensed financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

We have read the other information contained in the interim financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed interim financial statements.

Responsibilities for the interim consolidated condensed financial statements and the review

Our responsibilities and those of the directors

The interim financial report, including the interim consolidated condensed financial statements, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim financial report.

Our responsibility is to express to the directors of HSBC Bank Middle East Limited a conclusion on the interim consolidated condensed financial statements in the interim financial report based on our review. This report, including the conclusion, has been prepared for and only for this purpose. We do not, in giving this conclusion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

PricewaterhouseCoopers CI LLP
Chartered Accountants
Jersey, Channel Islands
3 August 2015

Independent Review Report by PricewaterhouseCoopers CI LLP to HSBC Bank Middle East Limited (continued)

Notes:

- (a) The maintenance and integrity of the HSBC Bank Middle East Limited website is the responsibility of the directors, the work carried out by PricewaterhouseCoopers CI LLP does not involve consideration of these matters and, accordingly, PricewaterhouseCoopers CI LLP accept no responsibility for any changes that may have occurred to the condensed consolidated set of financial statements or review report since the 3 August 2015. PricewaterhouseCoopers CI LLP has carried out no procedures of any nature subsequent to 3 August 2015 which in any way extends this date.
- (b) Legislation in Jersey governing the preparation and dissemination of condensed consolidated financial statements may differ from legislation in other jurisdictions. The directors shall remain responsible for establishing and controlling the process for doing so, and for ensuring that the condensed consolidated financial statements are complete and unaltered in any way.

