HSBC Bank Middle East Limited

Annual Report and Accounts 2011

HSBC

Annual Report and Accounts 2011

Contents

Page

Report of the Directors 1

Statement of Directors' Responsibilities in Relation to the Directors' Report and the Financial Statements 3

Independent Auditor's Report to the Member of HSBC Bank Middle East Limited 4

Financial Statements

Consolidated income statement for the year ended 31 December 2011 6

Consolidated statement of comprehensive income for the year ended 31 December 2011 7

Consolidated statement of financial position at 31 December 2011 8

Consolidated statement of cash flows for the year ended 31 December 2011 9

Consolidated statement of changes in equity for the year ended 31 December 2011 10

Notes on the Financial Statements 12

Presentation of Information

This document comprises the *Annual Report and Accounts 2011* for HSBC Bank Middle East Limited ('the bank') and its subsidiary undertakings (together 'the group'). It contains the Directors' Report and Accounts, together with the Auditors' report, as required by the Companies (Jersey) Law 1991. References to 'HSBC' or 'the HSBC Group' within this document mean HSBC Holdings plc together with its subsidiaries.

Report of the Directors

Board of Directors

D G Eldon, Chairman
S N Cooper, Chief Executive Officer & Deputy Chairman
A S M El Anwar
A A Flockhart
R B Gray
M M Hussain
C J M Keirle
A D R Monro-Davies
A H M H B Mostafawi
A M Sharaf
T L Slattery
N G Winsor

Changes in Directors

- A P Zeller was appointed as a Director on 14 February 2011 and resigned as a Director on 10 February 2012;
- A M Sharaf was appointed as a Director on 3 March 2011;
- D G Eldon was appointed as a Director and Chairman of the Board on 1 May 2011; and
- A A Flockhart was appointed as a Director on 7 July 2011.

The Directors who held office during the year and up to the date the Annual Report and Accounts were approved are listed above.

Principal activities

The group, through its branch network and subsidiary undertakings, provides a range of banking and related financial services in the Middle East and North Africa. There has been no significant change in this activity.

Profit/loss and dividends

The profit attributable to the shareholders of the parent company amounted to US$728 million (2010: US$462 million) as set out in the consolidated income statement on page 6.

During the year, first and second interim dividends for 2011 of US$200 million and US$35 million (2010: nil) were declared on 22 September 2011 and 8 December 2011 and paid on 28 September 2011 and 9 December 2011, respectively.

Non-equity preference share capital

On 19 December 2011 the bank redeemed two tranches of 100,000 cumulative redeemable preference shares of US$1.00 each (the 'Fourth and Fifth Issues') issued at a premium of US$999.00 per share.

The bank has resolved to redeem 100,000 cumulative redeemable preference shares of US$1.00 each (the 'Sixth Issue'), issued at a premium of US$999.00 per share, on 14 March 2012.

Registered office

HSBC House, Esplande, St Helier, Jersey, JE4 8UB, Channel Islands.

The bank is incorporated in Jersey, Channel Islands - number 85600.

Report of the Directors (continued)

Auditors

The shareholders of the bank having agreed to dispense with the requirement to hold annual general meetings, the auditors, KPMG Channel Islands Limited are deemed to be re-appointed, and continue in office at fees to be agreed by the Directors.

On behalf of the Board
J A Tothill, *Secretary*
21 February 2012

Statement of Directors' Responsibilities in Relation to the Directors' Report and the Financial Statements

The following statement, which should be read in conjunction with the Auditor's statement of their responsibilities set out in their report on page 4, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the Auditors in relation to the financial statements.

The Directors are responsible for preparing the financial statements in accordance with applicable law and International Financial Reporting Standards as adopted by the EU.

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the group and of the profit or loss of the group for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgments and estimates which are reasonable and prudent;
- state whether they have been prepared in accordance with International Financial Reporting Standards as adopted by the EU;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the group and enable them to ensure that the financial statements comply with the Companies (Jersey) Law 1991, the Banking Business (Jersey) Law 1991, the Financial Services (Trust Company and Investment Business (Accounts, Audits and Reports)) (Jersey) Order 2007, the Financial Services (Fund Services Business (Accounts, Audits and Reports) (Jersey)) Order 2007 and the Financial Services (General Insurance Mediation Business (Accounts, Audits, Reports and Solvency)) (Jersey) Order 2005. They are also responsible for safeguarding the assets of the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

On behalf of the Board
S N Cooper, Chief Executive Officer & Deputy Chairman

Independent Auditor's Report to the Member of HSBC Bank Middle East Limited

We have audited the consolidated financial statements ('the financial statements') of HSBC Bank Middle East Limited for the year ended 31 December 2011 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of financial position, the consolidated statement of cash flows, the consolidated statement of changes in equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the EU.

This report is made solely to the company's members, as a body, in accordance with Article 113A of the Companies (Jersey) Law 1991. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 3, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the group's affairs as at 31 December 2011 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the EU; and
- have been prepared in accordance with the requirements of the Companies (Jersey) Law 1991, the Banking Business (Jersey) Law 1991, the Financial Services (Trust Company and Investment Business (Accounts, Audits and Reports)) (Jersey) Order 2007, the Financial Services (Fund Services Business (Accounts, Audits and Reports) (Jersey)) Order 2007 and the Financial Services (General Insurance Mediation Business (Accounts, Audits, Reports and Solvency)) (Jersey) Order 2005.

Independent Auditor's Report to the Member of HSBC Bank Middle East Limited (continued)

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies (Jersey) Law 1991 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the company; or
- returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations we require for our audit.

Laurence Catterson
for and on behalf of KPMG Channel Islands Limited
Chartered Accountants
5 St Andrew's Place
Charing Cross
St Helier
Jersey
JE4 8WQ

28 February 2012

Notes:

- The maintenance and integrity of the HSBC Bank Middle East Limited and/or other HSBC Group websites is the responsibility of the directors; the work carried out by auditors does not involve consideration of these matters and accordingly, KPMG Channel Islands Limited accepts no responsibility for any changes that may have occurred to the financial statements or our audit report since 28 February 2012. KPMG Channel Islands Limited has carried out no procedures of any nature subsequent to 28 February 2012 which in any way extends this date.

- Legislation in Jersey governing the preparation and dissemination of 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 financial statements are complete and unaltered in any way.

Financial Statements

Consolidated income statement for the year ended 31 December 2011

	Notes	**2011 US$000**	2010 US$000
Interest income		**1,509,069**	1,536,116
Interest expense		**(375,738)**	(416,042)
Net interest income		**1,133,331**	1,120,074
Fee income		**611,851**	635,694
Fee expense		**(72,139)**	(54,094)
Net fee income		**539,712**	581,600
Trading income excluding net interest income		**369,598**	287,452
Net interest income on trading activities		**23,640**	11,474
Net trading income		**393,238**	298,926
Net income from financial instruments designated at fair value	*4*	**10,485**	-
Gains less losses from financial investments		**(4,841)**	(2,237)
Dividend income		**4,688**	6,157
Other operating income		**37,865**	(8,653)
Net operating income before loan impairment charges and other credit risk provisions		**2,114,478**	1,995,867
Loan impairment charges and other credit risk provisions		**(246,985)**	(533,742)
Net operating income	*5*	**1,867,493**	1,462,125
Employee compensation and benefits	*6*	**(556,790)**	(502,610)
General and administrative expenses		**(393,975)**	(374,351)
Depreciation and impairment of property, plant and equipment	*18*	**(24,416)**	(28,722)
Amortisation and impairment of intangible assets	*17*	**(5,826)**	(6,610)
Total operating expenses		**(981,007)**	(912,293)
Operating profit		**886,486**	549,832
Share of profit in associates		**3,465**	8,813
Profit before tax		**889,951**	558,645
Tax expense	*9*	**(136,490)**	(93,832)
Profit for the year		**753,461**	464,813
Profit attributable to shareholders of the parent company		**727,731**	462,152
Profit attributable to non-controlling interests		**25,730**	2,661

The accompanying notes on pages 12 to 98 form an integral part of these financial statements.

Financial Statements (continued)

Consolidated statement of comprehensive income for the year ended 31 December 2011

	2011	2010
	US$000	US$000
Profit for the year	**753,461**	464,813
Other comprehensive income/(expense)		
Available-for-sale investments:	**6,362**	(649)
– fair value gains/(losses)	**9,756**	(2,232)
– fair value gains transferred to income statement on disposal	**(3,326)**	(3)
– amounts transferred to the income statement in respect of impairment losses	**210**	1,338
– income taxes	**(278)**	248
Cash flow hedges	**18,856**	(9,928)
– fair value gains/(losses)	**18,145**	(8,906)
– fair value losses/(gains) transferred to income statement	**5,425**	(3,503)
– income taxes	**(4,714)**	2,481
Actuarial losses on defined benefit plans	**(8,722)**	(4,958)
– before income taxes	**(12,855)**	(6,851)
– income taxes	**4,133**	1,893
Exchange differences	**(5,667)**	(11,621)
Other comprehensive income/(expense) for the year, net of tax	**10,829**	(27,156)
Total comprehensive income for the year	**764,290**	437,657
Total comprehensive income for the year attributable to:		
– shareholders of the parent company	**738,544**	435,002
– non-controlling interests	**25,746**	2,655
	764,290	437,657

The accompanying notes on pages 12 to 98 form an integral part of these financial statements.

Financial Statements (continued)

Consolidated statement of financial position at 31 December 2011

	Notes	**2011** **US$000**	2010 US$000
Assets			
Cash and balances at central banks		**916,324**	719,363
Items in the course of collection from other banks		**84,478**	61,085
Trading assets	*13*	**855,781**	718,676
Derivatives	*14*	**1,269,988**	826,578
Loans and advances to banks	*27*	**8,076,477**	8,229,772
Loans and advances to customers	*27*	**21,560,861**	20,586,712
Financial investments	*15*	**10,329,413**	8,667,721
Other assets	*20*	**1,707,279**	1,269,993
Current tax assets		**754**	183
Prepayments and accrued income		**178,003**	173,903
Interests in associates	*16*	**35,189**	29,337
Intangible assets	*17*	**12,375**	13,293
Property, plant and equipment	*18*	**105,003**	123,821
Deferred tax assets	*9*	**173,719**	173,986
Total assets		**45,305,644**	41,594,423
Liabilities and equity			
Liabilities			
Deposits by banks	*27*	**2,080,192**	1,547,700
Customer accounts	*27*	**28,826,332**	26,343,980
Items in the course of transmission to other banks		**289,995**	766,308
Trading liabilities	*21*	**757,274**	121,733
Financial liabilities designated at fair value	*22*	**507,830**	-
Derivatives	*14*	**1,231,232**	834,806
Debt securities in issue	*23*	**4,398,163**	5,688,545
Other liabilities	*24*	**2,241,534**	1,924,724
Current tax liabilities		**164,499**	142,668
Accruals and deferred income		**176,480**	209,389
Provisions	*25*	**19,877**	15,372
Deferred tax liabilities	*9*	**5,973**	6,715
Retirement benefit liabilities	*6*	**75,790**	63,885
Total liabilities		**40,775,171**	37,665,825
Equity			
Called up share capital	*30*	**931,055**	931,055
Other reserves		**48,535**	24,241
Retained earnings		**3,175,496**	2,708,619
Total equity attributable to shareholders of the parent company		**4,155,086**	3,663,915
Non-controlling interests		**375,387**	264,683
Total equity		**4,530,473**	3,928,598
Total equity and liabilities		**45,305,644**	41,594,423

The accompanying notes on pages 12 to 98 form an integral part of these financial statements.

S N Cooper, *Chief Executive Officer and Deputy Chairman*

Financial Statements (continued)

Consolidated statement of cash flows for the year ended 31 December 2011

	Notes	**2011** **US$000**	2010 US$000
Cash flows from operating activities			
Profit before tax		**889,951**	558,645
Adjustments for:			
– other non-cash items included in profit before tax	*31*	**385,765**	625,856
– change in operating assets	*31*	**(1,383,658)**	(1,492,094)
– change in operating liabilities	*31*	**2,631,666**	1,001,139
– elimination of exchange differences[1]		**(16,082)**	(44,279)
– net loss/(gain) from investing activities		**(413)**	41,991
– share of profits in associates		**(3,465)**	(8,813)
– dividends received from associates		**1,102**	1,987
– contributions paid for defined benefit plans		**(253)**	(248)
– tax paid		**(104,727)**	(145,211)
Net cash generated from operating activities		**2,399,886**	538,973
Cash flows from investing activities			
Purchase of financial investments		**(7,174,279)**	(2,793,004)
Proceeds from the sale and maturity of financial investments		**4,931,136**	1,736,858
Purchase of property, plant and equipment		**(11,414)**	(25,675)
Proceeds from the sale of property, plant and equipment		**5,475**	2,187
Purchase of intangible assets		**(6,373)**	(5,812)
Net cash outflow from acquisition of and increase in stake of associates		**(100)**	(50)
Proceeds from disposal of associates		**-**	90,301
Net cash used in investing activities		**(2,255,555)**	(995,195)
Cash flows from financing activities			
Non equity preference share capital redeemed		**(200,000)**	-
Dividends paid to shareholders of the parent company		**(235,000)**	-
Dividends paid to non-controlling interests		**(17,760)**	(3,367)
Net cash used in financing activities		**(452,760)**	(3,367)
Net decrease in cash and cash equivalents		**(308,429)**	(459,589)
Cash and cash equivalents at 1 January		**10,983,043**	11,371,131
Effect of exchange rate changes on cash and cash equivalents		**24,237**	71,501
Cash and cash equivalents at 31 December	*31*	**10,698,851**	10,983,043

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 12 to 98 form an integral part of these financial statements.

Consolidated statement of changes in equity for the year ended 31 December 2011

	2011									
			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	**931,055**	**2,708,619**	**48,624**	**(13,628)**	**(3,684)**	**8,281**	**(15,352)**	**3,663,915**	**264,683**	**3,928,598**
Profit for the year	–	727,731	–	–	–	–	–	727,731	25,730	753,461
Other comprehensive income (net of tax)	–	(8,653)	6,363	18,857	(5,745)	(9)	–	10,813	16	10,829
Available-for-sale investments	–	–	6,362	–	–	–	–	6,362	–	6,362
Cash flow hedges	–	–	–	18,856	–	–	–	18,856	–	18,856
Actuarial losses on defined benefit plans	–	(8,722)	–	–	–	–	–	(8,722)	–	(8,722)
Exchange differences and other	–	69	1	1	(5,745)	(9)	–	(5,683)	16	(5,667)
Total comprehensive income for the year	–	719,078	6,363	18,857	(5,745)	(9)	–	738,544	25,746	764,290
Dividends to shareholders	–	(235,000)	–	–	–	–	–	(235,000)	(17,760)	(252,760)
Shares issued in lieu of dividends and amounts arising thereon	–	–	–	–	–	–	–	–	–	–
Exercise and lapse of share options and vesting of share awards	–	–	–	–	–	–	–	–	–	–
Cost of share-based payment arrangements	–	–	–	–	–	4,017	–	4,017	–	4,017
Other movements	–	(17,201)	1,338	–	–	(527)	–	(16,390)	(981)	(17,371)
Changes in ownership interests in subsidiaries	–	–	–	–	–	–	–	–	103,699	103,699
At 31 December	**931,055**	**3,175,496**	**56,325**	**5,229**	**(9,429)**	**11,762**	**(15,352)**	**4,155,086**	**375,387**	**4,530,473**

The accompanying notes on pages 12 to 98 form an integral part of these financial statements.

	2010									
			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	931,055	2,267,418	48,592	(3,701)	(2,929)	12,082	(15,352)	3,237,165	218,166	3,455,331
Profit for the year	–	462,152	–	–	–	–	–	462,152	2,661	464,813
Other comprehensive income (net of tax)	–	(15,822)	(642)	(9,927)	(755)	(4)	–	(27,150)	(6)	(27,156)
Available-for-sale investments	–	–	(649)	–	–	–	–	(649)	–	(649)
Cash flow hedges	–	–	–	(9,928)	–	–	–	(9,928)	–	(9,928)
Actuarial losses on defined benefit plans	–	(4,958)	–	–	–	–	–	(4,958)	–	(4,958)
Exchange differences and other	–	(10,864)	7	1	(755)	(4)	–	(11,615)	(6)	(11,621)
Total comprehensive income for the year	–	446,330	(642)	(9,927)	(755)	(4)	–	435,002	2,655	437,657
Dividends to shareholders	–	–	–	–	–	–	–	–	(3,367)	(3,367)
Shares issued in lieu of dividends and amounts arising thereon	–	–	–	–	–	(107)	–	(107)	–	(107)
Exercise and lapse of share options and vesting of share awards	–	–	–	–	–	(316)	–	(316)	–	(316)
Cost of share-based payment arrangements	–	–	–	–	–	805	–	805	–	805
Other movements	–	(5,129)	674	–	–	(4,179)	–	(8,634)	–	(8,634)
Changes in ownership interests in subsidiaries	–	–	–	–	–	–	–	–	47,229	47,229
At 31 December	931,055	2,708,619	48,624	(13,628)	(3,684)	8,281	(15,352)	3,663,915	264,683	3,928,598

The accompanying notes on pages 12 to 98 form an integral part of these financial statements.

Notes on the Financial Statements

1 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The consolidated financial statements of the group have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the EU. EU-endorsed IFRSs may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2011, there were no unendorsed standards effective for the year ended 31 December 2011 affecting these 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. Accordingly, the group's financial statements for the year ended 31 December 2011 are prepared in accordance with IFRSs as issued by the IASB.

IFRSs comprise accounting standards issued by the IASB and its predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') and its predecessor body.

During 2011, in addition to the above, the group adopted a number of interpretations and amendments to standards which had an insignificant effect on the consolidated financial statements of the group.

(b) Presentation of information

Capital disclosures under IAS 1 'Presentation of Financial Statements' have been included in Note 32.

The functional currency of the bank is US dollars, which is also the presentation currency of the consolidated financial statements of the group.

(c) Consolidation

The consolidated financial statements of the group comprise the financial statements of HSBC Bank Middle East Limited and its subsidiaries made up to 31 December.

Subsidiaries are consolidated from the date that the group gains control. The purchase method of accounting is used to account for the acquisition of subsidiaries by the group. The cost of an acquisition is measured at the fair value of the consideration, including contingent consideration, given at the date of exchange. Acquisition-related costs are recognised as an expense in the income statement in the period in which they are incurred. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Goodwill is measured as the excess of the aggregation of the consideration transferred, the amount of non-controlling interest and the fair value of the acquirer's previously held equity interest, if any, over the net of the amounts of the identifiable assets acquired and the liabilities assumed. The amount of non-controlling interest is measured either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. In a business combination achieved in stages, the previously held equity interest is remeasured at the acquisition-date fair value with resulting gain or loss recognised in the income statement or other comprehensive income as appropriate. In the event that the amount of net assets acquired is in excess of the aggregation of the consideration transferred, the amount of non-controlling interest and the fair value of the group's previously held equity interest, the difference is recognised immediately in the income statement.

The group has adopted the policy of 'predecessor accounting' for the transfer of business combinations under common control within the HSBC Group. Under IFRS where both HSBC Group entities adopt the same method for accounting for common control transactions the excess of the cost of the purchased group entity over the carrying value is recorded as a merger reserve on consolidation.

Entities that are controlled by the group are consolidated until the date that control ceases.

In the context of Special Purpose Entities ('SPEs'), the following circumstances may indicate a relationship in which, in substance, the group controls and, consequently, consolidates an SPE:

- the activities of the SPE are being conducted on behalf of the group according to its specific business needs so that the group obtains benefits from the SPE's operation;
- the group has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an 'autopilot' mechanism, the group has delegated these decision-making powers;

Notes on the Financial Statements (continued)

- the group has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incidental to the activities of the SPE; or
- the group retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The group performs a re-assessment of consolidation whenever there is a change in the substance of the relationship between the group and an SPE.

All intra-group transactions are eliminated on consolidation.

The consolidated financial statements of the group also include the attributable share of the results and reserves of associates. These are based on financial statements made up to 31 December.

(d) Future accounting developments

At 31 December 2011, a number of standards and interpretations, and amendments thereto, had been issued by the IASB, which are not effective for the group's consolidated financial statements as at 31 December 2011. In addition to the projects to complete financial instrument accounting, the IASB is continuing to work on projects on insurance, revenue recognition and lease accounting, which together with the standards described below, will represent widespread and significant changes to accounting requirements from 2013.

Standards and Interpretations issued by the IASB but not endorsed by the EU

Standards applicable in 2013

In May 2011, the IASB issued IFRS 10 'Consolidated Financial Statements' ('IFRS 10'), IFRS 11 'Joint Arrangements' ('IFRS 11') and IFRS 12 'Disclosure of Interests in Other Entities' ('IFRS 12'). The standards are effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IFRSs 10 and 11 are to be applied retrospectively.

Under IFRS 10, there will be one approach for determining consolidation for all entities, based on the concept of power, variability of returns and their linkage. This will replace the current approach which emphasises legal control or exposure to risks and rewards, depending on the nature of the entity. IFRS 11 places more focus on the investors' rights and obligations than on structure of the arrangement, and introduces the concept of a joint operation. IFRS 12 includes the disclosure requirements for subsidiaries, joint arrangements and associates and introduces new requirements for unconsolidated structured entities.

Based on our initial assessment, we do not expect IFRS 11 to have a material effect on the group's financial statements. The group is currently assessing the impact of IFRS 10 and it is not practical to quantify the effect as at the date of the publication of these financial statements.

In May 2011, the IASB also issued IFRS 13 'Fair Value Measurement' ('IFRS 13'). This standard is effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IFRS 13 is required to be applied prospectively from the beginning of the first annual period in which it is applied. The disclosure requirements of IFRS 13 do not require comparative information to be provided for periods prior to initial application.

IFRS 13 establishes a single source of guidance for all fair value measurements required or permitted by IFRSs. The standard clarifies the definition of fair value as an exit price, which is defined as a price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions, and enhances disclosures about fair value measurement.

The group is currently assessing IFRS 13 and it is not practical to quantify the effect as at the date of the publication of these financial statements.

In June 2011, the IASB issued amendments to IAS 19 'Employee Benefits' ('IAS 19 revised'). The revised standard is effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IAS 19 revised must be applied retrospectively.

The group is currently assessing IAS 19 and it is not practical to quantify the effect as at the date of the publication of these financial statements.

Notes on the Financial Statements (continued)

In December 2011, the IASB issued amendments to IFRS 7 'Disclosures – Offsetting Financial Assets and Financial Liabilities' which requires the disclosures about the effect or potential effects of offsetting financial assets and financial liabilities and related arrangements on an entity's financial position. The amendments are effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. The amendments are required to be applied retrospectively.

Standards applicable in 2014

In December 2011, the IASB issued amendments to IAS 32 'Offsetting Financial Assets and Financial Liabilities' which clarified the requirements for offsetting financial instruments and addressed inconsistencies in current practice when applying the offsetting criteria in IAS 32 'Financial Instruments: Presentation'. The amendments are effective for annual periods beginning on or after 1 January 2014 with early adoption permitted and are required to be applied retrospectively.

The group is currently assessing these clarifications but it is impracticable to quantify their effect as at the date of publication of these financial statements.

Standards applicable in 2015

In November 2009, the IASB issued IFRS 9 'Financial Instruments' ('IFRS 9') which introduced new requirements for the classification and measurement of financial assets. In October 2010, the IASB issued additions to IFRS 9 relating to financial liabilities. Together, these changes represent the first phase in the IASB's planned replacement of IAS 39 'Financial Instruments: Recognition and Measurement' ('IAS 39') with a less complex and improved standard for financial instruments.

Following the IASB's decision in December 2011 to defer the effective date, the standard is effective for annual periods beginning on or after 1 January 2015 with early adoption permitted. IFRS 9 is required to be applied retrospectively but prior periods need not be restated.

The second and third phases in the IASB's project to replace IAS 39 will address the impairment of financial assets measured at amortised cost and hedge accounting.

The IASB did not finalise the replacement of IAS 39 by its stated target of June 2011, and the IASB and the US Financial Accounting Standards Board have agreed to extend the timetable beyond this date to permit further work and consultation with stakeholders, including reopening IFRS 9 to address practice and other issues. The EU is not expected to endorse IFRS 9 until the completed standard is available. Therefore, the group remains unable to provide a date by which it plans to apply IFRS 9 and it remains impracticable to quantify the impact of IFRS 9 as at the date of publication of these consolidated financial statements.

2 Summary of significant accounting policies

(a) Interest income and expense

Interest income and expense for all financial instruments except for those classified as held-for-trading or designated at fair value (other than debt securities issued by the group and derivatives managed in conjunction with such debt securities issued) are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method. The effective interest method is a way of calculating the amortised cost of a financial asset or a financial liability (or groups of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the group estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the group that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

Interest on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Notes on the Financial Statements (continued)

(b) Non interest income

Fee income is earned from a diverse range of services provided by the group to its customers. Fee income is accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as an arrangement for the acquisition of shares or other securities);
- income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees); and
- income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and recorded in 'Interest income' (Note 2(a)).

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with related interest income, expense and dividends.

Net expense/income from financial instruments designated at fair value includes all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value through profit or loss. Interest income and expense and dividend income arising on these financial instruments are also included, except for interest arising from debt securities issued, and derivatives managed in conjunction with those debt securities, which is recognised in 'Interest expense'.

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders have approved the dividend for unlisted equity securities.

(c) Operating segments

The group's operating segments are organised into geographical regions comprising UAE, Qatar, and Rest of Middle East. The Rest of Middle East covers Algeria, Bahrain, Jordan, Kuwait, Lebanon, Oman, Pakistan and the Palestine Autonomous Area. Due to the nature of the group, the Board (chief operating decision maker) regularly reviews operating activity on a number of bases, including by geography and by Global Business. Although the Board reviews information on a number of bases, capital resources are allocated and performance assessed primarily by geographical region and the segmental analysis is presented on that basis. In addition, the economic conditions of each geographical region are highly influential in determining performance across the different types of business activity carried out in each region. Therefore, provision of segment information on a geographical basis provides the most meaningful information with which to understand the performance of the business.

Information provided to the Board to make decisions about allocating resources and assessing performance of operating segments is measured in accordance with IFRSs. Due to the nature of the HSBC Group's structure, the analysis of profits shown in Note 11 includes intra-group items between geographical regions with the elimination shown in a separate column. Such transactions are conducted on an arm's length basis. Shared costs are included in segments on the basis of the actual recharges made.

(d) Valuation of financial instruments

All financial instruments are recognised initially at fair value. In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (that is, the fair value of the consideration given or received). In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the group recognises a trading gain or loss on inception of the financial instrument, being the difference between the transaction price and the fair value. When unobservable market data has a significant impact on the valuation of financial instruments, the entire initial difference in fair value indicated by the valuation model from the transaction price is not recognised immediately in the income statement but is recognised over the life of the transaction on an appropriate basis, or when the inputs become observable, or the transaction matures or is closed out, or when the group enters into an offsetting transaction.

Notes on the Financial Statements (continued)

Subsequent to initial recognition, the fair values of financial instruments measured at fair value are determined in accordance with the group's valuation methodology which are described in Note 26.

(e) Reclassification of financial assets

Non-derivative financial assets (other than those designated at fair value through profit or loss upon initial recognition) may be reclassified out of the fair value through profit or loss category in the following circumstances:

- financial assets that would have met the definition of loans and receivables at initial recognition (if the financial asset had not been required to be classified as held for trading) may be reclassified out of the fair value through profit or loss category if there is the intention and ability to hold the financial asset for the foreseeable future or until maturity; and
- financial assets (except financial assets that would have met the definition of loans and receivables at initial recognition) may be reclassified out of the fair value through profit or loss category and into another category in rare circumstances.

When a financial asset is reclassified as described in the above circumstances, the financial asset is reclassified at its fair value on the date of reclassification. Any gain or loss already recognised in the income statement is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

(f) Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated by the group which are not classified either as held for trading or designated at fair value. Loans and advances are recognised when cash is advanced to a borrower. They are derecognised when either the borrower repays their obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less any reduction for impairment or uncollectibility. Where exposures are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment for the hedged risk only.

The group may commit to underwrite loans on fixed contractual terms for specified periods of time, where the drawdown of the loan is contingent upon certain future events outside the control of the group. Where the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative and measured at fair value through profit and loss. On drawdown, the loan is classified as held for trading and measured at fair value through profit and loss. Where it is not the group's intention to trade but hold the loan, a provision on the loan commitment is only recorded where it is probable that the group will incur a loss. This may occur, for example, where a loss of principal is probable or the interest rate charged on the loan is lower than the cost of funding. On inception of the loan, the hold portion is recorded at its fair value and subsequently measured at amortised cost using the effective interest method. For certain transactions, such as leverage finance and syndicated lending activities, the cash advanced is not necessarily the best evidence of the fair value of the loan. For these loans, where the initial fair value is lower than the cash amount advanced (for example, due to the rate of interest charged on the loan being below the market rate of interest), the write-down is charged to the income statement. The write-down will be recovered over the life of the loan, through the recognition of interest income using the effective interest method, unless the loan becomes impaired. The write down is recorded as a reduction to other operating income.

Financial assets which have been reclassified into the loans and receivables category are initially recorded at the fair value at the date of reclassification and are subsequently measured at amortised cost, using the effective interest rate determined at the date of reclassification.

(g) Impairment of loans and advances

Losses for impaired loans are recognised promptly when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment losses are calculated on individual loans and on groups of loans assessed collectively. Impairment losses are recorded as charges to the income statement. The carrying amount of impaired loans on the balance sheet is reduced through the use of impairment allowance accounts. Losses expected from future events are not recognised.

Notes on the Financial Statements (continued)

Individually assessed loans and advances

The factors considered in determining that a loan is individually significant for the purposes of assessing impairment include:

- the size of the loan;
- the number of loans in the portfolio; and
- the importance of the individual loan relationship, and how this is managed.

Loans that meet the above criteria will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to facilitate treatment under a collective assessment methodology.

Loans are considered as individually significant are typically to corporate and commercial customers and are for larger amounts, which are managed on an individual relationship basis. Retail lending portfolios are generally assessed for impairment on a collective basis as the portfolios generally consist of large pools of homogeneous loans.

For all loans that are considered individually significant, the group assesses on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired. The criteria used by the group to determine that there is such objective evidence include:

- known cash flow difficulties experienced by the borrower;
- past due contractual payments of either principal or interest;
- breach of loan covenants or conditions;
- a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in material forgiveness, or postponement of principal, interest or fees; and
- there has been deterioration in the financial condition or outlook of the borrower such that its ability to repay is considered doubtful.

For those loans where objective evidence of impairment exists, impairment losses are determined by considering the following factors:

- the group's aggregate exposure to the customer;
- the viability of the customer's business model and its capability to trade successfully out of financial difficulties and generate sufficient cash flow to service its debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors' commitments ranking ahead of, or *pari passu* with, the group and the likelihood of other creditors continuing to support the company;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding;
- the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and
- when available, the secondary market price of the debt.

The realisable value of security is determined based on the current market value when the impairment assessment is performed. The value is not adjusted for anticipated increases in future market prices, however adjustments are made to reflect local conditions, such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan at its original effective interest rate, and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least semi-annually, and more regularly when

circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

Collectively assessed loans and advances

Impairment is assessed on a collective basis in two circumstances:

- to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment; and
- for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss. These credit risk characteristics may include country of origination, type of business involved, type of products offered, security obtained or other relevant factors. This reflects impairment losses that the group has incurred as a result of events occurring before the balance sheet date, which the group is not able to identify on an individual loan basis, and that can be reliably estimated. These losses will only be individually identified in the future. As soon as information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed on an individual basis for impairment.

The collective impairment allowance is determined after taking into account:

- historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and
- management's experienced judgement as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by local management for each identified portfolio.

Homogeneous groups of loans and advances

Statistical methods are used to determine impairment losses on a collective basis for homogeneous groups of loans that are not considered individually significant, because individual loan assessment is impracticable. Losses in these groups of loans are recorded on an individual basis when individual loans are written off, at which point they are removed from the group. Two alternative methods are used to calculate allowances on a collective basis:

- When appropriate empirical information is available, the group utilises roll-rate methodology. This methodology employs statistical analyses of historical data and experience of delinquency and default to estimate the amount of loans that will eventually be written off as a result of the events occurring before the balance sheet date which the group is not able to identify on an individual loan basis, and that can be reliably estimated. Under this methodology, loans are grouped into ranges according to the number of days past due and statistical analysis is used to estimate the likelihood that loans in each range will progress through the various stages of delinquency, and ultimately prove irrecoverable. In addition to the delinquency groupings, loans are segmented according to their credit characteristics as described above. Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio, and the carrying amount of the portfolio.
- When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, the group adopts a basic formulaic approach based on historical loss rate experience.

Notes on the Financial Statements (continued)

In normal circumstances, historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio, though sometimes it provides less relevant information about the inherent loss in a given portfolio at the balance sheet date, for example, when there have been changes in economic, regulatory or behavioural conditions which result in the most recent trends in the portfolio risk factors being not fully reflected in the statistical models. In these circumstances, the risk factors are taken into account by adjusting the impairment allowances derived solely from historical loss experience.

These additional portfolio risk factors may include recent loan portfolio growth and product mix, unemployment rates, bankruptcy trends, geographic concentrations, loan product features (such as the ability of borrowers to repay adjustable-rate loans where reset interest rates give rise to increases in interest charges), economic conditions such as national and local trends in housing markets and interest rates, portfolio seasoning, account management policies and practices, current levels of write-offs, changes in laws and regulations and other items which can affect customer payment patterns on outstanding loans, such as natural disasters. These risk factors, where relevant, are taken into account when calculating the appropriate level of impairment allowances by adjusting the impairment allowances derived solely from historical loss experience.

Roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

Write-off of loans and advances

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

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognised in the income statement.

Reclassified loans and advances

Where financial assets have been reclassified out of the fair value through profit or loss category to the loans and receivables category, the effective interest rate determined at the date of reclassification is used to calculate any impairment losses.

Following reclassification, where there is a subsequent increase in the estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the effective interest rate from the date of change in the estimate rather than as an adjustment to the carrying amount of the asset at the date of change in the estimate.

Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans as part of an orderly realisation are recorded as assets held for sale and reported in ‘Other assets’ if the carrying amounts of the assets are recovered principally through sale, the assets are available for sale in their present condition and their sale is highly probably. The asset acquired is recorded at the lower of its fair value (less costs to sell) and the carrying amount of the loan (net of impairment allowance) at the date of exchange. No depreciation is charged in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recognised in the income statement, in ‘Other operating income’. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative write down, is also recognised in ‘Other operating income’, together with any realised gains or losses on disposal.

Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as up to date loans for measurement purposes once a minimum number of payments under the original or revised terms, as appropriate to the circumstances, have been received. Loans subject to collective impairment assessment whose terms have been renegotiated are segregated from other parts of the loan

Notes on the Financial Statements (continued)

portfolio for the purposes of collective impairment assessment, to reflect their risk profile. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired. The carrying amount of loans that have been classified as renegotiated retain this classification until maturity or derecognition. Interest is recorded on renegotiated loans taking into account the new contractual terms following renegotiation.

A loan that has been subject to a change in contractual cash flows as a result of renegotiation for credit purposes will be classified on renegotiation as impaired, unless the delay in payment is insignificant and there are no other indicators of impairment. The loan will remain classified as impaired until it has demonstrated a history of payment performance against the original or revised terms, as appropriate to the circumstances, that are sufficient to demonstrate a significant reduction in the risk of non-payment of future cash flows. Renegotiated loans in portfolios subject to collective impairment assessment which have been reclassified from impaired following successful completion of the required performance period remain segregated from the purposes of collective impairment assessments.

(h) Trading assets and trading liabilities

Treasury bills, debt securities, equity shares, loans, deposits, debt securities in issue, and short positions in securities are classified as held for trading if they have been acquired or incurred principally for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. These financial assets or financial liabilities are recognised on trade date, when the group enters into contractual arrangements with counterparties to purchase or sell the financial instruments, and are normally derecognised when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently their fair values are remeasured, and gains and losses from changes therein are recognised in the income statement in ‘Net trading income’.

(i) Financial instruments designated at fair value

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated by management. The group may designate financial instruments at fair value when the designation:

- eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities, or recognising gains and losses on them, on different bases. Under this criterion, the main classes of financial instruments designated by the group are:

  Long-term debt issues. The interest payable on certain fixed rate long-term debt securities issued has been matched with the interest on ‘receive fixed/pay variable’ interest rate swaps as part of a documented interest rate risk management strategy. An accounting mismatch would arise if the debt securities issued were accounted for at amortised cost, because the related derivatives are measured at fair value with changes in the fair value recognised in the income statement. By designating the long-term debt at fair value, the movement in the fair value of the long-term debt will also be recognised in the income statement.

- applies to groups of financial assets, financial liabilities or combinations thereof that are managed, and their performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, and where information about the groups of financial instruments is reported to management on that basis; and

- relates to financial instruments containing one or more embedded derivatives that significantly modify the cash flows resulting from those financial instruments, including certain debt issues and debt securities held.

The fair value designation, once made, is irrevocable. Designated financial assets and financial liabilities are recognised when the group enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and are normally derecognised when sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently, the fair values are remeasured, and gains and losses from changes therein are recognised in the income statement in ‘Net income from financial instruments designated at fair value’.

Notes on the Financial Statements (continued)

(j) Financial investments

Treasury bills, debt securities and equity shares intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale or held-to-maturity. Financial investments are recognised on trade date, when the group enters into contractual arrangements with counterparties to purchase securities, and are normally derecognised when either the securities are sold or the borrowers repay their obligations.

(i) Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income in 'Available-for-sale investments – fair value gains/ (losses) until the financial assets are either sold or become impaired. When available-for-sale financial assets are sold, cumulative gains or losses previously recognised in other comprehensive income are recognised in the income statement as 'Gains less losses from financial investments'.

Interest income is recognised on available-for-sale debt securities using the effective interest rate, calculated over the asset's expected life. Premiums and/or discounts arising on the purchase of dated investment securities are included in the calculation of their effective interest rates. Dividends are recognised in the income statement when the right to receive payment has been established.

At each balance sheet date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset. Impairment losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the income statement, is removed from other comprehensive income and recognised in the income statement.

Impairment losses for available-for-sale debt securities are recognised within 'Loan impairment charges and other credit risk provisions' in the income statement and impairment losses for available-for-sale equity securities are recognised within 'Gains less losses from financial investments' in the income statement. The impairment methodologies for available-for-sale financial assets are set out in more detail below:

– **Available-for-sale debt securities:** When assessing available-for-sale debt securities for objective evidence of impairment at the reporting date, the group considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. These events may include a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial reorganisation, or the disappearance of an active market for the debt security because of financial difficulties relating to the issuer. These types of specific event and other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment of a debt security.

– **Available-for-sale equity securities:** Objective evidence of impairment for available-for sale equity securities may include specific information about the issuer as detailed above, but may also include information about significant changes in technology, markets, economics or the law that provides evidence that the cost of the equity securities may not be recovered.

  A significant or prolonged decline in the fair value of the asset below its cost is also objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the period in which the fair value of the asset has been below its original cost at initial recognition.

Once an impairment loss has been recognised on an available-for-sale financial asset, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the nature of the available-for-sale financial asset concerned:

Notes on the Financial Statements (continued)

- for an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in the income statement when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in fair value of the financial asset is recognised in other comprehensive income. If the fair value of the debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement. If there is no longer objective evidence that the debt security is impaired, the impairment loss is also reversed through the income statement;
- for an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised directly in other comprehensive income. Impairment losses recognised on the equity security are not reversed through the income statement. Subsequent decreases in the fair value of the available-for-sale equity security are recognised in the income statement, to the extent that further cumulative impairment losses have been incurred in relation to the acquisition cost of the equity security.

(ii) Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the group positively intends, and is able, to hold until maturity. Held-to-maturity investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest rate method, less any impairment losses.

(k) Sale and repurchase agreements (including stock lending and borrowing)

When securities are sold subject to a commitment to repurchase them at a predetermined price ('repos'), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to sell ('reverse repos') are not recognised on the balance sheet and the consideration paid is recorded in 'Loans and advances to banks' or 'Loans and advances to customers' as appropriate. The difference between the sale and repurchase price is treated as interest and recognised over the life of the agreement.

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. The transfer of securities to counterparties under these agreements is not normally reflected on the balance sheet. Cash collateral advanced or received is recorded as an asset or a liability respectively.

Securities borrowed are not recognised on the balance sheet. If they are sold on to third parties, an obligation to return the securities is recorded as a trading liability and measured at fair value, and any gains or losses are included in 'Net trading income'.

(l) Derivatives and hedge accounting

Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values of exchange-traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models.

Derivatives may be embedded in other financial instruments, for example, a convertible bond with an embedded conversion option. Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract, and the combined contract is not held for trading nor designated at fair value. These embedded derivatives are measured at fair value with changes therein recognised in the income statement.

Derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are offset only if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

The method of recognising fair value gains or losses depends on whether derivatives are held for trading or are designated as hedging instruments, and if the latter, the nature of the risks being hedged. All gains and losses

from changes in the fair value of derivatives held for trading are recognised in the income statement. When derivatives are designated as hedges, the group classifies them as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedges'); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ('cash flow hedges'); or (iii) a hedge of net investments in a foreign operation ('net investment hedges'). Hedge accounting is applied to derivatives designated as hedging instruments in a fair value, cash flow or net investment hedge provided certain criteria are met.

Hedge accounting

At the inception of a hedging relationship, the group documents the relationship between the hedging instruments and hedged items, its risk management objective and its strategy for undertaking the hedge. The group also requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments, primarily derivatives, that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items. Interest on designated qualifying hedges is included in 'Net interest income'.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement, along with changes in the fair value of the hedged assets, liabilities or group thereof that are attributable to the hedged risk.

If a hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment to the carrying amount of the hedged item is amortised to the income statement based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised, in which case it is released to the income statement immediately.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income within the 'Cash flow hedges – fair value gains/(losses)'. Any gain or loss in fair value relating to an ineffective portion is recognised immediately in the income statement.

The accumulated gains and losses recognised in other comprehensive income are reclassified to the income statement in the periods in which the hedged item will affect profit or loss. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously recognised in other comprehensive income are removed from equity and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in other comprehensive income at that time remains in equity until the forecast transaction is eventually recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in other comprehensive income is immediately reclassified to the income statement.

Net investment hedge

Hedges of net investments in foreign operations are accounted for in a similar way to cash flow hedges. A gain or loss on the effective portion of the hedging instrument is recognised in other comprehensive income; a gain or loss on the ineffective portion is recognised immediately in the income statement. Gains and losses previously recognised in other comprehensive income are reclassified to the income statement on the disposal, or part disposal, of the foreign operation.

Hedge effectiveness testing

To qualify for hedge accounting, the group requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness) and demonstrate actual effectiveness (retrospective effectiveness) on an ongoing basis.

Notes on the Financial Statements (continued)

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method adopted by an entity to assess hedge effectiveness will depend on its risk management strategy.

For prospective effectiveness the hedging instrument must be expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness to be achieved, the changes in fair value or cash flows must offset each other in the range of 80% to 125%.

Hedge ineffectiveness is recognised in the income statement in 'Net trading income'.

Derivatives that do not qualify for hedge accounting

All gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in the income statement. These gains and losses are reported in 'Net trading income', except where derivatives are managed in conjunction with financial instruments designated at fair value (other than derivatives managed in conjunction with debt securities issued by the group), in which case gains and losses are reported in 'Net income from financial instruments designated at fair value'. The interest on derivatives managed in conjunction with debt securities issued by the group which are designated at fair value is recognised in 'Interest expense'. All other gains and losses on these derivatives are reported in 'Net income from financial instruments designated at fair value'.

Derivatives that do not qualify for hedge accounting include non-qualifying hedges entered into as part of documented interest rate management strategies for which hedge accounting was not, or could not, be applied. The size and direction of changes in fair value of non-qualifying hedges can be volatile from year to year, but do not alter the cash flows expected as part of the documented management strategies for both the non-qualifying hedge instruments and the assets and liabilities to which the documented interest rate strategies relate. Non-qualifying hedges therefore operate as economic hedges of the related assets and liabilities.

(m) Derecognition of financial assets and liabilities

Financial assets are derecognised when the contractual right to receive cash flows from the assets has expired; or when the group has transferred its contractual right to receive the cash flows of the financial assets, and either:

- substantially all the risks and rewards of ownership have been transferred; or
- the group has neither retained nor transferred substantially all the risks and rewards, but has not retained control.

Financial liabilities are derecognised when they are extinguished, that is when the obligation is discharged, cancelled or expires.

(n) Offsetting financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(o) Subsidiaries and associates

The group classifies investments in entities which it controls as subsidiaries. The group classifies investments in entities over which it has significant influence, and that are neither subsidiaries nor joint ventures, as associates. For the purpose of determining this classification, control is considered to be the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Investments in associates are recognised using the equity method. Under this method, such investments are initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in the group's share of net assets.

Profits on transactions between the group and its associates are eliminated to the extent of the group's interest in the respective associates. Losses are also eliminated to the extent of the group's interest in the associates unless the transaction provides evidence of an impairment of the asset transferred.

Notes on the Financial Statements (continued)

(p) Intangible assets

Intangible assets includes computer software. Computer software includes both purchased and internally generated software. The cost of internally generally software comprises all directly attributable costs necessary to create, produce and prepare the software to be capable of operating in the manner intended by management. Costs incurred in the ongoing maintenance of software are expensed immediately as incurred.

Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable. Where:

- Intangible assets that have a finite useful life are stated at cost less amortisation and accumulated impairment losses and are amortised over their estimated useful lives. Estimated useful life is the lower of legal duration and expected useful life.

Intangible assets with finite useful lives are amortised, generally on a straight-line basis, over their useful lives as follows:

Internally generated software	between 3 and 5 years
Purchased software	between 3 and 5 years

(q) Property, plant and equipment

Land and buildings are stated at historical cost, or fair value at the date of transition to IFRSs ('deemed cost'), less any impairment losses and depreciation calculated to write off the assets over their estimated useful lives as follows:

- freehold land is not depreciated;
- freehold buildings are depreciated at the greater of 2% per annum on a straight-line basis or over their remaining useful lives; and
- leasehold buildings are depreciated over the unexpired terms of the leases, or over their remaining useful lives.

Equipment, fixtures and fittings (including equipment on operating leases where the group is the lessor) are stated at cost less any impairment losses and depreciation calculated on a straight-line basis to write off the assets over their useful lives, which run to a maximum of 35 years but are generally between 5 years and 20 years.

Property, plant and equipment is subject to an impairment review if there are events or changes in circumstances which indicate that the carrying amount may not be recoverable.

(r) Finance and operating leases

Agreements which transfer to counterparties substantially all the risks and rewards incidental to the ownership of assets, but not necessarily legal title, are classified as finance leases. When the group is a lessor under finance leases the amounts due under the leases, after deduction of unearned charges, are included in 'Loans and advances to banks' or 'Loans and advances to customers', as appropriate. The finance income receivable is recognised in 'Net interest income' over the periods of the leases so as to give a constant rate of return on the net investment in the leases.

When the group is a lessee under finance leases, the leased assets are capitalised and included in 'Property, plant and equipment' and the corresponding liability to the lessor is included in 'Other liabilities'. A finance lease and its corresponding liability are recognised initially at the fair value of the asset or, if lower, the present value of the minimum lease payments. Finance charges payable are recognised in 'Net interest income' over the period of the lease based on the interest rate implicit in the lease so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are classified as operating leases. When acting as lessor, the group includes the assets subject to operating leases in 'Property, plant and equipment' and accounts for them accordingly. Impairment losses are recognised to the extent that residual values are not fully recoverable and the carrying value of the assets is thereby impaired. When the group is the lessee, leased assets are not recognised on the balance sheet. Rentals payable and receivable under operating leases are accounted for on a straight-line basis over the periods of the leases and are included in 'General and administrative expenses' and 'Other operating income', respectively.

Notes on the Financial Statements (continued)

(s) Income tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in the same statement in which the related item appears.

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantively enacted by the balance sheet date, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities are offset when the group intends to settle on a net basis and the legal right to offset exists.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled based on tax rates and laws enacted, or substantively enacted, by the balance sheet date. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when the group has a legal right to offset.

Deferred tax relating to actuarial gains and losses on post-employment benefits is recognised directly in other comprehensive income. Deferred tax relating to share-based payment transactions is recognised directly in equity to the extent that the amount of the estimated future tax deduction exceeds the amount of the related cumulative remuneration expense. Deferred tax relating to fair value re-measurement of available-for-sale investments and cash flow hedging instruments which are charged or credited directly to other comprehensive income, is also charged or credited to other comprehensive income and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

(t) Pension and other post-employment benefits

The group contributes to the Government pension and social security schemes in the countries in which it operates, as per local regulations. Where the group's obligations under the plans are equivalent to a defined contribution plan the payments made are charged as an expense as they fall due. End of service benefits are calculated and paid in accordance with local law. The group's net obligation in respect of such end of service benefits is the amount of future benefits that employees have earned in return for their service in current and prior periods.

The defined benefit pension costs and the present value of defined benefit obligations are calculated at the reporting date by the scheme’s actuaries using the Projected Unit Credit Method. The net charge to the income statement mainly comprises the current service cost, plus the unwinding of the discount rate on plan liabilities, less the expected return on plan assets, and is presented in operating expenses. Past service costs are charged immediately to the income statement to the extent that the benefits have vested, and are otherwise recognised on a straight-line basis over the average period until the benefits vest. Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred), as well as the effects of changes in actuarial assumptions. Actuarial gains and losses are recognised in other comprehensive income in the period in which they arise.

The defined benefit liability recognised in the balance sheet represents the present value of defined benefit obligations adjusted for unrecognised past service costs and reduced by the fair value of plan assets. Any net defined benefit surplus is limited to unrecognised past service costs plus the present value of available refunds and reductions in future contributions to the plan.

The group also makes contributions to the HSBC International Staff Retirement Benefit Scheme in respect of a small number of International Managers being seconded to the group by the HSBC Group. The group accounts for contributions to this scheme as if it is a defined contribution scheme on the basis that any actuarial gains and losses would not be material.

Notes on the Financial Statements (continued)

(u) Share-based payments

Shares in HSBC Holdings plc are awarded to employees in certain cases. Equity-settled share-based payment arrangements entitle employees to receive equity instruments of HSBC.

The cost of equity-settled share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted and recognised as an expense on a straight-line basis over the vesting period, with a corresponding credit to 'Retained earnings'. The vesting period is the period during which all the specified vesting conditions of the arrangement are to be satisfied. The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately.

Fair value is determined by using appropriate valuation models, taking into account the terms and conditions of the award. Vesting conditions include service conditions and performance conditions; any other features of a share-based payment arrangement are non-vesting conditions. Market performance conditions and non-vesting conditions are taken into account when estimating the fair value of equity instruments at the date of grant, so that an award is treated as vesting irrespective of whether the market performance condition or non-vesting condition is satisfied, provided all other vesting conditions are satisfied.

Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

Where an award has been modified, as a minimum the expense of the original award continues to be recognised as if it had not been modified. Where the effect of a modification is to increase the fair value of an award or increase the number of equity instruments, the incremental fair value of the award of the extra equity instruments is recognised in addition to the expense of the original grant, measured at the date of modification, over the modified vesting period.

A cancellation that occurs during the vesting period is treated as an acceleration of vesting, and recognised immediately for the amount that would otherwise have been recognised for services over the vesting period.

(v) Foreign currencies

Items included in the financial statements of each of the group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements of HSBC Bank Middle East Limited are presented in US dollars, which is also the group's functional currency.

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the balance sheet date. Any resulting exchange differences are included in the income statement. Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Any exchange component of a gain or loss on a non-monetary item is recognised in other comprehensive income if the gain or loss on the non-monetary item is recognised in other comprehensive income. Any exchange component of a gain or loss on a non-monetary item is recognised in the income statement if the gain or loss on the non-monetary item is recognised in the income statement.

The assets, including related goodwill where applicable, and liabilities of branches, subsidiaries and associates whose functional currency is not US dollars, are translated into the group's presentational currency at the rate of exchange ruling at the balance sheet date. The results of branches, subsidiaries and associates whose function currency is not US dollars are translated into US dollars at the average rates of exchange for the reporting period. Exchange differences arising from the retranslation of opening foreign currency net investments, and exchange differences arising from retranslation of the result for the reporting period from the average rate to the exchange rate prevailing at the period end, are recognised in other comprehensive income. In consolidated financial

Notes on the Financial Statements (continued)

statements, exchange differences on a monetary item that is part of a net investment in a foreign operation are recognised in other comprehensive income. On disposal of a foreign operation, exchange differences relating thereto and previously recognised in other comprehensive income are recognised in the income statement.

(w) Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation, which has arisen as a result of past events, and for which a reliable estimate can be made of the amount of the obligation.

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the group; or are present obligations that have arisen from past events but are not recognised because it not probable that settlement will require outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

(x) Financial guarantee contracts

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received or receivable. Subsequently, the financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations.

The bank may issue financial guarantees to other group entities. Where it has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the group may elect to account for guarantees as insurance contracts. This election is made on a contract by contract basis, but the election for each contract is irrevocable. Where these guarantees have been classified as insurance contracts, they are measured and recognised as insurance liabilities.

(y) Debt securities issued, non-equity preference share capital and deposits by customers and banks

Financial liabilities are recognised when the group enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at fair value, which is normally the consideration received net of directly attributable transaction costs incurred. Subsequent measurement of financial liabilities, other than those measured at fair value through profit or loss and financial guarantees, is at amortised cost, using the effective interest rate method to amortise the difference between proceeds received, net of directly attributable transaction costs incurred, and the redemption amount over the expected life of the instrument.

(z) Share capital

Shares are classified as equity when there is no contractual obligation to transfer cash or other financial assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

(aa) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition, and include cash and balances at central banks, treasury bills and other eligible bills, loans and advances to banks, items in the course of collection from or in transmission to other banks and certificates of deposit.

(ab) Assets held for sale

Non-current assets and disposal groups (including both the assets and liabilities of the disposal group) are classified as held for sale when their carrying amounts will be recovered principally through sale, they are available for sale in their present condition and their sale is highly probable.

Non-current assets held for sale and disposal groups are measured at the lower of carrying amount and fair value less cost to sell.

3 Use of assumptions, estimates and judgement

The results of the group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its consolidated financial statements. The accounting policies used in the preparation of the consolidated financial statements are described in detail in Note 2.

When preparing the financial statements, it is the Directors' responsibility to select suitable accounting policies and to make judgements and estimates that are reasonable and prudent.

The accounting policies that are deemed critical to the group's results and financial position, in terms of the materiality of the items to which the policy is applied, and the high degree of judgement involved, including the use of assumptions and estimation, are disclosed below:

Impairment of loans and advances

The group's accounting policy for losses arising from the impairment of customer loans and advances is described in Note 2(g). Further information can be found in Note 32 'Risk Management'. Loan impairment allowances represent management's best estimate of losses incurred in the loan portfolios at the balance sheet date.

Management is required to exercise judgement in making assumptions and estimations when calculating loan impairment allowances on both individually and collectively assessed loans and advances. The most significant judgemental area is the calculation of collective impairment allowances.

The methods used to calculate collective allowances on homogeneous groups of loans and advances that are not considered individually significant are disclosed in Note 2(g). They are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan basis because of the large number of individually insignificant loans in the portfolio.

The methods involve the use of statistically assessed historical information which is supplemented with significant management judgement to assess whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience. In normal circumstances, historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio, though sometimes it provides less relevant information about the inherent loss in a given portfolio at the balance sheet date, for example, where there have been changes in economic, regulatory or behavioural conditions such that the most recent trends in the portfolio risk factors are not fully reflected in the statistical models. In these circumstances, such risk factors are taken into account by adjusting the impairment allowances derived solely from historical loss experience.

Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographic concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other factors that can affect customer payment patterns. Different factors are applied in different countries to reflect different economic conditions and laws and regulations. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. For example, roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

However, the exercise of judgement requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas. Many of the factors have a high degree of interdependency and there is no single factor to which our loan impairment allowances as a whole are sensitive.

Valuation of financial instruments

The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The majority of valuation techniques employ only observable market data, and so the reliability of the fair value measurement is high. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are

unobservable. Valuation techniques that rely to a greater extent on unobservable inputs require a higher level of management judgement to calculate a fair value than those based wholly on observable inputs.

Valuation techniques used to calculate fair values are discussed in Note 26. The main assumptions and estimates which management considers when applying a model with valuation techniques are:

- the likelihood and expected timing of future cash flows on the instrument. These cash flows are usually governed by the terms of the instrument, although management judgement may be required when the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt. Future cash flows may be sensitive to changes in market rates;
- selecting an appropriate discount rate for the instrument. The determination of this rate is based on an assessment of what a market participant would regard as the appropriate spread of the rate for the instrument over the appropriate risk-free rate; and
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

When applying a model with unobservable inputs, estimates are made to reflect uncertainties in fair values resulting from a lack of market data inputs, for example, as a result of illiquidity in the market. For these instruments, the fair value measurement is less reliable. Inputs into valuations based on unobservable data are inherently uncertain because there is little or no current market data available from which to determine the level at which an arm's length transaction would occur under normal business conditions. However, in most cases there are some market data available on which to base a determination of fair value, for example historical data, and the fair values of most financial instruments are based on some market observable inputs even where the unobservable inputs are significant.

Given the uncertainty and subjective nature of valuing financial instruments at fair value, it is possible that the outcomes within the next financial year could differ from the assumptions used, and this would result in a material adjustment to the carrying amount of financial instruments measured at fair value.

Impairment of available-for-sale financial assets

The group's accounting policy for impairment on available-for-sale financial assets is described in Note 2(j).

Management is required to exercise judgement in determining whether there is objective evidence that an impairment loss has occurred. Once impairment has been identified, the amount of impairment is measured in relation to the fair value of the asset. More information on assumptions and estimates requiring management judgement relating to the determination of fair values of financial instruments is provided above in 'Valuation of financial instruments'.

Deciding whether an available-for-sale debt security is impaired requires objective evidence of both the occurrence of a loss event and a related decrease in estimated future cash flows. The degree of judgement involved is less when cash flows are readily determinable, but increases when estimating future cash flows requires consideration of a number of variables, some of which may be unobservable in current market conditions.

There is no single factor to which the group's charge for impairment of available-for-sale debt securities is particularly sensitive, because of the range of different types of securities held, the range of geographical areas in which those securities are held, and the wide range of factors which can affect the occurrence of loss events and the cash flows of securities, including different types of collateral.

It is possible that outcomes in the next financial year could be different from those modelled when seeking to identify impairment on available-for-sale debt securities. In this event, impairment may be identified in available-for-sale debt securities which had previously been determined not to be impaired, potentially resulting in the recognition of material impairment losses in the next financial year.

Pensions

The assumptions used are disclosed in Note 6 'Employee compensation and benefits'.

Share-based payments

The assumptions used are disclosed in Note 8 'Share-based payments'.

Notes on the Financial Statements (continued)

4 Net income/(expense) from financial instruments designated at fair value

Net income/(expense) from financial instruments designated at fair value includes:

- all gains and losses from changes in the fair value of financial assets and liabilities designated at fair value;
- all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets and liabilities designated at fair value; and
- interest income, interest expense and dividend income in respect of:
  - financial assets and liabilities designated at fair value; and
  - derivatives managed in conjunction with the above,

  except for interest arising from issued debt securities and derivatives managed in conjunction with those debt securities, which is recognised in 'Interest expense'.

	2011	2010
Net income on long-term debt issued and related derivatives	**US$000**	US$000
- changes in own credit spread on long-term debt	**13,696**	-
- other changes in fair value	**(3,211)**	-
	10,485	-

5 Net operating income

Net operating income is stated after the following items of income, expense, gains and losses:

	2011	2010
	US$000	US$000
Income		
Interest recognised on impaired financial assets	**29,306**	20,309
Fees earned on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	**462,558**	486,485
Fees earned on trust and other fiduciary activities where the group holds or invests assets on behalf of its customers	**20,723**	14,293
Income from listed investments	**48,727**	37,069
Income from unlisted investments	**100,238**	97,516
Expense		
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated at fair value	**(370,260)**	(415,018)
Fees payable on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	**(33,439)**	(27,652)
Losses		
Impairment of available-for-sale equity shares	**(12,962)**	(4,501)
Loss on disposal of property, plant and equipment, intangible assets and non-financial investments	**(2,657)**	(1,661)
Loan impairment charge and other credit risk provisions	**(246,985)**	(533,742)
Net impairment charge on loans and advances	**(247,021)**	(530,195)
Net impairment of available-for-sale debt securities	**(104)**	–
Net impairment in respect of other credit risk provisions	**140**	(3,547)

Notes on the Financial Statements (continued)

6 Employee compensation and benefits

	2011	2010
	US$000	US$000
Wages and salaries	**535,741**	480,879
Social security costs	**6,587**	7,543
Post-employment benefits	**14,462**	14,188
	556,790	502,610

The average number of persons employed by the group during the year was as follows:

	2011	2010
UAE	**2,899**	2,943
Qatar	**467**	534
Rest of Middle East	**1,956**	2,092
Total	**5,322**	5,569

Post-employment benefit plans

Income statement charge

	2011	2010
	US$000	US$000
Defined benefit pension plans	**12,625**	12,246
Defined contribution pension plans	**1,837**	1,942
	14,462	14,188

Net liabilities recognised on balance sheet in respect of defined benefit plans

	2011	2010
	US$000	US$000
Defined benefit pension plans	**75,790**	63,885

Total cumulative actuarial gains/(losses) recognised in other comprehensive income

	2011	2010
	US$000	US$000
Defined benefit pension plans	**(22,775)**	(9,920)

Defined benefit pension plans

Arrangements for staff retirement benefits in overseas locations vary from country to country and are made in accordance with local regulations and custom. The majority of branches operate staff indemnity schemes for local staff which take the form of gratuity schemes.

The schemes are reviewed at least annually or in accordance with local practice and regulations by qualified actuaries. The actuarial assumptions used to calculate the scheme obligations vary according to the economic conditions of the countries in which they are situated.

Notes on the Financial Statements (continued)

Net liability under defined benefit pension plans

Fair value of plan assets	2011 US$000	2010 US$000
At 1 January	**1,928**	1,579
Expected return on plan assets	**228**	209
Contributions by the group	**253**	248
Benefits paid	**(480)**	–
Exchange differences	**(84)**	(108)
At 31 December	**1,845**	1,928
Present value of defined benefit obligations		
At 1 January	**(65,813)**	(55,338)
Current service cost	**(10,565)**	(10,115)
Interest cost	**(2,288)**	(2,340)
Contributions by employees	**–**	(8)
Actuarial gains	**(12,855)**	(6,851)
Benefits paid	**15,304**	8,630
Reduction in liabilities resulting from curtailments	**531**	612
Liabilities extinguished on settlements	**–**	9
Exchange differences	**(1,949)**	(412)
At 31 December	**(77,635)**	(65,813)
Funded	**(1,845)**	(1,848)
Unfunded	**(75,790)**	(63,965)
Net liability	**(75,790)**	(63,885)

The actual return on plan assets for the year ended 31 December 2011 was a positive return US$228 thousand (2010: US$209 thousand). The group expects to make US$Nil contributions to defined benefit pension plans during 2011 (2010: US$9,496 thousand).

Total expense recognised in the income statement in 'Employee compensation and benefits'

	2011 US$000	2010 US$000
Current service cost	**10,565**	10,115
Interest cost	**2,288**	2,340
Expected return on plan assets	**(228)**	(209)
Total expense	**12,625**	12,246

Post-employment defined benefit plans' principal actuarial assumptions

The principal actuarial financial assumptions used to calculate the group's obligations under its defined benefit pension plans at 31 December each period, and used as the basis for measuring periodic costs under the plans in the following periods, were as follows:

Principal actuarial assumptions

	Discount rate %	Rate of pay increase %	Combined rate of resignation and employment termination %
At 31 December 2011			
United Arab Emirates	**3.18**	**4.00**	**15.00**
At 31 December 2010			
United Arab Emirates	4.26	4.00	20.00

The group determines discount rates to be applied to its obligations in consultation with the plans' local actuaries, on the basis of current average yields of long term, high quality corporate bonds or Central Bank certificate of deposits or longer dated swap rates of approximately 7 years as a proxy for a government bond yield of suitable term and currency to the liabilities of the scheme, where appropriate.

Notes on the Financial Statements (continued)

Actuarial assumption sensitivities

The discount rate is sensitive to changes in market conditions arising during the reporting period. The mortality rates used are sensitive to experience from the plan member profile. The following table shows the effect of changes in these and the other key assumptions on the principal plan:

	United Arab Emirates	
	2011	2010
	US$000	US$000
Discount rate		
Change in scheme obligation at year end from a 25bps increase	**(61,085)**	(48,051)
Change in scheme obligation at year end from a 25bps decrease	**62,763**	49,005
Change in following year scheme cost from a 25bps increase	**(12,207)**	(9,522)
Change in following year scheme cost from a 25bps decrease	**12,278**	9,468
Rate of pay increase		
Change in scheme obligation at year end from a 25bps increase	**(62,820)**	(49,087)
Change in scheme obligation at year end from a 25bps decrease	**61,026**	47,963
Change in following year scheme cost from a 25bps increase	**(12,457)**	(9,628)
Change in following year scheme cost from a 25bps decrease	**12,252**	9,423

7 Auditors' remuneration

Auditors' remuneration in relation to the statutory audit amounted to US$945 thousand (2010: US$942 thousand).

The following fees were payable by the group to the group's principal auditor, KPMG Channel Islands Limited and its associates (together 'KPMG'):

	2011	2010
	US$000	US$000
Audit fees for HSBC Bank Middle East Limited statutory audit:		
– fees relating to current year	**928**	942
– fees relating to prior year	**17**	-
	945	942
Fees payable to KPMG for other services provided to the group		
– other services pursuant to legislation	**952**	668
– tax services	**78**	59
– all other services	**201**	71
	1,231	798
Total fees payable	**2,176**	1,740

The following is a description of the type of services included within the categories listed above:

– Audit fees are in respect of fees payable to KPMG Channel Islands Limited and their associates for the statutory audit of the consolidated financial statements of the group.

– Other services pursuant to legislation include services for assurance and other services that are in relation to statutory and regulatory filings, including comfort letters and interim reviews.

– Tax services include tax compliance services and tax advisory services.

– All other services include other assurance and advisory services such as translation services, ad-hoc accounting advice and reviews of financial models.

No fees were payable to KPMG for the following types of services: internal audit services, valuation and actuarial services, services related to litigation and services related to recruitment and remuneration.

Notes on the Financial Statements (continued)

8 Share-based payments

Income statement charge

	2011 US$000	2010 US$000
Restricted share awards	**332**	227
Performance share awards	**24,842**	15,363
Savings-related share options plans	**1,051**	877
HSBC Holdings Group share options plan	**-**	(10)
	26,225	16,457

This charge, which was computed from the fair values of the share-based payment transaction when contracted, arose under employee share awards made in accordance with HSBC's reward structures (discussed further below).

The share-based payment income statement charge is recognised in wages and salaries (Note 6).

Deferred share awards

Included in the income statement charge above is US$26.2m (2010: US$16.5m) relating to deferred share awards. These awards are granted to employees after the performance year. The following table identifies the charge recognised in the current year, or expected to be recognised in future years, and the performance year to which the deferred awards relate.

Income statement impact of deferred share awards on current and future years

	Charge recognised in 2011 in respect of performance year:		Charge expected to be recognised in 2012 or later in respect of performance year:	
	2011[1] US$000	Pre-2011 US$000	2011[1] US$000	Pre-2011 US$000
HSBC deferred share awards	**8,804**	**13,116**	**6,098**	**6,606**

	Charge recognised in 2010 in respect of performance year:		Charge expected to be recognised in 2011 or later in respect of performance year:	
	2010[1] US$000	Pre-2010 US$000	2010[1] US$000	Pre-2010 US$000
HSBC deferred share awards	8,532	7,925	14,885	4,837

1 Regulatory and best practice guidance has clarified the required structure and terms of deferred bonus arrangements awarded to employees, who now have a better understanding of the likely nature of the awards to be granted. As a result, the vesting period for deferred share awards expected to be granted in 2012 in respect of the 2011 performance year was determined to have started on 1 January 2011 and a charge was recognised from that date. Previously, the charge was recognised from the grant date.

HSBC Share Awards

Award	Policy	Purpose
Restricted share awards	• Vesting of awards based on continued employment with HSBC of between one and five years from the date of award • Shares awarded without corporate performance conditions • Certain shares awarded subject to a retention requirement until cessation of employment	• Rewards employee performance, potential and retention requirements • To aid recruitment • Part-deferral of annual bonuses
Performance share awards	• Vesting of awards based on three independent performance measures (relative TSR (40%), economic profit (40%) and growth in earnings per share ('EPS') (20%)) and an over-riding 'sustained improvement' judgement by the HSBC Group Remuneration Committee • Performance conditions are measured over a three year period and reviewed annually • Awards are forfeited to the extent the performance conditions have not been met	• Align interests of executives with the creation of shareholder value and recognise individual performance and potential • To reflect HSBC's relative and absolute performance over the long-term, taking account of an external measure of value creation, a measure of the extent to which the return on capital invested in HSBC is in excess of a benchmark return and a direct measure of the profits generated for shareholders

Notes on the Financial Statements (continued)

Movement on HSBC share awards

	Restricted share awards		Performance share awards[1]	
	2011 Number (000's)	2010 Number (000's)	**2011 Number (000's)**	2010 Number (000's)
Outstanding at 1 January	**7,216**	2,677	**173**	279
Additions during the year	**403**	2,863	**6**	8
Transferred in the year	**(3,524)**	3,215	**-**	-
Released and forfeited in the year	**(1,063)**	(1,539)	**(179)**	(114)
Outstanding at 31 December	**3,032**	7,216	**-**	173
Weighted average fair value of awards granted (£)	**6.45**	7.14		

1 Additions during the year comprised reinvested dividend equivalents.

HSBC Share Option Plans

Main plans	Policy	Purpose
Savings-related share option plans	• Exercisable within three months following the first anniversary of the commencement of a one-year savings contract or within six months following either the third or fifth anniversaries of the commencement of three-year or five-year contracts, respectively • The exercise price is set at a 20% (2010: 20%) discount to the market value immediately preceding the date of invitation	• Eligible employees save up to £250 per month (or its equivalent in US dollars, Hong Kong dollars or euros), with the option to use the savings to acquire shares • To align the interests of all employees with the creation of shareholder value
HSBC Holdings Group share option plan	• Vesting of awards based on achievement of certain TSR targets • Exercisable between third and tenth anniversaries of the date of grant • Plan ceased in May 2005	• Long-term incentive plan between 2000 and 2005 during which certain HSBC employees were awarded share options • To align the interests of those higher performing employees with the creation of shareholder value

Calculation of fair values

Fair values of share options/awards, measured at the date of grant of the option/award, are calculated using a Black-Scholes model. When modelling options/share awards with vesting dependent on HSBC's Total Shareholder Return ('TSR') over a period, the TSR performance targets are incorporated into the model using Monte Carlo simulation. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used.

Significant weighted average assumptions used to estimate the fair value of the options granted:

2011	**1-year Savings-Related Share Option Plans**	**3-year Savings-Related Share Option Plans**	**5-year Savings-Related Share Option Plans**
Risk-free interest rate[1] (%)	**0.8**	**1.7**	**2.5**
Expected life[2] (years)	**1**	**3**	**5**
Expected volatility[3] (%)	**25**	**25**	**25**
Share price at grant date (£)	**6.37**	**6.37**	**6.37**
2010			
Risk-free interest rate[1] (%)	0.7	1.9	2.9
Expected life[2] (years)	1	3	5
Expected volatility[3] (%)	30	30	30
Share price at grant date (£)	6.82	6.82	6.82

1 The risk-free rate was determined from the UK gilts yield curve.

2 The expected life of options depends on the behaviour of option holders, which is incorporated into the option model on the basis of historical observable data and is not a single input parameter but a function of various behavioural assumptions.

3 Expected volatility is estimated by considering both historic average share price volatility and implied volatility derived from traded options over HSBC shares of similar maturity to those of the employee options.

Notes on the Financial Statements (continued)

The expected US dollar denominated dividend yield was determined to be 4.5% per annum in line with consensus analyst forecasts (2010: 4.5%).

Movement on HSBC share option plans

	Savings-related share option plans		**HSBC Holdings Group Share option plan**	
2011	**Number (000's)**	**Weighted average exercise price £**	**Number (000's)**	**Weighted average exercise price £**
Outstanding at 1 January	**2,581**	**4.09**	**1,769**	**7.07**
Granted during the year	**291**	**5.23**	**-**	**-**
Exercised during the year	**(107)**	**4.93**	**(12)**	**7.27**
Transferred during the year	**(1,056)**	**4.17**	**(577)**	**7.51**
Forfeited and expired in the year	**(161)**	**5.03**	**(294)**	**6.56**
Outstanding at 31 December	**1,548**	**4.13**	**886**	**7.41**
Weighted average fair value of options granted during the year (£)		**1.31**		**-**
Weighted average share price at the date the options were exercised (£)		**5.37**		**5.90**
At 31 December 2011				
Exercise price range (£):		**£3.15-£7.79**	**£6.00-£7.00**	**£7.01-£8.50**
Weighted average remaining contractual life (years)		**2.32**		**-**
Of which exercisable:				
number (000s)		**1,548**	**-**	**886**
weighted average exercise price		**6.88**	**-**	**7.41**

	Savings-related share option plans		HSBC Holdings Group Share option plan	
2010	Number (000's)	Weighted average exercise price £	Number (000's)	Weighted average exercise price £
Outstanding at 1 January	2,749	5.24	1,507	6.85
Granted during the year	425	5.33	-	-
Exercised during the year	(352)	4.01	(11)	6.02
Transferred during the year	(130)	5.57	299	6.89
Forfeited and expired in the year	(111)	4.62	(26)	6.93
Outstanding at 31 December	2,581	4.09	1,769	7.07
Weighted average fair value of options granted during the year (£)		1.59		-
Weighted average share price at the date the options were exercised (£)		6.65		7.07
At 31 December 2010				
Exercise price range (£):		£3.14-£8.14	£6.00-£7.00	£7.26-£8.50
Weighted average remaining contractual life (years)		2.05		-
Of which exercisable:				
number (000s)		2,581	345	1,424
weighted average exercise price		6.56	6.02	7.32

Notes on the Financial Statements (continued)

9 Tax expense

	2011 US$000	2010 US$000
Current tax		
Tax – on current year profit	**131,233**	73,830
Tax – adjustments in respect of prior years	**1,149**	21,471
	132,382	95,301
Deferred tax		
Origination and reversal of temporary differences	**5,656**	17,332
Adjustment in respect of prior years	**(1,548)**	(18,801)
	4,108	(1,469)
Tax expense	**136,490**	93,832

The group provides for taxation at the appropriate rates in the countries in which it operates.

Analysis of tax expense

	2011		2010	
	US$000	**Percentage of profit before tax %**	US$000	Percentage of profit before tax %
Taxation at UAE corporate tax rate of 20% (2010: 20 %)	**177,990**	**20.0**	109,966	19.7
Effect of taxing overseas profit in principal locations at different rates[1]	**(25,419)**	**(2.9)**	(11,888)	(2.1)
Income not subject to tax	**(26,889)**	**(3.0)**	(7,839)	(1.4)
Expenses not deductible for tax purposes	**3,924**	**0.5**	3,423	0.6
Adjustment in respect of prior period liabilities	**4,261**	**0.5**	15,127	2.7
Disallowance of loan impairment charges	**(1,065)**	**(0.2)**	(16,479)	(2.9)
Other items	**3,688**	**0.4**	1,522	0.2
Overall tax expense	**136,490**	**15.3**	93,832	16.8

1 *Overseas profits taxed at different rates to that which applies in the UAE contributed to a decrease in the effective tax rate of 1.5% (2010: decrease of 69.3%). The decrease in the effective tax rate is due to a decrease in the proportion of losses arising in tax free jurisdictions and corporate tax exemptions granted in 2011.*

In addition to the amount charged to the income statement the aggregate amount of deferred taxation, relating to items that are taken directly to equity, was a US$0.9 million decrease in equity (2010: US$4.6 million increase in equity).

The group is subject to income taxes in many jurisdictions and significant judgement is required in estimating the group's provision for income taxes. There are many transactions and interpretations of tax law for which the final outcome will not be established until some time later. The group recognises liabilities for taxation based on estimates of whether additional taxes will be payable. The estimation process includes seeking expert advice where appropriate. Where the final liability for taxation is different from the amounts that were initially recorded, these differences will affect the income tax and deferred taxation provisions in the period in which the estimate is revised or the final liability is established.

Deferred taxation

The following table shows the gross deferred tax assets and liabilities recognised in the balance sheet and the related movements recognised in the income statement, other comprehensive income and directly in equity:

Movement of net deferred tax assets before offsetting balances within countries

	Retirement benefits US$000	Loan impairment allowances US$000	Unused tax losses US$000	Accelerated capital allowances US$000	Available-for-sale investments US$000	Cash flow hedges US$000	Share-based payments US$000	Revaluation of property US$000	Relief for unused tax credits US$000	Other US$000	Total US$000
Assets	-	153,326	3,111	16	(3,139)	3,407	(564)	-	-	17,829	173,986
Liabilities	2,111	-	-	-	(2,765)	-	(504)	(1,906)	(3,193)	(458)	(6,715)
At 1 January 2011	2,111	153,326	3,111	16	(5,904)	3,407	(1,068)	(1,906)	(3,193)	17,371	167,271
Acquisition and disposals	-	-	-	-	2,091	-	572	-	-	-	2,663
Income statement	-	(6,288)	2,807	393	25	-	-	32	-	(1,077)	(4,108)
Other comprehensive income:											
- available-for-sale investment	-	-	-	-	(278)	-	-	-	-	-	(278)
- cash flow hedges	-	-	-	-	-	(4,714)	-	-	-	-	(4,714)
- actuarial losses	4,133	-	-	-	-	-	-	-	-	-	4,133
Equity:											
- share based payments	-	-	-	-	-	-	(1,666)	-	-	-	(1,666)
Foreign exchange and other adjustments	7	(53)	-	(10)	1,339	-	-	-	3,193	(31)	4,445
	6,251	146,985	5,918	399	(2,727)	(1,307)	(2,162)	(1,874)	-	16,263	167,746
Assets	6,251	146,985	5,918	399	(1,026)	(1,307)	-	-	-	16,499	173,719
Liabilities	-	-	-	-	(1,701)	-	(2,162)	(1,874)	-	(236)	(5,973)
At 31 December 2011	6,251	146,985	5,918	399	(2,727)	(1,307)	(2,162)	(1,874)	-	16,263	167,746
Assets	-	166,384	-	(363)	(3,773)	925	111	-	-	10,924	174,208
Liabilities	218	-	-	-	(2,126)	-	(86)	(2,477)	-	-	(4,471)
At 1 January 2010	218	166,384	-	(363)	(5,899)	925	25	(2,477)	-	10,924	169,737
Acquisition and disposals	-	-	-	-	-	-	-	-	-	-	-
Income statement	-	(157)	-	373	46	-	-	571	(3,153)	3,789	1,469
Other comprehensive income:											
- available-for-sale investment	-	-	-	-	248	-	-	-	-	-	248
- cash flow hedges	-	-	-	-	-	2,481	-	-	-	-	2,481
- actuarial losses	1,893	-	-	-	-	-	-	-	-	-	1,893
Equity:											
- share based payments	-	-	-	-	-	-	170	-	-	-	170
Foreign exchange and other adjustments	-	(12,901)	3,111	6	(299)	1	(1,263)	-	(40)	2,658	(8,727)
	2,111	153,326	3,111	16	(5,904)	3,407	(1,068)	(1,906)	(3,193)	17,371	167,271
Assets	-	153,326	3,111	16	(3,139)	3,407	(564)	-	-	17,829	173,986
Liabilities	2,111	-	-	-	(2,765)	-	(504)	(1,906)	(3,193)	(458)	(6,715)
At 31 December 2010	2,111	153,326	3,111	16	(5,904)	3,407	(1,068)	(1,906)	(3,193)	17,371	167,271

Notes on the Financial Statements (continued)

Analysis of deferred tax assets by country

	2011 US$000	2010 US$000
UAE	**162,594**	163,853
Qatar	**-**	-
Rest of Middle East	**11,125**	10,133
	173,719	173,986

10 Dividends

Dividends to shareholders of the parent company were as follows:

	2011		2010	
	US$ per share	**Total US$000**	US$ per share	Total US$000
Dividends declared on ordinary shares	**0.2524**	**235,000**	-	-

During the year, first and second interim dividends for 2011 of US$200 million and US$35 million (2010: nil) were declared on 22 September 2011 and 8 December 2011 and paid on 28 September 2011 and 9 December 2011, respectively.

11 Segment analysis

The factors used to identify the group's reporting segment are discussed in the 'Summary of significant accounting policies' in Note 2(c).

Products and services

The group provides a comprehensive range of banking and related financial services to its customers in its geographical regions. The products and services offered to customers are organised by customer group and global business.

- Retail Banking and Wealth Management (formerly 'Personal Financial Services') offers a broad range of products and services to meet the personal banking need, consumer finance and wealth management needs of individual customers. Personal banking products typically include current and savings accounts, mortgages and personal loans, credit cards, insurance, wealth management and local and international payment services.
- Commercial Banking product offerings include the provision of financing services, payments and cash management, international trade finance, treasury and capital markets, commercial cards, insurance, wealth management and investment banking services.
- Global Banking and Markets provide tailored financial solutions to government, corporate and institutional clients. The client focused business lines deliver a full range of banking capabilities including investment banking and financing solutions; a markets business that provides services in credit, rates, foreign exchange, money markets and securities services; global asset management and principle investment activities.
- Private Banking provides a range of services to meet the banking, investment and wealth advisory needs of high net worth individuals.

Notes on the Financial Statements (continued)

Financial information

Profit/ (loss) for the year

	UAE US$000	Qatar US$000	Rest of Middle East US$000	Intra-group items US$000	Total US$000
2011					
Net interest income	**745,985**	**107,586**	**279,760**	**–**	**1,133,331**
Net fee income	**344,824**	**72,554**	**122,334**	**–**	**539,712**
Net trading income	**270,833**	**43,330**	**79,075**	**–**	**393,238**
Other operating income	**130,274**	**1,997**	**2,513**	**(86,587)**	**48,197**
Net operating income before loan impairment charges and other credit risk provisions	**1,491,916**	**225,467**	**483,682**	**(86,587)**	**2,114,478**
Loan impairment charges and other credit risk provisions	**(211,535)**	**(14,193)**	**(21,257)**	**–**	**(246,985)**
Net operating income	**1,280,381**	**211,274**	**462,425**	**(86,587)**	**1,867,493**
Total operating expenses	**(719,494)**	**(99,067)**	**(249,033)**	**86,587**	**(981,007)**
Operating profit	**560,887**	**112,207**	**213,392**	**–**	**886,486**
Share of profit in associates	**3,465**	**–**	**–**	**–**	**3,465**
Profit before tax	**564,352**	**112,207**	**213,392**	**–**	**889,951**
By global business:					
Retail Banking and Wealth Management	**134,457**	**(4,326)**	**6,400**	**–**	**136,531**
Commercial Banking	**240,103**	**35,238**	**112,510**	**–**	**387,851**
Global Banking and Markets	**186,052**	**81,295**	**94,482**	**–**	**361,829**
Global Private Banking	**(5,615)**	**–**	**–**	**–**	**(5,615)**
Other[1]	**9,355**	**–**	**–**	**–**	**9,355**
2010					
Net interest income	710,022	149,565	260,487	–	1,120,074
Net fee income	391,486	70,712	119,402	–	581,600
Net trading income	202,631	31,076	65,219	–	298,926
Other operating income	52,188	644	3,591	(61,156)	(4,733)
Net operating income before loan impairment charges and other credit risk provisions	1,356,327	251,997	448,699	(61,156)	1,995,867
Loan impairment charges and other credit risk provisions	(384,888)	(25,449)	(123,405)	–	(533,742)
Net operating income	971,439	226,548	325,294	(61,156)	1,462,125
Total operating expenses	(668,261)	(88,813)	(216,375)	61,156	(912,293)
Operating profit	303,178	137,735	108,919	–	549,832
Share of profit in associates	8,813	–	–	–	8,813
Profit before tax	311,991	137,735	108,919	–	558,645
By global business:					
Retail Banking and Wealth Management	17,461	18,596	17,584	–	53,641
Commercial Banking	186,047	52,033	75,865	–	313,945
Global Banking and Markets	107,554	67,106	15,470	–	190,130
Global Private Banking	903	–	–	–	903
Other[1]	26	–	–	–	26

1 *The main items reported in the 'Other' category are movements in fair value of own debt.*

Notes on the Financial Statements (continued)

Performance ratios

	UAE %	Qatar %	Rest of Middle East %	Total %
Year ended 31 December 2011				
Share of the group's profit before tax	**63.4**	**12.6**	**24.0**	**100.0**
Cost efficiency ratio	**48.2**	**43.9**	**51.5**	**46.4**
Year ended 31 December 2010				
Share of the group's profit before tax	55.8	24.7	19.5	100.0
Cost efficiency ratio	49.3	35.2	48.2	45.7

Balance sheet information

	UAE US$000	Qatar US$000	Rest of Middle East US$000	Intra-group items US$000	Total US$000
Year ended 31 December 2011					
Loans and advances to customers (net)	**14,923,744**	**1,787,881**	**4,849,236**	**–**	**21,560,861**
Interest in associates	**35,189**	**–**	**–**	**–**	**35,189**
Total assets	**31,738,840**	**5,078,987**	**11,637,478**	**(3,149,661)**	**45,305,644**
Customer accounts	**18,192,687**	**2,795,789**	**7,837,856**	**–**	**28,826,332**
Total liabilities	**27,231,744**	**5,057,028**	**11,636,060**	**(3,149,661)**	**40,775,171**
Year ended 31 December 2010					
Loans and advances to customers (net)	13,982,792	1,716,331	4,887,589	–	20,586,712
Investment in associates	29,337	–	–	–	29,337
Total assets	28,440,704	5,509,230	10,601,050	(2,956,561)	41,594,423
Customer accounts	16,376,930	3,068,743	6,898,307	–	26,343,980
Total liabilities	24,521,133	5,504,587	10,596,666	(2,956,561)	37,665,825

Other financial information

Net operating income by global business

	Retail Banking and Wealth Management US$000	Commercial Banking US$000	Global Banking and Markets US$000	Private Banking US$000	Other US$000	Inter Segment US$000	Total US$000
Year ended 31 December 2011							
Net operating income:	**559,351**	**655,214**	**618,657**	**24,743**	**96,115**	**(86,587)**	**1,867,493**
External	**420,472**	**788,154**	**710,646**	**14,576**	**(66,355)**	**–**	**1,867,493**
Inter-segment	**138,879**	**(132,940)**	**(91,989)**	**10,167**	**162,470**	**(86,587)**	**–**
Year ended 31 December 2010							
Net operating income:	487,176	553,935	417,351	27,197	37,622	(61,156)	1,462,125
External	347,056	651,191	517,871	18,883	(72,876)	–	1,462,125
Inter-segment	140,120	(97,256)	(100,520)	8,314	110,498	(61,156)	–

Notes on the Financial Statements (continued)

Information by country

	31 December 2011		31 December 2010	
	External net operating income[1] US$000	**Non-current assets[2] US$000**	External net operating income[1] US$000	Non-current assets[2] US$000
UAE	**1,196,814**	**100,612**	912,016	110,952
Qatar	**211,275**	**12,671**	226,404	14,598
Rest of Middle East	**459,404**	**39,284**	323,705	40,901
TOTAL	**1,867,493**	**152,567**	1,462,125	166,451

1 *External net operating income is attributed to countries on the basis of the location of the branch responsible for reporting the results or advancing the funds.*
2 *Non current assets consist of property, plant and equipment, other intangible assets and certain other assets expected to be recovered more than twelve months after the reporting period.*

12 Analysis of financial assets and liabilities by measurement basis

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting policies in Note 2 (d) describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of the financial assets and liabilities by category as defined in IAS 39 and by balance sheet heading.

Notes on the Financial Statements (continued)

	At 31 December 2011					
	Held for trading US$000	Designated at fair value US$000	Available-for-sale securities US$000	Financial assets and liabilities at amortised cost US$000	Derivatives designated as cash flow hedging instruments US$000	Total US$000
Financial assets						
Cash and balances at central banks	-	-	-	916,324	-	916,324
Items in the course of collection from other banks	-	-	-	84,478	-	84,478
Trading assets	855,781	-	-	-	-	855,781
Derivatives	1,262,462	-	-	-	7,526	1,269,988
Loans and advances to banks	-	-	-	8,076,477	-	8,076,477
Loans and advances to customers	-	-	-	21,560,861	-	21,560,861
Financial investments	-	-	10,329,413	-	-	10,329,413
Other assets	-	-	-	1,405,119	-	1,405,119
Accrued income	-	-	-	178,003	-	178,003
Total financial assets	2,118,243	-	10,329,413	32,221,262	7,526	44,676,444
Total non-financial assets						629,200
Total assets						45,305,644
Financial liabilities						
Deposits by banks	-	-	-	2,080,192	-	2,080,192
Customer accounts	-	-	-	28,826,332	-	28,826,332
Items in the course of transmission to other banks	-	-	-	289,995	-	289,995
Trading liabilities	757,274	-	-	-	-	757,274
Financial liabilities designated at fair value	-	507,830	-	-	-	507,830
Derivatives	1,231,232	-	-	-	-	1,231,232
Debt securities in issue	-	-	-	4,398,163	-	4,398,163
Other liabilities	-	-	-	2,194,777	-	2,194,777
Accruals	-	-	-	92,884	-	92,884
Total financial liabilities	1,988,506	507,830	-	37,882,343	-	40,378,679
Total non-financial liabilities						396,492
Total liabilities						40,775,171

Notes on the Financial Statements (continued)

	At 31 December 2010					
	Held for trading US$000	Designated at fair value US$000	Available-for-sale securities US$000	Financial assets and liabilities at amortised cost US$000	Derivatives designated as cash flow hedging instruments US$000	Total US$000
Financial assets						
Cash and balances at central banks	-	-	-	719,363	-	719,363
Items in the course of collection from other banks	-	-	-	61,085	-	61,085
Trading assets	718,676	-	-	-	-	718,676
Derivatives	826,578	-	-	-	-	826,578
Loans and advances to banks	-	-	-	8,229,772	-	8,229,772
Loans and advances to customers	-	-	-	20,586,712	-	20,586,712
Financial investments	-	-	8,667,721	-	-	8,667,721
Other assets	-	-	-	1,266,916	-	1,266,916
Accrued income	-	-	-	173,903	-	173,903
Total financial assets	1,545,254	-	8,667,721	31,037,751	-	41,250,726
Total non-financial assets						343,697
Total assets						41,594,423
Financial liabilities						
Deposits by banks	-	-	-	1,547,700	-	1,547,700
Customer accounts	-	-	-	26,343,980	-	26,343,980
Items in the course of transmission to other banks	-	-	-	766,308	-	766,308
Trading liabilities	121,733	-	-	-	-	121,733
Derivatives	818,880	-	-	-	15,926	834,806
Debt securities in issue	-	-	-	5,688,545	-	5,688,545
Other liabilities	-	-	-	1,900,061	-	1,900,061
Accruals	-	-	-	104,692	-	104,692
Total financial liabilities	940,613	-	-	36,351,286	15,926	37,307,825
Total non-financial liabilities						358,000
Total liabilities						37,665,825

Notes on the Financial Statements (continued)

13 Trading assets

	2011	2010
	US$000	US$000
Trading assets:		
– not subject to repledge or resale by counterparties	**855,781**	718,676
	855,781	718,676
Debt securities	**601,587**	452,016
Equity securities	**-**	207,161
Treasury and other eligible bills	**37,781**	45,494
Loans and advances to banks	**199,978**	-
Loans and advances to customers	**16,435**	14,005
	855,781	718,676

14 Derivatives

Fair values of derivatives by product contract type held by the group

	Assets			**Liabilities**		
	Trading	**Hedging**	**Total**	**Trading**	**Hedging**	**Total**
At 31 December 2011	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**	**US$000**
Foreign exchange	**432,461**	**–**	**432,461**	**413,689**	**–**	**413,689**
Interest rate	**713,078**	**7,526**	**720,604**	**707,578**	**–**	**707,578**
Equity	**5,127**	**–**	**5,127**	**5,129**	**–**	**5,129**
Credit	**109,369**	**–**	**109,369**	**101,845**	**–**	**101,845**
Commodity and other	**2,427**	**–**	**2,427**	**2,991**	**–**	**2,991**
Total	**1,262,462**	**7,526**	**1,269,988**	**1,231,232**	**–**	**1,231,232**

	Assets			Liabilities		
	Trading	Hedging	Total	Trading	Hedging	Total
At 31 December 2010	US$000	US$000	US$000	US$000	US$000	US$000
Foreign exchange	354,311	-	354,311	335,134	-	335,134
Interest rate	408,464	-	408,464	429,146	15,926	445,072
Equity	17,416	-	17,416	17,416	-	17,416
Credit	40,317	-	40,317	35,344	-	35,344
Commodity and other	6,070	-	6,070	1,840	-	1,840
Total	826,578	-	826,578	818,880	15,926	834,806

Use of derivatives:

The group transacts derivatives for three primary purposes: to create risk management solutions for clients, to manage the portfolio risks arising from client business and to manage and hedge the group's own risks. Derivatives (except for derivatives which are designated as effective hedging instruments as defined in IAS 39) are held for trading. The held for trading classification includes two types of derivatives: those used in sales and trading activities, and those used for risk management purposes but which for various reasons do not meet the qualifying criteria for hedge accounting. The second category includes derivatives managed in conjunction with financial instruments designated at fair value. These activities are described more fully below.

The group's derivative activities give rise to significant open positions in portfolios of derivatives. These positions are managed constantly to ensure that they remain within acceptable risk levels, with matching deals being used to achieve this where necessary. When entering into derivative transactions, the group employs the same credit risk management procedures to assess and approve potential credit exposures that are used for traditional lending.

Trading derivatives:

Most of the group's derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities in derivatives are entered into principally for the purpose of generating profits from short-term fluctuations in price or margin. Positions may be traded actively or be held over a period of

Notes on the Financial Statements (continued)

time to benefit from expected changes in exchange rates, interest rates, equity prices or other market parameters. Trading includes market-making, positioning and arbitrage activities. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume; positioning means managing market risk positions in the expectation of benefiting from favourable movements in prices, rates or indices; arbitrage involves identifying and profiting from price differentials between markets and products.

As mentioned above, other derivatives classified as held-for-trading include non-qualifying hedging derivatives, ineffective hedging derivatives and the components of hedging derivatives that are excluded from assessing hedge effectiveness. Non-qualifying hedging derivatives are entered into for risk management purposes but do not meet the criteria for hedge accounting. These include derivatives managed in conjunction with financial instruments designated at fair value.

Gains and losses from changes in the fair value of derivatives, including the contractual interest, that do not qualify for hedge accounting are reported in 'Net trading income', except for derivatives managed in conjunction with financial instruments designated at fair value, where gains and losses are reported in 'Net income from financial instruments designated at fair value', together with the gains and losses on the economically hedged items. Where the derivatives are managed with debt securities in issue, the contractual interest is shown in 'interest expense' together with the interest payable on the issued debt.

The notional or contractual amounts of these instruments indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Notional contract amounts of derivatives held for trading purposes by product type

	2011	2010
	US$000	US$000
Foreign exchange	**50,978,510**	40,768,090
Interest rate	**37,272,862**	25,481,493
Equity	**472,101**	751,405
Credit	**5,425,159**	2,628,405
Commodity and other	**390,717**	144,244
	94,539,349	69,773,637

Credit derivatives:

The group trades credit derivatives and acts as a principal counterparty to a broad range of users, structuring deals to produce risk management products for its customers, or making markets in certain products. Risk is typically controlled through entering into offsetting credit derivative contracts with other counterparties.

The group manages the credit risk arising on buying and selling credit derivative protection by including the related credit exposures within its overall credit limit structure for the relevant counterparty. Trading of credit derivatives is restricted to a small number of offices which have the control infrastructure and market skills to manage effectively the credit risk inherent in the products.

Derivatives valued using models with unobservable inputs

The difference between the fair value at initial recognition (the transaction price) and the value that would have been derived had valuation techniques used for subsequent measurement been applied at initial recognition, less subsequent releases, is as follows:

Notes on the Financial Statements (continued)

Unamortised balance of derivatives valued using models with unobservable inputs

	2011	2010
	US$000	US$000
Unamortised balance at 1 January	**743**	14,132
Deferral on new transactions	**1,669**	2,006
Recognised in the income statement during the period:		
– amortisation	**(114)**	–
– subsequent to unobservable inputs becoming observable	–	(237)
Risk hedged	–	(15,158)
Unamortised balance at 31 December[1]	**2,298**	743

1 *This amount is yet to be recognised in the consolidated income statement.*

Hedging instruments:

The group uses derivatives (principally interest rate swaps) for hedging purposes in the management of its own asset and liability portfolios and structural positions. This enables the group to optimise the overall cost to the group of accessing debt capital markets, and to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities.

The accounting treatment of hedge transactions varies according to the nature of the instrument hedged and the type of hedge transactions. Derivatives may qualify as hedges for accounting purposes if they are fair value hedges, cash flow hedges, or hedges in net investment of foreign operations. These are described under the relevant headings below.

The notional contract amounts of derivatives held for hedging purposes indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Notional contract amounts of derivatives held for hedging purposes by product type

	At 31 December 2011		At 31 December 2010	
	Cash flow hedge	**Fair value hedge**	Cash flow hedge	Fair value hedge
	US$000	**US$000**	US$000	US$000
Interest rate	**499,946**	–	499,918	-

Cash flow hedges

The group's cash flow hedges consist principally of interest rate and cross-currency swaps that are used to protect against exposures to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio of financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedges of forecast transactions. Gains and losses are initially recognised in other comprehensive income, and accumulated in the cash flow hedging reserve, and are transferred to the income statement when the forecast cash flows affect the income statement.

Notes on the Financial Statements (continued)

Fair value of derivatives designated as cash flow hedges

	At 31 December 2011		At 31 December 2010	
	Assets	**Liabilities**	Assets	Liabilities
	US$000	**US$000**	US$000	US$000
Interest rate	**7,526**	**–**	–	15,926

Forecast principal balances on which interest cash flows are expected to arise

	3 months or less	More than 3 months but less than 1 year	5 years or less but more than 1 year	More than 5 years
	US$000	**US$000**	**US$000**	**US$000**
At 31 December 2011				
Assets	**499,946**	**499,946**	**499,946**	**–**
Liabilities	**–**	**–**	**–**	**–**
Net cash inflow exposure	**499,946**	**499,946**	**499,946**	**–**
At 31 December 2010				
Assets	499,918	499,918	499,918	–
Liabilities	–	–	–	–
Net cash inflow exposure	499,918	499,918	499,918	–

This table reflects the interest rate repricing profile of the underlying hedged items.

The gains and losses on ineffective portions of such derivatives are recognised immediately in 'Net trading income'. During the years ended 31 December 2011 and 31 December 2010, no gains or losses were recognised due to hedge ineffectiveness.

15 Financial investments

	2011	2010
	US$000	US$000
Financial investments:		
– not subject to repledge or resale by counterparties	**10,329,413**	8,667,721

	2011	2010
	US$000	US$000
Treasury and other eligible bills		
– available-for-sale	**1,793,482**	283,787
Debt securities		
– available-for-sale	**8,397,340**	8,265,287
Equity securities		
– available-for-sale	**138,591**	118,647
Total financial investments	**10,329,413**	8,667,721

Notes on the Financial Statements (continued)

16 Interests in associates

Principal associates of the group

	At 31 December 2011			
	Country of incorporation	**Principal activity**	**The group's interest in equity capital**	**Issued equity capital**
Arabian Real Estate Investment Trust Management Limited	Cayman Islands	Real Estate	42.23%	US$4.4 million fully paid
HSBC Middle East Leasing Partnership	Dubai, UAE	Leasing	15.00%	US$10 million fully paid
MENA Infrastructure Fund (GP) Limited	Dubai, UAE	Private Equity fund management	33.33%	US$0.99 million fully paid
MENA Holdings Limited	Cayman Islands	Petrochemical by-product	33.33%	US$ 5.4 million fully paid
Rewards Management Middle East Free Zone Limited Liability Company	Dubai, UAE	Multi-participant loyalty programmes	40.00%	AED 0.5million

The group's share of associates' contingent liabilities amounted to US$ nil at 31 December 2011 (2010: nil).

The associates are unlisted.

Arabian Real Estate Investment Trust Management Limited, HSBC Middle East Leasing Partnership and MENA Infrastructure Fund (GP) Limited operate in Dubai, UAE.

Rewards Management Middle East Free Zone Limited Liability Company operates in Dubai, UAE and Qatar.

MENA Holdings Limited operates in Cayman Islands.

HSBC Middle East Leasing Partnership is treated as an associate reflecting the significant influence over the company established as a result of representation on the Board of Directors.

Summarised aggregate financial information on associates

The group's share of:

	2011	2010
	US$000	US$000
Assets	**44,078**	41,141
Liabilities	**8,889**	7,608
Revenue	**4,924**	21,818
Profit after tax	**3,465**	8,813

Movement in investment in associates:

	2011	2010
	US$000	US$000
At 1 January	**29,337**	170,284
Additions	**100**	50
Transfer to held for sale assets	**-**	(131,821)
Share of results	**3,465**	8,813
Dividends	**(1,102)**	(1,987)
Impairment	**(100)**	(144)
Exchange and other movements	**3,489**	(15,858)
At 31 December	**35,189**	29,337

Notes on the Financial Statements (continued)

17 Intangible assets

Movement of intangible assets

	Internally generated software US$000	Purchased software US$000	Total US$000
Cost			
At 1 January 2011	**28,180**	**11,412**	**39,592**
Additions[1]	**4,639**	**1,922**	**6,561**
Disposals	**(169)**	**(447)**	**(616)**
Exchange differences	**–**	**2**	**2**
Other changes	**(1,233)**	**–**	**(1,233)**
At 31 December 2011	**31,417**	**12,889**	**44,306**
Accumulated amortisation			
At 1 January 2011	**(17,527)**	**(8,772)**	**(26,299)**
Charge for the year[2]	**(4,032)**	**(1,794)**	**(5,826)**
Impairment	**–**	**–**	**–**
Disposals	**–**	**428**	**428**
Other changes	**53**	**(287)**	**(234)**
At 31 December 2011	**(21,506)**	**(10,425)**	**(31,931)**
Net carrying amount at 31 December 2011[3]	**9,911**	**2,464**	**12,375**
Cost			
At 1 January 2010	18,595	10,780	29,375
Additions[1]	5,180	632	5,812
Disposals	–	–	–
Exchange differences	–	–	–
Other changes	4,405	–	4,405
At 31 December 2010	28,180	11,412	39,592
Accumulated amortisation			
At 1 January 2010	(12,885)	(6,851)	(19,736)
Charge for the year[2]	(4,642)	(1,968)	(6,610)
Impairment	–	–	–
Disposals	–	–	–
Other changes	–	47	47
At 31 December 2010	(17,527)	(8,772)	(26,299)
Net carrying amount at 31 December 2010	10,653	2,640	13,293

1 *At 31 December 2011, the group did not have any contractual commitments to acquire intangible assets (2010: nil).*
2 *The amortisation and impairment charges for the year are recognised within the income statement under 'Amortisation and impairment of intangible assets'.*
3 *There are no intangible assets whose title is restricted and/or pledged as security for liabilities*

Notes on the Financial Statements (continued)

18 Property, plant and equipment

	Freehold land and buildings US$000	Short leasehold land and buildings US$000	Equipment, fixtures and fittings US$000	Total US$000
Cost or fair value				
At 1 January 2011	**42,709**	**83,921**	**126,493**	**253,123**
Additions at cost[1]	**162**	**3,767**	**7,485**	**11,414**
Disposals	**(46)**	**(6,696)**	**(7,592)**	**(14,334)**
Exchange differences	**39**	**3**	**(442)**	**(400)**
Other changes	**(225)**	**(2,082)**	**2,293**	**(14)**
Reclassified as held for sale	**(1,321)**	**–**	**(196)**	**(1,517)**
At 31 December 2011	**41,318**	**78,913**	**128,041**	**248,272**
Accumulated depreciation				
At 1 January 2011	**(1,674)**	**(35,977)**	**(91,651)**	**(129,302)**
Depreciation charge for the year	**(1,201)**	**(8,058)**	**(14,521)**	**(23,780)**
Disposals	**8**	**2,869**	**6,798**	**9,675**
Impairment losses recognised	**–**	**–**	**(636)**	**(636)**
Exchange differences	**(14)**	**(2)**	**299**	**283**
Other changes	**389**	**(307)**	**(13)**	**69**
Reclassified as held for sale	**250**	**–**	**172**	**422**
At 31 December 2011	**(2,242)**	**(41,475)**	**(99,552)**	**(143,269)**
Net carrying amount at 31 December 2011	**39,076**	**37,438**	**28,489**	**105,003**
Cost or fair value				
At 1 January 2010	51,624	67,181	127,341	246,146
Additions at cost[1]	303	14,993	10,379	25,675
Disposals	–	(2,627)	(2,316)	(4,943)
Exchange differences	(38)	16	(147)	(169)
Other changes	–	4,358	(8,764)	(4,406)
Reclassified as held for sale	(9,180)	–	–	(9,180)
At 31 December 2010	42,709	83,921	126,493	253,123
Accumulated depreciation				
At 1 January 2010	(626)	(29,527)	(78,326)	(108,479)
Depreciation charge for the year	(1,633)	(7,367)	(14,636)	(23,636)
Disposals	94	1,080	1,288	2,462
Impairment losses recognised	(5,086)	–	–	(5,086)
Exchange differences	6	(13)	73	66
Other changes	148	(150)	(50)	(52)
Reclassified as held for sale	5,423	–	–	5,423
At 31 December 2010	(1,674)	(35,977)	(91,651)	(129,302)
Net carrying amount at 31 December 2010	41,035	47,944	34,842	123,821

1 *At 31 December 2011, the group had US$1.9 million (2010:nil) of contractual commitments to acquire property, plant and equipment.*

Notes on the Financial Statements (continued)

Included within 'Short leasehold land and buildings' are the following amounts in respect of assets classed as improvements to buildings, which are carried at depreciated historical cost:

	2011		2010	
	Cost	*Accumulated depreciation*	*Cost*	*Accumulated depreciation*
	US$000	**US$000**	US$000	US$000
At 1 January	**74,347**	**(34,060)**	62,407	(31,034)
Additions	**2,676**	**–**	9,976	–
Disposals	**(3,069)**	**–**	(2,400)	–
Depreciation charge for the year	**–**	**(3,650)**	–	(3,023)
Exchange differences	**3**	**3**	10	(3)
Other changes	**(2,307)**	**–**	4,354	–
At 31 December	**71,650**	**(37,707)**	74,347	(34,060)
Net carrying amount at 31 December	**33,943**		40,287	

19 Investments in subsidiaries

Subsidiary undertakings of the bank

	Country of Incorporation or registration	**Bank's interest in equity capital**
		%
HSBC Bank Middle East Nominees W.L.L.	Bahrain	95%
HSBC Financial Services (Middle East) Limited	Dubai, UAE	100%
HSBC Middle East Finance Company Limited	Dubai, UAE	80%
HSBC Middle East Securities LLC	Dubai, UAE	100%
HSBC Insurance Services (Lebanon) S.A.L.	Lebanon	100%

All the above make their financial statements up to 31 December.

The subsidiary undertakings are directly owned and are included in the consolidated financial statements of the group.

The countries of operation are the same as the countries of incorporation.

The subsidiary undertakings are unlisted.

In order to comply with local legal requirements, the ownership of the investment in HSBC Middle East Securities LLC is held 49.00% in the name of the bank and 51.00% in the personal name of Mr Abdul Wahid Al Ulama, as nominee. Under a Memorandum of Understanding, the nominee has transferred his legal and/or beneficial interest in HSBC Middle East Securities LLC to the bank. The total book value of the assets and equity and liabilities of HSBC Middle East Securities LLC amount to US$ 4,639 thousand (2010: US$7,601 thousand).

HSBC Financial Services (Middle East) Limited has a 100% subsidiary, HSBC Private Equity Middle East Limited, a limited liability company incorporated in British Virgin Islands. HSBC Private Equity Middle East Limited in turn owns 100% subsidiaries, HSBC Private Equity Middle East Management Limited and HSBC Private Equity Middle East Management 2 Limited, limited liability companies incorporated in British Virgin Islands. These companies manage HSBC Private Equity Middle East LP ("LP") and HSBC Private Equity Middle East LP 2 ("LP2") respectively.

Special purpose entities ('SPEs') consolidated where the group owns less than 50% of the voting rights at 31 December 2011:

	Carrying value of total consolidated assets US$000	**Nature of SPE**
HSBC Private Equity Middle East LP	100,651	Private equity fund
HSBC Private Equity Middle East LP II	304,805	Private equity fund
HBME Sukuk Company Limited	590,000	Corporate debt issuer

All of the above make their financial statements up to 31 December.

Notes on the Financial Statements (continued)

20 Other assets

	2011 US$000	2010 US$000
Assets held for sale	**302,160**	3,077
Endorsements and acceptances	**1,311,109**	1,201,496
Other accounts	**94,010**	65,420
	1,707,279	1,269,993

Assets held for sale

	2011 US$000	2010 US$000
Disposal group	**301,923**	–
Non-current assets held for sale		
- property, plant and equipment	**237**	3,077
Total assets held for sale	**302,160**	3,077

Disposal group

At 31 December 2011, the disposal group related to the sale of a majority interest in the private equity fund management business to the unit's senior management team. The transaction is expected to be completed in the first half of 2012. Associated liabilities of US$51.6 million are included in 'Other Liabilities'.

Property, plant and equipment

The property, plant and equipment classified as held for sale is a result of repossession of property and motor vehicles that had been pledged as collateral by customers. No fair value is calculated for repossessed properties. Repossessed motor vehicles are held at fair value. Gains and losses recognised on impairment of these assets to fair value are reported in 'Loan impairment charges'.

21 Trading liabilities

	2011 US$000	2010 US$000
Debt securities in issue	**707,711**	54,456
Other liabilities – net short positions	**49,563**	67,277
	757,274	121,733

22 Financial liabilities designated at fair value

	2011 US$000	2010 US$000
Debt securities in issue	**507,830**	–

At 31 December 2011, the accumulated amount of change in fair value attributable to changes in credit risk was a loss of US$13.7 million (2010: nil).

Notes on the Financial Statements (continued)

23 Debt securities in issue

	2011		2010	
	Carrying amount US$000	**Fair value US$000**	Carrying amount US$000	Fair value US$000
Medium term notes	**4,463,704**	**4,472,043**	4,393,001	4,327,379
Other debt securities in issue	**–**	**–**	–	-
Non-equity preference shares	**1,150,000**	**983,004**	1,350,000	1,337,592
	5,613,704	**5,455,047**	5,743,001	5,664,971
Of which debt securities in issue reported as				
- trading liabilities (see Note 21)	**(707,711)**	**(707,711)**	(54,456)	(54,456)
- financial liabilities designated at fair value (see Note 22)	**(507,830)**	**(507,830)**	–	–
	4,398,163	**4,239,506**	5,688,545	5,610,515

Certain debt securities in issue are managed on a fair value basis as part of the group's interest rate risk management policies. The hedged portion of these debt securities is presented within the balance sheet caption 'Financial liabilities designated at fair value', with the remaining portion included within 'Trading liabilities'.

Non-equity preference share capital

Authorised

The authorised non-equity preference share capital of the bank at 31 December 2011 was 1,350,000 (2010: 1,350,000) cumulative redeemable preference shares of US$1.00 each and 1,150,000 (2010: 1,150,000) non-cumulative redeemable preference shares of US$1.00 each.

Issued

Perpetual cumulative redeemable preference shares

Issue number	Issue Date	Perpetual cumulative redeemable preference shares	Cumulative redeemable preference dividends	Redeemable at the option of the bank on any date after
		Number	**%**	**Date**
1	29 October 1997	50,000	12 month US dollar LIBOR + 0.35	31 October 2002
2	01 April 1998	25,000	12 month US dollar LIBOR + 0.70	02 April 2003
6	14 March 2006	150,000	12 month US dollar LIBOR + 0.65	15 March 2011

1 The perpetual cumulative redeemable preference shares have been issued at a nominal value of US$1 each with a premium of US$999 per share.

2 Cumulative redeemable preference dividends are payable annually on the issue price of each perpetual share.

3 The perpetual cumulative redeemable preference shares bear no mandatory redemption date. On redemption, the holders of the shares shall be entitled to receive an amount equal to any accrued but unpaid dividends plus the issue price of each share.

4 Each share carries one vote at meetings of the shareholders of the bank.

5 In the event of a winding up, the US dollar preference shareholders would receive, in priority to the ordinary shareholders of the bank, repayment of US$1,000 per share, plus an amount equal to any accrued but unpaid dividends. With the exception of the above, the preference shares do not carry any right to participate in the surplus of assets on a winding up.

Notes on the Financial Statements (continued)

Dated cumulative redeemable preference shares:

Issue number	Issue date	Dated cumulative redeemable preference shares	Cumulative redeemable preference dividends	Redeemable at the option of the bank on any date after	Earliest redemption date (other than at the bank's option)
		Number	%	Date	Date
6	14 March 2006	100,000	12 month US dollar LIBOR + 0.40	14 March 2011	14 March 2016
7	20 June 2007	100,000	12 month US dollar LIBOR + 0.33	20 June 2012	20 June 2017
8	28 April 2008	200,000	12 month US dollar LIBOR + 2.34	28 April 2013	28 April 2018
9	31 July 2008	300,000	6.70 fixed rate	31 July 2013	31 July 2018

On 19 December 2011 the bank redeemed two tranches of 100,000 cumulative redeemable preference shares of US$1.00 each (the "Fourth and Fifth Issues") issued at a premium of US$999.00 per share.

The bank has resolved to redeem 100,000 cumulative redeemable preference shares of US$1.00 each (the 'Sixth Issue'), issued at a premium of US$999.00 per share, on 14 March 2012.

1 *The dated cumulative redeemable preference shares have been issued at a nominal value of US$1 each with a premium of US$999 per share.*

2 *Cumulative redeemable preference dividends are payable annually on the issue price of each dated share.*

3 *Redemption of the dated cumulative redeemable preference shares, other than at the option of the bank, will be subject to the approval of the ordinary shareholders of the bank. The earliest redemption date is as disclosed in the table above and if not approved by the shareholders will next fall for review at 10 yearly intervals thereafter. However, the shares may be redeemed at the option of the Bank without the approval of the ordinary shareholders of the bank. On redemption, the holders of the shares shall be entitled to receive an amount equal to any accrued but unpaid dividends plus the issue price of each share.*

4 *Each share carries one vote at meetings of the shareholders of the bank.*

5 *In the event of a winding up, the US dollar preference shareholders would receive, in priority to the ordinary shareholders of the bank, repayment of US$1,000 per share, plus an amount equal to any accrued but unpaid dividends. With the exception of the above, the preference shares do not carry any right to participate in the surplus of assets on a winding up.*

Dated non-cumulative redeemable preference shares:

Issue number	Issue date	Dated cumulative redeemable preference shares	Cumulative redeemable preference dividends	Redeemable at the option of the bank on any date after	Earliest redemption date (other than at the bank's option)
		Number	%	Date	Date
10	30 December 2009	225,000	12 month US dollar LIBOR + 6.80	30 December 2014	30 December 2019

1 *The dated non-cumulative redeemable preference shares have been issued at a nominal value of US$1 each with a premium of US$999 per share.*

2 *Non-cumulative redeemable preference dividends are payable annually on the issue price of each dated share.*

3 *Redemption of the dated cumulative redeemable preference shares, other than at the option of the bank, will be subject to the approval of the ordinary shareholders of the bank. The earliest redemption date is as disclosed in the table above and if not approved by the shareholders will next fall for review at 10 yearly intervals thereafter. However, the shares may be redeemed at the option of the bank without the approval of the ordinary shareholders of the bank. On redemption, the holders of the shares shall be entitled to receive an amount equal to any accrued but unpaid dividends plus the issue price of each share.*

4 *Each share carries one vote at meetings of the shareholders of the bank.*

5 *As regards dividends and on a winding up of the company as regards capital, the non-cumulative preference shares shall rank after the undated and dated cumulative preference shares already in issue and ahead of the ordinary shares.*

Notes on the Financial Statements (continued)

24 Other liabilities

	2011 US$000	2010 US$000
Share based payments liability to HSBC Holdings plc	**41,373**	11,172
Obligations under finance leases	**-**	9,180
Endorsements and acceptances	**1,311,109**	1,201,496
Other liabilities	**889,052**	702,876
	2,241,534	1,924,724

25 Provisions

	2011 US$000	2010 US$000
At 1 January	**15,372**	11,089
Additional provisions/increase in provisions	**2,189**	7,704
Provisions utilised	**(1,700)**	(383)
Amounts reversed	**(85)**	(5,084)
Exchange differences and other movements	**4,101**	2,046
At 31 December	**19,877**	15,372

Provisions include US$9,534 thousand (2010: US$8,677 thousand) relating to legal proceedings, investigations and regulatory matters, US$740 thousand (2010: US$1,096 thousand) relating to costs arising from contingent liabilities and contractual commitments; and US$9,603 thousand (2010: US$5,599 thousand) relating to provisions for onerous property contracts.

26 Fair value of financial instruments

The classification of financial instruments is determined in accordance with the accounting policies set out in Note 2 (j). The use of assumptions and estimation in valuing financial instruments is described below.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. The following table sets out the financial instruments carried at fair value.

Financial instruments carried at fair value and bases of valuation

		Valuation techniques:		
	Quoted market price Level 1 US$000	Using observable inputs Level 2 US$000	With significant non-observable inputs Level 3 US$000	Total US$000
At 31 December 2011				
Assets				
Trading assets	**46,561**	**601,509**	**207,711**	**855,781**
Derivatives	**-**	**1,265,229**	**4,759**	**1,269,988**
Financial investments: available-for-sale	**250,470**	**9,522,205**	**556,738**	**10,329,413**
Liabilities				
Trading liabilities	**-**	**757,274**	**-**	**757,274**
Financial liabilities designated at fair value	**507,830**	**-**	**-**	**507,830**
Derivatives	**-**	**1,228,601**	**2,631**	**1,231,232**
At 31 December 2010				
Assets				
Trading assets	86,160	441,939	190,577	718,676
Derivatives	-	824,123	2,455	826,578
Financial investments: available-for-sale	80,517	8,074,059	513,145	8,667,721
Liabilities				
Trading liabilities	-	121,733	-	121,733
Financial liabilities designated at fair value	-	-	-	-
Derivatives	-	824,269	10,537	834,806

Notes on the Financial Statements (continued)

There were no material transfers between Level 1 and Level 2 in the period.

Control framework

Fair values are subject to a control framework designed to ensure that they are either determined, or validated, by a function independent of the risk-taker. Finance establishes the accounting policies and procedures governing valuation, and is responsible for ensuring that they comply with all relevant accounting standards.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the group will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors that are considered in this regard are, *inter alia*:

- the extent to which prices may be expected to represent genuine traded or tradeable prices;
- the degree of similarity between financial instruments;
- the degree of consistency between different sources;
- the process followed by the pricing provider to derive the data;
- the elapsed time between the date to which the market data relates and the balance sheet date; and
- the manner in which the data was sourced.

For fair values determined using a valuation model, the control framework may include, as applicable, independent development or validation of (i) the logic within valuation models; (ii) the inputs to those models; (iii) any adjustments required outside the valuation models; and, (iv) where possible, model outputs. Valuation models are subject to a process of due diligence and calibration before becoming operational and are calibrated against external market data on an ongoing basis.

The results of the independent validation process are reported to, and considered by, Valuation Committees. Valuation Committees are composed of valuation experts from several independent support functions (Product Control, Market Risk Management, Derivative Model Review Group and Finance) in addition to senior management. Any adjustments made to the assessed fair values as a result of the validation process are reported to senior management.

Determination of fair value

Fair values are determined according to the following hierarchy:

- Level *1 – quoted market price*: financial instruments with quoted prices for identical instruments in active markets.
- Level *2 – valuation technique using observable inputs*: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
- Level *3 – valuation technique with significant unobservable inputs*: financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

The best evidence of fair value is a quoted price in an actively traded market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. Where a financial instrument has a quoted price in an active market and it is part of a portfolio, the fair value of the portfolio is calculated as the product of the number of units and quoted price and no block discounts are made. In the event that the market for a financial instrument is not active, a valuation technique is used.

The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads.The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. In inactive markets, obtaining assurance that the transaction price provides evidence of fair value or determining the adjustments to transaction prices that are necessary to measure the fair value of the instrument requires additional work during the valuation process.

Notes on the Financial Statements (continued)

Valuation techniques incorporate assumptions about factors that other market participants would use in their valuations, including interest rate yield curves, exchange rates, volatilities, and prepayment and default rates.

The majority of valuation techniques employ only observable market data, However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them, the derivation of fair value is more judgemental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's carrying amount and/or inception profit ('day 1 gain or loss') is driven by unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the level at which an arm's length transaction would be likely to occur. It generally does not mean that there is no market data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

In certain circumstances, primarily where debt is hedged with interest rate derivatives, the group records its own debt in issue at fair value, based on quoted prices in an active market for the specific instrument concerned, if available. When quoted market prices are unavailable, the own debt in issue is valued using valuation techniques, the inputs for which are either based upon quoted prices in an inactive market for the instrument, or are estimated by comparison with quoted prices in an active market for similar instruments. In both cases, the fair value includes the effect of applying the credit spread which is appropriate to the group's liabilities. The change in fair value of issued debt securities attributable to the group's own credit spread is computed as follows: for each security at each reporting date, an externally verifiable price is obtained or a price is derived using credit spreads for similar securities for the same issuer. Then, using discounted cash flow, each security is valued using a LIBOR-based discount curve. The difference in the valuations is attributable to the group's own credit spread. This methodology is applied consistently across all securities.

Structured notes issued and certain other hybrid instrument liabilities are included within trading liabilities and are measured at fair value. The credit spread applied to these instruments is derived from the spreads at which the group issues structured notes. These market spreads are significantly smaller than credit spreads observed for plain vanilla debt or in the credit default swap markets.

Gains and losses arising from changes in the credit spread of liabilities issued by the group reverse over the contractual life of the debt, provided that the debt is not repaid at a premium or a discount.

Fair value valuation bases:

Financial instruments measured at fair value using a valuation technique with significant unobservable inputs – Level 3

	Assets			Liabilities
	Available-for-sale US$000	Held for Trading US$000	Derivatives US$000	Derivatives US$000
At 31 December 2011				
Private equity investments	**134,817**	**-**	**-**	**-**
Other derivatives	**-**	**-**	**4,759**	**2,631**
Other portfolios	**421,921**	**207,711**	**-**	**-**
	556,738	**207,711**	**4,759**	**2,631**
At 31 December 2010				
Private equity investments	106,769	190,577	-	-
Other derivatives	-	-	2,455	10,537
Other portfolios	406,376	-	-	-
	513,145	190,577	2,455	10,537

Private equity

The group's private equity positions are generally classified as available-for-sale and are not traded in active markets. In the absence of an active market, an investment's fair value is estimated on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors, as well as by reference to market valuations for similar entities quoted in an active market, or the price at which similar companies have changed ownership.

Notes on the Financial Statements (continued)

Derivatives

OTC (i.e. non-exchange traded) derivatives are valued using valuation models. Valuation models calculate the present value of expected future cash flows, based upon 'no-arbitrage' principles. For many vanilla derivative products, such as interest rate swaps and European options, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some differences in market practice. Inputs to valuation models are determined from observable market data wherever possible, including prices available from exchanges, dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices via model calibration procedures or estimated from historical data or other sources. Examples of inputs that may be unobservable include volatility surfaces, in whole or in part, for less commonly traded option products, and correlations between market factors such as foreign exchange rates, interest rates and equity.

Other portfolios

Other portfolios include certain debt securities for which active quoted prices are not available and the valuations are based on internal assumptions.

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy:

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
2011				
At 1 January	**513,145**	**190,577**	**2,455**	**10,537**
Total gains or losses recognised in profit or loss	**(12,500)**	**-**	**2,304**	**(7,906)**
Total gains or losses recognised in other comprehensive income	**48,550**	**-**	**-**	**-**
Purchases	**7,543**	**207,711**	**-**	**-**
Transfers out	**-**	**(190,577)**	**-**	**-**
Transfers in	**-**	**-**	**-**	**-**
At 31 December	**556,738**	**207,711**	**4,759**	**2,631**
Total gains recognised in profit or loss relating to those assets and liabilities held on 31 December 2011	**12,146**	**7,051**	**2,304**	**7,906**
2010				
At 1 January	91,178	196,815	14,140	3,192
Total gains or losses recognised in profit or loss	13,063	(5,062)	(2,759)	(5,658)
Total gains or losses recognised in other comprehensive income	(13,045)	6	-	-
Purchases	284,607	-	-	-
Transfers out	(333)	(46,688)	(13,518)	-
Transfers in	137,675	45,506	4,592	13,003
At 31 December	513,145	190,577	2,455	10,537
Total gains/(losses) recognised in profit or loss relating to those assets and liabilities held on 31 December 2010	16,063	3,080	(363)	5,348

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.

Notes on the Financial Statements (continued)

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 equity	
	Favourable changes US$000	Unfavourable changes US$000	Favourable changes US$000	Unfavourable changes US$000
At 31 December 2011				
Derivatives/trading assets/trading liabilities[1] ...	**22,487**	**(21,099)**	**-**	**-**
Financial investments: available-for-sale	**-**	**-**	**55,673**	**(55,673)**
At 31 December 2010				
Derivatives/trading assets/trading liabilities[1] ...	21,507	(19,291)	-	-
Financial investments: available-for-sale	-	-	11,050	(11,315)

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 31 December 2011				
Private equity investments................................	**20,771**	**(20,771)**	**13,481**	**(13,481)**
Other derivatives...	**1,716**	**(328)**	**-**	**-**
Other portfolio	**-**	**-**	**42,192**	**(42,192)**
At 31 December 2010				
Private equity investments................................	19,058	(19,058)	10,676	(10,676)
Other derivatives...	2,449	(233)	-	-
Other portfolio	-	-	374	(639)

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 judgemental.

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 Financial Statements (continued)

Fair values of financial instruments not carried at fair value

Fair values of financial instruments which are not carried at fair value on the balance sheet

	At 31 December 2011		At 31 December 2010	
	Carrying amount US$000	**Fair value US$000**	Carrying amount US$000	Fair value US$000
Assets				
Loans and advances to banks	**8,076,477**	**8,083,175**	8,229,772	8,234,817
Loans and advances to customers	**21,560,861**	**21,614,872**	20,586,712	20,649,254
Liabilities				
Deposits by banks	**2,080,192**	**2,087,115**	1,547,700	1,524,829
Customer accounts	**28,826,332**	**28,820,783**	26,343,980	26,389,478
Debt securities in issue	**4,398,163**	**4,239,506**	5,688,545	5,610,515

The following is a list of financial instruments whose carrying amount is a reasonable approximation of fair value because, for example, they are short-term in nature or reprice to current market rates frequently:

Assets
Cash and balances at central banks
Items in the course of collection from other banks
Endorsements and acceptances
Short-term receivables within 'Other assets'
Accrued income

Liabilities
Items in the course of transmission to other banks
Endorsements and acceptances
Short-term payables within 'Other liabilities'
Accruals

Valuation:

The calculation of fair value incorporates the group's estimate of the amount at which financial assets could be exchanged, or financial liabilities settled, between knowledgeable, willing parties in an arm's length transaction. It does not reflect the economic benefits and costs that the group expects to flow from the instruments' cash flows over their expected future lives. Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available, so comparisons of fair values between entities may not be meaningful and users are advised to exercise caution when using this data.

(i) *Loans and advances to banks and customers*

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using discounted cash flow models. Performing loans are grouped, as far as possible, into homogeneous pools segregated by maturity and interest rates and contractual cash flows are generally discounted using the group's estimate of the discount rate that a market participant would use in valuing instruments with similar maturity, repricing and credit risk characteristics.

The fair value of a loan portfolio reflects both loan impairments at the balance sheet date and estimates of market participants' expectations of credit losses over the life of the loans. For impaired loans, fair value is estimated by discounting the future cash flows over the time period in which they are expected to be recovered.

(ii) *Financial investments*

The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that take into consideration the prices and future earnings streams of equivalent quoted securities.

Notes on the Financial Statements (continued)

(iii) *Deposits by banks and customer accounts*

For the purposes of estimating fair value, deposits by banks and customer accounts are grouped by remaining contractual maturity. Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is assumed to be the amount payable on demand at the balance sheet date.

(iv) *Debt securities in issue and subordinated liabilities*

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments.

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. In many cases, it would not be possible to realise immediately the estimated fair values given the size of the portfolios measured. Accordingly, these fair values do not represent the value of these financial instruments to the group as a going concern.

27 Maturity analysis of assets and liabilities

The following is an analysis by remaining contractual maturities at the balance sheet date, of assets and liability line items that combine amounts expected to be recovered or settled within one year and after more than one year.

Trading assets and liabilities are excluded because they are not held for collection or settlement over the period of contractual maturity.

Maturity analysis of assets and liabilities

	At 31 December 2011			At 31 December 2010		
	Due within one year	**Due after more than one year**	**Total**	Due within one year	Due after more than one year	Total
	US$000	**US$000**	**US$000**	US$000	US$000	US$000
Assets						
Loans and advances to banks	**7,702,479**	**373,998**	**8,076,477**	7,928,774	300,998	8,229,772
Loans and advances to customers	**13,993,250**	**7,567,611**	**21,560,861**	13,599,504	6,987,208	20,586,712
Financial investments	**9,129,572**	**1,199,841**	**10,329,413**	7,681,232	986,489	8,667,721
Other financial assets	**1,403,901**	**1,218**	**1,405,119**	1,260,478	6,438	1,266,916
	32,229,202	**9,142,668**	**41,371,870**	30,469,988	8,281,133	38,751,121
Liabilities						
Deposits by banks	**2,079,185**	**1,007**	**2,080,192**	1,546,760	940	1,547,700
Customer accounts	**28,642,405**	**183,927**	**28,826,332**	25,952,958	391,022	26,343,980
Financial liabilities designated at fair value	**–**	**507,830**	**507,830**	–	–	–
Debt securities in issue	**782,061**	**3,616,102**	**4,398,163**	1,394,969	4,293,576	5,688,545
Other financial liabilities	**2,098,996**	**45,259**	**2,144,255**	1,898,062	12,229	1,910,291
	33,602,647	**4,354,125**	**37,956,772**	30,792,749	4,697,767	35,490,516

Notes on the Financial Statements (continued)

The following is an analysis, by remaining contractual maturities at the balance sheet date, of undiscounted cash flows payable under financial liabilities.

	On demand US$000	Due within 3 months US$000	Due between 3 and 12 months US$000	Due between 1 and 5 years US$000	Due after 5 years US$000
At 31 December 2011					
Deposits by banks	**742,137**	**1,529,817**	**27,717**	**129**	**–**
Customer accounts	**20,099,785**	**5,917,400**	**2,171,178**	**189,088**	**–**
Trading liabilities	**757,274**	**–**	**–**	**–**	**–**
Financial liabilities designated at fair value	**–**	**–**	**–**	**507,830**	**–**
Derivatives	**1,231,232**	**–**	**362**	**–**	**–**
Debt securities in issue	**325,000**	**280,170**	**628,355**	**3,269,674**	**–**
Other financial liabilities	**160,869**	**1,195,128**	**235,356**	**1,218**	**–**
	23,316,297	**8,922,515**	**3,062,968**	**3,967,939**	**–**
Loan and other credit-related commitments	**4,099,720**	**5,010,548**	**6,402,637**	**935,913**	**104,834**
Financial guarantees and similar contracts	**613,203**	**1,920,558**	**1,384,834**	**1,698,751**	**6,383**
	28,029,220	**15,853,621**	**10,850,439**	**6,602,603**	**111,217**
At 31 December 2010					
Deposits by banks	966,206	786,920	8,105	40	–
Customer accounts	17,809,123	5,495,001	2,452,898	482,808	941
Trading liabilities	121,733	–	–	–	–
Financial liabilities designated at fair value	–	–	–	–	–
Derivatives	834,804	–	2,258	–	–
Debt securities in issue	275,000	380,242	1,321,404	4,029,419	–
Other financial liabilities	141,494	1,451,070	544,058	9,769	–
	20,148,360	8,113,233	4,328,723	4,522,036	941
Loan and other credit-related commitments	4,037,272	4,463,429	4,746,796	2,833,921	309,152
Financial guarantees and similar contracts	2,266,492	1,619,613	1,220,801	353,980	645
	26,452,124	14,196,275	10,296,320	7,709,937	310,738

Trading liabilities and trading derivatives have been included in the 'On demand' time bucket, and not by contractual maturity, because trading liabilities are typically held for short periods of time. The undiscounted cash flows on hedging derivative liabilities are classified according to their contractual maturity. The undiscounted cash flows potentially payable under financial guarantee contracts are classified on the basis of the earliest date they can be drawn down.

Further discussion of the group's liquidity and funding management can be found in Note 32 'Risk management'.

28 Foreign exchange exposures

Structural foreign exchange exposures:

The group's structural foreign currency exposure is represented by the net asset value of its foreign currency equity and subordinated debt investments in subsidiaries, branches and associates with non-US dollar functional currencies. Gains or losses on structural foreign exchange exposures are recognised in other comprehensive income.

The group's management of structural foreign currency exposures is discussed in Note 32 'Risk management'.

Notes on the Financial Statements (continued)

Net structural foreign currency exposures

Currency of structural exposure

	2011	2010
	US$000	US$000
Algerian dinar	**175,357**	156,333
Bahraini dinar	**184,974**	132,427
Jordanian dinar	**171,382**	180,395
Kuwaiti dinar	**105,893**	97,858
Lebanese pound	**72,400**	71,464
Omani riyal	**270,688**	233,413
Pakistani rupee	**21,212**	12,038
Qatari riyal	**607,984**	509,826
UAE dirham	**2,649,927**	2,468,419
Total	**4,259,817**	3,862,173

29 Assets charged as security for liabilities and collateral accepted as security for assets

Collateral accepted as security for assets:

The fair value of financial assets accepted as collateral that the group is permitted to sell or repledge in the absence of default is US$ 292,239 thousand (2010: US$ 188,814 thousand). The fair value of any such collateral that have been sold or repledged is US$ Nil (2010: US$ 3,488 thousand). The group is obliged to return these assets.

These transactions are conducted under terms that are usual and customary to standard securities borrowing and reverse repurchase agreements.

30 Called up share capital

Authorised

The authorised ordinary share capital of the Bank at 31 December 2011 was 1,500,000,000 (2010: 1,500,000,000) ordinary shares[1] of US$1.00 each.

Issued and fully paid

	Number	**US$000**
At 1 January 2011 and 31 December 2011	**931,055,000**	**931,055**
At 1 January 2010 and 31 December 2010	931,055,000	931,055

[1] *All ordinary shares in issue confer identical rights in respect of capital, dividends and otherwise.*

Notes on the Financial Statements (continued)

31 Notes on the cash flow statement

Non-cash items included in profit before tax

	2011 US$000	2010 US$000
Depreciation, amortisation and impairment	**30,242**	35,332
Share-based payment expense	**4,017**	805
Loan impairment losses gross of recoveries	**349,686**	586,911
Provisions	**2,000**	2,933
Impairment of financial investments	**105**	204
Charge for defined benefit plans	**12,625**	12,246
Accretion of discounts and amortisation of premiums	**(12,910)**	(12,575)
	385,765	625,856

Change in operating assets

	2011 US$000	2010 US$000
Change in prepayments and accrued income	**(4,200)**	23,644
Change in net trading securities and net derivatives	**478,503**	(164,154)
Change in loans and advances to banks	**(212,801)**	181,099
Change in loans and advances to customers	**(1,205,119)**	(1,272,006)
Change in other assets	**(440,041)**	(260,677)
	(1,383,658)	(1,492,094)

Change in operating liabilities

	2011 US$000	2010 US$000
Change in accruals and deferred income	**(32,909)**	(6,277)
Change in deposits by banks	**532,492**	(126,932)
Change in customer accounts	**2,482,352**	(180,507)
Change in debt securities in issue	**(1,090,382)**	598,337
Change in financial liabilities designated at fair value	**507,830**	-
Change in other liabilities	**232,283**	716,518
	2,631,666	1,001,139

Cash and cash equivalents

	2011 US$000	2010 US$000
Cash and balances at central banks	**916,324**	719,363
Items in the course of collection from other banks	**84,478**	61,085
Loans and advances to banks of one month or less	**6,586,887**	6,952,985
Treasury bills, other bills and certificates of deposit less than three months	**3,401,157**	4,015,918
Less: items in the course of transmission to other banks	**(289,995)**	(766,308)
Total cash and cash equivalents	**10,698,851**	10,983,043

Total interest paid by the group during the year was US$ 345,962 thousand (2010: US$385,065 thousand). Total interest received by the group during the year was US$ 1,493,833 thousand (2010: US$1,591,301 thousand). Total dividends received by the group during the year was US$ 13,006 thousand (2010: US$15,211 thousand).

32 Risk management

All the group's activities involve, to varying degrees, the analysis, evaluation, acceptance and management of risks or combinations of risks. The most important categories of risk that the group is exposed to are credit risk (including cross-border country risk), market risk, operational risks in various forms, liquidity risk, pension risk, residual value risk, reputational risk, legal risk and sustainability (environmental and social) risks. Market risk includes foreign exchange, interest rate and equity price risks.

The management of these various risk categories is discussed below.

The risk profiles of the group and of individual operating entities change constantly under the influence of a wide range of factors. The risk management framework established by the group fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interdependencies.

Risk governance and ownership

A well-established risk governance and ownership structure ensures oversight of, and accountability for, the effective management of risk at group, regional, customer group and operating entity levels.

The Board approves the group's risk appetite framework, plans and performance targets for the group and its principal operating subsidiaries, the appointment of senior officers, the delegation of authorities for credit and other risks and the establishment of effective control procedures. The Audit and Risk Committee is responsible for advising the Board on material risk matters and providing non-executive oversight of risk. Under authority delegated by the Board, the separately convened Risk Management Committee ('RMC') formulates high-level group risk management policy, exercises delegated risk authorities and oversees the implementation of risk appetite and controls. The RMC together with the Asset and Liability Committee ('ALCO') monitors all categories of risk, receives reports on actual performance and emerging issues, determines action to be taken and reviews the efficacy of the group's risk management framework.

In their oversight and stewardship of risk management at group level, RMC are supported by a dedicated Risk function headed by the Chief Risk Officer ('CRO'), who is a member of RMC and reports to Chief Executive Officer and to the Global CRO.

Risk has functional responsibility for the principal financial risk types, namely retail and wholesale credit, market, operational, security and fraud risks. For these it establishes group policy, exercises group-wide oversight and provides reporting and analysis of portfolio composition on a regional basis to senior management.

During the period we developed a new operating model for the global risk function. The new model integrates Compliance within Global Risk, establishes risk roles for RBWM and CMB in alignment with other global businesses and broadens the responsibility of Fraud and Security Risk. The new model is designed to enable the end-to-end management of risk in a consistent manner

Risk appetite

The group's approach to risk is encapsulated within our risk appetite framework.

The framework is maintained at regional and global business levels, operating through governance bodies, processes and metrics designed to assist in risk management. Risk appetite statements define, at various levels of the business, the qualitative and quantitative expressions of the risks which the group is prepared to embrace in alignment with its strategy and business plans. Quantitative metrics are assigned to five key categories: earnings, capital and liquidity, impairments and expected losses, risk category and diversification and scenario stress testing. Measurement against the metrics serves to:

- guide underlying business activity, ensuring it is aligned to risk appetite statements;
- determine risk-adjusted remuneration;
- enable the key underlying assumptions to be monitored and, where necessary, adjusted through subsequent business planning cycles; and
- promptly identify business decisions needed to mitigate risk.

Notes on the Financial Statements (continued)

Credit risk

Credit risk management:

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from direct lending, trade finance and leasing business, but also from off-balance sheet products such as guarantees and derivatives, and from the group's holdings of debt and other securities. Credit risk generates the largest regulatory capital requirement of the risks we incur.

HSBC Holdings plc is responsible for the formulation of high-level credit risk policies and provides high-level centralised oversight and management of credit risk for the HSBC Group worldwide. In addition its responsibilities include:

- Controlling exposures to sovereign entities, banks and other financial institutions, as well as debt securities which are not held solely for the purpose of trading.
- Monitoring intra-HSBC Group exposures to ensure they are maintained within regulatory limits.
- Controlling cross-border exposures, through the imposition of country limits with sub-limits by maturity and type of business. Country limits are determined by taking into account economic and political factors, and applying local business knowledge. Transactions with countries deemed to be higher risk are considered case by case.

Within the group, the Credit Risk function is headed by the Chief Risk Officer and reports to the Chief Executive Officer, with a functional reporting line to the HSBC Group Chief Risk Officer. Its responsibilities include:

- Formulating and recording detailed credit policies and procedures, consistent with HSBC Group policy.
- Issuing policy guidelines to subsidiaries and offices on appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain high-risk sectors.
- Undertaking independent review and objective assessment of risk. Credit Risk assesses all commercial non-bank credit facilities and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken.
- Monitoring the performance and management of portfolios.
- Maintaining policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to the group's capital base and remain within internal and regulatory limits.
- Maintaining and developing the governance and operation of HSBC Group's risk rating framework and systems, to classify exposures.
- Reporting on retail portfolio performance, high risk portfolios, risk concentrations, country limits and cross-border exposures, large impaired accounts, impairment allowances and stress testing results and recommendations to the Risk Management Committee, the Audit and Risk Committee and the Board of Directors.
- Acting on behalf of the group as the primary interface, for credit-related issues, with external parties including the rating agencies, corporate analysts, trade associations etc.

The group is required to implement credit policies, procedures and lending guidelines that meet local requirements while conforming to the HSBC Group standards.

Notes on the Financial Statements (continued)

Credit quality:

The group's credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. In the case of individually significant accounts, risk ratings are reviewed regularly and any amendments are implemented promptly. Within the group's retail business, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

Our risk rating system facilitates the internal ratings-based ('IRB') approach for portfolio management purposes. The system adopted by the group to support calculation under Basel II of our minimum credit regulatory capital requirement for banks, sovereigns and certain larger corporates.

Special attention is paid to problem exposures in order to accelerate remedial action. Where appropriate, the group use specialist units to provide customers with support in order to help them avoid default wherever possible.

Periodic risk-based audits of the group's credit processes and portfolios are also undertaken by an independent function.

Impairment Assessment

It is the group's policy that each operating company creates allowances for impaired loans promptly and consistently.

Impairment allowances may be assessed and created either for individually significant accounts or, on a collective basis, for groups of individually significant accounts for which no evidence of impairment has been individually identified or for high-volume groups of homogeneous loans that are not considered individually significant.

When impairment losses occur, the group reduces the carrying amount of loans and advances through the use of an allowance account. When impairment of available-for-sale financial assets and held-to-maturity financial investments occurs, the carrying amount of the asset is reduced directly.

Write-off of loans and advances

Loans are normally written off, either partially or in full, when there is no realistic prospect of further recovery. For secured loans, write-off generally occurs after receipt of any proceeds from the realisation of security.

Unsecured personal facilities, including credit cards, are generally written off at between 150 and 210 days past due, the standard period being the end of the month in which the account becomes 180 days contractually delinquent. Write-off periods may be extended, generally to no more than 360 days past due but in very exceptional circumstances exceeding that figure, in a few countries where local regulation or legislation constrain earlier writeoff, or where the realisation of collateral for secured real estate lending extends to this time.

In the event of bankruptcy or analogous proceedings, write-off may occur earlier than at the periods stated above. Collections procedures may continue after write-off.

Cross-border exposures

Management assesses the vulnerability of countries to foreign currency payment restrictions, including economic and political factors, when considering impairment allowances on cross-border exposures. Impairment allowances are assessed in respect of all qualifying exposures within these countries unless these exposures and the inherent risks are:

- performing, trade-related and of less than one year's maturity;
- mitigated by acceptable security cover which is, other than in exceptional cases, held outside the country concerned;
- in the form of securities held for trading purposes for which a liquid and active market exists, and which are measured at fair value daily; and
- performing facilities with a principal (excluding security) of US$1 million or below and/or with maturity dates shorter than three months.

Notes on the Financial Statements (continued)

Credit exposure

Maximum exposure to credit risk

The group's exposure to credit risk is spread across a broad range of asset classes, including derivatives, trading assets, loans and advances to customers, loans and advances to banks, and financial investments.

The following table presents the maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements (unless such credit enhancements meet offsetting requirements). For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees granted, it is the maximum amount that the group would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, the maximum exposure to credit risk is the full amount of the committed facilities.

Maximum exposure to credit risk

	At 31 December 2011			At 31 December 2010		
	Maximum exposure	Offset	Exposure to credit risk (net)	Maximum exposure	Offset	Exposure to credit risk (net)
	US$000	US$000	US$000	US$000	US$000	US$000
Cash and balances at central banks	**916,324**	-	**916,324**	719,363	-	719,363
Items in the course of collection from other banks	**84,478**	–	**84,478**	61,085	-	61,085
Trading assets	**855,781**	–	**855,781**	511,515	-	511,515
– treasury and other eligible bills	**37,781**	–	**37,781**	45,494	-	45,494
– debt securities	**601,587**	–	**601,587**	452,016	-	452,016
– loans and advances to banks	**199,978**	–	**199,978**			
– loans and advances to customers	**16,435**	–	**16,435**	14,005	-	14,005
Derivatives	**1,269,988**	–	**1,269,988**	826,578	-	826,578
Loans and advances held at amortised cost	**29,637,338**		**29,637,338**	28,816,484	-	28,816,484
– loans and advances to banks	**8,076,477**	–	**8,076,477**	8,229,772	-	8,229,772
– loans and advances to customers	**21,560,861**	–	**21,560,861**	20,586,712	-	20,586,712
Financial investments	**10,190,822**		**10,190,822**	8,549,074	-	8,549,074
– treasury and other similar bills	**1,793,482**	–	**1,793,482**	283,787	-	283,787
– debt securities	**8,397,340**	–	**8,397,340**	8,265,287	-	8,265,287
Other assets	**1,561,310**		**1,561,310**	1,416,425	-	1,416,425
– endorsements and acceptances	**1,311,109**	–	**1,311,109**	1,201,496	-	1,201,496
– accrued income and other	**250,201**	–	**250,201**	214,929	-	214,929
Financial guarantees and similar contracts	**5,623,731**	–	**5,623,731**	5,911,521	-	5,911,521
Loan commitments and other credit-related commitments	**16,700,645**	–	**16,700,645**	16,506,858	-	16,506,858
	66,840,417	–	**66,840,417**	63,318,903	-	63,318,903

Notes on the Financial Statements (continued)

Collateral and other credit enhancements held

Loans and advances held at amortised cost

Although collateral can be an important mitigant of credit risk, it is the group's practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured. However, for other lending decisions a charge over collateral is obtained, and is considered in determining the credit decision and pricing. In the event of default the bank may utilise the collateral as a source of repayment. This form of collateral has a significant financial effect in mitigating our exposure to credit risk. The financial effect is quantified in the tables below. We may manage our risk further by employing other types of collateral and credit risk enhancements but these have a lesser impact on credit risk mitigation, and their financial effect has not been quantified.

We have quantified below the value of fixed charges we hold over a specific asset (or assets) of a borrower for which we have a practical ability and history of enforcing in satisfying a debt in the event of a borrower failing to meet their contractual obligations and where the asset is cash or can be realised in the form of cash by sale in an established market.

The loans and advances offset adjustment in the *Maximum exposure to credit risk* table above primarily relates to customer loans and deposits, and balances arising from repo and reverse repo transactions. The offset relates to balances where there is a legally enforceable right of offset in the event of counterparty default, and where, as a result, there is a net exposure for credit risk management purposes. However, as there is no intention to settle these balances on a net basis under normal circumstances, they do not qualify for net presentation for accounting purposes.

Personal lending – Residential mortgages by level of collateral:

	2011	2010
	US$000	US$000
Uncollateralised	**12,548**	231,104
Fully collateralised	**1,761,543**	1,489,517
Less than 25% loan to value ('LTV')	**58,494**	58,069
25% to 50% LTV	**335,875**	235,057
51% to 75% LTV	**895,267**	633,771
76% to 90% LTV	**304,269**	408,779
91% to 100% LTV	**167,638**	153,841
Partially collaterised		
- greater than 100% LTV	**158,634**	170,751
- collateral value	**135,418**	151,563
Total residential mortgages	**1,932,725**	1,891,372

The above table shows residential mortgage lending including off-balance sheet loan commitments by level of collateral. The collateral included in the table above consists of fixed first charges on real estate.

The LTV ratio is calculated as the gross on-balance sheet carrying amount of the loan and any off-balance sheet loan commitment at the balance sheet date divided by the value of collateral. The methodologies for obtaining residential property collateral values are typically determined through a combination of professional appraisals, house price indices or statistical analysis. The collateral valuation excludes any adjustments for obtaining and selling the collateral. Annual professional appraisals are conducted when a loan is identified and assessed as impaired.

Notes on the Financial Statements (continued)

Personal lending – Other personal lending:

The other personal lending consists primarily of motor vehicle, credit cards and second lien portfolios. Motor vehicle lending is generally collateralised by the motor vehicle financed. Credit cards and overdrafts are generally unsecured. Second lien lending is supported by collateral but the claim on the collateral is subordinate to the first lien charge.

Corporate and commercial and financial (non-banking) lending:

Collateral held is analysed below for commercial real estate and other corporate, and commercial and financial (non-bank) lending. This reflects the difference in collateral held on the portfolios.

Commercial real estate:

The following table shows commercial real estate lending including off-balance sheet loan commitments by level of collateral.

	2011	2010
	US$000	US$000
Rated CRR/EL 1 to 7	**684,857**	969,630
Uncollateralised	**569,868**	677,446
Fully collateralised	**64,634**	64,385
Partially collateralised	**50,355**	227,799
- collateral value	**38,228**	148,482
Rated CRR/EL 8	**2,071**	569
Uncollateralised	**1,995**	553
Fully collateralised	**76**	16
Partially collateralised	**-**	-
- collateral value	**-**	-
Rated CRR/EL 9 to 10	**307,771**	270,875
Uncollateralised	**53,496**	38,972
Fully collateralised	**73,498**	13,949
Partially collateralised	**180,777**	217,954
- collateral value	**88,613**	205,642

The collateral included in the table above consists of fixed first charges on real estate.

The value of commercial real estate collateral is determined through a combination of professional and internal valuations and physical inspection. Indexation for commercial real estate is not generally undertaken because reliable, sufficiently granular indices are not available. Due to the complexity of collateral valuations for commercial real estate these valuations are refreshed less frequently, with local valuation policies determining the frequency of review based on local market conditions. Typically revaluations are sought where, as part of the regular credit assessment of the obligor, material concerns arise in relation to the transaction which may reflect on the underlying performance of the collateral. Revaluations also occur commonly in circumstances where an obligor's credit quality has declined sufficiently to cause concern that the principal payment source may not fully meet the obligation (i.e. the obligor's credit quality classification indicates it is at the lower end e.g. sub-standard, or approaching impaired). The collateral valuations reported above exclude any adjustments for obtaining and selling the collateral.

Notes on the Financial Statements (continued)

Other corporate and commercial and financial (non-bank) lending:

The following table shows corporate and commercial and financial (non-bank) lending including off-balance sheet loan commitments by level of collateral.

	2011 US$000	2010 US$000
Rated CRR/EL 8	**400,005**	655,792
Uncollateralised	**122,557**	609,996
Fully collateralised	**21,294**	2,127
Partially collateralised	**256,154**	43,669
- collateral value	**8,182**	-
Rated CRR/EL 9 to 10	**1,706,723**	1,535,872
Uncollateralised	**1,180,370**	1,024,596
Fully collateralised	**25,856**	57,714
Partially collateralised	**500,497**	453,562
- collateral value	**165,856**	103,232

The collateral used in the assessment of the above primarily includes first legal charges over real estate and charges over cash in the commercial and industrial sector, and charges over cash and marketable financial instruments in the financial sector. Government sector lending is generally unsecured.

It should be noted that the table above excludes other types of charge which are commonly taken for corporate and commercial lending such as unsupported guarantees and floating charges over the assets of a customer's business. While such mitigants have utility, often providing rights in insolvency, their assignable value is insufficiently certain. They are assigned no value for disclosure purposes.

As with commercial real estate the value of real estate collateral included in the table above is generally determined through a combination of professional and internal valuations and physical inspection. Frequency of revaluation is undertaken on the same basis to commercial real estate loans and advances; however, financing activities in corporate and commercial lending that are not predominantly commercial real estate oriented tend not to regard collateral value as strongly correlated to principal repayment performance. Collateral values will generally be refreshed when an obligor's general credit performance deteriorates and it is necessary to assess the likely performance of secondary sources of repayment should reliance upon them prove necessary. For this reason, the table above reports values only for customers with CRR 8 to 10, reflecting that these loans and advances generally have valuations which are of comparatively recent vintage. For the purposes of the table above, cash is valued at its nominal value and marketable securities at their fair value.

The collateral valuation will exclude any adjustments with respect of obtaining and selling the collateral.

Loans and advances to banks

The following table shows loans and advances to banks including off-balance sheet loan commitments by level of collateral.

	2011 US$000	2010 US$000
Uncollateralised	**8,853,030**	9,352,604
Fully collateralised	**31,909**	187,713
Partially collateralised	**-**	-
- collateral value	**-**	-
Total	**8,884,939**	9,540,317

The collateral used in the assessment of the above relates primarily to cash and marketable securities. Loans and advances to banks are however typically unsecured. Certain products such as securities financing transactions are effectively collateralised and have been included in the above as fully collateralised.

Notes on the Financial Statements (continued)

Derivatives

The International Swaps and Derivatives Association ('ISDA') Master Agreement is the group's preferred agreement for documenting derivatives activity. It provides the contractual framework within which dealing activity across a full range of over-the-counter ('OTC') products is conducted, and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or other pre agreed termination events occur. It is common, and the group's preferred practice, for the parties to execute a Credit Support Annex ('CSA') in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between the parties to mitigate the market-contingent counterparty risk inherent in the outstanding positions.

Other credit risk exposures

In addition to collaterilised lending described above, other credit enhancements are employed and methods used to mitigate credit risk arising from financial assets. These are described in more detail below.

Government, bank and other financial institution issued securities may benefit from additional credit enhancement, notably through government guarantees that references these assets.

Trading assets include loans and advances held with trading intent, the majority of which consist of reverse repos, by their nature are collateralised.

The group's maximum exposure to credit risk includes financial guarantees and similar arrangement that it issues or enters into, and loan commitments that it is irrevocably committed to. Depending on the terms of the arrangement, the bank may have recourse to additional credit mitigation in the event that a guarantee is called upon or a loan commitment is drawn and subsequently defaults.

Collateral and other credit enhancements obtained

The group obtained assets by taking possession of collateral held as security, or calling upon other credit enhancements, as follows:

	At 31 December	
Nature of assets	**2011**	2010
	US$000	US$000
Residential property and motor vehicles	-	3,077

Repossessed properties and motor vehicles are made available for sale in orderly fashion, with the proceeds used to reduce or repay the outstanding indebtedness. Where excess funds are available they are used either for other secured lenders with lower priority or are returned to the customer. The group does not generally occupy the repossessed properties for its business use.

Concentration of exposure:

Concentrations of credit risk arise when a number of counterparties or exposure have comparable economic characteristics, or such counterparties are engaged in similar activities, or operate in the same geographical areas or industry sectors, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. The group uses a number of controls and measures to minimise undue concentration of exposure in its portfolios across industry, country and global businesses. These include portfolio and counterparty limits, approval and review controls, and stress testing.

Wrong-way risk is an aggravated form of concentration risk and arises when there is a strong correlation between the counterparty's probability of default and the mark-to-market value of the underlying transaction. We use a range of procedures to monitor and control wrong-way risk, including requiring entities to obtain prior approval before undertaking wrong-way risk transactions outside pre-agreed guidelines.

The group provides a diverse range of financial services both in the Middle East and internationally. As a result, its portfolio of financial instruments with credit risk is diversified, with no exposures to individual industries or economic groupings totalling more than 10% of consolidated total assets, except as follows:

- the majority of the group's exposure to credit risk is concentrated in the Middle East. Within the Middle East, the group's credit risk is diversified over a wide range of industrial and economic groupings; and

Notes on the Financial Statements (continued)

- the group's position as part of a major international banking group means, that it has a significant concentration of exposure to banking counterparties. The majority of credit risk to the banking industry at 31 December 2011 and 31 December 2010 was concentrated in the Middle East.

Debt securities, treasury and other eligible bills

At US$10,191 million total financial investments excluding equity securities were 19% higher at 31 December 2011 than at 31 December 2010. Debt securities, at US$8,397 million, represented the largest concentration of financial investments at 82% of the total, compared with US$8,265 million (97%) at 31 December 2010. The group's holdings of government, corporate debt, and other securities were spread across a wide range of issuers and geographical regions.

Investments in securities of governments and government agencies of US$9,918 million were 97% of overall financial investments excluding equity shares (2010 - US$7,483 million (88%)).

Derivatives

Derivatives exposures at 31 December 2011 were US$1,270 million, an increase of 54% from 31 December 2010, with increases across all asset classes, notably interest rate, foreign exchange, commodity and other derivatives. Higher volatility within the financial markets, flattening yield curves in major currencies and widening credit spreads led to an increase in the fair value of outstanding derivative contracts. Derivatives exposure is shown gross under IFRSs. Derivative liabilities increased for the same reasons.

Loans and advances

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

Notes on the Financial Statements (continued)

Gross loans and advances to customers by industry sector

	Gross loans and advances to customers	
	Total	As a % of total gross loans
At 31 December 2011	**US$000**	**%**
Personal		
Residential mortgages	**1,834,344**	**7.95**
Other personal	**2,968,359**	**12.87**
	4,802,703	**20.82**
Corporate and commercial		
Commercial, industrial and international trade	**9,984,165**	**43.28**
Commercial real estate	**941,561**	**4.08**
Other property-related	**1,730,276**	**7.50**
Government	**1,380,671**	**5.98**
Other commercial	**3,207,907**	**13.90**
	17,244,580	**74.74**
Financial		
Non-bank financial institutions	**1,018,996**	**4.42**
Settlement accounts	**4,458**	**0.02**
	1,023,454	**4.44**
Total gross loans and advances to customers	**23,070,737**	**100.00**
Impaired loans		
- as a percentage of gross loans and advances to customers	**9.62%**	
Total impairment allowances		
- as a percentage of gross loans and advances to customers	**6.55%**	
At 31 December 2010		
Personal		
Residential mortgages	1,748,385	7.93
Other personal	3,208,214	14.55
	4,956,599	22.48
Corporate and commercial		
Commercial, industrial and international trade	9,265,264	42.01
Commercial real estate	1,039,723	4.71
Other property-related	1,709,730	7.75
Government	1,154,751	5.24
Other commercial	2,731,875	12.39
	15,901,343	72.10
Financial		
Non-bank financial institutions	1,189,390	5.39
Settlement accounts	5,778	0.03
	1,195,168	5.42
Total gross loans and advances to customers	22,053,110	100.00
Impaired loans[1]		
- as a percentage of gross loans and advances to customers	10.18%	
Total impairment allowances		
- as a percentage of gross loans and advances to customers	6.65%	

1 2010 information has been presented in accordance with the revised disclosure convention adopted by the group for impaired loans and advances in 2011.

Notes on the Financial Statements (continued)

Areas of special interest

Middle East and North Africa

Although significant unrest and political changes were witnessed in the Middle East and North Africa in 2011, the majority of the HSBC Group's exposures in the region were concentrated in the HSBC Group's associate investment in Saudi Arabia and in the UAE, where the respective political landscapes remained stable and economic growth continued to recover. In the remaining countries in which the group has a presence and there was unrest or political change (or which exhibited similar socio-economic, political and demographic profiles to countries experiencing unrest), the group continued to carefully monitor and respond to developments while assisting customers in managing their own risks in the volatile environment.

The group also continued to work closely with Dubai World and the various entities related to the Government of Dubai to address their prevailing issues. In March 2011, Dubai World signed a final deal with HSBC and other creditors restructuring US$25bn of its debt. The arrangement extends loan maturities for five to eight years at discounted rates, allowing Dubai World to sell off its non-core assets while focusing on its core earnings.

Wholesale lending

Wholesale lending covers the range of credit facilities granted to sovereign borrowers, banks, non-bank financial institutions and corporate entities. The group's wholesale portfolios are well diversified across industry sectors throughout the region, with exposure subject to portfolio controls. Overall credit quality remained stable, although the rise in business confidence seen towards the end of 2010 failed to continue throughout 2011 and generally remained low in many sectors given the uncertainties in both the global economic environment and the regional political situation.

During 2011, steps were taken to reduce our counterparty exposures to the eurozone and additional control measures were introduced to manage our counterparty exposures in MENA countries most at risk from the uncertain political environment. The level of new problems arising was relatively low given these scenarios but the lack of investor appetite has delayed recovery processes and certain assets continued to be very illiquid.

Commercial real *estate*

Commercial real estate lending to customers for the purpose of property investment at 31 December 2011 represented 4.08% (2010: 4.71%) of total gross loans and advances to customers. In 2011, credit quality across this sector showed some deterioration from 2010 and there remains risk of stress in certain markets. Accordingly, across the group's portfolios, credit risk is mitigated by long-standing and conservative policies on asset origination which focus on relationships with long-term customers and limited initial leverage. HSBC Group Risk, in conjunction with major subsidiaries, designates real estate as a Controlled Sector and, accordingly, implements enhanced exposure approval, monitoring and reporting procedures. For example, the group monitors risk appetite limits for the sector at regional level to detect and prevent higher risk concentrations.

Sovereign counterparties

The overall quality of the group's sovereign portfolio remained strong during the period with the large majority of both in-country and cross-border limits extended to countries with strong internal credit risk ratings. There was some downward shift in the quality composition of the portfolio as credit spreads and external ratings were subject to downgrade and volatility. The group regularly updates its assessment of higher risk countries and adjusts its risk appetite to reflect such changes.

Personal lending

The group provides a broad range of secured and unsecured personal lending products to meet customer needs. Given the diverse nature of the markets in which the group operates, the range is not standardised across all countries but is tailored to meet the demands of individual markets while using appropriate distribution channels and, wherever possible, common global IT platforms.

Personal lending includes advances to customers for asset purchase, such as residential property and motor vehicles, where the loans are typically secured on the assets being acquired. The group also offers loans secured on existing assets; unsecured lending products such as overdrafts, credit cards and payroll loans; and debt consolidation loans which may be secured or unsecured.

Notes on the Financial Statements (continued)

During 2011, the growth strategy focused on higher quality accounts, particularly employees of companies that have remained strong through the recent history. At a portfolio level, loan impairment charges reduced from prior year levels as the economic situation stabilised. The portfolio primarily consists of seasoned accounts, that have managed to maintain payments throughout the downturn, and recent originations that passed through a strong credit criterion.

Credit quality of financial instruments

The five credit quality classifications defined below each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending business, as well as the external rating, attributed by external agencies to debt securities.

There is no direct correlation between the internal and external ratings at granular level, except to the extent each falls within a single quality classification.

Credit quality classification

	Wholesale	Retail lending	Debt securities/other
Quality classification	**Internal credit rating**	**Internal credit rating[1]**	**External credit rating**
Strong	CRR 1 to CRR 2	EL 1 to EL 2	A- and above
Good	CRR 3	EL 3	BBB+ to BBB-
Satisfactory	CRR 4 to CRR 5	EL 4 to EL 5	BB+ to B+ and unrated
Sub – standard	CRR 6 to CRR 8	EL 6 to EL 8	B and below
Impaired	CRR 9 to CRR 10	EL 9 to EL 10	Impaired

1 *We observe the disclosure convention that, in addition to those classified as EL9 to EL10, retail accounts classified EL1 to EL8 that are delinquent by 90 days or more are considered impaired, unless individually they have been assessed as not impaired (see 'Past due but not impaired gross financial instruments').*

Quality classification definitions

'Strong': exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss. Retail accounts operate within product parameters and only exceptionally show any period of delinquency.

'Good': exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.

'Satisfactory': exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minor following the adoption of recovery processes.

'Sub-standard': exposures require varying degrees of special attention and default risk is of greater concern. Retail portfolio segments show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes.

'Impaired': exposures have been assessed, individually or collectively, as impaired.

Risk rating scales

The Customer Risk Rating ('CRR') 10-grade scale above summarises a more granular underlying 23-grade scale of obligor probability of default ('PD'). The 23-grade scale was introduced in September 2010 following the harmonisation of PDs for three asset classes (banks, sovereigns and corporates) into one scale which required an additional PD band. All distinct group customers use the 10 or 23-grade scale, depending on the degree of sophistication of the Basel II approach adopted for the exposure.

The Expected Loss ('EL') 10-grade scale for retail business summarises a more granular underlying EL scale for these customer segments; this combines obligor and facility/product risk factors in a composite measure.

For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications. The ratings of Standard and Poor's are cited, with those of other agencies being treated equivalently. Debt securities with short-term issue ratings are reported against the long-term rating of the issuer of those securities. If major rating agencies have different ratings for the same debt securities, a prudent rating selection is made in line with regulatory requirements.

Notes on the Financial Statements (continued)

For the purpose of the following disclosure, retail loans which are past due up to 89 days and are not otherwise classified as EL9 or EL10, are not disclosed within the EL grade to which they relate but are separately classified as past due but not impaired.

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

Distribution of financial instruments by credit quality

	31 December 2011							
	Neither past due nor impaired							
	Strong US$000	Good US$000	Satisfactory US$000	Sub-Standard US$000	Past due not impaired US$000	Impaired US$000	Impairment allowances US$000	Total US$000
Cash and balances at central banks	**850,050**	–	**66,274**	–	–	–	–	**916,324**
Items in the course of collection from other banks	**4,482**	**33,713**	**46,283**	–	–	–	–	**84,478**
Trading assets	**428,467**	**59,459**	**344,291**	**23,564**				**855,781**
– treasury and other eligible bills	**34,153**	–	**3,628**	–	–	–	–	**37,781**
– debt securities	**377,879**	**59,459**	**140,685**	**23,564**	–	–	–	**601,587**
– loans and advances to banks	–	–	**199,978**	–	–	–	–	**199,978**
– loans and advances to customers	**16,435**	–	–	–	–	–	–	**16,435**
Derivatives	**115,654**	**55,031**	**894,326**	**204,977**	–	–	–	**1,269,988**
Loans and advances held at amortised cost	**12,693,112**	**6,203,738**	**7,347,862**	**1,534,346**	**1,144,691**	**2,240,464**	**(1,526,875)**	**29,637,338**
– loans and advances to banks	**6,499,638**	**829,637**	**688,160**	**56,046**	–	**20,000**	**(17,004)**	**8,076,477**
– loans and advances to customers	**6,193,474**	**5,374,101**	**6,659,702**	**1,478,300**	**1,144,691**	**2,220,464**	**(1,509,871)**	**21,560,861**
Financial investments	**2,747,258**	**581,746**	**6,691,588**	**170,230**	–	–	–	**10,190,822**
– treasury and other eligible bills	**1,140,920**	**345,368**	**245,706**	**61,488**	–	–	–	**1,793,482**
– debt securities	**1,606,338**	**236,378**	**6,445,882**	**108,742**	–	–	–	**8,397,340**
Other assets	**77,889**	**242,094**	**1,102,065**	**127,902**	**9,309**	**2,053**	–	**1,561,312**
– endorsements and acceptances	**70,932**	**242,094**	**858,819**	**127,902**	**9,309**	**2,053**	–	**1,311,109**
– accrued income and other	**6,957**	–	**243,246**	–	–	–	–	**250,203**
Total financial instruments	**16,916,912**	**7,175,781**	**16,492,689**	**2,061,019**	**1,154,000**	**2,242,517**	**(1,526,875)**	**44,516,043**

Notes on the Financial Statements (continued)

	31 December 2010							
	Neither past due nor impaired							
	Strong US$000	Good US$000	Satisfactory US$000	Sub-Standard US$000	Past due not impaired US$000	Impaired[1] US$000	Impairment allowances US$000	Total US$000
Cash and balances at central banks	719,363	-	-	-	-	-	-	719,363
Items in the course of collection from other banks	6,834	4,127	50,124	-	-	-	-	61,085
Trading assets	192,159	74,378	232,957	12,021	-	-	-	511,515
– treasury and other eligible bills	-	-	45,494	-	-	-	-	45,494
– debt securities	178,154	74,378	187,463	12,021	-	-	-	452,016
– loans and advances to customers	14,005	-	-	-	-	-	-	14,005
Derivatives	118,811	368,061	339,317	389	-	-	-	826,578
Loans and advances held at amortised cost	13,129,442	5,216,468	6,312,609	2,072,218	1,304,335	2,264,839	(1,483,427)	28,816,484
– loans and advances to banks	7,432,054	179,408	161,281	454,033	-	20,025	(17,029)	8,229,772
– loans and advances to customers[1]	5,697,388	5,037,060	6,151,328	1,618,185	1,304,335	2,244,814	(1,466,398)	20,586,712
Financial investments	2,742,356	-	5,272,662	534,056	-	-	-	8,549,074
– treasury and other eligible bills	150,107	-	67,166	66,514	-	-	-	283,787
– debt securities	2,592,249	-	5,205,496	467,542	-	-	-	8,265,287
Other assets	93,086	207,887	968,435	145,335	957	725	-	1,416,425
– endorsements and acceptances	88,549	207,887	758,043	145,335	957	725	-	1,201,496
– accrued income and other	4,537	-	210,392	-	-	-	-	214,929
Total financial instruments	17,002,051	5,870,921	13,176,104	2,764,019	1,305,292	2,265,564	(1,483,427)	40,900,524

1 *2010 information has been presented in accordance with the revised disclosure convention adopted by the group for impaired loans and advances in 2011.*

Notes on the Financial Statements (continued)

Past due but not impaired gross financial instruments

Past due but not impaired loans are those for which the customer is in the early stages of delinquency and has failed to make a payment, or a partial payment, in accordance with the contractual terms of the loan agreement. This is typically where a loan is less than 90 days past due and there are no other indicators of impairment.

Examples of exposures past due but not impaired include overdue loans fully secured by cash collateral; mortgages that are individually assessed for impairment, and that are in arrears more than 90 days, but where the value of collateral is sufficient to repay both the principal debt and all potential interest for at least one year; and short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

The following table provides an analysis of gross loans and advances to customers held at amortised cost which are past due but not considered impaired. There are no other significant balance sheet items where past due balances are not considered impaired.

	Up to 29 days US$000	30-59 days US$000	60-89 days US$000	90-179 days US$000	Over 180 days US$000	Total US$000
At 31 December 2011	**729,400**	**131,761**	**69,665**	**95,149**	**118,716**	**1,144,691**
At 31 December 2010[1]	907,224	40,142	93,700	157,834	105,435	1,304,335

1 2010 information has been presented in accordance with the revised disclosure convention adopted by the group for impaired loans and advances in 2011.

Renegotiated loans and forbearance

The contractual terms of a loan may be modified for a number of reasons which include changing market conditions, customer retention and other factors not related to the current or potential credit deterioration of a customer. When the contractual payment terms of a loan have been modified because the lender has significant concerns about the borrower's ability to meet contractual payments when due, these loans are classified as 'renegotiated loans'. For the purposes of this disclosure the term forbearance describes the process by which loans are renegotiated.

A range of forbearance strategies are employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default, foreclosure or repossession. They include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, debt consolidations, the deferral of foreclosures, and other forms of loan modifications and re-ages.

HSBC Group's policies and practices are based on criteria which enable local management to judge whether repayment is likely to continue. These typically provide a customer with terms and conditions that are more favourable than those provided initially. Loan forbearance is only granted in situations where the customer has showed a willingness to repay the borrowing and is expected to be able to meet the revised obligations.

For retail lending the group's credit risk management policy sets out restrictions on the number and frequency of renegotiations, the minimum period an account must have been opened before any renegotiation can be considered and the number of qualifying payments that must be received. The application of this policy varies according to the nature of the market, the product and the management of customer relationships through the occurrence of exceptional events.

During 2011, the group adopted a more stringent disclosure convention for impaired loans and advances for geographical regions with material levels of forbearance.

A renegotiated loan is disclosed as impaired when:

- there has been a change in contractual cash flows as a result of a concession which the lender would otherwise not consider, and
- it is probable that without the concession, the borrower would be unable to meet contractual payment obligations in full,

unless the concession is insignificant and there are no other indicators of impairment.

The renegotiated loan will remain disclosed as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment. For loans

Notes on the Financial Statements (continued)

that are assessed for impairment on a collective basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case by case basis.

For retail lending the minimum period of payment performance required depends on the nature of loans in the portfolio, but is typically not less than six months. This period of payment performance is in addition to the receipt of a minimum of two payments within a 60 day period from a customer to initially qualify for the renegotiation. These qualifying payments are required in order to demonstrate that the renegotiated terms are sustainable for the borrower. For corporate and commercial loans, which are individually assessed for impairment and where non-monthly payments are more commonly agreed, the history of payment performance will depend on the underlying structure of payments agreed as part of the restructure.

Renegotiated loans and advances to customers

	At 31 December 2011				At 31 December 2010			
	Neither past due nor impaired US$000	**Past Due but not impaired US$000**	**Impaired US$000**	**Total US$000**	Neither past due nor impaired US$000	Past Due but not impaired US$000	Impaired US$000	Total US$000
Retail	**102,526**	**4,727**	**90,523**	**197,776**	104,613	–	96,026	200,639
Residential Mortgages	**43,378**	**–**	**49,735**	**93,113**	27,694	–	30,691	58,385
Other personal	**59,148**	**4,727**	**40,788**	**104,663**	76,919	–	65,335	142,254
Commercial real estate	**341,933**	**4,584**	**331,509**	**678,026**	374,721	–	196,420	571,141
Corporate and commercial	**452,077**	**300,369**	**384,609**	**1,137,055**	698,857	40,219	243,140	982,216
Financial	**229,603**	**–**	**4,532**	**234,135**	–	–	–	–
Total renegotiated loans and advances to customers	**1,126,139**	**309,680**	**811,173**	**2,246,992**	1,178,191	40,219	535,586	1,753,996
Total impairment allowance on renegotiated loans				**300,052**				70,626

Renegotiated loans and recognition of impairment allowances

Under IFRSs, an entity is required to assess whether there is objective evidence that financial assets are impaired at the end of each reporting period. A loan is impaired when there is objective evidence of a loss event that has an effect on the cash flows of the loan which can be reliably estimated. When the group grants a concession to a customer that the group would not otherwise consider, as a result of their financial difficulty, this is objective evidence of impairment and impairment losses are measured accordingly.

In case of retail lending, loans are consolidated for customers with a reduced ability to pay and often involves combining credit cards and unsecured loans. Such loans are segregated from other parts of the loan portfolio for collective impairment assessment to reflect the higher rates of losses often encountered in these segments. When empirical evidence indicates an increased propensity to default and higher losses on such accounts, the use of roll-rate methodology ensures these factors are taken into account when calculating impairment allowances by applying roll rates specifically calculated on the pool of loans subject to forbearance. When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, a basic formulaic approach based on historical loss rate experience is used. When we consider that there are additional risk factors inherent in the portfolios that may not be fully reflected in the statistical roll rates or historical experience, these risk factors are taken into account by adjusting the impairment allowances derived solely from statistical or historical experience.

In the corporate and commercial sectors, renegotiated loans are typically assessed individually. Credit risk ratings are intrinsic to the impairment assessment. A distressed restructuring is classified as an impaired loan. The individual impairment assessment takes into account the higher risk of the non-payment of future cash flows inherent in renegotiated loans.

Notes on the Financial Statements (continued)

Loans that have been identified as renegotiated retain this designation until maturity or derecognition. When a loan is restructured as part of a forbearance strategy and the restructuring results in derecognition of the existing loan, such as in some debt consolidations, the new loan is disclosed as renegotiated. Interest is recorded on renegotiated loans on the basis of new contractual terms following renegotiation.

Impaired loans disclosure

During the year we adopted a revised disclosure convention for impaired loans and advances. The impaired loan disclosure convention continues to be based on internal credit rating grades and, for retail exposures, 90 days or more past due status (see below). The revision introduces a more stringent approach to the presentation of renegotiated loans as impaired. Management believes that this revised approach better reflects the nature of risks and inherent credit quality in our loan portfolio. It also reflects developments in industry disclosure best practice. The revised disclosure convention affects the disclosure presentation of impaired loans but does not affect the accounting policy for the recognition of impairment allowances.

Under this revised disclosure convention, impaired loans and advances are those that meet any of the following criteria:

- loans and advances classified as CRR 9, CRR 10, EL 9 or EL 10 (a description of our internal credit rating grades is provided above;
- retail exposures 90 days or more past due, unless individually they have been assessed as not impaired; or
- renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet its contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment. For retail lending, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For corporate and commercial lending, all available evidence is assessed on a case by case basis.

Dependent on the nature and volume of forbearance and the credit risk characteristics surrounding the renegotiation, the demonstrated history of payment performance could be assessed against either the original or revised term of the contract.

Impaired loans and advances

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 2011	**17,029**	**996,803**	**469,595**	**1,483,427**
Amounts written off	**(25)**	**(18,604)**	**(168,894)**	**(187,523)**
Recoveries of loans and advances written off in previous years	–	**49,165**	**53,396**	**102,561**
Charge to income statement	–	**193,193**	**53,828**	**247,021**
Exchange and other movements [1]	–	**(118,313)**	**(298)**	**(118,611)**
At 31 December 2011	**17,004**	**1,102,244**	**407,627**	**1,526,875**
At 1 January 2010	15,025	611,167	670,975	1,297,167
Amounts written off	-	(11,671)	(372,766)	(384,437)
Recoveries of loans and advances written off in previous years	-	4,182	52,534	56,716
Charge to income statement	2,004	409,416	118,775	530,195
Exchange and other movements	-	(16,291)	77	(16,214)
At 31 December 2010	17,029	996,803	469,595	1,483,427

1 *This includes USD95m of provisions reversed on derecognition of a loan following a restructuring.*

Notes on the Financial Statements (continued)

Impairment allowances as a percentage of gross loans and advances to banks and customers[1]

	At 31 December	
	2011	2010
	%	%
Banks		
Individually assessed impairment allowances	**0.21%**	0.20%
Customers		
Individually assessed impairment allowances	**4.78%**	4.52%
Collectively assessed impairment allowances	**1.77%**	2.13%
	6.55%	6.65%

1 *Net of reverse repo transactions and settlement accounts.*

Liquidity and funding

Liquidity risk is the risk that the group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows. Funding risk (a form of liquidity risk) arises when the liquidity needed to fund illiquid asset positions cannot be obtained on the expected terms and when required.

The objective of the group's liquidity and funding management framework is to ensure that all foreseeable funding commitments can be met when due, and that access to the wholesale markets is co-ordinated and cost-effective. To this end, the group maintains a diversified funding base comprising core retail and corporate customer deposits and institutional balances. This is augmented with wholesale funding and portfolios of highly liquid assets diversified by currency and maturity which are held to enable the group to respond quickly and smoothly to unforeseen liquidity requirements.

The group adapts its liquidity and funding risk management framework in response to changes in the mix of business that it undertakes, and to changes in the nature of the markets in which it operates. The group also seeks to continuously evolve and strengthen our liquidity and funding risk management framework.

The group employs a number of measures to monitor liquidity risk.

Policies and procedures

The management of liquidity and funding is primarily undertaken locally in the group's operating entities in compliance with practices and limits set by the HSBC Group's Risk Management Meeting ('RMM'). These limits vary according to the depth and liquidity of the market in which the entities operate. It is HSBC's general policy that each banking entity should be self-sufficient when funding its own operations. Exceptions are permitted for certain short-term treasury requirements and start-up operations or branches which do not have access to local deposit markets. The limits place formal restrictions on the transfer of resources between group entities and reflect the broad range of currencies, markets and time zones within which the group operates.

The group's liquidity and funding management process includes:

- projecting cash flows by major currency under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet liquidity and advances to deposits ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- managing the concentration and profile of debt maturities;
- managing contingent liquidity commitment exposures within pre-determined caps;
- maintaining debt financing plans;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises, while minimising adverse long-term implications for the business.

Notes on the Financial Statements (continued)

Primary sources of funding

Current accounts and savings deposits payable on demand or at short notice form a significant part of the group's funding, and the group places considerable importance on maintaining their stability. For deposits, stability depends upon preserving depositor confidence in the group's capital strength and liquidity, and on competitive and transparent pricing.

Cash flows payable in respect of customer accounts are primarily contractually repayable on demand or at short notice. However, in practice, short-term deposit balances remain stable as inflows and outflows broadly match and a significant portion of loan commitments expire without being drawn upon.

Of total liabilities of US$40,775,171 thousand at 31 December 2011, funding from customers amounted to US$28,826,332 thousand, of which US$28,642,405 thousand was contractually repayable within one year.

An analysis of cash flows payable by the group under financial liabilities by remaining contractual maturities at the balance sheet date is included in Note 27.

Assets available to meet these liabilities, and to cover outstanding commitments to lend (US$16,700,645 thousand), included cash, central bank balances, items in the course of collection and treasury and other bills (US$2,832,065 thousand); loans to banks (US$8,076,477 thousand, including US$7,702,479 thousand repayable within one year); and loans to customers (US$21,560,861 thousand, including US$13,993,255 thousand repayable within one year). In the normal course of business, a proportion of customer loans contractually repayable within one year will be extended.

Management of liquidity risk

Core deposits

The group's internal framework is based on our categorisation of customer deposits into core and non-core. This characterisation takes into account the inherent liquidity risk categorisation of the entity originating the deposit, the nature of the customer and the size and pricing of the deposit.

Advances to core funding ratio

The group emphasises the importance of core customer deposits as a source of funds to finance lending to customers, and discourages reliance on short-term professional funding. This is achieved by placing limits on banking entities (including branches) which restrict their ability to increase loans and advances to customers without corresponding growth in core customer deposits or long term debt funding; this measure is referred to as the 'advances to core funding' ratio.

Advances to core funding ratio limits for major markets in which the group operates are set by the Asset and Liability Management Committee ('ALCO'). The ratio describes current loans and advances to customers as a percentage of the total of core customer deposit and term funding with a remaining term to maturity in excess of one year. Loans and advances to customers which are part of reverse repurchase arrangements, and where the group receives securities which are deemed to be liquid, are excluded from the advances to core funding ratio.

	Advances to core funding ratio during:		Stressed one month coverage ratio during:	
	2011	2010	**2011**	2010
	%	%	**%**	%
Year-end	**102.7**	111.3	**132.0**	139.0
Maximum	**112.5**	122.2	**141.0**	139.0
Minimum	**97.8**	106.5	**126.0**	119.0
Average	**103.9**	113.3	**132.0**	126.3

The group would meet any unexpected net cash outflows by using its cash and balances at central banks, selling securities or accessing additional funding sources such as interbank or collateralised lending markets. The distinction between core and non-core deposits generally means that our measure of advances to core funding is more restrictive than that which can be inferred from the published financial statements.

Notes on the Financial Statements (continued)

Stressed one month coverage ratio

The stressed one month coverage ratios tabulated above are derived from projected cash flow scenario analyses, and express the stressed cash inflows as a percentage of stressed cash outflows over a one month time horizon. HSBC Group entities are required to target a ratio of 100% or greater.

Projected cash flow scenario analyses

The group uses a number of standard projected cash flow scenarios designed to model both group-specific and market-wide liquidity crises, in which the rate and timing of deposit withdrawals and drawdowns on committed lending facilities are varied, and the ability to access interbank funding and term debt markets and generate funds from asset portfolios is restricted. The scenarios are modelled by all HSBC Group banking entities. The appropriateness of the assumptions under each scenario is regularly reviewed. In addition to the HSBC Group's standard projected cash flow scenarios, individual entities are required to design their own scenarios tailored to reflect specific local market conditions, products and funding bases.

Limits for cumulative net cash flows under stress scenarios are set for each banking entity. Both ratio and cash flow limits reflect the local market place, the diversity of funding sources available and the concentration risk from large depositors. Compliance with entity level limits is monitored and reported regularly to ALCO.

Market risk management

Market risk is the risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices will reduce the group's income or the value of its portfolios.

The group's exposure to market risk is separated into trading or non-trading portfolios. Trading portfolios include those positions arising from market-making, position-taking and others designated as marked-to-market positions. Non-trading portfolios include positions that primarily arise from the interest rate management of the group's retail and commercial banking assets and liabilities, financial investments designated as available-for-sale and held-to-maturity.

Monitoring and limited market risk exposure:

The objective of the group's market risk management is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the group's status as a premier provider of financial products and services.

The management of market risk is principally undertaken in Global Markets using risk limits approved by the board. Limits are set for portfolios, products and risk types, with market liquidity being a principal factor in determining the level of limits set. HSBC Group Risk, an independent unit within the Group Management Office of HSBC Holdings plc, is responsible for HSBC's market risk management policies and measurement techniques. Each major operating entity has independent market risk management and control functions which are responsible for measuring market risk exposures in accordance with the policies defined by HSBC Group Risk, and monitoring and reporting these exposures against the prescribed limits on a daily basis.

Each operating entity is required to assess the market risks arising on each product in its business and to transfer these risks to either its local Global Markets unit for management, or to separate books managed under the supervision of the local Asset and Liability Management Committee ('ALCO'). The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to manage such risks professionally. In certain cases where the market risks cannot be fully transferred, simulation modelling is used to identify the impact of varying scenarios on valuations and net interest income.

The group uses a range of tools to monitor and limit market risk exposures. These include sensitivity analysis, value at risk ('VAR') and stress testing.

Sensitivity analysis

Sensitivity measures are used to monitor the market risk positions within each risk type, for example, the present value of a basis point movement in interest rates, for interest rate risk. Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

Notes on the Financial Statements (continued)

Value at risk ('VAR')

VAR is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence.

The VAR models used by the group are predominantly based on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates, such as interest rates and foreign exchange rates. The models also incorporate the effect of option features on the underlying exposures.

The historical simulation models assess potential market movements with reference to data from the past two years and calculate VAR to a 99% confidence level and for a one-day holding period.

The group routinely validates the accuracy of its VAR models by back-testing the actual daily profit and loss results, adjusted to remove non-modelled items such as fees and commissions, against the corresponding VAR numbers. Statistically, the group would expect to see losses in excess of VAR only 1% of the time over a one-year period. The actual number of excesses over this period can therefore be used to gauge how well the models are performing.

Although a valuable guide to risk, VAR should always be viewed in the context of its limitations:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or the risks offset in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and
- VAR is unlikely to reflect loss potential on exposures that only arise under significant market moves.

Stress testing

In recognition of the limitations of VAR, the group augments VAR with stress testing to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables.

The process is governed by the Stress Testing Review Group forum which, in conjunction with the regional risk managers, determines the scenarios to be applied at portfolio and consolidated level, as follows:

- sensitivity scenarios consider the impact of any single risk factor or a set of factors that are unlikely to be captured within the VAR models such as the break of a currency peg;
- technical scenarios, consider the largest move in each risk factor, without consideration of any underlying market correlation;
- hypothetical scenarios, which consider potential macro economic events, for example, a global flu pandemic; and
- historical scenarios, which incorporate historical observations of market movements during previous periods of stress which would not be captured within VAR.

Stress testing results provide senior management with an assessment of the financial impact such events would have on the group's profit.

Notes on the Financial Statements (continued)

Trading and non-trading portfolios

The following table provides an overview of the reporting of risks within this section:

	Portfolio	
	Trading	**Non-trading**
Risk type		
Foreign exchange and commodity	VAR	VAR[1]
Interest rate	VAR	VAR
Credit spread	VAR	VAR

1 *The reporting of commodity risk is consolidated with foreign exchange risk and is not applicable to non-trading portfolios.*

Value at risk of the trading and non-trading portfolios

The group VAR, both trading and non-trading, is below:

Value at risk

	2011	2010
	US$000	US$000
At 31 December	**3,528**	2,241
Average	**3,446**	4,436
Minimum	**1,993**	1,823
Maximum	**5,227**	8,378

Trading portfolios

The group's control of market risk in the trading portfolios is based on a policy of restricting individual operations to trading within a list of permissible instruments authorised for each site by HSBC Group Risk, of enforcing rigorous new product and approval procedures, and of restricting trading in the more complex derivative products only to offices with appropriate levels of product expertise and robust control systems.

Market-making and position-taking is undertaken within Global Markets. The VAR for such trading intent activity at 31 December 2011 was US$ 1,472 thousand (2010: US$1,498 thousand). This is analysed below by risk type:

VAR by risk type for the trading intent activities

	Foreign exchange US$000	**Interest rate US$000**	**Credit US$000**	**Total[1] US$000**
At 31 December 2011	**1,351**	**2,630**	**963**	**1,472**
At 31 December 2010[2]	1,923	3,092	994	1,668
Average				
2011	**1,668**	**3,000**	**920**	**2,051**
2010[2]	4,151	4,134	1,272	2,714
Minimum				
2011	**1,059**	**915**	**622**	**1,117**
2010[2]	1,900	1,966	547	1,393
Maximum				
2011	**3,055**	**4,674**	**1,526**	**3,495**
2010[2]	5,945	6,292	5,491	4,480

1 *The total VAR is non-additive across risk types due to diversification effects.*
2 *2010 VAR information is presented for 'trading intent activities' instead of 'trading activities' as previously reported.*

Gap risk

Even for transactions which are structured to render the risk to the group negligible under a wide range of market conditions or events, there exists a remote possibility that a significant gap event could lead to loss. A gap event could arise from a significant change in market price with no accompanying trading opportunity, with the result that the threshold is breached beyond which the risk profile changes from no risk to full exposure to the underlying

structure. Such movements may occur for example, when, in reaction to an adverse event or unexpected news announcement, the market for a specific investment becomes illiquid, making hedging impossible.

Given the characteristics, these transactions, they will make little or no contribution to VAR or to traditional market risk sensitivity measures. The group captures the risks for such transactions within the stress testing scenarios and monitor gap risk on an ongoing basis. The group incurred no material gap losses arising from movements in the underlying market price on such transactions in the 12 months ended 31 December 2011.

Non-trading portfolios

The principal objective of market risk management of non-trading portfolios is to optimise net interest income.

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

The control of market risk in the non-trading portfolios is based on transferring the risks to the books managed by Global Markets or the local ALCO. The net exposure is typically managed through the use of interest rate swaps within agreed limits. The VAR for these portfolios is included within the group VAR.

Equity securities classified as available-for-sale

Market risk arises on equity securities held as available-for-sale. The fair value of these securities at 31 December 2011 was US$138,591 thousand (2010: US$118,647 thousand).

Sensitivity of net interest income

A principal part of the group's management of market risk in non-trading portfolios is monitoring the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). The group aims, through our management of market risk in non-trading portfolios, to mitigate the impact of prospective interest rate movements which could reduce future net interest income, while balancing the cost of hedging such activities on the current net revenue stream.

For simulation modelling, businesses use a combination of scenarios relevant to their local businesses and markets and standard scenarios which are required throughout the HSBC Group. The latter are consolidated to illustrate the combined pro forma effect on the group's consolidated portfolio valuations and net interest income.

Projected net interest income sensitivity figures represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and the group's current interest rate risk profile. This effect, however, does not incorporate actions which would probably be taken by Global Markets or in the business units to mitigate the effect of interest rate risk. In reality, Global Markets seeks proactively to change the interest rate risk profile to minimise losses and optimise net revenues. The projections also assume that interest rates of all maturities move by the same amount (although rates are not assumed to become negative in the falling rates scenario) and, therefore, do not reflect the potential impact on net interest income of some rates changing while others remain unchanged. In addition, the projections take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates linked to other bases (such as Central Bank rates or product rates over which the entity has discretion in terms of the timing and extent of rate changes). The projections make other simplifying assumptions, including that all positions run to maturity.

Projecting the movement in net interest income from prospective changes in interest rates is a complex interaction of structural and managed exposures. The group's exposure to the effect of movements in interest rates on our net interest income arises in two main areas: core deposit franchises and Balance Sheet Management.

- core deposit franchises are exposed to changes in the cost of deposits raised and spreads on wholesale funds. The net interest income benefit of core deposits increases as interest rates rise and decreases as interest rates fall. This risk is asymmetrical in a very low interest rate environment, however, as there is limited room to lower deposit pricing in the event of interest rate reductions; and
- residual interest rate risk is managed within Balance Sheet Management, under our policy of transferring interest rate risk to Balance Sheet Management to be managed within defined limits and with flexibility as to the instruments used.

Notes on the Financial Statements (continued)

The sensitivity analysis reflects the fact that our deposit taking businesses generally benefit from rising rates which are partially offset by increased funding costs in Balance Sheet Management given our simplifying assumption of unchanged Balance Sheet Management positioning. The benefit to deposit taking businesses of rising rates is also offset by the increased funding cost of trading assets, which is recorded in 'Net interest income' and therefore captured in the sensitivity analysis, whereas the income from such assets is recorded in 'Net trading income'.

Structural foreign exchange exposures

Structural foreign exchange exposures represent net investments in subsidiaries, branches or associates, the functional currencies of which are currencies other than the US dollar. An entity's functional currency is the currency of the primary economic environment in which the entity operates.

Exchange differences on structural exposures are recorded in other comprehensive income. The main operating (or functional) currencies of the group are UAE dirham and other Gulf currencies that are linked to the US dollar.

The group's policy is to hedge structural foreign currency exposures only in limited circumstances. The group's structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that the group's capital ratio is protected from the effect of changes in exchange rates. This is usually achieved by holding qualifying capital broadly in proportion to the corresponding foreign-currency-denominated risk-weighted assets. The group considers hedging structural foreign currency exposures only in limited circumstances to protect the capital ratio or the US dollar value of capital invested. Such hedging would be undertaken using forward foreign exchange controls or by financing the borrowings in the same currencies as the functional currencies involved.

Defined benefit pension scheme

Market risk also arises within the group's defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows. Pension scheme obligations fluctuate with changes in long-term interest rates, inflation, salary levels and the longevity of scheme members. Pension scheme assets include equities and debt securities, the cash flows of which change as equity prices and interest rates vary. There is a risk that market movements in equity prices and interest rates could result in asset values which, taken together with regular ongoing contributions, are insufficient over time to cover the level of projected obligations and these, in turn, could increase with a rise in inflation and members living longer. Management, together with the trustees who act on behalf of the pension scheme beneficiaries, assess these risks using reports prepared by independent external actuaries and takes action and, where appropriate, adjust investment strategies and contribution levels accordingly.

Operational risk management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. Operational risk is relevant to every aspect of the group's business and covers a wide spectrum of issues. Losses arising through fraud, unauthorised activities, errors, omission, inefficiency, systems failure or from external events all fall within the operational risk definition.

A formal governance structure provides oversight over the management of operational risk. An Operational Risk and Internal Control Committee, which reports to the Risk Management Committee, meets monthly to discuss key risk issues and review the effectiveness of the operational risk management framework.

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

A centralised database is used to record the results of the operational risk management process. Operational risk and control assessments, and losses, are input and maintained by the business units. To ensure that operational risk losses are consistently reported and monitored at group level, all group companies are required to report individual losses when the net loss is expected to exceed US$10,000.

Legal risk

Each operating company is required to implement procedures to manage legal risk that conform to group standards. Legal risk falls within the definition of operational risk and includes contractual risk, dispute risk, legislative risk and non-contractual rights risk.

Notes on the Financial Statements (continued)

- Contractual risk is the risk that the rights and/or obligations of a group company within a contractual relationship are defective.
- Dispute risk is the risk that a group company is subject to when it is involved in or managing a potential or actual dispute.
- Legislative risk is the risk that a group company fails to adhere to the laws of the jurisdictions in which it operates.
- Non-contractual rights risk is the risk that a group company's assets are not properly owned or are infringed by others, or a group company infringes another party's rights.

The group has a legal function to assist management in controlling legal risk. The function provides legal advice and support in managing claims against group companies, as well as in respect of non-routine debt recoveries or other litigation against third parties.

Operating companies must notify the legal department immediately if any litigation is either threatened or commenced against the group or an employee. The legal department must be immediately advised (and must in turn immediately advise the HSBC Group Head Office legal department) of any action by a regulatory authority, where the proceedings are criminal, or where the claim might materially affect HSBC Group's reputation. Further, any claims which exceed US$1.5 million or equivalent must also be advised to the legal department and the legal department must immediately advise the HSBC Group Head Office if any such claim exceeds US$5 million. All such matters are then reported to the HSBC Group Risk Management Meeting of the HSBC Group Board in a monthly paper.

An exception report must be made to the local compliance function and escalated to the head of group compliance in respect of any breach which has given rise to a fine and/or costs levied by a court of law or regulatory body where the amount is US$1,500 or more, and material or significant issues are reported to RMM and/or the group Audit Committee.

In addition, operating companies are required to submit quarterly returns detailing outstanding claims where the claim (or group of similar claims) exceeds US$10 million, where the action is by a regulatory authority, where the proceedings are criminal, where the claim might materially affect the group's reputation, or, where the HSBC Group Head Office has requested returns be completed for a particular claim. These returns are used for reporting to the HSBC Group Audit Committee and the Board of HSBC Holdings.

Capital management

The Jersey Financial Services Commission ('JFSC') supervises the bank on a solo basis and, as such, receives information on the capital adequacy of, and sets capital requirements for, the bank as a whole. Individual branches and subsidiaries are directly regulated by their local banking supervisors, who set and monitor their capital adequacy requirements.

Under the Banking Business (Jersey) Law 1991, the JFSC requires each bank to maintain a ratio of total capital to risk-weighted assets taking into account both balance sheet assets and off-balance sheet transactions.

The bank's capital is divided into two tiers:

- Tier 1 capital comprises shareholders' funds less deductions for the book values of intangible assets and 50% of the investment in subsidiaries, associates and capital of other banks at cost, and after adjusting for items reflected in shareholders' funds which are treated differently for the purposes of capital adequacy.
- Tier 2 capital comprises qualifying non-equity preference share capital, collective impairment allowances and reserves arising from the revaluation of properties less deductions for 50% of the investment in subsidiaries, associates and capital of other banks at cost.

Various limits are applied to elements of the capital base. Qualifying tier 2 capital cannot exceed tier 1 capital, and qualifying term non-equity preference share capital may not exceed 50% of tier 1 capital.

Notes on the Financial Statements (continued)

There are also limitations on the amount of collective impairment allowances which may be included as part of tier 2 capital. From the total of tier 1 and tier 2 capital are deducted the net asset value of investments in associates and the book value of investments in the capital of banks.

Risk-weighted assets are measured by means of a hierarchy of risk weightings classified according to the nature of each asset and counterparty, taking into account any eligible collateral or guarantees. Off-balance-sheet items giving rise to credit, foreign exchange or interest rate risk are assigned weights appropriate to the category of the counterparty, taking into account any eligible collateral or guarantees.

Up to 30 June 2010 the bank operated under both Basel I and Basel II standardised frameworks for the calculation and monitoring of capital adequacy ratios. From 1 July 2010 the bank operated under the Basel II standardised framework only. The bank complied with the JFSC capital adequacy requirements during that period.

Capital structure at 31 December (solo basis)

	2011	2010
	Basel II	Basel II
	US$000	US$000
Composition of regulatory capital		
Tier 1 capital	**4,029,122**	3,544,613
Tier 2 capital	**1,314,951**	1,532,204
Total regulatory capital	**5,344,073**	5,076,817
Risk weighted assets		
Credit and counterparty risk	**31,502,230**	28,368,467
Market risk	**2,525,385**	1,967,382
Operational risk	**3,875,806**	3,940,571
	37,903,421	34,276,420
Capital ratios	**%**	%
Capital adequacy ratio	**14.10**	14.81

Notes on the Financial Statements (continued)

33 Contingent liabilities, contractual commitments and guarantees

	2011 US$000	2010 US$000
Guarantees and other contingent liabilities		
Guarantees	**11,634,963**	11,328,404
	11,634,963	11,328,404
Commitments		
Documentary credits and short-term trade-related transactions	**1,638,403**	1,313,334
Undrawn formal standby facilities, credit lines and other commitments to lend:	**15,062,242**	15,193,523
	16,700,645	16,506,857

The table above discloses the nominal principal amounts of commitments, excluding capital commitments, which are separately disclosed below, guarantees and other contingent liabilities; 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 portion of guarantees and commitments is expected to expire without being drawn upon, the total of these nominal principal amounts is not representative of future liquidity requirements.

Included in the above are the following liabilities on account of other members of the HSBC Group:

	2011 US$000	2010 US$000
Guarantees and assets pledged by the bank as collateral security	**1,204,090**	1,021,947
Documentary credits and short-term trade-related transactions	**146,988**	116,287
	1,351,078	1,138,234

Guarantees

The group provides guarantees and similar undertakings on behalf of both third party customers and other entities within the group. These guarantees are generally provided in the normal course of the group's banking business. The principal types of guarantees provided, and the maximum potential amount of future payments which the group could be required to make at 31 December, were as follows:

	At 31 December 2011		At 31 December 2010	
	Guarantees in favour of third parties US$000	**Guarantees by the group in favour of other HSBC Group entities US$000**	Guarantees in favour of third parties US$000	Guarantees by the group in favour of other HSBC Group entities US$000
Guarantee type				
Financial guarantee[1]	**1,570,242**	**191,310**	1,483,397	185,810
Credit related substitutes[2]	**4,053,491**	**354,495**	3,978,130	264,182
Other [3]	**4,807,140**	**658,285**	4,844,930	571,955
Total	**10,430,873**	**1,204,090**	10,306,457	1,021,947

1 *Financial guarantees are contracts that require the issuer to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. Intra-group financial guarantees include a guarantee of a capital nature issued by the group to a HSBC Group entity for inclusion as capital support by the latter's regulator.*

2 *Credit related guarantees are contracts that have similar features to financial guarantee contracts but fail to meet the strict definition of a financial guarantee contracts under IAS 39.*

3 *Other guarantee contracts accounted for as contingent liabilities under IAS 37 (as they do not meet criteria to be accounted for as financial instruments under IAS 39) and are not credit risk related guarantee contracts.*

The amounts disclosed in the above table are nominal principal amounts and reflect the group's maximum exposure under a large number of individual guarantee undertakings. The risks and exposures arising from guarantees are captured and managed in accordance with the group's overall credit risk management policies and procedures. Guarantees with terms of more than one year are subject to the group's annual credit review process.

Notes on the Financial Statements (continued)

Provisions in respect of the group's obligations under outstanding guarantees

	2011 US$000	2010 US$000
Other items	**605**	246
	605	246

Other commitments

In addition to the commitments disclosed above, at 31 December 2011 the group had US$53 thousand (2010: US$1,423 thousand) of capital commitments authorised but not contracted for.

Associates

The group and its operations are contingently liable with respect to lawsuits and other matters that arise in the normal course of business. Management is of the opinion that the eventual outcome of the legal and financial liability is not expected to materially affect the group's financial position and operations.

34 Lease commitments

Finance lease commitments

The group leases land and buildings (including branches) and equipment from third parties under finance lease arrangements to support its operations.

	2011			2010		
	Total future minimum payments US$000	**Future interest charges US$000**	**Present value of finance lease commitments US$000**	Total future minimum payments US$000	Future interest charges US$000	Present value of finance lease commitments US$000
No later than one year	**–**	**–**	**–**	–	9,180	9,180
Later than one year and no later than five years	**–**	**–**	**–**	–	–	–
	–	**–**	**–**	–	9,180	9,180

Operating lease commitments

At 31 December 2011, the group was obligated under a number of non-cancellable operating leases for properties, plant and equipment for which the future minimum lease payments extend over a number of years.

	Land and buildings	
	2011 US$000	2010 US$000
Future minimum lease payments under non-cancellable operating leases expiring:		
– no later than one year	**28,493**	16,643
– later than one year and no later than five years	**90,687**	57,734
– later than five years	**20,700**	26,109
	139,880	100,486

In 2011, US$21,136 thousand (2010: US$22,401 thousand) was charged to 'General and administrative expenses' in respect of lease agreements related to minimum lease payments.

Finance lease receivables

The group leases a variety of assets to third parties under finance leases. At the end of the lease terms, assets may be sold to third parties or leased for further terms. Lessees may participate in any sales proceeds achieved. Lease rentals arising during the lease terms will either be fixed in quantum or be varied to reflect changes in, for example, tax or interest rates. Rentals are calculated to recover the cost of assets less their residual value, and earn future income.

Notes on the Financial Statements (continued)

	2011			2010		
	Total future minimum payments US$000	**Future interest charges US$000**	**Present value of finance lease commitments US$000**	Total future minimum payments US$000	Future interest charges US$000	Present value of finance lease commitments US$000
Lease receivables:						
- no later than one year	**55,130**	**10,978**	**66,108**	88,863	12,100	100,963
- later than one year and no later than five years	**425,151**	**86,688**	**511,839**	318,860	139,249	458,109
- later than five years	**118,375**	**1,454**	**119,829**	193,908	–	193,908
	598,656	**99,120**	**697,776**	601,631	151,349	752,980

35 Legal proceedings and regulatory matters

The group, through a number of its branches, is named in and is defending legal actions in various jurisdictions arising from its normal business.

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

The group is co-operating in ongoing investigations by the US Department of Justice, the New York County District Attorney's Office, the Office of Foreign Asset Control ('OFAC'), the Federal Reserve and the Office of the Comptroller of the Currency regarding historical transactions involving Iranian parties and other parties subject to OFAC economic sanctions.

36 Related party transactions

The ultimate parent company of the group is HSBC Holdings plc, which is incorporated in England.

Copies of the HSBC Group financial statements may be obtained from the following address:

HSBC Holdings plc
8 Canada Square
London
E14 5HQ

The group's related parties include the parent, fellow subsidiaries, associates, joint ventures, post-employment benefit plans for HSBC employees, key management personnel, close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced by Key Management Personnel or their close family members.

The Key Management Personnel have been identified as being the Directors of the group. The emoluments of a number of the Key Management Personnel are paid by other HSBC Group companies who make no recharge to the group. The Directors are also Directors of a number of other HSBC Group companies and it is not possible to make a reasonable apportionment of their emoluments in respect of each of the companies. Accordingly, no emoluments in respect of the Directors paid by other HSBC Group companies and applicable to the group has been included in the following disclosure.

Transactions, arrangements and agreements including Key Management Personnel

Compensation of Key Management Personnel

	2011 US$000	2010 US$000
Remuneration (wages and bonus)	**4,945**	3,512
Post-employment benefits	**78**	74
Share based payments – value of shares awarded	**2,060**	1,338
	7,083	4,924

Notes on the Financial Statements (continued)

The table below set out transactions which fall to be disclosed under IAS 24 'Related Party Disclosures' between the group and the Key Management Personnel of both the bank and its parent company, HSBC Holdings plc, and their connected persons or controlled companies.

	2011		2010	
	Highest balance during the year[1] US$000	**Balance at 31 December[1] US$000**	Highest balance during the year[1] US$000	Balance at 31 December[1] US$000
Key Management Personnel and connected persons and companies controlled by them				
Loans	**4,217**	**4,028**	3,872	3,463
Credit cards	**75**	**54**	84	84
Guarantees	**-**	**-**	3	-

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

The above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Transactions with other related parties

Associates

	2011		2010	
	Highest balance during the year[1] US$000	**Balance at 31 December [1] US$000**	Highest balance during the year[1] US$000	Balance at 31 December [1] US$000
Amounts due from associates	**413**	**271**	127,254	456
Amounts due to associates	**33,513**	**6,352**	32,102	31,434

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

Transactions of the group with HSBC Holdings plc and fellow subsidiaries of HSBC Holdings plc

Transactions detailed below include amounts due to/from HSBC Holdings plc

	2011		2010	
	Highest balance during the year[1] US$000	**Balance at 31 December [1] US$000**	Highest balance during the year[1] US$000	Balance at 31 December [1] US$000
Assets				
Loans and advances to customers	**4,047**	**4,031**	88	71
Liabilities				
Customer accounts	**22,572**	**8,939**	21,625	10,396
Subordinated amounts due	**300,000**	**300,000**	300,000	300,000

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

Notes on the Financial Statements (continued)

	For the year ended 31 December 2011 US$000	For the year ended 31 December 2010 US$000
Income Statement		
Interest expense	**20,100**	20,100
Other operating income	**280**	195
General and administrative expenses	**26,309**	27,173

Transactions detailed below include amounts due to/from fellow subsidiaries of HSBC Holdings plc

	2011		2010	
	Highest balance during the year[1] US$000	**Balance at the year end[1] US$000**	Highest balance during the year[1] US$000	Balance at the year end[1] US$000
Assets				
Derivatives	**731,445**	**686,537**	331,498	314,157
Loans and advances to banks	**2,089,579**	**1,412,735**	1,127,495	1,127,495
Liabilities				
Deposits by banks	**422,160**	**244,551**	476,900	250,722
Derivatives	**1,179,616**	**1,077,509**	797,623	739,427
Subordinated amounts due	**1,050,000**	**850,000**	1,050,000	1,050,000
Guarantees	**202,090**	**191,310**	215,621	185,811

	For the year ended 31 December 2011 US$000	For the year ended 31 December 2010 US$000
Income Statement		
Interest income	**2,638**	1,255
Interest expense	**29,747**	37,527
Fee income	**54,328**	63,348
Fee expense	**30,720**	20,982
Other operating income	**39,432**	26,958
General and administrative expenses	**134,871**	125,469

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

Transactions between HSBC Bank Middle East Limited and its subsidiaries

Transactions detailed below include amounts due to/from HSBC Bank Middle East Limited and its subsidiaries

	2011		2010	
	Highest balance during the year[1] US$000	**Balance at the year end[1] US$000**	Highest balance during the year[1] US$000	Balance at the year end[1] US$000
Assets				
Loans and advances to customers	**428,632**	**396,208**	560,252	425,671
Liabilities				
Customer accounts	**166,268**	**166,268**	125,426	125,426

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

Notes on the Financial Statements (continued)

37 Events after the balance sheet date

These accounts were approved by the Board of Directors on 21 February 2012 and authorised for issue.

HSBC Bank Middle East Limited and other Group Offices in the Region

HSBC Bank Middle East Limited
Head Office
HSBC House, Esplanade,
St. Helier, Jersey JE4 8UB,
Channel Islands
Tel: (44–1534) 606512
Fax: (44–1534) 606149

Middle East Management Office
HSBC Building,
Emaar Square
P O Box 66
Dubai
United Arab Emirates
Tel: (971–4) 4235168
Fax: (971–4) 4267397

ALGERIA
El Mohammadia branch
Hydra branch

BAHRAIN
Seef – Main Branch
Adliya
Manama – Batelco Building
Sanad
2 Customer Service Units

JORDAN
Amman (Western Amman Main Branch)
Amman (Jebel Hussein Branch)
Amman (Abdoun Branch)
Amman (Madinah Munawarah Branch)

KUWAIT
Kuwait City - Qibla Area

LEBANON
Beirut – St. Georges Bay
Beirut – Ras–Beirut Branch Rbeiz Building
Beirut – Verdun – Farid Trad St
Greater Beirut – Dora Branch

LIBYA
Tripoli Representative Office

OMAN
Bait Al Falaj – HSBC Building
Muscat City Centre
Qurum – Roundabout
Salalah – Al Salam St
Sohar – Al Tareef St
3 Customer Service Units

PAKISTAN
Faisalabad– Jail Road
Islamabad– F–6 Markaz
Islamabad– F–11
Karachi– Shaheen Commercial Complex
Karachi–Clifton
Karachi–Defence
Karachi–Citi Tower
Lahore–Gulberg
Lahore–Model Town
Rawalpindi–Bank Road Saddar
Sialkot—Qayyum Trade Centre

PALESTINIAN AUTONOMOUS AREA
Ramallah – Jaffa St

QATAR
Doha – Airport Road
Doha – West Bay
Doha – Salwa Road

UNITED ARAB EMIRATES
Abu Dhabi – Old Airport Road
Al Ain – Mansouri Bldg, 13th St
Dubai – Deira Al Muraqqabat
Dubai – Bur Dubai
Jebel Ali – Free Trade Zone
Fujairah – Hamad Bin Abdulla St
Ras Al Khaimah – Corniche Rd
Sharjah – King Faisal Road
16 Customer Service Units and 4
Management Offices

PRINCIPAL SUBSIDIARY COMPANIES
HSBC Financial Services (Middle East)
Limited
Dubai

HSBC Middle East Securities LLC
Dubai

HSBC Middle East Finance Company
Limited
Abu Dhabi – Al Salam St
Al Ain – Mansouri Bldg, 13th St
Dubai – Sheikh Zayed Road
Ras Al Khaimah – Al Faisal St

ASSOCIATED COMPANIES
Arabian Real Estate Investment Trust
Management Limited
Cayman Islands

Rewards Management Middle East Free
Zone Limited Liability Company
Dubai

MENA Infrastructure Fund (GP) Limited
Dubai

MENA Holdings Limited
Cayman Islands

HSBC Middle East Leasing Partnership
Dubai

SPECIAL CONNECTIONS WITH THESE MEMBERS OF THE HSBC GROUP
Dar Es Salaam Investment Bank
Iraq, Baghdad Head Office and 10 branches

HSBC Bank Egypt S.A.E.
Cairo, Head Office, 85 branches and
14 Customer Service Units

HSBC Bank International Limited

HSBC Insurance Brokers Limited

HSBC Securities (Egypt) S.A.E.

HSBC Saudi Arabia Limited

The Hongkong and Shanghai Banking
Corporation Limited
Seef, Bahrain – Wholesale (Offshore)

The Saudi British Bank
Riyadh Head Office and 80 branches

HSBC Bank Middle East Limited
HSBC House, Esplanade
St Helier, Jersey, Channel Islands
Telephone: 44 1534 606512
www.hsbc.ae