



The Hongkong and Shanghai Banking
Corporation Limited

Interim Report 2015

Interim Report 2015

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Certain defined terms

This document comprises the *Interim Report 2015* for The Hongkong and Shanghai Banking Corporation Limited ('the Bank') and its subsidiaries (together 'the group'). References to 'HSBC', 'the Group' or 'the HSBC Group' within this document mean HSBC Holdings plc together with its subsidiaries. Within this document the Hong Kong Special Administrative Region of the People's Republic of China is referred to as 'Hong Kong'. The abbreviations 'HK\$m' and 'HK\$b' represent millions and billions (thousands of millions) of Hong Kong dollars respectively.

Cautionary statement regarding forward-looking statements

This *Interim Report* contains certain forward-looking statements with respect to the financial condition, results of operations and business of the group.

Statements that are not historical facts, including statements about the Bank's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential' and 'reasonably possible', variations of these words and similar expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made, and it should not be assumed that they have been revised or updated in the light of new information or future events.

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward-looking statement.

Chinese translation

A Chinese translation of the *Interim Report* is available upon request from: Communications (Asia), Level 32, HSBC Main Building, 1 Queen's Road Central, Hong Kong. The report is also available, in English and Chinese, on the Bank's website at www.hsbc.com.hk.

本《中期業績報告》備有中譯本，如欲查閱可向下列地址索取：香港皇后大道中 1 號滙豐總行大廈 32 樓企業傳訊部（亞太區）。本報告之中英文本亦載於本行之網址 www.hsbc.com.hk。

Financial Highlights

- Profit before tax up 19% to HK\$70,079m (HK\$59,096m in the first half of 2014).
- Attributable profit up 12% to HK\$52,290m (HK\$46,667m in the first half of 2014).
- Return on average shareholders' equity of 18.6% (19.5% in the first half of 2014).
- Total assets up 4% to HK\$7,168bn (HK\$6,877bn at the end of 2014).
- Common equity tier 1 ratio of 14.3% (14.4% at the end of 2014), total capital ratio of 17.4% (15.7% at the end of 2014).
- Cost efficiency ratio of 37.7% (40.3% for the first half of 2014.)

Reported results in the first half of 2015 included a gain of HK\$10,636m on the partial disposal of our shareholding in Industrial Bank Co., Limited ('Industrial Bank'), while the first half of 2014 included a gain of HK\$3,320m on the disposal of our shareholding in Bank of Shanghai. Excluding these gains:

- Return on average shareholders' equity of 14.8% (18.1% for the first half of 2014).
- Cost efficiency ratio of 42.1% (41.9% for the first half of 2014).

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Comment by Stuart Gulliver, Chairman

Economic growth in Asia moderated during the first half of 2015. Investment and demand slowed and exports were weaker than expected, particularly into mainland China, although exports from Asia to the US and Europe accelerated. China's economy cooled, despite policy easing, while regional economies also experienced slowing growth. In ASEAN, consumer demand and spending both weakened. In Hong Kong, lower demand resulted in reduced exports to mainland China, while domestic retail sales were also lower. However, unemployment remained low and inflationary pressures were subdued. India, in contrast, has seen an acceleration in economic growth and activity, led by increased public investment and urban consumption.

Against this mixed backdrop, in the first six months of 2015 The Hongkong and Shanghai Banking Corporation Limited recorded profit before tax of HK\$70,079m, which included a gain on the partial disposal of Hang Seng Bank Limited's ('Hang Seng') shareholding in Industrial Bank of HK\$10,636m. This compares with HK\$59,096m in the first half of 2014, which included a gain on the disposal of our shareholding in Bank of Shanghai. Excluding these gains, profit before tax was 7% higher, including an 8% growth in revenue partly offset by a 9% increase in costs as we continued to invest in growth and in Regulatory programmes and Compliance initiatives. The cost efficiency ratio for the period was 42.1%, broadly flat to prior year.

Loans and advances to customers continued to grow during the period across the region, principally in mortgages and corporate lending. We also grew deposits, mainly in Hong Kong. At the end of June 2015, the loans to deposits ratio stood at 61.9%. Our capital position remained strong, with a common equity tier 1 ratio of 14.3% at the end of June 2015. Return on average shareholders' equity was 14.8%, excluding the gains referred to above, lower than the first half of 2014 as we continued to transition to Basel III.

In the first half of 2015, we received a number of awards including 'Best Regional Trade Finance Bank in Asia Pacific' by *Global Finance*, and 'Best Bank', 'Best Equity House' and 'Best Debt House' in Hong Kong by *Asiamoney*. We continued to be the leading international bank for renminbi services and we were named 'Best Overall Offshore RMB Products and Services Provider' by *Asiamoney* for the fourth successive year.

In Retail Banking and Wealth Management, we maintained our leading market share in mortgages in Hong Kong and continued to grow mortgage lending balances. Other personal lending also increased. We grew net fee income from higher securities brokerage and unit trust fees. A number of new mutual funds were successfully launched during the period. We continued to invest in our branch network. In mainland China, HSBC and Hang Seng combined now have a total of 253 outlets, of which 86 are in Guangdong and, within that figure, 71 in the Pearl River Delta area.

In Commercial Banking, in line with our ambition to strengthen our position as the leading international renminbi bank, we continued to explore renminbi internationalisation opportunities and we became one of the first foreign banks to set up a Free Trade Unit in the Shanghai Free Trade Zone. We launched a number of innovative renminbi solutions in the areas of trade finance and payments and cash management. We also continued to identify opportunities for collaboration with Global Banking & Markets in support of our clients. We grew customer lending, particularly term lending in a number of markets including Hong Kong, India and Malaysia.

In Global Banking & Markets, we continued to support our clients through our broad and integrated range of products, and maintained our leading positions in offshore renminbi bond issuance in Hong Kong, as well as in Hong Kong dollar bond issuance. We also continued to lead the market in onshore custodianship in the renminbi Qualified Foreign Institutional Investors scheme. A strong performance was maintained in Asian local currency bonds. We secured a number of market first mandates, including the first two-way renminbi cross-border sweeping deal in Germany, as well as underwriting the first renminbi bond issued in Thailand. We held the top position for M&A deals in Hong Kong by deal value for the period, and number two position for M&A deals by value across Asia. Following the launch of the Hong Kong-Shanghai Stock Connect scheme in late 2014, we established a strong market share in equity trading through the scheme.

Looking forward, an improvement in trade growth will depend on the global economy regaining momentum. Mainland China's economy is showing signs of stabilisation, and with further policy easing we expect growth to pick up during the second half of this year, led by accelerating infrastructure investment combined with improving conditions in the property sector. We expect GDP growth in mainland China of 7.1% in 2015 and 7.4% next year. Against this backdrop, and with our strong balance sheet position, we see opportunities to continue to serve our retail and commercial customers' needs as they grow their activities across the region, and particularly in the economic areas of ASEAN and Greater China.

Financial Review

Geographical Regions

Profit before tax by geographical region

| | Hong Kong HK\$m | Rest of Asia- Pacific HK\$m | Intra-segment elimination HK\$m | Total HK\$m |
|---------------------------------------------------------------------------------------------------|--------------------|-----------------------------------|---------------------------------------|----------------|
| Period ended 30 June 2015 | | | | |
| Net interest income | 25,828 | 21,116 | – | 46,944 |
| Net fee income | 17,718 | 7,173 | – | 24,891 |
| Net trading income | 8,827 | 4,900 | – | 13,727 |
| Net income from financial instruments designated at fair value | 3,119 | 914 | – | 4,033 |
| Gains less losses from financial investments | 11,095 | 110 | – | 11,205 |
| Dividend income | 170 | 8 | – | 178 |
| Net insurance premium income | 24,964 | 3,125 | – | 28,089 |
| Other operating income | 6,773 | 657 | (2,077) | 5,353 |
| Total operating income | 98,494 | 38,003 | (2,077) | 134,420 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders | (28,467) | (3,309) | – | (31,776) |
| Net operating income before loan impairment charges and other credit risk provisions | 70,027 | 34,694 | (2,077) | 102,644 |
| Loan impairment charges and other credit risk provisions | (445) | (1,462) | – | (1,907) |
| Net operating income | 69,582 | 33,232 | (2,077) | 100,737 |
| Operating expenses | (23,177) | (17,602) | 2,077 | (38,702) |
| Operating profit | 46,405 | 15,630 | – | 62,035 |
| Share of profit in associates and joint ventures | 123 | 7,921 | – | 8,044 |
| Profit before tax | 46,528 | 23,551 | – | 70,079 |
| Share of profit before tax | 66.4% | 33.6% | – | 100.0% |
| Cost efficiency ratio | 33.1% | 50.7% | – | 37.7% |
| Net loans and advances to customers | 1,726,814 | 1,154,183 | – | 2,880,997 |
| Customer accounts | 3,198,940 | 1,452,533 | – | 4,651,473 |
| Period ended 30 June 2014 | | | | |
| Net interest income | 24,767 | 22,418 | 2 | 47,187 |
| Net fee income | 15,070 | 7,351 | – | 22,421 |
| Net trading income | 6,027 | 4,209 | (2) | 10,234 |
| Net income from financial instruments designated at fair value | 2,495 | 453 | – | 2,948 |
| Gains less losses from financial investments | 3,366 | 47 | – | 3,413 |
| Dividend income | 150 | 5 | – | 155 |
| Net insurance premium income | 26,406 | 3,336 | – | 29,742 |
| Other operating income | 6,094 | 590 | (2,076) | 4,608 |
| Total operating income | 84,375 | 38,409 | (2,076) | 120,708 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders | (28,775) | (3,398) | – | (32,173) |
| Net operating income before loan impairment charges and other credit risk provisions | 55,600 | 35,011 | (2,076) | 88,535 |
| Loan impairment charges and other credit risk provisions | (776) | (818) | – | (1,594) |
| Net operating income | 54,824 | 34,193 | (2,076) | 86,941 |
| Operating expenses | (20,659) | (17,083) | 2,076 | (35,666) |
| Operating profit | 34,165 | 17,110 | – | 51,275 |
| Share of profit in associates and joint ventures | 194 | 7,627 | – | 7,821 |
| Profit before tax | 34,359 | 24,737 | – | 59,096 |
| Share of profit before tax | 58.1% | 41.9% | – | 100.0% |
| Cost efficiency ratio | 37.2% | 48.8% | – | 40.3% |
| Net loans and advances to customers | 1,623,743 | 1,185,636 | – | 2,809,379 |
| Customer accounts | 2,953,407 | 1,467,043 | – | 4,420,450 |

Financial Review (continued)

Geographical Regions (continued)

Profit before tax by global business – Hong Kong

| | Retail Banking and Wealth Management HK\$m | Commercial Banking HK\$m | Global Banking and Markets HK\$m | Global Private Banking HK\$m | Other HK\$m | Intra- segment elimination HK\$m | Total HK\$m |
|-----------------------------------------------------------------------------------------------------|-----------------------------------------------------------|--------------------------------|----------------------------------------------|---------------------------------------|----------------|-------------------------------------------|----------------|
| Period ended 30 June 2015 | | | | | | | |
| Net interest income/(expense) | 13,435 | 8,298 | 5,103 | 417 | (959) | (466) | 25,828 |
| Net fee income | 10,202 | 3,933 | 2,783 | 694 | 106 | – | 17,718 |
| Net trading income/(expense) | 754 | 811 | 6,505 | 444 | (153) | 466 | 8,827 |
| Net income/(expense) from financial instruments designated at fair value | 3,106 | (85) | 48 | – | 50 | – | 3,119 |
| Gains less losses from financial investments | 289 | 136 | 27 | – | 10,643 | – | 11,095 |
| Dividend income | 1 | – | – | – | 169 | – | 170 |
| Net insurance premium income | 22,188 | 2,776 | – | – | – | – | 24,964 |
| Other operating income | 2,296 | 241 | 391 | 5 | 4,828 | (988) | 6,773 |
| Total operating income | 52,271 | 16,110 | 14,857 | 1,560 | 14,684 | (988) | 98,494 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders | (25,679) | (2,788) | – | – | – | – | (28,467) |
| Net operating income before loan impairment charges and other credit risk provisions | 26,592 | 13,322 | 14,857 | 1,560 | 14,684 | (988) | 70,027 |
| Loan impairment (charges)/ releases and other credit risk provisions | (627) | (144) | 345 | (20) | 1 | – | (445) |
| Net operating income | 25,965 | 13,178 | 15,202 | 1,540 | 14,685 | (988) | 69,582 |
| Operating expenses | (9,240) | (3,573) | (5,940) | (779) | (4,633) | 988 | (23,177) |
| Operating profit | 16,725 | 9,605 | 9,262 | 761 | 10,052 | – | 46,405 |
| Share of profit in associates and joint ventures | 121 | 1 | 1 | – | – | – | 123 |
| Profit before tax | 16,846 | 9,606 | 9,263 | 761 | 10,052 | – | 46,528 |
| Share of profit before tax | 24.0% | 13.7% | 13.2% | 1.1% | 14.4% | – | 66.4% |
| Net loans and advances to customers | 566,399 | 635,554 | 436,342 | 71,016 | 17,503 | – | 1,726,814 |
| Customer accounts | 1,835,941 | 867,880 | 347,063 | 142,057 | 5,999 | – | 3,198,940 |

Financial Review (continued)**Geographical Regions** (continued)*Profit before tax by global business – Hong Kong*

| | Retail Banking and Wealth Management HK\$m | Commercial Banking HK\$m | Global Banking and Markets HK\$m | Global Private Banking HK\$m | Other HK\$m | Intra- segment elimination HK\$m | Total HK\$m |
|--------------------------------------------------------------------------------------------------|-----------------------------------------------------------|--------------------------------|----------------------------------------------|---------------------------------------|----------------|-------------------------------------------|-----------------|
| Period ended 30 June 2014 | | | | | | | |
| Net interest income/(expense) | 12,433 | 7,233 | 6,037 | 379 | (1,118) | (197) | 24,767 |
| Net fee income | 7,981 | 3,908 | 2,613 | 483 | 85 | – | 15,070 |
| Net trading income | 463 | 868 | 3,999 | 462 | 38 | 197 | 6,027 |
| Net income/(expense) from financial instruments designated at fair value | 2,654 | (131) | 16 | – | (44) | – | 2,495 |
| Gains less losses from financial investments | 2 | 34 | 16 | – | 3,314 | – | 3,366 |
| Dividend income | 1 | – | – | – | 149 | – | 150 |
| Net insurance premium income | 24,447 | 1,959 | – | – | – | – | 26,406 |
| Other operating income | 2,266 | 272 | 234 | – | 4,286 | (964) | 6,094 |
| Total operating income | 50,247 | 14,143 | 12,915 | 1,324 | 6,710 | (964) | 84,375 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders | (26,825) | (1,950) | – | – | – | – | (28,775) |
| Net operating income before loan impairment charges and other credit risk provisions | 23,422 | 12,193 | 12,915 | 1,324 | 6,710 | (964) | 55,600 |
| Loan impairment (charges)/ releases and other credit risk provisions | (552) | (253) | 30 | – | (1) | – | (776) |
| Net operating income | 22,870 | 11,940 | 12,945 | 1,324 | 6,709 | (964) | 54,824 |
| Operating expenses | (8,105) | (3,212) | (5,395) | (659) | (4,252) | 964 | (20,659) |
| Operating profit | 14,765 | 8,728 | 7,550 | 665 | 2,457 | – | 34,165 |
| Share of profit in associates and joint ventures | 190 | 1 | 2 | – | 1 | – | 194 |
| Profit before tax | 14,955 | 8,729 | 7,552 | 665 | 2,458 | – | 34,359 |
| Share of profit before tax | 25.3% | 14.8% | 12.8% | 1.1% | 4.1% | – | 58.1% |
| Net loans and advances to customers | 520,855 | 614,189 | 415,952 | 62,086 | 10,661 | – | 1,623,743 |
| Customer accounts | 1,679,960 | 790,035 | 335,888 | 145,960 | 1,564 | – | 2,953,407 |

Financial Review (continued)

Geographical Regions (continued)

Profit before tax by global business – Rest of Asia-Pacific

| | Retail Banking and Wealth Management HK\$m | Commercial Banking HK\$m | Global Banking and Markets HK\$m | Global Private Banking HK\$m | Other HK\$m | Intra- segment elimination HK\$m | Total HK\$m |
|-----------------------------------------------------------------------------------------------------------|-----------------------------------------------------------|--------------------------------|----------------------------------------------|---------------------------------------|----------------|-------------------------------------------|----------------|
| Period ended 30 June 2015 | | | | | | | |
| Net interest income | 6,166 | 5,721 | 8,167 | 271 | 565 | 226 | 21,116 |
| Net fee income/(expense) | 2,418 | 2,072 | 2,477 | 266 | (60) | – | 7,173 |
| Net trading income | 297 | 685 | 3,996 | 141 | 7 | (226) | 4,900 |
| Net income/(expense) from financial instruments designated at fair value.... | 906 | 11 | 13 | – | (16) | – | 914 |
| Gains less losses from financial investments | (3) | – | 119 | – | (6) | – | 110 |
| Dividend income | 5 | – | – | – | 3 | – | 8 |
| Net insurance premium income..... | 2,538 | 590 | – | – | – | (3) | 3,125 |
| Other operating income | 134 | 9 | 253 | 4 | 612 | (355) | 657 |
| Total operating income | 12,461 | 9,088 | 15,025 | 682 | 1,105 | (358) | 38,003 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders | (2,814) | (496) | – | – | – | 1 | (3,309) |
| Net operating income before loan impairment charges and other credit risk provisions | 9,647 | 8,592 | 15,025 | 682 | 1,105 | (357) | 34,694 |
| Loan impairment charges and other credit risk provisions | (463) | (960) | (22) | (16) | (1) | – | (1,462) |
| Net operating income | 9,184 | 7,632 | 15,003 | 666 | 1,104 | (357) | 33,232 |
| Operating expenses | (7,457) | (4,299) | (4,947) | (471) | (785) | 357 | (17,602) |
| Operating profit | 1,727 | 3,333 | 10,056 | 195 | 319 | – | 15,630 |
| Share of profit in associates and joint ventures | 1,033 | 5,700 | 1,188 | – | – | – | 7,921 |
| Profit before tax | 2,760 | 9,033 | 11,244 | 195 | 319 | – | 23,551 |
| Share of profit before tax | 4.0% | 12.9% | 16.0% | 0.3% | 0.4% | – | 33.6% |
| Net loans and advances to customers | 346,302 | 400,667 | 372,248 | 33,588 | 1,378 | – | 1,154,183 |
| Customer accounts | 482,199 | 357,923 | 531,677 | 80,245 | 489 | – | 1,452,533 |

Financial Review (continued)

Geographical Regions (continued)

Profit before tax by global business – Rest of Asia-Pacific

| | Retail Banking and Wealth Management HK\$m | Commercial Banking HK\$m | Global Banking And Markets HK\$m | Global Private Banking HK\$m | Other HK\$m | Intra- segment elimination HK\$m | Total HK\$m |
|---------------------------------------------------------------------------------------------|-----------------------------------------------------------|--------------------------------|----------------------------------------------|---------------------------------------|----------------|-------------------------------------------|----------------|
| Period ended 30 June 2014 | | | | | | | |
| Net interest income | 6,694 | 5,475 | 8,269 | 292 | 983 | 705 | 22,418 |
| Net fee income/(expense) | 2,489 | 2,180 | 2,516 | 208 | (42) | – | 7,351 |
| Net trading income | 294 | 730 | 3,677 | 151 | 62 | (705) | 4,209 |
| Net income/(expense) from financial instruments designated at fair value | 464 | 1 | 2 | – | (14) | – | 453 |
| Gains less losses from financial investments | – | – | 31 | – | 16 | – | 47 |
| Dividend income | 3 | – | – | – | 2 | – | 5 |
| Net insurance premium income | 2,499 | 844 | – | – | – | (7) | 3,336 |
| Other operating income | 373 | 124 | 226 | 2 | 163 | (298) | 590 |
| Total operating income | 12,816 | 9,354 | 14,721 | 653 | 1,170 | (305) | 38,409 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders .. | (2,614) | (785) | – | – | – | 1 | (3,398) |
| Net operating income before loan impairment charges and other credit risk provisions ... | 10,202 | 8,569 | 14,721 | 653 | 1,170 | (304) | 35,011 |
| Loan impairment (charges)/ releases and other credit risk provisions | (634) | (266) | 80 | 1 | 1 | – | (818) |
| Net operating income | 9,568 | 8,303 | 14,801 | 654 | 1,171 | (304) | 34,193 |
| Operating expenses | (7,451) | (4,098) | (4,781) | (430) | (627) | 304 | (17,083) |
| Operating profit | 2,117 | 4,205 | 10,020 | 224 | 544 | – | 17,110 |
| Share of profit in associates and joint ventures | 1,031 | 5,459 | 1,137 | – | – | – | 7,627 |
| Profit before tax | 3,148 | 9,664 | 11,157 | 224 | 544 | – | 24,737 |
| Share of profit before tax | 5.3% | 16.3% | 18.9% | 0.4% | 1.0% | – | 41.9% |
| Net loans and advances to customers | 374,654 | 408,325 | 367,021 | 34,150 | 1,486 | – | 1,185,636 |
| Customer accounts | 519,131 | 365,940 | 493,847 | 87,635 | 490 | – | 1,467,043 |

Financial Review (continued)

Geographical Regions (continued)

Profit before tax by global business

| | Retail Banking and Wealth Management HK\$m | Commercial Banking HK\$m | Global Banking and Markets HK\$m | Global Private Banking HK\$m | Other HK\$m | Intra- segment elimination HK\$m | Total HK\$m |
|-----------------------------------------------------------------------------------------------------------|-----------------------------------------------------------|--------------------------------|----------------------------------------------|---------------------------------------|----------------|-------------------------------------------|----------------|
| Period ended 30 June 2015 | | | | | | | |
| Net interest income/(expense) | 19,601 | 14,019 | 13,243 | 688 | (367) | (240) | 46,944 |
| Net fee income | 12,617 | 6,004 | 5,263 | 960 | 47 | – | 24,891 |
| Net trading income/(expense) | 1,051 | 1,496 | 10,501 | 585 | (146) | 240 | 13,727 |
| Net income/(expense) from financial instruments designated at fair value | 4,012 | (74) | 61 | – | 34 | – | 4,033 |
| Gains less losses from financial investments | 286 | 136 | 146 | – | 10,637 | – | 11,205 |
| Dividend income | 6 | – | – | – | 172 | – | 178 |
| Net insurance premium income | 24,726 | 3,366 | – | – | – | (3) | 28,089 |
| Other operating income | 2,430 | 250 | 610 | 9 | 5,393 | (3,339) | 5,353 |
| Total operating income | 64,729 | 25,197 | 29,824 | 2,242 | 15,770 | (3,342) | 134,420 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders .. | (28,493) | (3,284) | – | – | – | 1 | (31,776) |
| Net operating income before loan impairment charges and other credit risk provisions | 36,236 | 21,913 | 29,824 | 2,242 | 15,770 | (3,341) | 102,644 |
| Loan impairment (charges)/ releases and other credit risk provisions | (1,090) | (1,104) | 323 | (36) | – | – | (1,907) |
| Net operating income | 35,146 | 20,809 | 30,147 | 2,206 | 15,770 | (3,341) | 100,737 |
| Operating expenses | (16,697) | (7,872) | (10,853) | (1,250) | (5,371) | 3,341 | (38,702) |
| Operating profit | 18,449 | 12,937 | 19,294 | 956 | 10,399 | – | 62,035 |
| Share of profit in associates and joint ventures | 1,154 | 5,701 | 1,189 | – | – | – | 8,044 |
| Profit before tax | 19,603 | 18,638 | 20,483 | 956 | 10,399 | – | 70,079 |
| Share of profit before tax | 28.0% | 26.6% | 29.2% | 1.4% | 14.8% | – | 100% |
| Net loans and advances to customers | 912,701 | 1,036,221 | 808,590 | 104,604 | 18,881 | – | 2,880,997 |
| Customer accounts | 2,318,140 | 1,225,803 | 878,740 | 222,302 | 6,488 | – | 4,651,473 |

Financial Review (continued)**Geographical Regions** (continued)*Profit before tax by global business*

| | Retail Banking and Wealth Management HK\$m | Commercial Banking HK\$m | Global Banking and Markets HK\$m | Global Private Banking HK\$m | Other HK\$m | Intra- segment elimination HK\$m | Total HK\$m |
|--------------------------------------------------------------------------------------------------|-----------------------------------------------------------|--------------------------------|----------------------------------------------|---------------------------------------|----------------|-------------------------------------------|----------------|
| Period ended 30 June 2014 | | | | | | | |
| Net interest income/(expense) | 19,127 | 12,708 | 14,306 | 671 | (135) | 510 | 47,187 |
| Net fee income | 10,470 | 6,088 | 5,129 | 691 | 43 | – | 22,421 |
| Net trading income | 757 | 1,598 | 7,676 | 613 | 100 | (510) | 10,234 |
| Net income/(expense) from financial instruments designated at fair value | 3,118 | (130) | 18 | – | (58) | – | 2,948 |
| Gains less losses from financial investments | 2 | 34 | 47 | – | 3,330 | – | 3,413 |
| Dividend income | 4 | – | – | – | 151 | – | 155 |
| Net insurance premium income | 26,946 | 2,803 | – | – | – | (7) | 29,742 |
| Other operating income | 2,639 | 396 | 417 | 2 | 4,409 | (3,255) | 4,608 |
| Total operating income | 63,063 | 23,497 | 27,593 | 1,977 | 7,840 | (3,262) | 120,708 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders .. | (29,439) | (2,735) | – | – | – | 1 | (32,173) |
| Net operating income before loan impairment charges and other credit risk provisions | 33,624 | 20,762 | 27,593 | 1,977 | 7,840 | (3,261) | 88,535 |
| Loan impairment (charges)/ releases and other credit risk provisions | (1,186) | (519) | 110 | 1 | – | – | (1,594) |
| Net operating income | 32,438 | 20,243 | 27,703 | 1,978 | 7,840 | (3,261) | 86,941 |
| Operating expenses | (15,556) | (7,310) | (10,133) | (1,089) | (4,839) | 3,261 | (35,666) |
| Operating profit | 16,882 | 12,933 | 17,570 | 889 | 3,001 | – | 51,275 |
| Share of profit in associates and joint ventures | 1,221 | 5,460 | 1,139 | – | 1 | – | 7,821 |
| Profit before tax | 18,103 | 18,393 | 18,709 | 889 | 3,002 | – | 59,096 |
| Share of profit before tax | 30.6% | 31.1% | 31.7% | 1.5% | 5.1% | – | 100.0% |
| Net loans and advances to customers | 895,509 | 1,022,514 | 782,973 | 96,236 | 12,147 | – | 2,809,379 |
| Customer accounts | 2,199,091 | 1,155,975 | 829,735 | 233,595 | 2,054 | – | 4,420,450 |

Financial Review (continued)

Hong Kong reported pre-tax profits of HK\$46,528m compared with HK\$34,359m in the first half of 2014, an increase of 35%. The increase in pre-tax profits was mainly due to the gain on the partial disposal of Hang Seng's shareholding in Industrial Bank of HK\$10,636m, partly offset by the disposal gain on our shareholding in Bank of Shanghai of HK\$3,320m in the first half of 2014. Excluding these disposal gains, pre-tax profits increased by HK\$4,853m, or 16%.

Revenue increased by HK\$14,427m, or 26%, mainly reflecting the gain on the partial disposal of Industrial Bank. Excluding both of the disposal gains mentioned above, revenue rose 14%, primarily in Retail Banking and Wealth Management ('RBWM') and Global Banking and Markets ('GB&M'), and to a lesser extent in Commercial Banking ('CMB'). The increase also included a gain from the 150th anniversary banknotes issuance, which was fully offset by a corresponding increase in operating expenses related to this issuance.

Revenue in RBWM increased by 14% compared with the first half of 2014, driven by higher net fee income from increased securities brokerage and unit trust fees from a favourable equity market performance. Net interest income also increased from growth in average lending balances, mainly mortgages and other personal lending, and from growth in average deposit balances, although the benefit was partly offset by spread compression on unsecured lending.

Revenue in GB&M increased by 15%, driven by higher trading income from the Equities business due to a favourable equity market performance, coupled with higher Foreign Exchange ('FX') and Rates revenue from increased client flows and market volatility. This was partly offset by lower Balance Sheet Management ('BSM') revenue due to decreased net interest income from lower reinvestment yields, particularly in the renminbi portfolio.

Revenue in CMB increased by 9%, mainly due to higher net interest income from growth in term lending balances and improved lending spreads.

Loan impairment charges were lower by HK\$331m compared to the first half of 2014, primarily due to a release of individually assessed impairment charges in GB&M.

Operating expenses rose by HK\$2,518m or 12% in the first half of 2015, reflecting wage inflation and additional headcount to support business growth, and from Regulatory programmes and Compliance initiatives. The increase also included charitable donations and other expenses in relation to the 150th anniversary banknotes issuance.

Financial Review (continued)

Rest of Asia-Pacific reported pre-tax profits of HK\$23,551m compared with HK\$24,737m in the first half of 2014, a decrease of 5%. The decrease in pre-tax profits was largely due to higher individually assessed impairment charges, coupled with higher operating expenses.

Revenue decreased by HK\$317m, or 1% compared with the first half of 2014, mainly due to an unfavourable impact from foreign exchange. Excluding this impact, revenue increased by 5%, mainly driven by an increase in trading income, and to a lesser extent net fee income. These increases were partly offset by lower net interest income from BSM.

In mainland China, revenue increased by 6%, driven by higher trading income in GB&M, mainly from Rates and FX. Net interest income decreased from lower BSM revenues resulting from lower re-investment yields, partly offset by higher revenues from deposit growth in Securities Services and from lending growth in Capital Financing. Revenue from RBWM also increased, mainly from insurance operations.

Elsewhere in Asia, excluding the impact from foreign exchange, revenue growth was reported by most countries across the region. Increased revenue in Australia was driven by higher trading income in GB&M, partly offset by lower RBWM revenue following the sale of the credit card portfolio in 2014. Revenue in Malaysia and Singapore also increased, driven by GB&M. These increases were partly offset by lower revenue in Taiwan, primarily in GB&M from lower FX and Rates income, coupled with lower net interest income from compressed lending and deposit spreads.

Loan impairment charges increased by HK\$644m compared with the first half of 2014, mainly in CMB from a small number of individually assessed impairment charges in Indonesia, mainland China and India.

Operating expenses increased by HK\$519m, mainly due to increased staff costs, with increased headcount to support business growth and investments in Regulatory programmes and Compliance initiatives, coupled with wage inflation. Other administrative expenses also increased, mainly from increased usage of Global Services Centres.

Share of profit in associates and joint ventures rose by HK\$294m, mainly from a higher share of profits from Bank of Communications.

Financial Review (continued)**Net interest income**

| | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|---------------------------------------|-----------------------------------------------------------|------------------------------------------------|
| Net interest income | 46,944 | 47,187 |
| Average interest-earning assets | 5,272,723 | 4,893,026 |
| Net interest spread | 1.69% | 1.83% |
| Net interest margin | 1.80% | 1.94% |

Net interest income ('NII') decreased by HK\$243m compared with the first half of 2014 due to an unfavourable foreign exchange impact. Excluding the impact from foreign exchange, NII rose by HK\$914m, or 2%, mainly from balance sheet growth in Hong Kong, although this was largely offset by lower BSM revenue in Hong Kong and mainland China.

Average interest-earning assets increased by HK\$380bn, or 8%, compared with the first half of 2014. Average customer lending increased by 5%, notably in term lending. Financial investments also increased by 9%.

Net interest margin decreased by 14 basis points compared with the first half of 2014, driven by compressed spreads on both customer lending and financial investments, partly offset by widened spreads on customer deposits.

In **Hong Kong**, the net interest margin for the Bank remained broadly flat, with narrower spreads on term lending and financial investments being largely offset by improved deposit spreads.

At **Hang Seng Bank**, the net interest margin decreased by 12 basis points, mainly due to narrower spreads on customer term lending and lower reinvestment yields in BSM, partly offset by improved deposit spreads from an increase in low cost savings balances.

In the **Rest of Asia-Pacific**, the net interest margin decreased by 13 basis points, mainly from lower reinvestment yields in BSM, partly offset by improved spreads on corporate lending.

Net fee income

| | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|------------------------------|-----------------------------------------------------------|------------------------------------------------|
| Account services | 1,470 | 1,439 |
| Credit facilities | 1,757 | 1,643 |
| Import/export | 2,227 | 2,391 |
| Remittances | 1,682 | 1,710 |
| Securities/broking | 5,376 | 3,618 |
| Cards | 3,493 | 3,451 |
| Insurance | 774 | 723 |
| Unit trusts | 4,014 | 3,372 |
| Funds under management | 2,314 | 1,919 |
| Underwriting | 617 | 1,185 |
| Other | 4,226 | 3,873 |
| Fee income | 27,950 | 25,324 |
| Fee expense | (3,059) | (2,903) |
| | 24,891 | 22,421 |

Financial Review (continued)**Net trading income**

| | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|-------------------------------------------------------------|-----------------------------------------------------------|------------------------------------------------|
| Dealing profits | 10,143 | 7,769 |
| Net interest income on trading assets and liabilities | 2,728 | 1,951 |
| Dividend income from trading securities | 864 | 523 |
| Net loss from hedging activities | (8) | (9) |
| | 13,727 | 10,234 |

Gains less losses from financial investments

| | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|-----------------------------------------------------------|-----------------------------------------------------------|------------------------------------------------|
| Gain on partial disposal of Industrial Bank | 10,636 | – |
| Gain on sale of Bank of Shanghai | – | 3,320 |
| Gains on disposal of available-for-sale securities | 569 | 102 |
| Impairment of available-for-sale equity investments | – | (9) |
| | 11,205 | 3,413 |

Other operating income

| | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|--------------------------------------------------------------------------------------------|-----------------------------------------------------------|------------------------------------------------|
| Gain on 150 th anniversary banknotes issuance | 706 | – |
| Movement in present value of in-force insurance business | 2,075 | 2,416 |
| Gain on investment properties | 261 | 319 |
| Gain on disposal of property, plant and equipment, and assets held for sale | 150 | 48 |
| Gain on disposal of subsidiaries, associates, joint ventures and business portfolios | 23 | 88 |
| Loss on reclassification of TechCom Bank | – | (251) |
| Other | 2,138 | 1,988 |
| | 5,353 | 4,608 |

In 2015, the Bank issued commemorative banknotes to celebrate its 150th anniversary, recognising a gain on banknotes issuance. There is a corresponding increase in operating expenses, reflecting charitable donations and other expenses in relation to the banknotes issuance.

Financial Review (continued)**Insurance income**

Included in net operating income are the following revenues earned by the insurance business:

| | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|-------------------------------------------------------------------------------------------|-----------------------------------------------------------|------------------------------------------------|
| Net interest income | 5,045 | 4,552 |
| Net fee income | 1,057 | 1,102 |
| Net trading loss | (148) | (91) |
| Net income from financial instruments designated at fair value | 3,937 | 2,988 |
| Net insurance premium income | 28,089 | 29,742 |
| Movement in present value of in-force business | 2,075 | 2,416 |
| Other operating income | 543 | 126 |
| | 40,598 | 40,835 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders | (31,776) | (32,173) |
| Net operating income | 8,822 | 8,662 |

Net interest income increased by 11%, driven by growth in the debt securities portfolio, reflecting net inflows from new and renewal life insurance premiums.

Net income from financial instruments designated at fair value increased by 32%, reflecting a favourable equity market performance in the first half of 2015. To the extent that revaluation is attributable to policyholders, there is an offsetting movement reported under 'Net insurance claims and benefits paid and movement in liabilities to policyholders'.

Net insurance premium income decreased by 6%, mainly in Hong Kong due to lower premiums from unit-linked contracts partly offset by higher new business premiums from a high net-worth product. The drop in premium income resulted in a corresponding decrease in 'Net insurance claims and benefits paid and movement in liabilities to policyholders'.

The movement in present value of in-force business decreased by HK\$341m, mainly due to a decrease in the value of new business as a result of the change in sales mix, partly offset by a favourable interest rate assumption update in the first half of 2015, with a corresponding increase in 'Net insurance claims and benefits paid and movement in liabilities to policyholders'.

Other operating income was higher largely due to a gain on disposal of available-for-sale securities, which resulted in a corresponding increase in 'Net insurance claims and benefits paid and movements in liabilities to policyholders'.

Loan impairment charges and other credit risk provisions

| | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|----------------------------------------------------------------|-----------------------------------------------------------|------------------------------------------------|
| Individually assessed impairment charges | 636 | 309 |
| Collectively assessed impairment charges | 1,238 | 1,285 |
| Other credit risk provisions | 33 | – |
| Loan impairment charges and other credit risk provisions | 1,907 | 1,594 |

Individually assessed impairment charge increased in the first half of 2015, primarily in CMB, comprising charges against a small number of customers mainly in Indonesia, mainland China and India, partly offset by an impairment release against a GB&M customer in Hong Kong. Loan impairment charges as a percentage of average gross customer advances remained low at 0.13% for the first half of 2015 (first half of 2014: 0.12%)

Financial Review (continued)**Employee compensation and benefits**

| | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|--------------------------------|-----------------------------------------------------------|------------------------------------------------|
| Wages and salaries | 19,278 | 17,616 |
| Social security costs | 535 | 513 |
| Retirement benefit costs | 1,230 | 1,156 |
| | 21,043 | 19,285 |

Employee compensation and benefits increased by HK\$1,758m, reflecting wage inflation and a year-on-year increase in average headcount, mainly to support IT infrastructure, Risk and Compliance initiatives and business growth.

| | At 30 June 2015 | At 31 December 2014 |
|-------------------------------------------------------|--------------------------------|---------------------------|
| Staff numbers by region – full-time equivalent | | |
| Hong Kong | 29,350 | 29,368 |
| Rest of Asia-Pacific | 38,690 | 38,926 |
| Total | 68,040 | 68,294 |

General and administrative expenses

| | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|------------------------------------------|-----------------------------------------------------------|------------------------------------------------|
| Premises and equipment | | |
| – Rental expenses | 1,746 | 1,777 |
| – Other premises and equipment | 1,962 | 1,921 |
| | 3,708 | 3,698 |
| Marketing and advertising expenses | 1,952 | 1,858 |
| Other administrative expenses | 9,091 | 7,992 |
| | 14,751 | 13,548 |

The increase in other administrative expenses was largely due to charitable donations and other expenses in relation to the 150th anniversary banknotes issuance.

Share of profit in associates and joint ventures

Share of profit in associates and joint ventures of HK\$8,044m principally represents the group's share of post-tax profits from Bank of Communications. See note 8 of the Condensed Consolidated Financial Statements ('the Financial Statements') for further information on our interests in associates.

Financial Review (continued)

Capital adequacy

The following tables show the capital ratios, risk-weighted assets and capital base as contained in the 'Capital Adequacy Ratio' return required to be submitted to the Hong Kong Monetary Authority ('HKMA') by the Bank on a consolidated basis that is specified by the HKMA under the requirements of section 3C(1) of the Banking (Capital) Rules.

The group uses the advanced internal ratings-based approach to calculate its credit risk for the majority of its non-securitisation exposures and the internal ratings-based (securitisation) approach to determine credit risk for its banking book securitisation exposures. For market risk, the group uses an internal models approach to calculate its general market risk for the risk categories of interest rate exposures, foreign exchange (including gold) exposures, and equity exposures. The group also uses an internal models approach to calculate its market risk in respect of specific risk for interest rate exposures and equity exposures. The group uses the standardised (market risk) approach for calculating other market risk positions as well as trading book securitisation exposures, and the standardised (operational risk) approach to calculate its operational risk.

The Bank and its banking subsidiaries maintain a regulatory reserve to satisfy the provisions of the Hong Kong Banking Ordinance and local regulatory requirements for prudential supervision purposes. At 30 June 2015, the effect of this requirement is to restrict the amount of reserves which can be distributed to shareholders by HK\$28,845m (31 December 2014: HK\$27,959m). There are no relevant capital shortfalls in any of the group's subsidiaries at 30 June 2015 (31 December 2014: Nil) which are not included in its consolidation group for regulatory purposes.

The basis of consolidation for the calculation of capital ratios for regulatory purposes is different from that for accounting purposes. Further information on the regulatory consolidation basis is set out in the Supplementary Notes that will be posted in the Regulatory Disclosures section of our website www.hsbc.com.hk.

A detailed breakdown of the group's common equity tier 1 ('CET1') capital, additional tier 1 ('AT1') capital, tier 2 capital and regulatory deductions and a full reconciliation between the group's accounting and regulatory balance sheets can be viewed in the Supplementary Notes Appendices that will be posted in the Regulatory Disclosures section of our website www.hsbc.com.hk.

| | At 30 June 2015 % | At 31 December 2014 % |
|------------------------------------------|-------------------------|-----------------------------|
| Capital ratios | | |
| CET1 capital | 14.3 | 14.4 |
| Tier 1 capital | 15.3 | 14.4 |
| Total capital | 17.4 | 15.7 |
| Risk weighted assets by risk type | HK\$m | HK\$m |
| Credit risk | 2,100,944 | 2,064,687 |
| Counterparty credit risk | 202,865 | 209,703 |
| Market risk | 124,405 | 143,199 |
| Operational risk | 295,259 | 290,342 |
| | 2,723,473 | 2,707,931 |

The following table sets out the composition of the group's capital base under Basel III at 30 June 2015. The position at 30 June 2015 benefitted from transitional arrangements which will be phased out.

Financial Review (continued)**Capital adequacy** (continued)

| | At 30 June 2015 HK\$m | At 31 December 2014 HK\$m |
|---------------------------------------------------------------------------------------------|-----------------------------|---------------------------------|
| <i>Capital base</i> | | |
| Common equity tier 1 ('CET1') capital | | |
| Shareholders' equity | 508,456 | 491,545 |
| Shareholders' equity per balance sheet | 577,681 | 557,835 |
| Revaluation reserve capitalisation issue | (1,454) | (1,454) |
| Other equity instruments | (14,737) | (14,737) |
| Unconsolidated subsidiaries | (53,034) | (50,099) |
| Non-controlling interests | 22,512 | 27,971 |
| Non-controlling interests per balance sheet | 50,625 | 50,511 |
| Non-controlling interests in unconsolidated subsidiaries | (5,448) | (4,873) |
| Surplus non-controlling interests disallowed in CET1 | (22,665) | (17,667) |
| Regulatory deductions to CET1 capital | (141,243) | (129,771) |
| Valuation adjustments | (1,957) | (2,030) |
| Goodwill and intangible assets | (14,437) | (14,683) |
| Deferred tax assets net of deferred tax liabilities | (1,394) | (1,485) |
| Cash flow hedging reserve | (108) | 182 |
| Changes in own credit risk on fair valued liabilities | (853) | (596) |
| Defined benefit pension fund assets | (43) | (89) |
| Significant capital investments in unconsolidated financial sector entities | (38,605) | (28,866) |
| Property revaluation reserves ¹ | (55,001) | (52,657) |
| Regulatory reserve | (28,845) | (27,959) |
| Excess AT1 deductions | – | (1,588) |
| Total CET1 capital | 389,725 | 389,745 |
| Additional tier 1 ('AT1') capital | | |
| Total AT1 capital before regulatory deductions | 52,198 | 48,750 |
| Perpetual subordinated loans | 14,737 | 14,737 |
| Perpetual non-cumulative preference shares | 25,218 | 25,229 |
| Allowable non-controlling interests in AT1 capital | 12,243 | 8,784 |
| Regulatory deductions to AT1 capital | (25,312) | (48,750) |
| Significant capital investments in unconsolidated financial sector entities | (25,312) | (50,338) |
| Excess AT1 deductions | – | 1,588 |
| Total AT1 capital | 26,886 | – |
| Total tier 1 capital | 416,611 | 389,745 |
| Tier 2 capital | | |
| Total Tier 2 capital before regulatory deductions | 86,108 | 88,802 |
| Perpetual cumulative preference shares | 3,101 | 3,102 |
| Cumulative term preferences shares | 8,140 | 8,143 |
| Perpetual subordinated debt | 9,324 | 9,337 |
| Term subordinated debt | 25,018 | 25,400 |
| Property revaluation reserves ¹ | 25,405 | 24,350 |
| Impairment allowances and regulatory reserve eligible for inclusion in Tier 2 capital | 15,120 | 14,957 |
| Allowable non-controlling interests in Tier 2 capital | – | 3,513 |
| Regulatory deductions to Tier 2 capital | (28,484) | (53,510) |
| Significant capital investments in unconsolidated financial sector entities | (28,484) | (53,510) |
| Total tier 2 capital | 57,624 | 35,292 |
| Total capital | 474,235 | 425,037 |

1. Includes the revaluation surplus on investment properties which is reported as part of retained profits and adjustments made in accordance with the Banking (Capital) Rules issued by the HKMA.

Financial Review (continued)**Capital adequacy** (continued)

The following table shows the pro-forma Basel III end point basis position once all transitional arrangements have been phased out, based on the Transition Disclosures Template. It should be noted that the pro-forma Basel III end point basis position takes no account of, for example, any future profits or management actions. In addition, the current regulations or their application may change before full implementation. Given this, the final impact on the group's capital ratios may differ from the pro-forma position, which is a mechanical application of the current rules to the balance sheet at 30 June 2015; it is not a projection. On this pro-forma basis, the group's CET1 ratio is 12.5%, which is above the Basel III minimum requirement plus expected regulatory capital buffer requirements.

Reconciliation of regulatory capital from transitional basis to a pro-forma Basel III end point basis

| | At 30 June 2015 HK\$m | At 31 December 2014 HK\$m |
|-----------------------------------------------------------------------------------|--------------------------------------|---------------------------------|
| CET1 capital on a transitional basis | 389,725 | 389,745 |
| Transitional provisions: | | |
| Significant capital investments in unconsolidated financial sector entities | (50,624) | (100,676) |
| Excess AT1 deductions | – | 1,588 |
| CET1 capital end point basis | 339,101 | 290,657 |
| AT1 capital on a transitional basis | 26,886 | – |
| Grandfathered instruments: | | |
| Perpetual non-cumulative preference shares | (25,218) | (25,229) |
| Transitional provisions: | | |
| Allowable non-controlling interests in AT1 capital | (10,814) | (5,389) |
| Significant capital investments in unconsolidated financial sector entities | 25,312 | 50,338 |
| Excess AT1 deductions | – | (1,588) |
| AT1 capital end point basis | 16,166 | 18,132 |
| Tier 2 capital on a transitional basis | 57,624 | 35,292 |
| Grandfathered instruments: | | |
| Perpetual cumulative preference shares | (3,101) | (3,102) |
| Cumulative term preference shares | (8,140) | (8,143) |
| Perpetual subordinated debt | (9,324) | (9,337) |
| Term subordinated debt | (6,412) | (6,787) |
| Transitional provisions: | | |
| Significant capital investments in unconsolidated financial sector entities | 25,312 | 50,338 |
| Tier 2 capital end point basis | 55,959 | 58,261 |

Principal risks and uncertainties

The group continuously monitors and identifies risks. This process, which is informed by its risk factors and the results of its stress testing programme, gives rise to the classification of certain principal risks. Changes in the assessment of principal risks may result in adjustments to the group's business strategy and potentially, its risk appetite.

Our principal banking risks are credit risk, operational risk, market risk, liquidity and funding risk, reputational risk and insurance risk. There is no material change in the principal risks and uncertainties for the remaining six months of the financial year, the description of which can be found in the risk report of the Bank's *Annual Report and Accounts 2014*.

Statement of Directors' Responsibilities

The Directors, the names of whom are set out below, confirm to the best of their knowledge that:

- the condensed consolidated financial statements have been prepared in accordance with Hong Kong Accounting Standard ('HKAS') 34 'Interim Financial Reporting'; and
- the interim report includes a fair review of the information required by DTR4.2.7R of the Disclosure Rules and Transparency Rules issued by the UK Financial Conduct Authority, being an indication of important events that have occurred during the first six months of the financial year ending 31 December 2015 and their impact on the condensed consolidated financial statements; and a description of the principal risks and uncertainties for the remaining six months of the financial year.

Stuart T Gulliver (Chairman); Peter Wong Tung Shun (Deputy Chairman & Chief Executive);
Laura Cha May Lung*, GBS (Deputy Chairman); Zia Mody* (Deputy Chairman); Graham John Bradley*;
Dr Christopher Cheng Wai Chee*, GBS, OBE; Dr Raymond Ch'ien Kuo Fung*, GBS, CBE; Naina L Kidwai;
Irene Lee Yun-lien*; Rose Lee Wai Mun; Jennifer Li Xinzhe*; Victor Li Tzar Kuo[#]; James Riley*; John Robert Slosar*;
Dr Rosanna Wong Yick-ming*, DBE; Marjorie Yang Mun Tak*, GBS; Tan Sri Dr Francis Yeoh Sock Ping*, CBE

* *independent non-executive Director*

[#] *non-executive Director*

On behalf of the Board
Stuart T Gulliver, *Chairman*
3 August 2015

Condensed Consolidated Financial Statements (unaudited)

Consolidated Income Statement

| | <i>Note</i> | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|---------------------------------------------------------------------------------------------------|-------------|-----------------------------------------------------------|------------------------------------------------|
| Interest income | | 62,819 | 62,621 |
| Interest expense | | (15,875) | (15,434) |
| Net interest income | | 46,944 | 47,187 |
| Fee income | | 27,950 | 25,324 |
| Fee expense | | (3,059) | (2,903) |
| Net fee income | | 24,891 | 22,421 |
| Net trading income | | 13,727 | 10,234 |
| Net income from financial instruments designated at fair value | | 4,033 | 2,948 |
| Gains less losses from financial investments | | 11,205 | 3,413 |
| Dividend income | | 178 | 155 |
| Net insurance premium income | | 28,089 | 29,742 |
| Other operating income | | 5,353 | 4,608 |
| Total operating income | | 134,420 | 120,708 |
| Net insurance claims and benefits paid and movement in liabilities to policyholders | | (31,776) | (32,173) |
| Net operating income before loan impairment charges and other credit risk provisions | | 102,644 | 88,535 |
| Loan impairment charges and other credit risk provisions | 2 | (1,907) | (1,594) |
| Net operating income | | 100,737 | 86,941 |
| Employee compensation and benefits | | (21,043) | (19,285) |
| General and administrative expenses | | (14,751) | (13,548) |
| Depreciation of property, plant and equipment | | (2,165) | (2,026) |
| Amortisation and impairment of intangible assets | | (743) | (807) |
| Total operating expenses | | (38,702) | (35,666) |
| Operating profit | | 62,035 | 51,275 |
| Share of profit in associates and joint ventures | | 8,044 | 7,821 |
| Profit before tax | | 70,079 | 59,096 |
| Tax expense | 4 | (10,177) | (9,192) |
| Profit for the period | | 59,902 | 49,904 |
| Profit attributable to shareholders of the parent company | | 52,290 | 46,667 |
| Profit attributable to non-controlling interests | | 7,612 | 3,237 |

Condensed Consolidated Financial Statements (unaudited) (continued)**Consolidated Statement of Comprehensive Income**

| | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|---------------------------------------------------------------------------------------------------------------|------------------------------------------------|------------------------------------------------|
| Profit for the period | 59,902 | 49,904 |
| Other comprehensive income/(expense) | | |
| Items that will be reclassified subsequently to the income statement when specific conditions are met: | | |
| Available-for-sale investments: | | |
| – fair value changes taken to equity | 66 | 4,485 |
| – fair value changes transferred to the income statement on disposal | (15,330) | (3,407) |
| – amounts transferred to the income statement on impairment | – | (21) |
| – fair value changes transferred to the income statement on hedged items | (247) | (310) |
| – income taxes | 137 | (870) |
| Cash flow hedges: | | |
| – fair value changes taken to equity | 1,138 | (1,515) |
| – fair value changes transferred to the income statement | (789) | 1,337 |
| – income taxes | (117) | 46 |
| Share of other comprehensive income/(expense) of associates and joint venture | 197 | (277) |
| Exchange differences | (3,647) | (776) |
| Items that will not be reclassified subsequently to the income statement: | | |
| Property revaluation: | | |
| – fair value changes taken to equity | 3,889 | 1,768 |
| – income taxes | (661) | (278) |
| Remeasurement of defined benefit: | | |
| – before income taxes | (490) | (250) |
| – income taxes | 103 | 6 |
| Other comprehensive expense for the period, net of tax | (15,751) | (62) |
| Total comprehensive income for the period, net of tax | 44,151 | 49,842 |
| Total comprehensive income for the period attributable to: | | |
| – shareholders of the parent company | 41,576 | 46,748 |
| – non-controlling interests | 2,575 | 3,094 |
| | 44,151 | 49,842 |

Condensed Consolidated Financial Statements (unaudited) (continued)**Consolidated Balance Sheet**

| | <i>Note</i> | At 30 June 2015 HK\$m | At 31 December 2014 HK\$m |
|----------------------------------------------------------|-------------|------------------------------------------|----------------------------------------------|
| ASSETS | | | |
| Cash and sight balances at central banks | | 257,729 | 156,475 |
| Items in the course of collection from other banks | | 55,847 | 21,122 |
| Hong Kong Government certificates of indebtedness | | 217,864 | 214,654 |
| Trading assets | | 363,639 | 407,026 |
| Derivatives | | 375,485 | 389,934 |
| Financial assets designated at fair value | | 105,293 | 98,195 |
| Reverse repurchase agreements - non-trading | | 216,368 | 218,901 |
| Placings with and advances to banks | | 513,826 | 488,313 |
| Loans and advances to customers | 5 | 2,880,997 | 2,815,216 |
| Financial investments | | 1,549,957 | 1,456,493 |
| Amounts due from Group companies | | 204,904 | 191,694 |
| Interests in associates and joint ventures | 8 | 119,973 | 116,654 |
| Goodwill and intangible assets | | 47,035 | 45,078 |
| Property, plant and equipment | | 108,121 | 104,679 |
| Deferred tax assets | | 1,335 | 1,436 |
| Other assets | 9 | 149,292 | 150,876 |
| Total assets | | 7,167,665 | 6,876,746 |
| LIABILITIES | | | |
| Hong Kong currency notes in circulation | | 217,864 | 214,654 |
| Items in the course of transmission to other banks | | 82,606 | 31,331 |
| Repurchase agreements - non-trading | | 13,131 | 28,379 |
| Deposits by banks | | 213,464 | 226,713 |
| Customer accounts | 10 | 4,651,473 | 4,479,992 |
| Trading liabilities | | 252,062 | 215,812 |
| Derivatives | | 357,510 | 367,128 |
| Financial liabilities designated at fair value | | 52,119 | 48,834 |
| Debt securities in issue | | 42,756 | 45,297 |
| Retirement benefit liabilities | | 6,156 | 5,606 |
| Amounts due to Group companies | | 155,657 | 135,814 |
| Other liabilities and provisions | 11 | 90,394 | 87,731 |
| Liabilities under insurance contracts | | 329,203 | 310,182 |
| Current tax liabilities | | 6,534 | 2,927 |
| Deferred tax liabilities | | 19,282 | 18,586 |
| Subordinated liabilities | | 12,583 | 12,832 |
| Preference shares | | 36,565 | 36,582 |
| Total liabilities | | 6,539,359 | 6,268,400 |
| EQUITY | | | |
| Share capital | | 96,052 | 96,052 |
| Other equity instruments | | 14,737 | 14,737 |
| Other reserves | | 99,678 | 107,985 |
| Retained profits | | 359,714 | 324,811 |
| Proposed dividend | | 7,500 | 14,250 |
| Total shareholders' equity | | 577,681 | 557,835 |
| Non-controlling interests | | 50,625 | 50,511 |
| Total equity | | 628,306 | 608,346 |
| Total equity and liabilities | | 7,167,665 | 6,876,746 |

Consolidated Statement of Changes in Equity

| | Half- year ended 30 June 2015 | | | | | | | | | | |
|----------------------------------------------------------------------------------|-------------------------------|---------------------------------------------------|----------------------------------------------------------|----------------------------------------------------------|-----------------------------------------------------------------------|-----------------------------------------------------|------------------------------------------------------|------------------------------------------------|-------------------------------------------|--------------------------|-----------------------------|
| | Share capital HK\$m | Other equity instruments ⁶ HK\$m | Retained profits and proposed dividend HK\$m | Other reserves | | | | Total share- holders' equity HK\$m | Non- controlling interests HK\$m | Total equity HK\$m | |
| | | | | Property revaluation reserve ¹ HK\$m | Available- for-sale investment reserve ² HK\$m | Cash flow hedge reserve ³ HK\$m | Foreign exchange reserve ⁴ HK\$m | | | | Other ⁵ HK\$m |
| At 1 January 2015 | 96,052 | 14,737 | 339,061 | 48,481 | 16,537 | (166) | 1,872 | 41,261 | 557,835 | 50,511 | 608,346 |
| Profit for the period | - | - | 52,290 | - | - | - | - | - | 52,290 | 7,612 | 59,902 |
| Other comprehensive income (net of tax) | - | - | (594) | 2,998 | (9,715) | 226 | (3,608) | (21) | (10,714) | (5,037) | (15,751) |
| Available-for-sale investments | - | - | - | - | (9,926) | - | - | - | (9,926) | (5,448) | (15,374) |
| Cash flow hedges | - | - | - | - | - | 226 | - | - | 226 | 6 | 232 |
| Property revaluation | - | - | (117) | 2,998 | - | - | - | - | 2,881 | 347 | 3,228 |
| Actuarial losses/(gains) on defined benefit plans | - | - | (479) | - | - | - | - | - | (479) | 92 | (387) |
| Share of other comprehensive income of associates and joint ventures | - | - | 2 | - | 211 | - | - | (16) | 197 | - | 197 |
| Exchange differences | - | - | - | - | - | - | (3,608) | (5) | (3,613) | (34) | (3,647) |
| Total comprehensive income for the period | - | - | 51,696 | 2,998 | (9,715) | 226 | (3,608) | (21) | 41,576 | 2,575 | 44,151 |
| Dividends paid | - | - | (21,750) | - | - | - | - | - | (21,750) | (2,461) | (24,211) |
| Movement in respect of share-based payment arrangements | - | - | 4 | - | - | - | - | 32 | 36 | 1 | 37 |
| Other movements | - | - | (1) | (15) | - | - | - | - | (16) | (1) | (17) |
| Transfers ⁷ | - | - | (1,796) | (794) | - | - | - | 2,590 | - | - | - |
| At 30 June 2015 | 96,052 | 14,737 | 367,214 | 50,670 | 6,822 | 60 | (1,736) | 43,862 | 577,681 | 50,625 | 628,306 |

For footnotes, see page 25.

Consolidated Statement of Changes in Equity (continued)

Half-year ended 31 December 2014

| | Share capital HK\$m | Other equity instruments ⁶ HK\$m | Retained profits and proposed dividend HK\$m | Other reserves | | | | | Total shareholders' equity HK\$m | Non-controlling interests HK\$m | Total equity HK\$m |
|----------------------------------------------------------------------------|------------------------|------------------------------------------------|-------------------------------------------------|----------------------------------------------------|-------------------------------------------------------------|-----------------------------------------------|------------------------------------------------|-----------------------------|-------------------------------------|------------------------------------|-----------------------|
| | | | | Property revaluation reserve ¹ HK\$m | Available-for-sale investment reserve ² HK\$m | Cash flow hedge reserve ³ HK\$m | Foreign exchange reserve ⁴ HK\$m | Other ⁵ HK\$m | | | |
| At 1 July 2014 | 96,052 | – | 326,035 | 47,017 | 2,606 | 66 | 9,150 | 32,860 | 513,786 | 41,946 | 555,732 |
| Profit for the period | – | – | 39,761 | – | – | – | – | – | 39,761 | 2,512 | 42,273 |
| Other comprehensive income (net of tax) | – | – | (569) | 2,136 | 13,622 | (232) | (7,278) | (7) | 7,672 | 7,613 | 15,285 |
| Available-for-sale investments | – | – | – | – | 13,007 | – | – | – | 13,007 | 7,300 | 20,307 |
| Cash flow hedges | – | – | – | – | – | (232) | – | – | (232) | (6) | (238) |
| Property revaluation | – | – | (113) | 2,136 | – | – | – | – | 2,023 | 266 | 2,289 |
| Actuarial losses/(gains) on defined benefit plans | – | – | (448) | – | – | – | – | – | (448) | 29 | (419) |
| Share of other comprehensive income of associates and joint ventures | – | – | (5) | – | 615 | – | – | (7) | 603 | – | 603 |
| Exchange differences | – | – | (3) | – | – | – | (7,278) | – | (7,281) | 24 | (7,257) |
| Total comprehensive income for the period | – | – | 39,192 | 2,136 | 13,622 | (232) | (7,278) | (7) | 47,433 | 10,125 | 57,558 |
| Other equity instruments issued | – | 14,737 | – | – | – | – | – | – | 14,737 | – | 14,737 |
| Dividends paid | – | – | (18,500) | – | – | – | – | – | (18,500) | (1,593) | (20,093) |
| Movement in respect of share-based payment arrangements | – | – | (15) | – | – | – | – | 72 | 57 | 2 | 59 |
| Other movements | – | – | 16 | – | 306 | – | – | – | 322 | 31 | 353 |
| Transfers ⁷ | – | – | (7,667) | (672) | 3 | – | – | 8,336 | – | – | – |
| At 31 December 2014 | 96,052 | 14,737 | 339,061 | 48,481 | 16,537 | (166) | 1,872 | 41,261 | 557,835 | 50,511 | 608,346 |

For footnotes, see page 25.

Consolidated Statement of Changes in Equity (continued)

| | Half-year ended 30 June 2014 | | | | | | | | | |
|----------------------------------------------------------------------------|------------------------------|-------------------------------------------------|-------------------------------------------------------------|-----------------------------------------------|------------------------------------------------|-----------------------------|--------|-------------------------------------|------------------------------------|-----------------------|
| | Share capital HK\$m | Retained profits and proposed dividend HK\$m | Other reserves | | | | | Total shareholders' equity HK\$m | Non-controlling interests HK\$m | Total equity HK\$m |
| Property revaluation reserve ¹ HK\$m | | | Available-for-sale investment reserve ² HK\$m | Cash flow hedge reserve ³ HK\$m | Foreign exchange reserve ⁴ HK\$m | Other ⁵ HK\$m | | | | |
| At 1 January 2014 | 85,319 | 305,926 | 46,336 | 3,280 | 197 | 9,619 | 30,132 | 480,809 | 41,415 | 522,224 |
| Profit for the period | – | 46,667 | – | – | – | – | – | 46,667 | 3,237 | 49,904 |
| Other comprehensive income (net of tax) | – | (361) | 1,404 | (367) | (131) | (469) | 5 | 81 | (143) | (62) |
| Available-for-sale investments | – | – | – | (75) | – | – | – | (75) | (48) | (123) |
| Cash flow hedges | – | – | – | – | (131) | – | – | (131) | (1) | (132) |
| Property revaluation | – | (107) | 1,404 | – | – | – | – | 1,297 | 193 | 1,490 |
| Actuarial losses/(gains) on defined benefit plans | – | (267) | – | – | – | – | – | (267) | 23 | (244) |
| Share of other comprehensive income of associates and joint ventures | – | 10 | – | (292) | – | – | 5 | (277) | – | (277) |
| Exchange differences | – | 3 | – | – | – | (469) | – | (466) | (310) | (776) |
| Total comprehensive income for the period | – | 46,306 | 1,404 | (367) | (131) | (469) | 5 | 46,748 | 3,094 | 49,842 |
| Shares issued | 10,733 | – | – | – | – | – | – | 10,733 | – | 10,733 |
| Dividends paid | – | (24,250) | – | – | – | – | – | (24,250) | (2,388) | (26,638) |
| Movement in respect of share-based payment arrangements | – | (126) | – | – | – | – | 189 | 63 | 3 | 66 |
| Other movements | – | (10) | – | (307) | – | – | – | (317) | (178) | (495) |
| Transfers ⁷ | – | (1,811) | (723) | – | – | – | 2,534 | – | – | – |
| At 30 June 2014 | 96,052 | 326,035 | 47,017 | 2,606 | 66 | 9,150 | 32,860 | 513,786 | 41,946 | 555,732 |

1 The property revaluation reserve represents the difference between the fair value of the property and its depreciated cost.

2 The available-for-sale investment reserve includes the cumulative net change in the fair value of available-for-sale investments other than impairments which have been recognised in the income statement.

3 The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions.

4 The foreign exchange reserve comprises all foreign exchange differences arising from the translation of the Financial Statements of foreign operations as well as from the translation of liabilities that hedge the Bank's net investments in foreign operations.

5 The other reserves mainly comprise the share-based payment reserve account, purchase premium arising from transfer of business within the HSBC Group and other non-distributable reserves. The share-based payment reserve account is used to record the amount relating to share options granted to employees of the group directly by HSBC Holdings plc.

6 During 2014, the Bank issued new capital instruments that are included in the group's capital base as Basel III-compliant additional tier 1 capital under the Banking (Capital) Rules.

7 The movement from Retained profits to Other reserves mainly includes the relevant transfers in an associate according to local regulatory requirements.

Condensed Consolidated Financial Statements (unaudited) (continued)**Consolidated Cash Flow Statement**

| | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|------------------------------------------------------------------------------------|------------------------------------------------|------------------------------------------------|
| Operating activities | | |
| Cash generated from operations | 173,685 | 29,841 |
| Interest received on financial investments | 7,683 | 7,477 |
| Dividends received on financial investments | 233 | 85 |
| Dividends received from associates | 79 | 70 |
| Taxation paid | (4,376) | (4,739) |
| Net cash inflow from operating activities | 177,304 | 32,734 |
| Investing activities | | |
| Purchase of financial investments | (270,772) | (186,839) |
| Proceeds from sale or redemption of financial investments | 265,324 | 204,118 |
| Purchase of property, plant and equipment | (1,853) | (917) |
| Proceeds from sale of property, plant and equipment and assets held for sale | 343 | 153 |
| Purchase of other intangible assets | (741) | (678) |
| Net cash inflow from the sale of interests in business portfolios | 4,001 | 2,953 |
| Net cash (outflow)/inflow from investing activities | (3,698) | 18,790 |
| Net cash inflow before financing activities | 173,606 | 51,524 |
| Financing activities | | |
| Issue of ordinary share capital | – | 10,733 |
| Issue of subordinated liabilities | – | 12,402 |
| Redemption of preference shares | – | (10,736) |
| Ordinary dividends paid | (21,750) | (24,250) |
| Dividends paid to non-controlling interests | (2,461) | (2,388) |
| Interest paid on preference shares | (550) | (790) |
| Interest paid on subordinated liabilities | (510) | (462) |
| Net cash outflow from financing activities | (25,271) | (15,491) |
| Increase in cash and cash equivalents | 148,335 | 36,033 |
| Changes in cash and cash equivalents | | |
| | 2015 | 2014 |
| | HK\$m | HK\$m |
| At 1 January | 679,670 | 687,596 |
| Net cash inflow before the effect of foreign exchange movements | 148,335 | 36,033 |
| Effect of foreign exchange movements | (11,052) | 4,590 |
| At 30 June | 816,953 | 728,219 |

Notes on the Condensed Consolidated Financial Statements (unaudited)

1 Basis of preparation

a Compliance with Hong Kong Financial Reporting Standards

The Financial Statements of the group have been prepared in accordance with HKAS 34 'Interim Financial Reporting' as issued by the Hong Kong Institute of Certified Public Accountants ('HKICPA'). The Financial Statements should be read in conjunction with the Bank's *Annual Report and Accounts 2014* which have been prepared in accordance with Hong Kong Financial Reporting Standards issued by the HKICPA.

Standards adopted during the half year to 30 June 2015

There were no new standards adopted during the half year to 30 June 2015.

During the half year to 30 June 2015, the group applied a number of amendments to standards which had an insignificant effect on the Financial Statements.

New Companies Ordinance

The new Companies Ordinance that came into effect on 3 March 2014 has no material impact on the Financial Statements.

b Use of estimates and judgements

Management believes that the group's critical accounting estimates and judgements are those which relate to impairment of loans and advances, goodwill impairment, the valuation of financial instruments, deferred tax assets, provisions for liabilities and interests in associates. There was no change in the current period to the critical accounting estimates and judgements applied in 2014, which are stated in note 2 of the Bank's *Annual Report and Accounts 2014*.

c Composition of group

There were no material changes in the composition of the group in the half year to 30 June 2015.

d Future accounting developments

Information on future accounting developments and their potential effect on the Financial Statements of the group are provided in note 1 of the Bank's *Annual Report and Accounts 2014*.

e Going concern

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

f Accounting policies

The accounting policies and methods of computation applied by the group for the Financial Statements are consistent with those described in note 3 of the Bank's *Annual Report and Accounts 2014*. The methods of computation applied by the group for the Financial Statements are consistent with those applied for the Bank's *Annual Report and Accounts 2014*.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**2. Loan impairment charges and other credit risk provisions**

| | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|----------------------------------------------------------------|-----------------------------------------------------------|------------------------------------------------|
| Individually assessed impairment charges: | | |
| New charges | 1,716 | 1,138 |
| Releases | (964) | (759) |
| Recoveries | (116) | (70) |
| | 636 | 309 |
| Collectively assessed impairment charges | 1,238 | 1,285 |
| Other credit risk provisions | 33 | – |
| Loan impairment charges and other credit risk provisions | 1,907 | 1,594 |

There were no impairment losses or provisions against held-to-maturity or available-for-sale debt investments (2014: nil).

3. Dividends

| | Half-year ended 30 June 2015 | | Half-year ended 30 June 2014 | |
|------------------------------------------------------------------------------------------------------------------|-----------------------------------------|---------------|---------------------------------|---------------|
| | HK\$ per share | HK\$m | HK\$ per share | HK\$m |
| Ordinary dividends paid | | | | |
| – fourth interim dividend in respect of the previous financial year approved and paid during the half-year | 0.37 | 14,250 | 0.44 | 15,000 |
| – first interim dividend paid | 0.20 | 7,500 | 0.27 | 9,250 |
| | 0.57 | 21,750 | 0.71 | 24,250 |

The Directors have declared a second interim dividend in respect of the half-year ended 30 June 2015 of HK\$0.20 per ordinary share (HK\$7,500m) (half-year ended 30 June 2014 of HK\$0.24 per ordinary share (HK\$9,250m)).

4. Tax expense

The tax expense in the consolidated income statement comprises:

| | Half-year ended 30 June 2015 HK\$m | Half-year ended 30 June 2014 HK\$m |
|-------------------------------|-----------------------------------------------------------|------------------------------------------------|
| Current income tax | | |
| – Hong Kong profits tax | 5,409 | 4,547 |
| – Overseas taxation | 4,482 | 4,553 |
| Deferred taxation | 286 | 92 |
| | 10,177 | 9,192 |

The effective tax rate for the first half of 2015 was 14.5%, compared with 15.5% for the first half of 2014, as the non-taxable gains from disposal of available-for-sale investments were significantly higher in 2015.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**5. Loans and advances to customers**

| | At 30 June 2015 HK\$m | At 31 December 2014 HK\$m |
|----------------------------------------------------------------------|--------------------------------|------------------------------------|
| Gross loans and advances to customers | 2,891,834 | 2,825,736 |
| Impairment allowances: | | |
| – Individually assessed | (6,590) | (6,299) |
| – Collectively assessed | (4,247) | (4,221) |
| | <u>(10,837)</u> | <u>(10,520)</u> |
| Net loans and advances to customers | <u>2,880,997</u> | <u>2,815,216</u> |
| Allowances as a percentage of gross loans and advances to customers: | | |
| – Individually assessed | 0.22% | 0.22% |
| – Collectively assessed | 0.15% | 0.15% |
| Total allowances | <u>0.37%</u> | <u>0.37%</u> |

6. Impairment allowances against loans and advances to customers

| | Individually assessed HK\$m | Collectively assessed HK\$m | Total HK\$m |
|----------------------------------------------------------------------|-----------------------------------|-----------------------------------|----------------|
| At 1 January 2015 | 6,299 | 4,221 | 10,520 |
| Amounts written off | (246) | (1,595) | (1,841) |
| Recoveries of loans and advances written off in previous years | 117 | 489 | 606 |
| Net charge to income statement | 636 | 1,238 | 1,874 |
| Unwinding of discount of loan impairment | (100) | (36) | (136) |
| Exchange and other adjustments | (116) | (70) | (186) |
| At 30 June 2015 | 6,590 | 4,247 | 10,837 |
| | | | |
| At 1 January 2014 | 5,007 | 4,494 | 9,501 |
| Amounts written off | (399) | (1,709) | (2,108) |
| Recoveries of loans and advances written off in previous years | 70 | 514 | 584 |
| Net charge to income statement | 309 | 1,285 | 1,594 |
| Unwinding of discount of loan impairment | (64) | (42) | (106) |
| Exchange and other adjustments | 128 | – | 128 |
| At 30 June 2014 | <u>5,051</u> | <u>4,542</u> | <u>9,593</u> |

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**7. Analysis of loans and advances to customers based on categories used by the HSBC Group**

The following analysis of loans and advances to customers is based on categories used by the HSBC Group, including The Hongkong and Shanghai Banking Corporation Limited and its subsidiaries, to manage associated risks.

| | Hong Kong HK\$m | Rest of Asia-Pacific HK\$m | Total HK\$m |
|------------------------------------------------------|--------------------|----------------------------------|------------------|
| At 30 June 2015 | | | |
| Residential mortgages | 456,475 | 281,342 | 737,817 |
| Credit card advances | 52,287 | 23,376 | 75,663 |
| Other personal | 136,708 | 76,000 | 212,708 |
| Total personal | 645,470 | 380,718 | 1,026,188 |
| Commercial, industrial and international trade | 432,876 | 437,553 | 870,429 |
| Commercial real estate | 189,773 | 75,732 | 265,505 |
| Other property-related lending | 241,455 | 64,897 | 306,352 |
| Government | 5,962 | 2,697 | 8,659 |
| Other commercial | 137,943 | 157,285 | 295,228 |
| Total corporate and commercial | 1,008,009 | 738,164 | 1,746,173 |
| Non-bank financial institutions | 71,245 | 41,112 | 112,357 |
| Settlement accounts | 6,350 | 766 | 7,116 |
| Total financial | 77,595 | 41,878 | 119,473 |
| Gross loans and advances to customers | 1,731,074 | 1,160,760 | 2,891,834 |
| Individually assessed impairment allowances | (2,146) | (4,444) | (6,590) |
| Collectively assessed impairment allowances | (2,114) | (2,133) | (4,247) |
| Net loans and advances to customers | 1,726,814 | 1,154,183 | 2,880,997 |
| At 31 December 2014 | | | |
| Residential mortgages | 439,451 | 283,042 | 722,493 |
| Credit card advances | 54,943 | 24,863 | 79,806 |
| Other personal | 122,613 | 79,670 | 202,283 |
| Total personal | 617,007 | 387,575 | 1,004,582 |
| Commercial, industrial and international trade | 416,759 | 440,967 | 857,726 |
| Commercial real estate | 201,103 | 75,631 | 276,734 |
| Other property-related lending | 203,850 | 62,810 | 266,660 |
| Government | 6,613 | 2,654 | 9,267 |
| Other commercial | 150,314 | 151,930 | 302,244 |
| Total corporate and commercial | 978,639 | 733,992 | 1,712,631 |
| Non-bank financial institutions | 61,264 | 42,747 | 104,011 |
| Settlement accounts | 3,887 | 625 | 4,512 |
| Total financial | 65,151 | 43,372 | 108,523 |
| Gross loans and advances to customers | 1,660,797 | 1,164,939 | 2,825,736 |
| Individually assessed impairment allowances | (2,411) | (3,888) | (6,299) |
| Collectively assessed impairment allowances | (2,103) | (2,118) | (4,221) |
| Net loans and advances to customers | 1,656,283 | 1,158,933 | 2,815,216 |

Loans and advances to customers in Hong Kong increased by HK\$70bn, or 4%, during the first half of 2015, mainly from growth in corporate and commercial lending of HK\$29bn, reflecting the Bank's continued support to business. Residential mortgage lending and other personal lending also increased by HK\$17bn and HK\$14bn respectively.

In the Rest of Asia-Pacific, loans and advances to customers decreased by HK\$4bn, or 0.4%, including unfavourable foreign exchange translation effects of HK\$61bn. The underlying increase of HK\$57bn was mainly from growth in corporate and commercial lending of HK\$39bn from business growth in India, Malaysia and mainland China.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**8. Interests in associates and joint ventures****Bank of Communications Co., Limited ('BoCom')***Impairment testing*

At 30 June 2015, the fair value of the group's investment in BoCom had been below the carrying amount for approximately 38 months, apart from a short period in 2013 and briefly during the first half of 2015. As a result, the group performed an impairment test on the carrying amount of the investment in BoCom. The test confirmed that there was no impairment as at 30 June 2015.

| | At 30 June 2015 | | | At 31 December 2014 | | |
|--------------------|-----------------|-----------------------------|-------------------------|---------------------|-----------------------------|-------------------------|
| | VIU HK\$bn | Carrying Value HK\$bn | Fair Value HK\$bn | VIU HK\$bn | Carrying Value HK\$bn | Fair Value HK\$bn |
| BoCom | 127.9 | 117.1 | 114.2 | 121.7 | 113.8 | 101.9 |

Basis of recoverable amount

The impairment test was performed by comparing the recoverable amount of BoCom, determined by a value-in-use ('VIU') calculation, with its carrying amount. The VIU calculation uses discounted cash flow projections based on management's estimates of earnings. Cash flows beyond the short- to medium-term are then extrapolated in perpetuity using a long-term growth rate. An imputed capital maintenance charge ('CMC') is included to meet the expected regulatory capital requirements, and calculated as a deduction from forecast cash flows. The principal inputs to the CMC calculation include estimates of asset growth, the ratio of risk-weighted assets to total assets, and the expected regulatory capital requirements. Management judgement is required in estimating the future cash flows of BoCom.

During 2015, the long-term asset growth rate was further identified as a key assumption to which the VIU is sensitive.

Key assumptions in VIU calculation

Long-term growth rate: the growth rate used was 5% (2014: 5%) for periods after 2018 and does not exceed forecast GDP growth in China.

Long-term asset growth rate: the growth rate used was 4% (2014: 4%) for periods after 2018 and this is the rate of growth required for an assumed 5% long-term growth rate in profit.

Discount rate: the discount rate of 13% (2014: 13%) is derived from a range of values obtained by applying a Capital Asset Pricing Model ('CAPM') calculation for BoCom, using market data. Management supplements this by comparing the rates derived by CAPM with discount rates available from external sources, and HSBC's discount rate for evaluating investments in China. The discount rate used was within the range of 10.1% to 14.3% (2014: 11.4% to 14.2%) indicated by the CAPM and external sources.

Loan impairment charge as a percentage of customer advances: the ratio used ranges from 0.73% to 1% (2014: 0.73% to 1%) in the short- to medium-term. The long-term ratio was assumed to revert to a historical rate of 0.65% (2014: 0.65%). The rates were within the short- to medium-term range forecasts of 0.54% to 1.02% (2014: 0.51% to 1.08%) disclosed by external analysts.

Risk-weighted assets as a percentage of total assets: the ratio used ranges from 70% to 72% (2014: 70% to 72%) in the short- to medium-term. The long-term ratio reverts to a rate of 70% (2014: 70%).

Cost-income ratio: the ratio used was 41% (2014: ranged from 40% to 42.4%) in the short- to medium-term. The ratios were within the short- to medium-term range forecasts of 37.5% to 43.5% (2014: 37.2% to 44.5%) disclosed by external analysts.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**8. Interests in associates and joint ventures** (continued)

Sensitivity analyses were performed on each key assumption to ascertain the impact of reasonably possible changes in assumptions. The following changes to each key assumption on its own used in the VIU calculation would be necessary to reduce headroom to nil:

| Key assumption | Changes to key assumption to reduce headroom to nil |
|---------------------------------------------------------------|-----------------------------------------------------|
| • Long-term growth rate | • Decrease by 56 basis points |
| • Long-term asset growth rate | • Increase by 56 basis points |
| • Discount rate | • Increase by 72 basis points |
| • Loan impairment charge as a percentage of customer advances | • Increase by 12 basis points |
| • Risk-weighted assets as a percentage of total assets | • Increase by 4.4% |
| • Cost-income ratio | • Increase by 2.5% |

9. Other assets

| | At 30 June 2015 HK\$m | At 31 December 2014 HK\$m |
|--------------------------------------|--------------------------------|------------------------------------|
| Current tax assets | 609 | 2,418 |
| Assets held for sale | 120 | 148 |
| Prepayments and accrued income | 10,201 | 3,821 |
| Accrued interest receivable | 18,259 | 18,370 |
| Acceptances and endorsements | 31,496 | 31,200 |
| Gold bullion | 51,636 | 59,401 |
| Other | 36,971 | 35,518 |
| | 149,292 | 150,876 |

'Other' includes other financial assets and insurance debtors.

10. Customer accounts

| | At 30 June 2015 HK\$m | At 31 December 2014 HK\$m |
|------------------------------|--------------------------------|------------------------------------|
| Current accounts | 995,645 | 919,343 |
| Savings accounts | 2,489,693 | 2,379,651 |
| Other deposit accounts | 1,166,135 | 1,180,998 |
| | 4,651,473 | 4,479,992 |

11. Other liabilities and provisions

| | At 30 June 2015 HK\$m | At 31 December 2014 HK\$m |
|----------------------------------------------------------|--------------------------------|------------------------------------|
| Accruals and deferred income | 23,903 | 26,435 |
| Provisions for liabilities and charges | 538 | 1,141 |
| Acceptances and endorsements | 31,496 | 31,200 |
| Share-based payment liability to HSBC Holdings plc | 1,851 | 2,186 |
| Other liabilities | 32,606 | 26,769 |
| | 90,394 | 87,731 |

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**12. Contingent liabilities and commitments**

| | At 30 June 2015 HK\$m | At 31 December 2014 HK\$m |
|------------------------------|--------------------------------|------------------------------------|
| Contract amount: | | |
| Contingent liabilities | 256,220 | 248,127 |
| Commitments | 1,975,816 | 1,896,242 |
| | 2,232,036 | 2,144,369 |

The above analysis discloses the nominal principal amounts of commitments, excluding capital commitments, guarantees and other contingent liabilities, which are mainly credit-related instruments including both financial and non-financial guarantees and commitments to extend credit.

13. Segmental analysis

The basis of identifying segments and measuring segmental results is set out in note 46 'Segmental Analysis' of the Bank's *Annual Report and Accounts 2014*. There have been no material changes to the segments since 31 December 2014.

| Geographical regions | Hong Kong HK\$m | Rest of Asia- Pacific HK\$m | Intra-segment elimination HK\$m | Total HK\$m |
|-----------------------------------------|--------------------|-----------------------------------|---------------------------------------|----------------|
| Half-year ended 30 June 2015 | | | | |
| Total operating income | 98,494 | 38,003 | (2,077) | 134,420 |
| Profit before tax | 46,528 | 23,551 | – | 70,079 |
| Total assets | 4,955,249 | 2,771,602 | (559,186) | 7,167,665 |
| Total liabilities | 4,638,322 | 2,460,223 | (559,186) | 6,539,359 |
| Half-year ended 30 June 2014 | | | | |
| Total operating income | 84,375 | 38,409 | (2,076) | 120,708 |
| Profit before tax | 34,359 | 24,737 | – | 59,096 |
| Total assets | 4,511,362 | 2,770,964 | (516,663) | 6,765,663 |
| Total liabilities | 4,252,591 | 2,474,003 | (516,663) | 6,209,931 |
| Half-year ended 31 December 2014 | | | | |
| Total operating income | 75,938 | 38,912 | (1,987) | 112,863 |
| Profit before tax | 28,607 | 23,486 | – | 52,093 |
| Total assets | 4,630,716 | 2,788,418 | (542,388) | 6,876,746 |
| Total liabilities | 4,325,607 | 2,485,181 | (542,388) | 6,268,400 |

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**14. Fair values of financial instruments carried at fair value**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

The following table provides an analysis of the basis for the valuation of financial assets and financial liabilities carried at fair value in the Financial Statements:

| | Valuation techniques | | | Third party total HK\$m | Amounts with HSBC entities HK\$m | Total HK\$m |
|------------------------------------------------------|-----------------------------------------|---------------------------------------------|----------------------------------------------------------|----------------------------|----------------------------------------|------------------|
| | Quoted market price Level 1 HK\$m | Using observable inputs Level 2 HK\$m | With significant unobservable inputs Level 3 HK\$m | | | |
| At 30 June 2015 | | | | | | |
| Assets | | | | | | |
| Trading assets | 178,179 | 185,058 | 402 | 363,639 | – | 363,639 |
| Derivatives | 12,093 | 252,227 | 759 | 265,079 | 110,406 | 375,485 |
| Financial assets designated at fair value | 71,077 | 31,613 | 2,603 | 105,293 | – | 105,293 |
| Available-for-sale investments | 834,090 | 496,395 | 7,263 | 1,337,748 | – | 1,337,748 |
| | 1,095,439 | 965,293 | 11,027 | 2,071,759 | 110,406 | 2,182,165 |
| Liabilities | | | | | | |
| Trading liabilities | 76,185 | 165,550 | 10,327 | 252,062 | – | 252,062 |
| Derivatives | 12,474 | 236,299 | 1,240 | 250,013 | 107,497 | 357,510 |
| Financial liabilities designated at fair value | – | 52,119 | – | 52,119 | – | 52,119 |
| | 88,659 | 453,968 | 11,567 | 554,194 | 107,497 | 661,691 |
| At 31 December 2014 | | | | | | |
| Assets | | | | | | |
| Trading assets | 210,397 | 196,464 | 165 | 407,026 | – | 407,026 |
| Derivatives | 9,039 | 281,764 | 785 | 291,588 | 98,346 | 389,934 |
| Financial assets designated at fair value | 73,337 | 22,947 | 1,911 | 98,195 | – | 98,195 |
| Available-for-sale investments | 736,254 | 530,901 | 6,712 | 1,273,867 | – | 1,273,867 |
| | 1,029,027 | 1,032,076 | 9,573 | 2,070,676 | 98,346 | 2,169,022 |
| Liabilities | | | | | | |
| Trading liabilities | 63,614 | 140,045 | 12,153 | 215,812 | – | 215,812 |
| Derivatives | 10,766 | 248,550 | 1,108 | 260,424 | 106,704 | 367,128 |
| Financial liabilities designated at fair value | – | 48,834 | – | 48,834 | – | 48,834 |
| | 74,380 | 437,429 | 13,261 | 525,070 | 106,704 | 631,774 |

Details of the control framework, fair values determined using valuation techniques, fair value adjustments, and the approach used to calculate the fair value of each type of financial instrument are included in note 49 of the Bank's Annual Report and Accounts 2014.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**14. Fair values of financial instruments carried at fair value** (continued)

The table below sets out quantitative information about significant unobservable inputs used in measuring financial instruments with Level 3 valuations.

| Valuation technique | Key unobservable inputs | Assets- fair value HK\$m | Liabilities- fair value HK\$m | Range of inputs | |
|------------------------------------------------|-----------------------------|--------------------------------|-------------------------------------|-----------------|--------|
| | | | | Lower | Higher |
| At 30 June 2015 | | | | | |
| Structured notes and deposits | | | | | |
| Option model | Equity correlation | – | 2,747 | 0.35 | 0.91 |
| Option model | Equity volatility | – | 5,274 | 12% | 55% |
| Option model | Interest rate correlation | – | 1,029 | 0.42 | 0.99 |
| Option model | Foreign exchange volatility | – | 1,120 | 2% | 18% |
| Corporate bonds | | | | | |
| Market comparable approach | Bid quotes | 1,310 | – | 99.94 | 101.52 |
| Private equity including strategic investments | | | | | |
| Market comparable approach | Multiples | 4,015 | – | 0.36 | 35.24 |
| Net asset value | Equity valuation | 871 | – | n/a | n/a |
| Net asset value | Fund valuation | 2,862 | – | n/a | n/a |
| Broker pricing | Bid quotes | 620 | – | 0.46 | 0.47 |
| Other | | 1,349 | 1,397 | | |
| | | 11,027 | 11,567 | | |
| At 31 December 2014 | | | | | |
| Structured notes and deposits | | | | | |
| Option model | Equity correlation | – | 6,342 | 0.27 | 0.92 |
| Option model | Equity volatility | – | 3,354 | 12% | 50% |
| Option model | Interest rate correlation | – | 791 | 0.40 | 0.96 |
| Option model | Foreign exchange volatility | – | 1,509 | 4% | 19% |
| Corporate bonds | | | | | |
| Market comparable approach | Bid quotes | 765 | – | 97.60 | 99.69 |
| Private equity including strategic investments | | | | | |
| Market comparable approach | Multiples | 4,189 | – | 0.62 | 36.66 |
| Net asset value | Equity valuation | 704 | – | n/a | n/a |
| Net asset value | Fund valuation | 2,108 | – | n/a | n/a |
| Broker pricing | Bid quotes | 610 | – | 0.44 | 0.47 |
| Other | | 1,197 | 1,265 | | |
| | | 9,573 | 13,261 | | |

For descriptions of the key unobservable inputs and the inter-relationships between key unobservable inputs used in fair value measurement, please refer to note 49 of the Bank's Annual Report and Accounts 2014.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**14. Fair values of financial instruments carried at fair value** (continued)

Movement in Level 3 financial instruments

| | Assets | | | | Liabilities | |
|-----------------------------------------------------------------------------------------------------------------------------------|-----------------------------|---------------------------|----------------------------------------------------------|----------------------|---------------------------|----------------------|
| | Available-for-sale HK\$m | Held for trading HK\$m | Designated at fair value through profit or loss HK\$m | Derivatives HK\$m | Held for trading HK\$m | Derivatives HK\$m |
| At 1 January 2015 | 6,712 | 165 | 1,911 | 785 | 12,153 | 1,108 |
| Total gains/(losses) recognised in profit or loss | 4 | 4 | 137 | 191 | (829) | 349 |
| – Trading income excluding net interest income | – | 4 | – | 191 | (829) | 349 |
| – Net income from other financial instruments designated at fair value | – | – | 137 | – | – | – |
| – Gains less losses from financial investments | 4 | – | – | – | – | – |
| Total gains/(losses) recognised in other comprehensive income ¹ | 61 | – | (1) | (1) | (163) | (2) |
| – Available-for-sale investments: fair value gains | 96 | – | – | – | – | – |
| – Exchange differences | (35) | – | (1) | (1) | (163) | (2) |
| Purchases | 527 | 283 | 1,283 | – | – | – |
| Issues | – | – | – | – | 3,312 | – |
| Sales | (41) | (19) | (45) | – | – | – |
| Deposits/settlements | – | – | (368) | (69) | (821) | (62) |
| Transfers out | – | (31) | (314) | (147) | (3,698) | (153) |
| Transfers in | – | – | – | – | 373 | – |
| At 30 June 2015 | 7,263 | 402 | 2,603 | 759 | 10,327 | 1,240 |
| Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 30 June 2015 ¹ | – | 5 | 136 | 116 | – | (18) |
| – Trading income excluding net interest income | – | 5 | – | 116 | – | (18) |
| – Net income from other financial instruments designated at fair value | – | – | 136 | – | – | – |
| – Impairment charges | – | – | – | – | – | – |

1 The amount has been reported on a net basis, after taking into consideration the total gains or losses arising from those transactions where the risk has been backed out to other HSBC entities.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**14. Fair values of financial instruments carried at fair value** (continued)

| | Assets | | | | Liabilities | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------|------------------------------|----------------------------------------------------------------------|----------------------|----------------------------------|------------------------------|----------------------|
| | Available- for-sale HK\$m | Held for trading HK\$m | Designated at fair value through profit or loss HK\$m | Derivatives HK\$m | Assets held for sale HK\$m | Held for trading HK\$m | Derivatives HK\$m |
| At 1 January 2014 | 11,218 | 664 | 1,353 | 1,112 | 4,295 | 17,829 | 1,445 |
| Total gains/(losses) recognised in profit or loss | 91 | 1 | 177 | 16 | 3,332 | (242) | (185) |
| – Trading income excluding net interest income | – | 1 | – | 16 | – | (242) | (185) |
| – Net income from other financial instruments designated at fair value | – | – | 177 | – | – | – | – |
| – Gains less losses from financial investments | 91 | – | – | – | 3,332 | – | – |
| Total gains/(losses) recognised in other comprehensive income ¹ | 293 | – | – | 3 | (3,458) | (6) | (4) |
| – Available-for-sale investments: fair value gains/(losses) | 305 | – | – | – | (3,458) | – | – |
| – Exchange differences | (12) | – | – | 3 | – | (6) | (4) |
| Purchases | 1,359 | 379 | 292 | – | – | – | – |
| Issues | – | – | – | – | – | 2,971 | – |
| Sales | (38) | (412) | (21) | – | (4,169) | – | – |
| Deposits/settlements | (3,235) | – | (221) | (84) | – | 307 | 155 |
| Transfers out | – | (91) | – | (348) | – | (1,971) | (233) |
| Transfers in | – | – | 26 | 7 | – | – | 92 |
| At 30 June 2014 | 9,688 | 541 | 1,606 | 706 | – | 18,888 | 1,270 |
| Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held at 30 June 2014 ¹ | (3) | 1 | 178 | 24 | – | (10) | (136) |
| – Trading income excluding net interest income | – | 1 | – | 24 | – | (10) | (136) |
| – Net income from other financial instruments designated at fair value | – | – | 178 | – | – | – | – |
| – Impairment charges | (3) | – | – | – | – | – | – |

1 The amount has been reported on a net basis, after taking into consideration the total gains or losses arising from those transactions where the risk has been backed out to other HSBC entities.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**14. Fair values of financial instruments carried at fair value** (continued)

The fair values of financial instruments are, in certain circumstances, measured using valuation models that incorporate assumptions that are not supported 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 these fair values to reasonably possible alternative assumptions:

| | Reflected in income statement | | Reflected in other comprehensive income | |
|-------------------------------------------------------------|-------------------------------|-------------------------------|-----------------------------------------|-------------------------------|
| | Favourable changes HK\$m | Unfavourable changes HK\$m | Favourable changes HK\$m | Unfavourable changes HK\$m |
| At 30 June 2015 | | | | |
| Derivatives/trading assets/trading liabilities | 216 | (210) | – | – |
| Financial assets/liabilities designated at fair value | 260 | (260) | – | – |
| Financial investments: available-for-sale | – | – | 727 | (728) |
| | 476 | (470) | 727 | (728) |
| At 31 December 2014 | | | | |
| Derivatives/trading assets/trading liabilities | 329 | (322) | – | – |
| Financial assets/liabilities designated at fair value | 191 | (191) | – | – |
| Financial investments: available-for-sale | – | – | 672 | (674) |
| | 520 | (513) | 672 | (674) |

Details of the sensitivity of fair values to reasonably possible alternative assumptions, by Level 3 instrument type, are included in note 49 of the Bank's Annual Report and Accounts 2014.

Transfers between levels of the fair value hierarchy are deemed to occur at the end of the reporting period.

Transfers out of Level 3 held for trading liabilities predominantly resulted from an increase in the observability of inputs, such as correlations, used for pricing the instruments.

15. Fair values of financial instruments not carried at fair value

The accounting policies which determine the classification of financial instruments, and the use of assumptions and estimation in valuing them, are described in note 3 of the Bank's Annual Report and Accounts 2014.

| | At 30 June 2015 | | At 31 December 2014 | |
|---------------------------------------------------|--------------------------|---------------------|--------------------------|---------------------|
| | Carrying amount HK\$m | Fair value HK\$m | Carrying amount HK\$m | Fair value HK\$m |
| Assets | | | | |
| Reverse repurchase agreements – non-trading | 216,368 | 216,540 | 218,901 | 218,976 |
| Placings with and advances to banks | 513,826 | 513,931 | 488,313 | 488,454 |
| Loans and advances to customers | 2,880,997 | 2,870,250 | 2,815,216 | 2,803,298 |
| Financial investment debt securities | 212,209 | 219,289 | 182,626 | 190,736 |
| Liabilities | | | | |
| Repurchase agreements – non-trading | 13,131 | 13,131 | 28,379 | 28,379 |
| Deposits by banks | 213,464 | 213,464 | 226,713 | 226,712 |
| Customer accounts | 4,651,473 | 4,652,112 | 4,479,992 | 4,479,985 |
| Debt securities in issue | 42,756 | 42,801 | 45,297 | 45,325 |
| Subordinated liabilities | 12,583 | 11,722 | 12,832 | 11,950 |
| Preference shares | 36,565 | 32,678 | 36,582 | 32,623 |

Details of how the fair values of financial instruments that are not carried at fair value on the balance sheet are calculated can be found in note 50 of the Bank's Annual Report and Accounts 2014.

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**16. Legal and regulatory matters**

The group is party to legal proceedings and regulatory matters in a number of jurisdictions arising out of its normal business operations. Apart from the matters described below, the Bank considers that none of these matters are material. The recognition of provisions is determined in accordance with the accounting policies set out in note 3(v) of the Bank's Annual Report and Accounts 2014. While the outcome of legal proceedings and regulatory matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of these matters as at 30 June 2015. Where an individual provision is material, the fact that a provision has been made is stated and quantified. Any provision recognised does not constitute an admission of wrongdoing or legal liability. It is not practicable to provide an aggregate estimate of potential liability for our legal proceedings and regulatory matters as a class of contingent liabilities.

Anti-money laundering and sanctions-related matter

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

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

Under these agreements, HSBC Holdings plc and HSBC Bank USA made payments totalling US\$1.9bn to US authorities and are continuing to comply with ongoing obligations. In July 2013, the US District Court for the Eastern District of New York approved the US DPA and retained authority to oversee implementation of that agreement. Under the agreements with the DoJ, FCA, and the FRB, an independent monitor (who is, for FCA purposes, a 'skilled person' under Section 166 of the Financial Services and Markets Act) is evaluating and regularly assessing the effectiveness of HSBC's AML and sanctions compliance function and HSBC's progress in implementing its remedial obligations under the agreements.

HSBC Holdings plc has fulfilled all of the requirements imposed by the DANY DPA which expired by its terms at the end of the two-year period of that agreement in December 2014. If HSBC Holdings plc and HSBC Bank USA fulfil all of the requirements imposed by the US DPA, the DoJ charges against those entities will be dismissed at the end of the five-year period of that agreement. The DoJ may prosecute HSBC Holdings plc or HSBC Bank USA in relation to any matters that are the subject of the US DPA if HSBC Holdings plc or HSBC Bank USA breaches the terms of the US DPA.

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

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

Notes on the Condensed Consolidated Financial Statements (unaudited) (continued)**16. Legal and regulatory matters** (continued)*Tax investigations*

The Bank continues to cooperate with the relevant US and other authorities, including with respect to US-based clients of the Bank in India.

In addition, various tax administration, regulatory and law enforcement authorities around the world, including in India, are conducting investigations and reviews of HSBC Swiss Private Bank in connection with allegations of tax evasion or tax fraud, money laundering and unlawful cross-border banking solicitation. The Indian tax authority issued a summons and request for information to the Bank in India.

With respect to each of these ongoing matters, the Bank and other HSBC companies are cooperating with the relevant authorities. There are many factors that may affect the range of outcomes, and the resulting financial impact, of these investigations and reviews, which could be significant.

In light of the recent media attention regarding these matters, it is possible that other tax administration, regulatory or law enforcement authorities will also initiate or enlarge similar investigations or regulatory proceedings.

Foreign exchange rate investigations

Various regulators and competition and enforcement authorities around the world, including South Korea and elsewhere, are conducting investigations and reviews into a number of firms, including the Bank, related to trading on the foreign exchange markets. These include investigations by the civil competition authorities in South Korea.

The Bank has been cooperating with these ongoing investigations. There are many factors that may affect the range of outcomes, and the resulting financial impact of these investigations, which could be significant.

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

17. Additional information

Additional financial information relating to the period ended 30 June 2015, prepared in accordance with the Banking (Disclosure) Rules made under section 60A of the Banking Ordinance, will be made available on our website: www.hsbc.com.hk. A press release will be issued to announce the availability of this information.

18. Interim Report 2015 and statutory accounts

The information in this *Interim Report 2015* is not audited and does not constitute statutory accounts.

Certain financial information in the interim report is extracted from the statutory accounts for the year ended 31 December 2014 which have been delivered to the Registrar of Companies and the Hong Kong Monetary Authority. The auditors expressed an unqualified opinion on those statutory accounts in their report dated 23 February 2015. The Annual Report and Accounts for the year ended 31 December 2014, which include the statutory accounts, can be obtained on request from Communications (Asia), The Hongkong and Shanghai Banking Corporation Limited, 1 Queen's Road Central, Hong Kong, and may be viewed on our website: www.hsbc.com.hk.

19. Ultimate holding company

The Hongkong and Shanghai Banking Corporation Limited is an indirectly-held, wholly-owned subsidiary of HSBC Holdings plc, which is incorporated in England.

Report on Review of Interim Financial Information to the Board of Directors of The Hongkong and Shanghai Banking Corporation Limited

Introduction

We have reviewed the interim financial information set out on pages 20 to 41, which comprises the condensed consolidated balance sheet of The Hongkong and Shanghai Banking Corporation Limited (the 'Bank') and its subsidiaries (together, the 'group') as at 30 June 2015 and the related condensed consolidated statements of income, comprehensive income, changes in equity and cash flows for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes. The directors of the Bank are responsible for the preparation and presentation of this interim financial information in accordance with Hong Kong Accounting Standard ('HKAS') 34 'Interim Financial Reporting' issued by the Hong Kong Institute of Certified Public Accountants and the Disclosure Rules and Transparency Rules of the United Kingdom's Financial Conduct Authority. Our responsibility is to express a conclusion on this interim financial information based on our review and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the United Kingdom's Auditing Practices Board. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the interim financial information is not prepared, in all material respects, in accordance with HKAS 34 'Interim Financial Reporting' and the Disclosure Rules and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Other matters

The interim financial information includes comparative information as required by HKAS 34, 'Interim Financial Reporting'. The comparative information for the condensed consolidated balance sheet is based on the audited financial statements as at 31 December 2014. The comparative information for the condensed consolidated statements of income, comprehensive income, changes in equity and cash flows, and related explanatory notes, for the six-month period ended 30 June 2014 has not been audited or reviewed.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong
3 August 2015