



# Annual Report and Accounts 2015

## Presentation of Information

This document comprises the Annual Report and Accounts 2015 for HSBC Bank plc ('the bank') and its subsidiaries (together 'the group'). 'We', 'us' and 'our' refer to HSBC Bank plc together with its subsidiaries. It contains the Strategic Report, the Report of the Directors, the Statement of Directors' Responsibilities and Financial Statements, together with the Independent Auditor's Report, as required by the UK Companies Act 2006. References to 'HSBC' or 'the Group' within this document mean HSBC Holdings plc together with its subsidiaries.

HM Treasury has transposed the requirements set out under CRD IV and issued the Capital Requirements Country-by-Country Reporting Regulations 2013, effective 1 January 2014. The legislation will require HSBC Holdings plc to publish additional information, in respect of the year ended 31 December 2015, by 31 December 2016. This information will be available on HSBC's website: [www.hsbc.com](http://www.hsbc.com). This enables HSBC Bank plc to be exempt from the reporting obligation and therefore the bank will not separately disclose this information.

Additional information, including commentary on 2014 versus 2013 and certain statistical and other information, may be found in a separate document entitled 'Additional Information 2015' and can also be found at [www.hsbc.com](http://www.hsbc.com).

Pillar 3 disclosures for the group are also available on [www.hsbc.com](http://www.hsbc.com).

All disclosures within the Report of the Directors are unaudited unless otherwise stated.

## Cautionary Statement Regarding Forward-Looking Statements

This Annual 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 group'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. HSBC Bank plc makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statement.

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.

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## Strategic Report: Highlights

	2015	2014
<b>For the year (£m)</b>		
Profit before tax (reported basis)	2,971	1,953
Profit before tax (adjusted basis) <sup>1</sup>	4,068	4,032
Net operating income before loan impairment charges and other credit risk provisions <sup>2</sup>	12,870	11,886
Profit attributable to shareholders of the parent company	1,942	1,354
<b>At year-end (£m)</b>		
Total equity attributable to shareholders of the parent company	37,497	36,078
Total assets	727,941	797,289
Risk-weighted assets	229,382	243,652
Loans and advances to customers (net of impairment allowances)	258,506	257,252
Customer accounts	332,830	346,507
<b>Capital ratios<sup>3</sup> (%)</b>		
Common equity tier 1	9.6	8.7
Tier 1	11.8	10.3
Total capital	15.5	13.8
<b>Performance, efficiency and other ratios (annualised %)</b>		
Return on average shareholders' equity of the parent company <sup>4</sup>	5.9	4.2
Pre-tax return on average risk-weighted assets (reported basis)	1.2	0.8
Pre-tax return on average risk-weighted assets (adjusted basis)	1.7	1.7
Cost efficiency ratio (adjusted basis) <sup>5</sup>	64.1	64.3
Jaws (adjusted basis) <sup>6</sup>	0.3	(6.8)
Ratio of customer advances to customer accounts	77.7	74.2

1 Adjusted performance is computed by adjusting reported results for the effect of significant items as detailed on pages 12 and 13.

2 Net operating income before loan impairment charges and other credit risk provisions is also referred to as revenue.

3 Capital ratios are based on transitional CRD IV rules (refer to page 75).

4 The return on average total shareholders' equity is defined as profit attributable to shareholders of the parent company divided by the average total shareholders' equity.

5 Adjusted cost efficiency ratio is defined as total operating expenses (adjusted) divided by net operating income before loan impairment charges and other credit risk provisions (adjusted). Net operating income before loan impairment charges and other credit risk provisions (adjusted) is also referred to as revenue (adjusted).

6 Adjusted jaws measures the difference between adjusted revenue and adjusted cost growth rates.

## Strategic Report: Purpose and Strategy

### HSBC at a glance

#### Global businesses

HSBC’s operating model consists of four global businesses as detailed in the table below.

The businesses set consistent business strategies and operating models to supplement HSBC strategy across Europe. They manage the products and business propositions offered to our customers.

Retail Banking and Wealth Management ('RBWM')	Commercial Banking ('CMB')	Global Banking and Markets ('GB&M')	Global Private Banking ('GPB')
We help millions of people to manage their finances, buy their home and save and invest for their future. Our Insurance and Asset Management businesses support all of our businesses to meet their customers' needs.	We provide business customers with banking products and services to support and enable them operate and grow their business. Our customers range from small enterprises focused primarily on their domestic markets, through to large corporates operating globally.	We provide financial services and products to corporates, governments and institutions. Our comprehensive range of products and solutions can be combined and customised to meet our clients' specific objectives – across capital financing, advisory and transaction banking services.	We help high-net-worth individuals and their families to grow, manage and preserve their wealth.

### Our Purpose

The purpose of HSBC Bank plc is to connect customers to opportunities, enable businesses to thrive and economies to prosper, and ultimately help people to fulfil their hopes and realise their ambitions.

#### Geographical presence

In Europe, we operate in over 15 countries. Our operating entities represent the group to customers, regulators, employees and other stakeholders. Our priority markets are the UK, France and Germany.

#### HSBC worldwide

The group is part of HSBC, which has more than 250,000 employees working around the world to provide more than 47 million customers with a broad range of banking products and services to meet their financial needs.

#### HSBC values

HSBC values define who we are as an organisation and what makes us distinctive.

##### Open

- We are open to different ideas and cultures and value diverse perspectives.

##### Connected

- We are connected to our customers, communities, regulators and each other, caring about individuals and their progress.

##### Dependable

- We are dependable, standing firm for what is right and delivering on commitments.

#### Our role in society

How we do business is as important as what we do. Our responsibilities to our customers, employees and shareholders as well as to wider society go far beyond simply being profitable.

We seek to build trusting and lasting relationships with our many stakeholders to generate value in society.

### Our strategy

The group’s strategy and strategic direction is embedded in HSBC’s strategy, which aims to capture value from its international network.

Our strategy is built around long-term trends and reflects our distinctive advantages.

#### Long-term trends

##### Increasing global connectivity

The international flow of goods, services and finance continues to expand, aided by the development of technology and data in personal and commercial exchanges.

##### Distinctive advantages

###### Unrivalled global presence

HSBC’s network provides access to more than 90 per cent of global trade and capital flows. We use it to enable clients to participate in global growth opportunities and offer leading product capabilities to build deeper and more enduring relationships with businesses and individuals with international needs.

###### Universal banking model

We serve the full range of banking customers through our four businesses, from individual savers to large multinational corporations. This universal banking model enables us to effectively meet our clients’ diverse financial needs, support a strong capital and funding base, reduce risk profile and volatility, and generate stable returns for shareholders.

#### Long-term strategy

##### Develop our international network

The group derives value from HSBC’s network of businesses to support future growth and increase global connectivity.

We aim to develop and leverage on the presence and global reach of HSBC in our long-term commitment towards our strategic European markets.

## Strategic Report: Purpose and Strategy (continued)

### Invest in wealth management and select retail businesses

We aim to capture opportunities arising from social mobility, wealth creation and long-term demographic changes in our priority markets where we can achieve profitable scale.

### Value of the network

HSBC's network of businesses covers the world's largest and fastest growing trade corridors and economic zones.

#### Services around the world

We provide products and services to meet our clients' diverse financial needs. HSBC's geographic reach and network of clients allows greater insight into the trade and capital flows across supply chains.

#### Business synergies

We share resources and product capabilities across our businesses and leverage these synergies when serving our customers. We are able to provide global markets products, for example, to large multinationals as well as to small businesses. We issue insurance products to individuals and corporations alike. Many of our private banking clients are business owners who we also serve as corporate clients.

### Strategic actions

At HSBC's Investor Update in June 2015, the Group outlined plans to commit and capture value from its global network by adapting to structural changes in the operating environment and pursuing growth opportunities.

HSBC has set out strategic actions to be mostly completed by 2017, many of which are applicable to the group:

- Reduce risk weighted assets ('RWAs') across the Group
- Optimise HSBC's global network
- Set up a UK ring-fenced bank
- Deliver USD \$4.5-5.0 billion of cost savings
- Deliver revenue growth above Gross Domestic Product ('GDP') from HSBC's international network
- Grow business from renminbi ('RMB') internationalisation
- Implement Global Standards

The Group's strategic actions will help in achieving our medium-term financial targets, such as increasing our return on equity and achieving positive jaws. Details of structural reform including ring-fencing can be found below. Details of our strategic decision regarding our Turkish business can be found on page 21.

### Structural Reform

#### Policy background to recovery and resolution

Following the financial crisis, G20 leaders requested that the Financial Stability Board ('FSB') establish more effective arrangements for the recovery and resolution of 30 designated Global Systemically Important Banks ('G-SIBs'), resulting in a series of policy recommendations in relation to recovery and resolution planning, cross-border cooperation agreements and measures to mitigate obstacles to resolution.

### Banking structural reform and recovery and resolution planning

Globally there have been a number of developments relating to banking structural reform and the introduction of recovery and resolution regimes. As recovery and resolution planning developed, some regulators and national authorities have also required changes to the corporate structures of banks. These include requiring the local incorporation of banks or ring-fencing of certain businesses. In the UK, ring-fencing legislation has been enacted requiring the separation of retail and small and medium-sized enterprise ('SME') banking activity from trading activity.

#### HSBC resolution strategy

The Group continues to work with primary regulators to develop and agree a resolution strategy for HSBC. It is viewed that a strategy by which the Group breaks up at a subsidiary bank level at the point of resolution (referred to as Multiple Point of Entry strategy) rather than being kept together as a Group at the point of resolution (referred to as a Single Point of Entry strategy) is the optimal approach as it is aligned to the Group's existing legal and business structure. Similar to all G-SIBs, the Group is working with regulators to better understand inter-dependencies between different businesses and subsidiary banking entities in the Group in order to enhance resolvability.

#### Implementation of the ServCo group

The Group started making changes to its corporate structure to mitigate or remove critical inter-dependencies to further facilitate the resolution of the Group. In particular, to remove operational dependencies (where one subsidiary bank provides critical services to another), the Group is in the process of transferring critical services from subsidiary banks to a separately incorporated group of service companies ('ServCo group'). The ServCo group will be separately capitalised and funded to ensure continuity of services in resolution. A significant portion of the ServCo group already exists and this initiative involves transferring the remaining critical services still held by subsidiary banks into the ServCo group. The services will then be provided to the subsidiary banks by the ServCo group.

In 2015, to progress implementation, 12,065 employees performing shared services in the UK were transferred from HSBC Bank plc to the ServCo group, which is not a subsidiary of HSBC Bank plc but of HSBC Holdings plc. There were no changes to employment terms and conditions or pension benefits as a result of these transfers.

To support the creation of the ServCo group and to ensure that employees transferred retained existing pension benefits, a new section of the HSBC Bank (UK) Pension Scheme was created with segregated assets and liabilities. The new section provides ServCo group employees with their defined contribution pension and, where relevant, defined benefit pension benefits arising from future salary increases above CPI.

## Strategic Report: Purpose and Strategy (continued)

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Further transfer of employees, critical shared services and assets in the UK and other jurisdictions are planned to occur during 2016.

### UK ring-fencing

In 2013 and 2014, UK legislation was enacted requiring large banking groups to 'ring-fence' UK retail banking activity in a separately incorporated banking subsidiary (a 'ring-fenced' bank), which will not be a subsidiary of HSBC Bank plc, that is prohibited from engaging in significant trading activity. Ring-fencing is to be completed by 1 January 2019. The legislation also details the applicable customers to be transferred to the ring-fenced bank by reference to gross worth and enterprises to be transferred based on turnover, assets and number of employees. In addition, the legislation places restrictions on the activities and geographical scope of ring-fenced banks.

There continue to be regulatory developments related to the proposed rules on ring-fencing. During the year, the Prudential Regulation Authority ('PRA') and other regulators issued new proposed rules on governance arrangements, ring-fencing transfer schemes, prudential requirements, intragroup arrangements and operational continuity and the use of financial market infrastructure. The regulatory landscape continues to evolve and the finalisation of rules in respect of ring-fencing is expected to continue in 2016 and 2017.

In March 2015, Birmingham was announced as the location of the headquarters of the UK ring-fenced bank, HSBC UK. Our ambition is to be the bank of choice in the UK and as a name, HSBC UK will build on the global connectivity and customer trust of the HSBC brand and differentiate us in a competitive market.

The final business design provides for the transfer into HSBC UK of the qualifying components of HSBC Bank plc's UK RBWM, CMB and GPB businesses. HSBC Bank plc's UK GB&M business will remain in HSBC Bank plc. HSBC Bank plc remains the issuer under its debt issuance programmes and outstanding securities issued under such programmes will continue to be obligations of HSBC Bank plc.

The Group presented a final ring-fencing project plan to regulators in January 2016. The plan remains subject to certain internal approvals and is ultimately subject to the approval of the PRA, Financial Conduct Authority ('FCA') and other applicable regulators.

## Strategic Report: Products and services

### Products and services

The group manages its products and services through its four businesses: RBWM; CMB; GB&M; and GPB.

#### Retail Banking and Wealth Management

##### Customers

RBWM serves customers through four main business areas: Retail Banking, Wealth Management, Asset Management and Insurance.

Since 2012, RBWM has taken numerous actions to improve the way it conducts its business. It has removed the formulaic link between product sales and remuneration, paying all staff on a discretionary basis including assessment of their behaviour and the satisfaction of its customers. RBWM has reduced its product range, reviewed the fairness of its product features and pricing, and enhanced the way it monitors sales quality.

##### Products and services

RBWM provides services to individuals under the HSBC Premier and Advance propositions, targeted at mass affluent and emerging affluent customers who value international connectivity. For customers who have simpler everyday banking needs, RBWM offers a full range of banking products and services reflecting local requirements.

##### Business synergies

RBWM makes a significant contribution to the overall success of the Group. Insurance and Asset Management provide services to clients across all of the global businesses; and the foreign exchange and wealth management needs of RBWM clients create opportunities for GB&M.

##### Areas of focus

RBWM's focus is on growing the business through relationship-led lending and wealth management, whilst transforming customer experience and cost base through investment in digital infrastructure.

#### Commercial Banking

##### Customers

Our customers range from small enterprises focused primarily on their domestic markets, through to large corporates operating nationally, regionally and globally.

##### Products and services

We support our customers with tailored financial products and services to allow them to operate efficiently and to grow. We provide working capital, term loans, payment services and international trade facilitation. We offer expertise in mergers and acquisitions, and provide access to financial markets.

##### Business synergies

CMB is at the centre of creating revenue synergies within the Group. For instance we provide trade finance, working capital and liquidity management solutions to GB&M clients. We also provide Capital Finance expertise and Insurance and Asset Management capabilities from across the group to benefit CMB clients.

##### Areas of focus

HSBC is focused on creating value from its network which covers 90 per cent of the global trade and capital flows. HSBC is therefore investing heavily in digital and technology aspects of its core Payments and Cash

Management ('PCM') and Global Trade and Receivables Finance ('GTRF') propositions.

#### Global Banking and Markets

##### Customers

GB&M supports corporate and institutional clients worldwide in achieving their long-term strategic goals through tailored and innovative solutions. GB&M's deep sector expertise extends across transactional banking, financing, investments, advisory and risk management. To strengthen our relationship with clients and the services we provide, we use independent benchmarking and internal programmes to regularly assess these relationships.

##### Products and services

GB&M's product specialists continue to deliver a comprehensive range of capital financing, advisory and transaction banking services.

##### Business synergies

In 2015, GB&M enabled business synergies, recognising growth in a number of areas. For example, we grew revenues from the sale of capital financing products sold to CMB clients.

##### Areas of focus

We are reducing RWAs as we continue to exit legacy credit, manage our Markets and Capital Financing business and employ a disciplined approach to new client business.

Our focus on cost discipline will result in further simplification of the business through streamlining business lines, operations and technology.

Deepening relationships with clients in both event and transaction banking remain a priority. We are growing our business from the internationalisation of China's RMB currency and by investing in digital capabilities.

#### Global Private Banking

##### Customers

GPB serves high net worth individuals with complex needs.

Since 2011, GPB has taken significant steps to simplify and improve the way it conducts its business. GPB remains committed to implementing the most effective global standards, including customer due diligence, a tax transparency framework, and financial crime compliance measures.

##### Products and services

GPB works closely with its clients to provide solutions to grow, manage and preserve wealth. Its products and services include: Investment Management, incorporating advisory, discretionary and brokerage services.

##### Business synergies

GPB utilises distributes its products within GB&M, CMB and RBWM, including asset management, research, insurance, trade finance and capital financing, to offer propositions to our clients.

##### Areas of focus

GPB aspires to build on HSBC's commercial banking heritage and be the leading private bank for high net worth business owners and principals.

## Strategic Report: How we do business

### How we do business

We conduct our business intent on supporting the sustained success of our people, customers and communities. We see investment in our capabilities, employees and processes as a source of long-term competitive advantage.

How we do business strengthens the durability of our earnings and our ability to return value to shareholders.

#### Led by our values

HSBC values underpin how we do business. We are open to differences and believe diversity makes us stronger. We are connected, and our personal relationships are essential to our business. We are dependable in fulfilling our responsibilities in society and delivering on commitments.

- Building lasting business relationships
- Empowering people
- Ensuring sustainable outcomes

#### Building lasting business relationships

##### Ensuring fair outcomes

We recognise that the delivery of fair outcomes for customers and upholding of financial market integrity is critical to a sustainable business model. HSBC continues to enhance product governance processes to ensure products are designed to meet customers' needs and are sold to suitable customer groups. For example, we send text messages to alert customers when they are about to go into overdraft, resulting in customer savings in overdraft fees.

##### Increasing quality of service

We seek feedback from customers to assess how well we are doing and what we can do better. In 2015, we improved our processes for responding to customer complaints and tools for understanding their causes.

##### Developing long-term opportunities

Technology and climate change are two areas which present both challenges and opportunities to us and our customers.

HSBC is investing in innovation and digital capabilities to better serve its customers. This includes enhancing security around financial transactions and protecting customer data. In 2015, we enabled the Apple Pay mobile payment service, launched live-chat online customer service, and made digital secure keys available to simplify customer login experience.

#### Empowering people

##### Valuing diversity

HSBC is proud to provide an open, supportive and inclusive workplace where people can grow and achieve their potential. The Group's commitment to diversity and inclusion helps to attract, develop and retain employees. HSBC is also committed to reflecting the communities we serve.

To help managers address bias in hiring, promotion and talent identification we use education programmes and have expanded mentoring initiatives for under-represented groups. We continue to address gender representation, particularly at senior levels, with additional focus on promotions and hiring. We also continue to expand support and flexible working programmes for parents returning to work.

#### Equipping our employees

HSBC's training programmes facilitate a culture grounded in HSBC values and ensure employees are clear about HSBC policies. In 2015, the Group completed a three year programme of values-led leadership training for all employees. During the year, HSBC launched a global whistleblowing hotline (HSBC Confidential), allowing employees to raise concerns and escalate issues confidentially without fear of personal repercussions. The hotline can be accessed by telephone, email, web and mail.

#### Ensuring sustainable outcomes

##### Managing environmental and social impacts

HSBC continues to reduce the environmental impact of its operations, implementing robust policies and processes to manage sustainability risks in its business activities.

HSBC's sustainability risk policies cover a number of sensitive industries and themes.

##### Respecting human rights

HSBC respects human rights directly as they affect employees and indirectly through suppliers and customers, and also through actions to prevent bribery and corruption.

##### Investing in our communities

HSBC believes that education and the environment are essential to resilient communities. For over 10 years, HSBC has focused its community investment activities in these two areas. This year, following responses from employees and growing challenges in public health, HSBC has decided to add medical charities to the causes it supports.

##### Our approach to tax

HSBC seeks to apply the spirit as well as the letter of the law in all the territories in which it operates, and has adopted the UK Code of Practice for the Taxation of Banks.

We have systems and processes designed to ensure that our banking services are not associated with any arrangements that are known or suspected to be designed to facilitate tax evasion. The Group Finance Director is responsible for Board level oversight of the Group's tax affairs.

HSBC supports the global initiatives to improve tax transparency including:

- the US Foreign Account Tax Compliance Act ('FATCA');
- the Organisation for Economic Co-operation and Development ('OECD') Standard for Automatic Exchange of Financial Account Information (also known as the Common Reporting Standard);
- the UK International Tax Compliance (Crown Dependencies and Gibraltar) Regulations 2014 (commonly referred to as UK FATCA);
- Country-by-Country Reporting under the Capital Requirements Directive IV ('CRD IV'); and
- the OECD Base Erosion and Profit Sharing ('BEPS') initiative.

The OECD BEPS initiative aims to close gaps in international tax rules that allow profits to be artificially diverted to low tax jurisdictions. We do not expect the BEPS or similar initiatives adopted by national governments to adversely impact our results.



## Strategic Report: Key performance indicators

### Key Performance Indicators

The Board of Directors tracks the group's progress in implementing its strategy with a range of financial and non-financial measures or key performance indicators ('KPIs'). Progress is assessed by comparison with the group strategic priorities, operating plan targets and historical performance.

From time to time the group reviews its KPIs in light of its strategic objectives and may adopt new or refined measures to better align the KPIs to HSBC's strategy and strategic priorities.

#### Financial KPIs

	2015	2014
Profit before tax (reported) (£m)	2,971	1,953
Profit before tax (adjusted) (£m)	4,068	4,032
Jaws (adjusted) (%)	0.3	(6.8)
Cost efficiency ratio (adjusted) (%)	64.1	64.3
Pre-tax return on average risk-weighted asset ratio (reported) (%)	1.2	0.8
Pre-tax return on average risk-weighted asset ratio (adjusted) (%)	1.7	1.7
Common equity tier 1 ratio (%)	9.6	8.7

**Profit before tax (reported / adjusted):** Reported profit before tax is the profit as reported under IFRS. Adjusted profit before tax adjusts the reported profit for the effect of significant items as detailed on pages 12 and 13.

*Outcome (reported):* Reported profit before tax increased in GB&M, RBWM, CMB and GPB, whereas reported profit before tax reduced in 'Other'. The increase was mainly driven by higher revenue and lower provisions arising from the on-going review of compliance with the Consumer Credit Act ('CCA') in RBWM and higher trading revenue in GB&M.

*Outcome (adjusted):* Adjusted profit before tax increased driven by higher revenue, notably in GB&M due to strong trading income, partly offset by an increase in operating expenses primarily due to an increase in compliance and regulatory programme costs.

**Adjusted jaws** measures the difference between adjusted revenue and adjusted cost growth rates (excluding the effects of costs-to-achieve and other significant items as detailed on pages 12 and 13). Our target is to grow revenues faster than operating expenses on an adjusted basis. This is referred to as positive jaws.

*Outcome:* In 2015, we grew revenue by 1.0 per cent whilst our operating expenses also went up but by 0.7 per cent. Jaws was therefore positive 0.3 per cent.

Adjusted revenue was up due to higher income in Equities, Foreign Exchange and Credit in GB&M, although this was partly offset by reductions in RBWM and Other customer groups. Adjusted costs also increased, but to a lesser extent, due to increased regulatory programmes and compliance-related costs.

**Cost efficiency ratio (adjusted)** is measured as total operating expenses divided by net operating income before loan impairment and other credit risk provisions.

*Outcome:* The cost efficiency ratio remains broadly stable at 64.1 per cent year-on-year.

**Pre-tax return on average risk-weighted assets ratio (reported / adjusted)** is measured as pre-tax profit (divided by average risk-weighted assets). The group targets a return in the medium term of between 1.8 and 2.0 per cent.

*Outcome (reported):* The return on average risk-weighted assets was significantly below the target range predominantly but improved compared to 2014 due to an increase in profits and reduced RWAs.

*Outcome (adjusted):* The return on average risk-weighted assets was slightly below the target range.

**Common equity tier 1 capital ratio** – represents the ratio of common equity tier 1 capital comprising shareholders' equity and related non-controlling interests less regulatory deductions and adjustments, to total risk weighted assets. The group seeks to maintain a strong capital base to support the development of its business and meet regulatory capital requirements at all times.

*Outcome:* The common equity tier 1 ratio increased compared to prior year due to profit accretion and a reduction of RWAs.

#### Non-financial KPIs

We also monitor a range of non-financial KPIs focussing on customers, people, culture and values including customer service satisfaction, employee involvement and engagement, and diversity and sustainability.

For details on customer service and satisfaction please refer below, for the remaining non-financial KPIs refer to the Corporate Governance section on pages 88 and 89.

#### Customer service and satisfaction

In RBWM, customer satisfaction is measured through an independent market research survey of retail banking customers, using a Customer Recommendation Index ('CRI') to score performance. In the UK during 2015 our CRI ranking improved and we met the target set for the business. Continued focus around making it easier for our customers to do business with us and removing redundant processes has helped improve this score. The UK bank's 'Mortgage in a day' is a great example of this work in action. In Turkey we also saw an improved performance around our CRI and as of third quarter of 2015, HSBC Turkey has been ranked as the second most recommended bank in the market. France did not meet the target, impacted in the first half year by reputational issues. However this improved slightly at the end of the year. France performs above the market in terms of measures relating to relationship manager satisfaction. First Direct continues to lead the whole of the UK banking industry based on the CRI study.

Throughout 2015, CMB continued to draw insight and metrics from its current customers via its global customer engagement programme, carried out by an independent third party, as well as other benchmark studies. The results showed that our relationship managers continue to be highly rated in the UK. In the UK we also perform very strongly on future loyalty from our own customers as well as high levels of consideration amongst other banked businesses. We perform in line or slightly ahead of our competitors in Germany, however, in France we lag the competition and this is an area of opportunity in 2016.

## Strategic Report: Business Review

### Economic background and outlook

#### Economic background

Growth in the UK slowed in 2015, with preliminary estimates indicating the full year real GDP growth rate fell to 2.2 per cent, from 2.9 per cent in 2014. Investments slowed down, as a result of concerns over a UK exit of the EU and a slowdown in global growth, as weak net exports restricted growth. However, private consumption accelerated, as a continued fall in unemployment, better wage growth and lower inflation boosted real incomes. The unemployment rate dropped to 5.2 per cent in November 2015, down from 5.8 per cent in November 2014. Wage growth increased during the first half of the year, reaching 2.9 per cent in July (over a 3 month average year-on-year), but dropped back to 2.0 per cent in November. Inflation continued to decline from prior year's 14-year low to negative on two occasions, and remained very low (0.2 per cent year-on-year in December). The housing market picked up in 2015, following a slowdown in the second half of 2014, however price growth was moderate. The Bank of England left the bank rate on hold at 0.5 per cent.

The eurozone continued its recovery in 2015 against the slowdown in global growth and emerging markets. GDP growth for 2015 is estimated to be around 1.5 per cent, up from 0.9 per cent in 2014. The European Central Bank ('ECB') started its Quantitative Easing ('QE') programme at the beginning of the year, purchasing EUR 60 billion of assets a month, including sovereign bonds. QE helped to stimulate growth through three channels, mainly: (i) contributed to the depreciation of the euro, supporting exports, (ii) reduced borrowing costs for the highly indebted eurozone countries, allowing them to relax the pace of fiscal austerity, and (iii) supported credit recovery, reducing borrowing costs for households and firms across the monetary union. However, QE was not enough to lift inflation which came in at zero per cent for 2015, falling for the fourth consecutive year. Inflation remained low due to the dramatic fall in oil prices, and limited wage pressures even in countries like Germany where the labour market is already very tight. The low inflation which provided a boost to real incomes, prompted for a recovery that was mainly domestic-led, which is unusual for the eurozone. In the first half of the year, exports increased significantly, particularly to the US and UK which accounted for around 60 per cent of the total eurozone export growth. However, in the second half of the year, slowdown in emerging economies, particularly China, weighed on overall GDP growth, as export growth declined.

In Turkey, real GDP growth in the third quarter was 4.0 per cent year-on-year, up from the 3.8 per cent seen in second quarter. This was as a result of stronger than expected growth in household spending, public sector spending, and inventory accumulation. Annual inflation remained high throughout the year despite a sharp drop in oil prices, and ended the year at 8.8 per cent, well above the central bank's target of 5 per cent. The current account deficit narrowed as Turkey's oil import bill shrank, but it remained large compared to most emerging markets. The central bank cut its key policy rate to 7.5 per cent in February and kept it unchanged until year-end.

Effective market rates were higher, close to 9 per cent, in December.

#### Economic outlook

Global GDP growth is expected at 2.5 per cent in 2016, slightly up from 2.4 per cent in 2015. UK real GDP expected to grow by 2.4 per cent in 2016, up from an estimated 2.2 per cent in 2015. Growth will continue to be led by private consumption, as investments are likely to further slow down due to uncertainties over the global environment and the UK's continued membership of the EU. Government consumption is likely to make a small positive contribution to GDP growth as fiscal austerity has been loosened relative to previous plans, however, weak net exports will continue to restrict growth. Consumer price inflation should increase to around 1 per cent by year-end due to base effects, unless the global oil prices continue to decline. It is expected that the Bank of England will start raising interest rates in November 2016.

Eurozone growth in 2016 should be broadly in line with 2015. The tailwinds from the renewed fall in oil prices, together with the improvements in the labour market, will continue to boost consumer spending. In 2016, growth is further supported by a net fiscal expansion in the eurozone, seen for the first time in six years, due to QE action. The German government will be among the countries spending more, in part because of the costs related to the migration crisis that has been affecting EU countries since last year. Recovery should also spread to the housing markets, which are now starting to stabilise including in countries like France, Italy and Spain. Due to the latest fall in oil prices, inflation outlook remains subdued. However with the recovery remaining on track and many technical and political constraints to an expansion of the QE programme, any further meaningful monetary expansion is not expected in 2016.

In Turkey, real GDP growth is expected to slow to 2.1 per cent in 2016 for two reasons. Firstly, global growth and global trade cycle remain weak, exerting downwards pressure on Turkey's export performance. In addition, Russia recently announced that it would sanction certain Turkish imports in response to heightened political tension between the two countries. Secondly, subdued growth in private sector investments is expected as Turkish corporates' balance sheets have become stretched. They have increased their hard currency leverage rapidly, which resulted in a sizeable short-FX position on their balance sheets. This vulnerability is putting a cap on firms' investment appetite. Average inflation of 8.3 per cent in 2016 is expected. Low oil prices should help the inflation outlook, but the government's decision to raise the minimum wage by 30 per cent will create price pressure.

## Strategic Report: Business Review (continued)

### Financial summary

Summary consolidated income statement for the year ended

	2015	2014
	£m	£m
Net interest income	6,818	6,629
Net fee income	2,863	3,266
Net trading income	2,751	1,609
Net income from financial instruments designated at fair value	376	371
Gains less losses from financial investments	150	321
Net insurance premium income	1,613	1,823
Other operating income	347	183
<b>Total operating income<sup>1</sup></b>	<b>14,918</b>	<b>14,202</b>
Net insurance claims, benefits paid and movement in liabilities to policyholders	(2,048)	(2,316)
<b>Net operating income before loan impairment and other credit risk provisions</b>	<b>12,870</b>	<b>11,886</b>
Loan impairment charges and other credit risk provisions	(481)	(449)
<b>Net operating income</b>	<b>12,389</b>	<b>11,437</b>
Total operating expenses <sup>1</sup>	(9,420)	(9,487)
<b>Operating profit</b>	<b>2,969</b>	<b>1,950</b>
Share of profit in associates and joint ventures	2	3
<b>Profit before tax</b>	<b>2,971</b>	<b>1,953</b>
Tax expense	(997)	(564)
<b>Profit for the year</b>	<b>1,974</b>	<b>1,389</b>
Profit attributable to shareholders of the parent company	1,942	1,354
Profit attributable to non-controlling interests	32	35

<sup>1</sup> Total operating income and expenses includes significant items as detailed on pages 12 and 13.

### Review of business performance

HSBC Bank plc and its subsidiary undertakings reported profit before tax of £2,971 million, £1,018 million or 52 per cent higher than 2014.

**Net interest income** increased by £189 million or 3 per cent. This increase was primarily due to lower provisions arising from the on-going review of compliance with the CCA of £5 million taken in 2015 compared to £379 million in 2014. Net interest income increased in CMB, primarily in the UK, on growth from Credit and Lending resulting from new business lending, and deposits from PCM. By contrast, excluding the on-going review of compliance with the CCA noted above, net interest income decreased in RBWM due to spread compression on mortgages and lower card balances. This was partly offset by higher deposit spread due to the reduction of interest rates paid to customers, and higher deposit volume. In addition, net interest income was also affected by adverse foreign exchange movements.

**Net fee income** decreased by £403 million or 12 per cent. In RBWM the reduction was mainly in the UK, due to lower overdraft fees following re-pricing and the introduction of customer overdraft text-alert service. Fees were also lower in Turkey on cards that were adversely affected by regulatory changes. In GB&M, the reduction was due to higher fees paid to HSBC entities in other regions relating to increased trading activity.

**Net trading income** increased by £1,142 million or 71 per cent. The increase includes a number of significant items including:

- favourable movement in the debit valuation adjustment ('DVA') on derivative contracts of £62 million in GB&M compared to the adverse movements of £143 million in the prior year; and
- minimal positive fair value adjustments on non-qualifying hedges of £3 million, notably in our French home loan portfolio in RBWM, compared to adverse movements of £151 million in the prior year.

Excluding these items, net trading income increased by £783 million, predominantly in GB&M driven by Markets. Revenues increased in Equities, Foreign Exchange and Credit reflecting higher volatility and higher client flows. In addition, Equities and Rates benefitted from favourable movements on own credit spread.

The funding fair value adjustment ('FFVA') on certain derivative contracts in 2014 resulted in a higher prior year charge, affecting Rates and Credit.

**Net income from financial instruments designated at fair value** was broadly unchanged. Favourable movements in credit spread of the group's own long-term debt and favourable foreign exchange movements on economically hedged foreign currency debt were mostly offset by the reduction in net income arising from financial assets held to meet liabilities under insurance and investment contracts, reflecting lower net investment returns in 2015.

## Strategic Report: Business Review (continued)

These returns reflected weaker stock market movements notably in France and the disposal of the pension business in the UK.

**Gains less losses from financial investments** decreased by £171 million, partly due to lower net gains on the disposal of government debt securities, notably in the UK.

**Net insurance premium income** decreased by £210 million or 12 per cent, including adverse foreign exchange movements. Excluding these movements, net earned insurance premiums decreased in the UK driven by lower pension premiums following a decision to exit the commercial pensions market in 2014. This was partly offset by higher sales of investment contracts in RBWM France reflecting customer demand.

**Other operating income** increased by £164 million, driven by an increase in the present value of in-force ('PVIF') long term insurance business in RBWM France. This is a result of positive investment assumption changes due to rising long-term interest rates in 2015 compared to falling rates in 2014.

**Net insurance claims, benefits paid and movement in liabilities to policyholders** decreased by £268 million, primarily due to lower investment returns on policyholder contracts where the policyholder bears investment risk due to weaker stock market performance.

**Loan impairment charges and other credit risk provisions** increased by £32 million or 7 per cent. This was driven by GPB due to higher individually assessed provisions and collective impairment provisions compared to releases in the prior period. In RBWM loan impairment charges also increased due to lower recoveries resulting from a lower participation in UK debt sales.

**Total operating expenses** decreased by £67 million including favourable foreign exchange movements. Excluding these, operating expenses increased driven by a number of significant items including:

- £172 million non-recurring insurance recovery in 2014 relating to Madoff litigation costs; and
- £258 million of costs-to-achieve (as defined on page 12); partially offset by
- lower settlements and provisions in connection with legal and regulatory matters in GB&M (2015: £611 million; 2014: £746 million); and
- lower UK customer redress provisions, for possible mis-selling in previous years of payment protection insurance ('PPI') policies (2015: £359 million; 2014: £583 million).

Excluding these, expenses were higher reflecting an increase in compliance and regulatory programme costs across RBWM, CMB and GB&M in line with the implementation of Global Standards. In addition, GB&M expenses also increased due to higher staff and IT costs.

**Tax expense** totalled £997 million in 2015, compared to £564 million in 2014. The effective tax rate for 2015 was 33.6 per cent, compared to 28.9 per cent in 2014. The effective tax rate has increased since 2014 primarily due to the introduction of the 8 per cent surcharge on UK banking profits that increased the value of deferred tax liabilities, and increased profits in France, which has a statutory tax rate of 38 per cent. Excluding the one-off impact of the change in tax rates, the effective tax rate would be 30.8 per cent.

## Strategic Report: Business Review (continued)

### Review of business position

Summary consolidated balance sheet as at 31 December

	2015 £m	2014 £m
<b>Total assets</b>	<b>727,941</b>	<b>797,289</b>
Cash and balances at central banks	39,749	42,853
Trading assets	110,585	130,127
Financial assets designated at fair value	6,829	6,899
Derivative assets	166,785	187,736
Loans and advances to banks	23,222	25,262
Loans and advances to customers	258,506	257,252
Reverse repurchase agreements – non-trading	30,537	41,945
Financial investments	71,352	76,194
Other	20,376	29,021
<b>Total liabilities</b>	<b>689,816</b>	<b>760,591</b>
Deposits by banks	24,202	27,590
Customer accounts	332,830	346,507
Repurchase agreements – non-trading	17,000	23,353
Trading liabilities	73,489	82,600
Financial liabilities designated at fair value	19,001	22,552
Derivative liabilities	162,864	188,278
Debt securities in issue	26,069	27,921
Liabilities under insurance contracts issued	16,664	17,522
Other	17,697	24,268
<b>Total equity</b>	<b>38,125</b>	<b>36,698</b>
Total shareholders' equity	37,497	36,078
Non-controlling interests	628	620

### Movements in 2015

Total reported assets were 8.7 per cent lower than at 31 December 2014, while the ratio of customer advances to customer accounts increased to 77.7 per cent (2014: 74.2 per cent).

The group's Common Equity Tier 1 ratio increased to 9.6 per cent (2014: 8.7 per cent). Risk-weighted assets of £229,382 million were 6 per cent lower than at 31 December 2014, principally due to the disposal of securitisation exposures and reductions in counterparty credit risk exposures combined with use of better rated counterparties.

#### Assets

*Cash and balances at central banks* reduced by 7 per cent as the group looked to optimise the balance sheet, reducing sources of liquidity risk and improving the co-ordination of funding.

*Trading assets* decreased by 15 per cent as the group reduced its trading inventory in line with the group's risk appetite.

*Derivative assets* decreased by 11 per cent primarily due to the upwards shift in major yield curves. This was partially offset by a reduction in the level of allowable derivative netting. The group changed its presentation of variation margin received from clearing houses to offset against derivative assets in 2015.

*Loans and advances to customers* remained broadly flat as a reduction in gross corporate overdrafts was offset by increases in commercial customer lending. The reduction in gross corporate overdrafts had a corresponding reduction

in customer accounts and was driven by an initiative with clients to settle positions in notional pooling accounts, reducing balance sheet usage.

*Reverse repurchase agreements – non-trading* reduced by 27 per cent due to reduced client demand from bank counterparties.

*Financial investments* reduced by 6 per cent principally due to legacy assets, as the group looks to optimise its RWA usage.

*Other assets* reduced by 30 per cent primarily due to the sale of the UK pension insurance business which had been reported as held for sale in 2014. There was an additional reduction following the group's change in presentation to offset variation margin placed with clearing houses against derivative liabilities from 2015.

#### Liabilities

*Customer accounts* decreased by 4 per cent. The decline was driven by a reduction in gross customer deposits as part of an initiative to reduce balances in notional pooling accounts (see loans and advances to customers). The group also saw a reduction in non-core customer liabilities driven by evolving liquidity and capital regulations. These targeted reductions were partially offset by an increase in core customer deposits.

*Repurchase agreements – non trading* reduced by 27 per cent in line with reverse repurchase agreements.

*Trading liabilities* decreased by 11 per cent in line with trading assets.

*Financial liabilities designated at fair value and debt securities in issue* reduced by 16 per cent and 7 per cent respectively, due to a reduction in short term wholesale

## Strategic Report: Business Review (continued)

funding requirements as the group's core funding base continued to improve in 2015.

*Derivative liabilities* reduced by 13 per cent, broadly in line with derivative assets as the underlying risk is broadly matched.

*Other liabilities* reduced by 27 per cent primarily due to the sale of the UK pension insurance business which had been reported as held for sale in 2014. There was an additional reduction following the group's change in presentation to offset variation margin received with clearing houses against derivative assets from 2015.

### Equity

*Total shareholders' equity* increased by 4 per cent due to an increase in retained earnings and the issuance of new additional tier 1 capital instruments.

## Business review

Profit on ordinary activities before tax

	2015 £m	2014 £m
Retail Banking and Wealth Management	866	213
Commercial Banking	1,597	1,592
Global Banking and Markets	634	(19)
Global Private Banking	145	115
Other	(271)	52
	<b>2,971</b>	<b>1,953</b>

HSBC Bank plc and its subsidiaries reported a profit before tax of £2,971 million, £1,018 million or 52 per cent higher than 2014. GB&M, RBWM, CMB and GPB reported higher profits in 2015, while reported profits reduced in 'Other'.

### Use of non-GAAP financial measures

Our reported results are prepared in accordance with IFRSs as detailed in the Financial Statements on page 102. In

*Significant revenue items by business segment – (gains)/losses*

	RBWM £m	CMB £m	GB&M £m	GPB £m	Other £m	Intersegment £m	Total £m
<b>31 December 2015</b>							
Reported revenue	4,553	3,388	4,350	368	307	(96)	12,870
Significant revenue items	(2)	11	(50)	(20)	(142)	–	(203)
Change in credit spread on long-term debt	–	–	–	–	(143)	–	(143)
Debit valuation adjustment on derivative contracts	–	–	(62)	–	–	–	(62)
Fair value movement on non-qualifying hedges	(16)	(1)	12	1	1	–	(3)
Provisions arising from the on-going review of compliance with the CCA in the UK	14	12	–	(21)	–	–	5
<b>Adjusted revenue</b>	<b>4,551</b>	<b>3,399</b>	<b>4,300</b>	<b>348</b>	<b>165</b>	<b>(96)</b>	<b>12,667</b>
<b>31 December 2014</b>							
Reported revenue	4,208	3,434	3,679	324	324	(83)	11,886
Significant revenue items	492	15	140	26	(17)	–	656
Change in credit spread on long-term debt	–	–	–	–	(17)	–	(17)
Debit valuation adjustment on derivative contracts	–	–	143	–	–	–	143
Fair value movement on non-qualifying hedges	155	(1)	(3)	–	–	–	151
Provisions arising from the on-going review of compliance with the CCA in the UK	337	16	–	26	–	–	379
<b>Adjusted revenue</b>	<b>4,700</b>	<b>3,449</b>	<b>3,819</b>	<b>350</b>	<b>307</b>	<b>(83)</b>	<b>12,542</b>

measuring our business performance, the primary financial measure that we use is 'adjusted performance' as detailed below.

### Adjusted performance

Adjusted performance is computed by adjusting reported results for the year-on-year effects of significant items which distort year-on-year comparisons.

We use the term 'significant items' to collectively describe the group of individual adjustments which are excluded from reported results when arriving at adjusted performance. Significant items, which are detailed below, are those items which management and investors would ordinarily identify and consider separately when assessing performance in order to better understand the underlying trends in the business.

In 2015, two new categories of significant items in relation to expenses have been added, namely costs-to-achieve ('CTA') and costs to establish UK ring-fenced bank. CTA comprise those specific costs relating to the achievement of strategic actions set out in the Investor Update in June 2015. These are costs incurred between 1 July 2015 and 31 December 2017, and do not include ongoing initiatives such as Global Standards. Any costs arising within this category have been incurred as part of a significant transformation programme and are included within significant items. CTA include restructuring costs which were identified as a separate significant item prior to 1 July 2015.

We believe adjusted performance provides useful information for investors by aligning internal and external reporting, identifying and quantifying items management believe to be significant and providing insight into how management assesses year-on-year performance.

A reconciliation to the adjusted basis is given in the tables below.

## Strategic Report: Business Review (continued)

### Significant cost items by business segment – (recoveries)/charges

	RBWM £m	CMB £m	GB&M £m	GPB £m	Other £m	Intersegment £m	Total £m
<b>31 December 2015</b>							
Reported operating expenses	(3,517)	(1,480)	(3,727)	(213)	(579)	96	(9,420)
Significant cost items	397	84	646	3	170	–	1,300
UK customer redress programmes	359	10	(11)	–	–	–	358
Restructuring and other related costs	1	1	8	–	22	–	32
Madoff related litigation costs	–	–	–	–	–	–	–
Costs to achieve	37	73	38	3	107	–	258
Costs to establish UK ring-fenced bank	–	–	–	–	41	–	41
Settlements and provisions in connection with legal and regulatory matters	–	–	611	–	–	–	611
<b>Adjusted operating expenses</b>	<b>(3,120)</b>	<b>(1,396)</b>	<b>(3,081)</b>	<b>(210)</b>	<b>(409)</b>	<b>96</b>	<b>(8,120)</b>

<b>31 December 2014</b>							
Reported operating expenses	(3,834)	(1,535)	(3,715)	(213)	(273)	83	(9,487)
Significant cost items	617	93	678	–	35	–	1,423
UK customer redress programmes	602	85	90	–	–	–	777
Restructuring and other related costs	15	8	14	–	35	–	72
Madoff related litigation costs	–	–	(172)	–	–	–	(172)
Settlements and provisions in connection with legal and regulatory matters	–	–	746	–	–	–	746
<b>Adjusted operating expenses</b>	<b>(3,217)</b>	<b>(1,442)</b>	<b>(3,037)</b>	<b>(213)</b>	<b>(238)</b>	<b>83</b>	<b>(8,064)</b>

### Net impact on profit before tax by business segment

	RBWM £m	CMB £m	GB&M £m	GPB £m	Other £m	Intersegment £m	Total £m
<b>31 December 2015</b>							
Reported profit/(loss) before tax	866	1,597	634	145	(271)	–	2,971
Significant revenue items	(2)	11	(50)	(20)	(142)	–	(203)
Significant cost items	397	84	646	3	170	–	1,300
<b>Adjusted profit/(loss) before tax</b>	<b>1,261</b>	<b>1,692</b>	<b>1,230</b>	<b>128</b>	<b>(243)</b>	<b>–</b>	<b>4,068</b>
Net impact on reported profit and loss	395	95	596	(17)	28	–	1,097
<b>31 December 2014</b>							
Reported profit/(loss) before tax	213	1,592	(19)	115	52	–	1,953
Significant revenue items	492	15	140	26	(17)	–	656
Significant cost items	617	93	678	–	35	–	1,423
<b>Adjusted profit/(loss) before tax</b>	<b>1,322</b>	<b>1,700</b>	<b>799</b>	<b>141</b>	<b>70</b>	<b>–</b>	<b>4,032</b>
Net impact on reported profit and loss	1,109	108	818	26	18	–	2,079

### Business Commentary

The following business commentary is on an adjusted basis unless stated otherwise.

**Profit before tax** HSBC Bank plc and its subsidiaries recorded an adjusted profit before tax of £4,068 million, £36 million higher than 2014. Overall profits in GB&M increased while RBWM, CMB and GPB recorded a reduction in adjusted profits compared to the prior year.

**Revenue**, which is defined as the net operating income before loan impairment charges and other credit risk provisions, has increased by £125 million, dampened by adverse foreign exchange movements. Revenue increased in GB&M due to higher income in Equities, Foreign Exchange and Credit resulting from increased volatility and higher client flows. These were partly offset by decreases in RBWM, driven by lower income on mortgages and overdrafts in UK despite higher revenue in France. Revenue decreased in 'Other', due to gains of £114 million recorded in 2014 arising from external hedging of an intra-group financing transaction. In addition, unfavourable fair value movements of £38 million from interest and exchange rate

ineffectiveness in the hedging of long term debt issued contributed to the fall in revenue.

**Loan impairment charges and other credit risk provisions** increased by £32 million or 7 per cent. This was driven by GPB due to higher individually assessed provisions and collective impairment provisions compared to releases in the prior period. In RBWM loan impairment charges also increased due to lower recoveries resulting from lower participation in UK debt sales.

**Total operating expenses** increased by £56 million to £8,120 million although this was dampened by foreign exchange movements. The increase in operating expenses was primarily due to increased regulatory programmes and compliance related costs in line with the implementation of Global Standards. In addition, GB&M expenses increased driven by higher staff and IT costs.

The profit before tax tables for the businesses on pages 14 to 17 are presented on a reported basis unless stated otherwise.

**Strategic Report: Business Review** (continued)**Retail Banking and Wealth Management**

	2015	2014
	£m	£m
Net interest income	3,352	3,158
Net fee income	1,091	1,356
Trading income	71	(149)
Other income	39	(157)
Net operating income before impairments and provisions	4,553	4,208
Loan impairment charges and other credit risk provisions	(171)	(162)
<b>Net operating income</b>	<b>4,382</b>	<b>4,046</b>
Total operating expense	(3,517)	(3,834)
<b>Operating profit</b>	<b>865</b>	<b>212</b>
Share of profit in associates and joint ventures	1	1
<b>Profit before tax</b>	<b>866</b>	<b>213</b>

*Profit before tax – by country*

	2015	2014
	£m	£m
United Kingdom	716	381
France	253	(113)
Germany	15	17
Turkey	(101)	(94)
Other	(17)	22
<b>Profit before tax</b>	<b>866</b>	<b>213</b>

**Review of reported performance***Profit before tax (£m)*

RBWM reported a profit before tax of £866 million, £653 million higher than 2014.

This was primarily due to an increase in revenue from lower provisions of £323 million arising from the on-going review of compliance with the CCA, and lower operating expenses driven by a decrease in customer redress provisions of £243 million.

**Review of adjusted performance**

	2015	2014
	£m	£m
<b>Reported profit before tax</b>	<b>866</b>	<b>213</b>
Net impact of significant items – (recoveries)/charges	395	1,109
<b>Adjusted profit before tax</b>	<b>1,261</b>	<b>1,322</b>

*Profit before tax (£m)*

On an adjusted basis, RBWM profit before tax was £1,261 million compared to £1,322 million in 2014, primarily due to a reduction in revenue notably in UK and Turkey, partly offset by an increase in France. Operating expenses fell.

**Revenue** decreased by £149 million mainly in the UK due to lower spreads on mortgages and a reduction in overdraft fees due to re-pricing and a fall in overdraft balances arising from the introduction of a new overdraft text-alert for customers. These were partly offset by higher spreads on savings and higher current account balances. Revenue decreased in Turkey due to the effect of regulatory changes affecting card and loan fees.

By contrast, revenue increased in France, notably in the Insurance business, due to favourable movements in the PVIF driven by positive investment assumption changes.

**Loan impairment charges** increased in the UK due to lower recoveries.

**Operating expenses** were £97 million or 3 per cent lower than 2014, primarily driven by favourable foreign exchange movements in France and Turkey. In the UK, expenses increased reflecting higher costs relating to asset management, higher IT amortisation and lower capitalisation costs, pay inflation and higher bonus costs. In addition, there was an increase in regulatory programmes and compliance related costs in line with the implementation of Global Standards.



**Strategic Report: Business Review** (continued)**Commercial Banking**

	2015	2014
	£m	£m
Net interest income	2,245	2,195
Net fee income	1,101	1,153
Trading income	19	21
Other income	23	65
Net operating income before impairments and provisions	3,388	3,434
Loan impairment charges and other credit risk provisions	(311)	(308)
<b>Net operating income</b>	<b>3,077</b>	<b>3,126</b>
Total operating expenses	(1,480)	(1,535)
<b>Operating profit</b>	<b>1,597</b>	<b>1,591</b>
Share of profit in associates and joint ventures	-	1
<b>Profit before tax</b>	<b>1,597</b>	<b>1,592</b>
<i>Profit before tax – by country</i>		
	2015	2014
	£m	£m
United Kingdom	1,414	1,377
France	99	146
Germany	43	43
Turkey	15	2
Other	26	24
<b>Profit before tax</b>	<b>1,597</b>	<b>1,592</b>

**Review of reported performance***Profit before tax (£m)*

CMB reported a profit before tax of £1,597 million, broadly in line with 2014.

Profit before tax grew in the UK partly offset by a fall in France, partly reflecting the weakness of the Euro.

**Review of adjusted performance**

	2015	2014
	£m	£m
<b>Reported profit before tax</b>	<b>1,597</b>	<b>1,592</b>
Net impact of significant items – (recoveries)/charges	95	108
<b>Adjusted profit before tax</b>	<b>1,692</b>	<b>1,700</b>

*Profit before tax (£m)*

On an adjusted basis, CMB profit before tax was £1,692 million compared to £1,700 million in 2014, a decrease of £8 million. The decrease in profit was driven by lower revenue and higher loan impairment charges, partly offset by lower operating expenses.

**Revenue** fell due to adverse currency movements.

Adjusting for this, CMB delivered an increase in revenue, with UK balance growth in Credit and Lending and PCM being partly offset by falling deposit spreads in France.

**Loan impairment charges** were broadly unchanged.

Higher individually assessed provisions in the UK and Spain were partly offset by lower individually assessed provisions in Malta and higher collective releases in Turkey.

**Operating expenses** were £46 million lower compared to 2014, primarily driven by favourable exchange movements. Excluding this, expenses increased mainly in the UK driven by increased regulatory programmes and compliance related costs.

## Strategic Report: Business Review (continued)

### Global Banking and Markets

	2015	2014
	£m	£m
Net interest income <sup>1</sup>	1,174	1,180
Net fee income	563	643
Trading income <sup>1</sup>	2,470	1,637
Other income	143	219
Net operating income before impairments and provisions	4,350	3,679
Loan impairment charges and other credit risk provisions	10	16
<b>Net operating income</b>	<b>4,360</b>	<b>3,695</b>
Total operating expenses	(3,727)	(3,715)
<b>Operating profit</b>	<b>633</b>	<b>(20)</b>
Share of profit in associates and joint ventures	1	1
<b>Profit before tax</b>	<b>634</b>	<b>(19)</b>

<sup>1</sup> The bank's Balance Sheet Management business, reported within GB&M, provides funding to the trading businesses. To report GB&M Trading income on a fully funded basis, Net interest income and Trading income are grossed up to reflect internal funding transactions prior to their elimination in the Inter Segment column (refer to Note 10).

#### Profit before tax – by country

	2015	2014
	£m	£m
United Kingdom	199	(708)
France	72	212
Germany	103	99
Turkey	61	56
Other <sup>1</sup>	199	322
<b>Profit before tax</b>	<b>634</b>	<b>(19)</b>

<sup>1</sup> Refer to Madoff related litigation costs in the significant items table on pages 12 and 13 for details of year-on-year movement.

### Review of reported performance

#### Profit before tax (£m)

GB&M reported a profit before tax of £634 million, compared to a loss of £19 million in 2014, driven mainly by higher revenue.

### Review of adjusted performance

	2015	2014
	£m	£m
Reported profit/(loss) before tax	634	(19)
Net impact of significant items – (recoveries)/charges	596	818
<b>Adjusted profit/(loss) before tax</b>	<b>1,230</b>	<b>799</b>

#### Profit before tax (£m)

On an adjusted basis, GB&M profit before tax was £1,230 million compared to £799 million in 2014, an increase of £431 million, primarily due to higher revenue, which was partly offset by higher operating expenses.

**Revenue** increased from £3,819 million to £4,300 million, notably in Markets, where income from Equities, Foreign Exchange and Credit increased following increased volatility and higher client flows. Rates revenue increased due to a number of valuation movements. In 2014, we revised our estimation methodology for valuing uncollateralised derivative portfolios, resulting in a higher FFVA charge. The Rates business also benefitted from favourable movements on own credit spread on structured liabilities compared with 2014. These movements contributed to increased revenue although client activity remained subdued.

In addition, revenue in 2015 was favourably impacted in the UK and adversely affected in France in respect of cash flow and foreign exchange hedging programmes, assessed as not satisfying all the accounting requirements of hedge accounting.

**Loan impairment releases** fell mainly driven by a lower net release of credit risk provisions on available-for-sale asset backed securities in the UK, and lower individually assessed provisions across UK, Spain and Russia.

**Operating expenses** were £44 million or 1 per cent higher than 2014 primarily reflecting an increase in regulatory programmes and compliance related costs along with increase in staff costs. Staff costs increased notably in UK, and to a lesser extent in France.

## Strategic Report: Business Review (continued)

### Global Private Banking

	2015	2014
	£m	£m
Net interest income	233	203
Net fee income	107	112
Trading income	13	11
Other income	15	(2)
Net operating income before impairments and provisions	368	324
Loan impairment charges and other credit risk provisions	(10)	4
<b>Net operating income</b>	<b>358</b>	<b>328</b>
Total operating expenses	(213)	(213)
<b>Operating profit</b>	<b>145</b>	<b>115</b>
Share of profit in associates and joint ventures	–	–
<b>Profit before tax</b>	<b>145</b>	<b>115</b>
<i>Profit before tax – by country</i>		
	2015	2014
	£m	£m
United Kingdom	125	100
France	9	–
Germany	13	16
Turkey	1	–
Other	(3)	(1)
<b>Profit before tax</b>	<b>145</b>	<b>115</b>

#### Review of reported performance

##### Profit before tax (£m)

GPB reported a profit before tax of £145 million, £30 million or 26 per cent higher than 2014.

##### Review of adjusted performance

	2015	2014
	£m	£m
<b>Reported profit/(loss) before tax</b>	<b>145</b>	<b>115</b>
Net impact of significant items – (recoveries)/charges	(17)	26
<b>Adjusted profit/(loss) before tax</b>	<b>128</b>	<b>141</b>

##### Profit before tax (£m)

GPB adjusted profit before tax was £128 million compared to £141 million in 2014, a decrease of £13 million.

**Revenue** was broadly unchanged year-on-year.

**Loan impairment charges** increased due to higher individually assessed provision in 2015 and collective impairment provision releases in 2014.

**Operating expenses** were broadly in line with 2014.

### Other

'Other' contains the results of financing operations, central support and functional costs with associated recoveries, certain property transactions and movements in fair value of own debt.

	2015	2014
	£m	£m
Net interest income	(63)	(42)
Net fee income	1	2
Trading income	55	24
Change in credit spread on long-term debt	143	17
Other income	171	323
Net operating income before impairments and provisions	307	324
Loan impairment charges and other credit risk provisions	1	1
<b>Net operating income/(expense)</b>	<b>308</b>	<b>325</b>
Total operating expenses	(579)	(273)
<b>Operating (loss)/profit</b>	<b>(271)</b>	<b>52</b>
Share of profit in associates and joint ventures	–	–
<b>Profit/(loss) before tax</b>	<b>(271)</b>	<b>52</b>

#### Review of reported performance

##### Profit before tax (£m)

Other reported a loss of £271 million, a decrease of £323 million compared to 2014.

##### Review of adjusted performance

	2015	2014
	£m	£m
<b>Reported profit/(loss) before tax</b>	<b>(271)</b>	<b>52</b>
Net impact of significant items – (recoveries)/charges	28	18
<b>Adjusted profit/(loss) before tax</b>	<b>(243)</b>	<b>70</b>

##### Profit before tax (£m)

Other adjusted loss was £243 million compared to a profit of £70 million in 2014, a decrease of £313 million.

**Revenue** decreased from £307 million to £165 million primarily due to a gain arising from external hedging of an intra-group financing transaction of £114 million in 2014. This was partly offset by increased income from intra-group recharges.

**Operating expenses** increased by £171 million compared to 2014 which was mainly due to intra-group charges and an increase in regulatory programmes and compliance related costs.

## Strategic Report: Risk overview

### Risk overview

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 banking risks are credit risk, operational risk, market risk, liquidity and funding risk, compliance risk and reputational risk. We also incur insurance risk.

In addition to these banking risks, we have identified principal risks with the potential to have a material impact on our financial results or reputation and the sustainability of our long-term business model.

The exposure to our risks and risk management of these are explained in more details in the Risk section of the Report of the Directors on pages 21 to 25.

During 2015 a number of changes to our principal risks have been made to reflect its revised assessment of their effect on the group.

Risk	Trend	Mitigants
<b>Externally driven</b>		
Economic outlook and capital flows	►	We closely monitor economic developments in key markets, undertaking business or portfolio reviews or stress tests as required, and take appropriate action as circumstances evolve.
Geopolitical risk	▲	We continuously assess the impact of the geopolitical outlook on our country limits and exposures to ensure we remain within our risk appetite.
Turning of the credit cycle	▲	We undertook portfolio and limit reviews and conducted stress tests on the sectors and portfolios that are most sensitive to the credit cycle.
Regulatory developments with adverse impact on business model and profitability	►	We actively assess the impact of relevant developments and engage closely with governments and regulators, seeking to ensure that requirements are considered properly and implemented in an effective manner.
Regulatory focus on conduct of business and financial crime	►	We are enhancing our financial crime and regulatory compliance controls and resources and are implementing significant programmes to enhance the management of conduct and financial crime risks.
US Deferred Prosecution Agreement ('DPA') and related agreements and consent orders	▲	We continue to take concerted action to remedy anti-money laundering and sanctions compliance deficiencies and to implement Global Standards.
System resilience	▲	We continue to improve our governance and controls framework to protect HSBC information and technical infrastructure against ever-increasing demands and sophisticated cyber-threats.
<b>Internally driven</b>		
People risk	►	We continue to focus on attracting and retaining key talent and are implementing a number of initiatives to improve employee capability, collaboration and engagement.
Execution risk	▲	We have strengthened our prioritisation and governance processes for significant strategic, regulatory and compliance projects.
Data management	►	A number of key initiatives and projects are in progress to implement our data strategy to enable consistent data aggregation, reporting and management.



Risk has heightened during 2015



Risk remains at the same level as 2014

On behalf of the Board

A P S Simoes, *Director*

Registered number 14259

22 February 2016

## Report of the Directors: Risk

### Results for 2015

The consolidated reported profit for the year attributable to the shareholders of the bank was £1,942 million.

Interim dividends of £315 million, in lieu of a final dividend in respect of the previous financial year, and £540 million in respect of 2015 were paid on the ordinary share capital during the year.

A second interim dividend, in lieu of a final dividend, of £272 million was declared after 31 December 2015, payable on 25 February 2016.

Further information about the results is given in the consolidated income statement on page 94. Information about future developments likely to affect the group is given in the Strategic Report.

As at 31 December 2015, the bank had 964 branches in the United Kingdom, and 13 located in the Isle of Man and the Channel Islands. The bank and its subsidiaries had further banks, branches and offices in Armenia, Belgium, the Channel Islands, Czech Republic, France, Germany, Greece, Hong Kong Special Administrative Region of the People's Republic of China, Ireland, Israel, Italy, Luxembourg, Malta, Netherlands, Poland, Russia, South Africa, Spain, Switzerland and Turkey.

### Risk Management

As a provider of banking and financial services, the group actively manages risk as a core part of its day-to-day activities. It continues to maintain a strong liquidity position and is well positioned for the evolving regulatory landscape.

The group also maintained its conservative risk profile by reducing exposure to the most likely areas of stress:

- the group regularly assessed its exposure to sovereign debt and bank counterparties to ensure that the overall quality of the portfolio remained strong;
- the group regularly assessed higher risk countries and adjusted its risk appetite and exposures accordingly; and
- the group repositioned certain portfolios and, in addition, made its client selection filters more robust in managing the risk of financial crime.

#### Risk management framework

An established risk governance framework and ownership structure ensures oversight of, and accountability, for the effective management of risk. The group's risk management framework fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions. Integral to the group's risk management framework are risk appetite, stress testing and the identification of emerging risks.

The bank's Risk Committee focuses on risk governance and provides a forward-looking view of risks and their mitigation. The Risk Committee is a committee of the Board and has responsibility for oversight and advice to the Board on, inter alia, the bank's risk appetite, tolerance and strategy, systems of risk management, internal control and compliance. Additionally, members of the Risk Committee attend meetings of the Chairman's Nominations and Remuneration Committee at which the alignment of the reward structures to risk appetite is considered.

In carrying out its responsibilities, the Risk Committee is closely supported by the Chief Risk Officer, the Chief Financial Officer, the Head of Internal Audit, and the Heads of Compliance, together with other business functions on risks within their respective areas of responsibility.

#### Risk culture

All employees are required to identify, assess and manage risk within the scope of their assigned responsibilities. Global Standards set the tone from the top and are central to the group's approach to balancing risk and reward.

Personal accountability is reinforced by the HSBC Values, with employees expected to act with courageous integrity in conducting their duties.

Employees are supported by a disclosure line which enables them to raise concerns in a confidential manner. The group also has in place a suite of mandatory training to ensure a clear and consistent attitude is communicated to staff. Mandatory training not only focuses on the technical aspects of risk but also on the group's attitude towards risk and the behaviours expected.

The risk culture is reinforced by the Group's approach to remuneration; individual awards are based on the achievement of both financial and non-financial (relating to the HSBC Values) objectives which are aligned to the global strategy.

Risks are assumed by the Businesses in accordance with their risk appetite and managed at global business and regional levels. Risks are identified through the group's risk map process which sets out the group's risk profile in relation to key risk categories.

#### Risk appetite

The group's Risk Appetite Statement describes the types and levels of risk that the group is prepared to accept in executing its strategy. Quantitative and qualitative metrics are assigned to nine key categories including: financial return and costs, capital, liquidity and funding cost of risk, credit risk concentration and operational risk.

Measurement against the metrics:

- guides underlying business activity;
- informs risk-adjusted remuneration;
- enables the key underlying assumptions to be monitored and, where necessary, adjusted through subsequent business planning cycles; and
- promptly identifies business decisions needed to mitigate risk.

The Risk Appetite Statement is approved by the Board following advice from the Risk Committee. It is central to the annual planning process, in which global businesses, geographical regions and functions are required to articulate their individual risk appetite statements. These are aligned with the group strategy, and provide a risk profile of each global business, region or function in the context of the individual risk categories.

## Report of the Directors: Risk (continued)

### Stress testing

Stress testing and scenario analysis form a key component of the group's integrated risk management framework. They provide a forward-looking assessment of risk, identify key fault lines under a range of scenarios, and facilitate the monitoring of principal risks and the development of appropriate mitigating actions and contingency plans, across a range of stressed conditions. As part of the group's risk appetite process, scenario analysis and stress testing support the setting of risk appetite tolerances and inform business, capital planning and strategic decision making.

A number of internal macroeconomic and event driven scenarios specific to the European region were considered and reported to senior management during the course of the year. Analysis was conducted under a range of scenarios including: Eurozone downturn scenarios, a UK EU exit, and a sustained low oil price scenario. The group also conducts reverse stress testing. This exercise requires a firm to assess scenarios and circumstances that would render its business model unviable, thereby identifying potential business vulnerabilities.

HSBC Bank plc is subject to regulatory stress testing in several jurisdictions. They include the programmes of the Bank of England ('BoE'), PRA and the European Banking Authority ('EBA'). Assessment by regulators is on both a quantitative and qualitative basis, the latter focusing on our portfolio quality, data provision, stress testing capability and capital planning processes. Stress testing is an important tool for the authorities to assess vulnerabilities in individual banks and the financial banking sector, under hypothetical adverse scenarios, the results of which are used to assess banks' resilience to a range of adverse shocks and to assess their capital adequacy.

During 2015 the group participated in the successful completion of the 2015 BoE concurrent stress testing exercise. This scenario incorporates a global recession in which disinflationary pressures and weakening expectations of growth lead to diminished risk appetite, falling commodity prices and lower market liquidity.

The BoE published the results of the 2015 UK stress test in December 2015, confirming that these tests did not reveal any capital inadequacies for the HSBC Group. At the European level, the EBA did not undertake a stress testing exercise in 2015 but instead carried out a transparency exercise, the results of which were published in November 2015.

In October 2015, the BoE published details of its medium-term approach to stress testing the UK banking system. The approach sets out that the outcome of the UK stress testing exercise will be considered by the Financial Policy Committee ('FPC') when determining the UK Countercyclical Capital Buffer ('CCyB') rate, and will also be considered when assessing the PRA buffer. Furthermore from 2016, the applicable hurdle rate (the amount of capital that banks are expected to maintain under a stress) is to include Pillar 1, Pillar 2A and Globally Systemically Important Institutions ('G-SII') buffer requirements.

In addition, the EBA also disclosed a timeline for the 2016 EU wide stress test exercise, which is expected to be aligned with banks' annual Pillar 2 supervisory review and evaluation process.

### Financial crime compliance and regulatory compliance

HSBC has continued to experience increased levels of compliance risk as regulators and other agencies pursued investigations into historical activities, for example, continued engagement with respect to compliance with Anti Money Laundering ('AML') and sanctions law (historical investigations gave rise to the US DPA and related FCA Direction), ongoing interaction with regulators relating to mis-selling of PPI policies and allegations of pressure selling in the UK, investigations in relation to conduct in the foreign exchange market, benchmark interest rate and commodity price setting. Details of these investigations and legal proceedings can be found in Note 37 on the Financial Statements.

The level of inherent compliance risk remained high in 2015 as the industry continued to experience greater regulatory scrutiny and heightened levels of regulatory oversight and supervision.

#### The Monitor

Under the agreements entered into with the DoJ and the FCA in 2012, including the five-year US DPA, the Monitor was appointed to produce annual assessments of the effectiveness of the Group's AML and sanctions compliance programme.

In January 2016, the Monitor delivered his second annual follow-up review report based on various thematic and country reviews he had conducted over the course of 2015. In his report, the Monitor concluded that, in 2015, HSBC made progress in developing an effective and sustainable financial crime compliance programme. However, he expressed significant concerns about the pace of that progress, instances of potential financial crime and systems and controls deficiencies, whether HSBC is on track to meet its goal to the Monitor's satisfaction within the five-year period of the US DPA and, pending further review and discussion with HSBC, did not certify as to HSBC's implementation of and adherence to remedial measures specified in the US DPA. The US DPA and related agreements and consent orders are discussed in 'Principal risks' on page 23.

#### Oil and gas prices

Oil and commodity prices have remained low since the middle of 2014 as a result of existing global supply and demand imbalances, with significant price declines in late 2015 and early 2016. Continued lower oil prices cause increased credit risks within oil-related industries together with fiscal and financing challenges for the energy exporters.

The overall portfolio of exposures directly exposed to oil and gas companies had drawn risk exposures amounting to about £4.7 billion with sub-sectoral distributions as follows: integrated producers 61%, service companies 16%, pure producers 21% and infrastructure companies 2%.

The credit quality distribution of the oil and gas portfolio was as follows: 'strong, good and satisfactory' categories made up of 91 per cent of the portfolio, 'sub-standard' 6 per cent and 'impaired' 3 per cent.

Oil and gas related counterparties have responded rapidly to the changing economic outlook, cutting back on capital

## Report of the Directors: Risk (continued)

expenditure as well as reducing operating expenses in order to manage cash flows and sustain profitability.

Large integrated producers remained resilient. Similarly, service companies continued to be more vulnerable as producers curtailed capital expenditures.

Individually assessed loan impairment charges in 2015 remained contained at approximately £53 million. Oil prices are now predicted to remain lower for longer and the oil price recovery is dependent on the removal of the excess supply that currently exists in the market. In view of these factors, collective allowances for exposures related to oil and gas as at 31 December 2015 stood at £30 million. Total allowances in respect of the oil and gas portfolio were £84 million.

### Turkey

At our Investor Update in June 2015, we announced our intention to sell our full banking operations in Turkey. Since June we have received a number of offers for this business, none of which were deemed to be in the best interests of shareholders. We have therefore decided to retain and restructure our Turkish operations, maintaining our wholesale banking business and refocussing our retail banking network in Turkey. This will provide better value for shareholders and will continue to allow our clients to capitalise on HSBC's international footprint.

## Principal risks and uncertainties

Principal risks are those that may impact on the financial results, reputation or business model of the bank. If these risks were to occur, they could have a material effect on the group.

The exposure to these risks and our risk management are explained in more detail below.

### Externally driven risks

#### Economic outlook and capital flows

Economic growth remained subdued in 2015, with a number of headwinds adversely affecting both developed and emerging market countries.

The slowdown of the mainland Chinese economy has dampened global trade flows and caused volatility in currency and global stock markets. Market concerns persist as to the scale of the slowdown and the potential for further depreciation of the RMB and emerging market currencies.

Global Trade has been subdued, particularly for lower value transactions throughout 2015, which combined with increased capital and regulatory pressures, have been translated by many institutions into a greater focus on core activities, which may exclude trade finance particularly in those countries with limited access to international markets. A continuation of this trend has the potential to detrimentally affect the global recovery given that historically, trade has been the primary engine for world growth.

Oil and gas prices fell further during 2015 and early 2016 as a result of continuing global supply and demand imbalances, raising the risk that any recovery in oil prices over the medium term will be even more gradual than currently expected. Although oil importers benefit from

low prices, low oil prices increase fiscal and financing challenges for exporters and accentuate deflationary risks.

The economic recovery in the eurozone remains fragile, driven by a combination of low oil prices, a weak euro, slowing growth and loose monetary policy. Populist parties are in the ascendancy in several EU countries, helped by the subdued economic backdrop as well as other issues such as migration. A referendum on the UK's EU membership is expected to occur within the lifetime of the current Parliament, and might be held as early as mid-2016 (see Geopolitical risk below). While the risk of Greece exiting the EU has faded, the implementation of required structural reforms could prove politically challenging.

### Potential impact on the group

- HSBC's results could be impacted by a prolonged period of low oil prices, particularly in conjunction with a low inflation environment and/or low or negative interest rates.
- The intensification of fragmentation risks in the EU could have both political and economic consequences for Europe.

### Mitigating actions

- We closely monitor economic developments in key markets and sectors with the aim of ensuring trends are identified, the implications for specific customers, customer segments or portfolios are assessed and appropriate mitigating action - which may include revising key risk appetite metrics or limits - is taken as circumstances evolve.
- We use internal stress testing and scenario analysis, as well as regulatory stress test programmes to evaluate the impact of macroeconomic shocks on our businesses and portfolios. Analysis undertaken on our oil and gas portfolio can be found on page 20.

### Geopolitical risk

Our operations and portfolios are exposed to risks arising from political instability, civil unrest and military conflict in many parts of the world.

In the Middle East, the intervention of Russia and the rise of the terrorist group, Daesh, have added to an already complex civil war in Syria and further destabilised Iraq. These are conflicts which show few signs of resolution. Daesh has proved capable of carrying out attacks in neighbouring countries and further afield. The lifting of sanctions following a deal between Iran and the five permanent members of the UN Security Council on the country's nuclear programme has done little to calm regional tensions.

Violence in Ukraine has abated but the conflict in the east of the country has not been resolved. Sanctions imposed by the US and EU against the Russian government, institutions and individuals have damaged the Russian economy.

European states are experiencing heightened political tension, reflecting concerns over migration, fears of terrorism and the possibility that the UK may vote to exit the EU following a referendum. An exit could have a significant impact on UK, European and global macroeconomic conditions, as well as substantial political ramifications.

## Report of the Directors: Risk (continued)

### Potential impact on the group

- Our results are subject to the risk of loss from physical conflicts or terrorist attacks, unfavourable political developments, currency fluctuations, social instability and changes in government policies in the jurisdictions in which we operate.
- Physical conflicts or terrorist attacks could expose our staff to physical risk and/or result in physical damage to our assets and disruptions to our operations.
- The effect of a UK exit from the EU on HSBC would depend on the manner in which the exit was to occur. A disorderly exit could force changes to HSBC's operating model, affect our ability to access ECB and high value euro payments, and affect our transaction volumes due to possible disruption to global trade flows.

### Mitigating actions

- We continually monitor the geopolitical outlook, in particular in countries where we have material exposures and/or a physical presence.
- Our internal credit risk ratings of sovereign counterparties take geopolitical factors into account and drives our appetite for conducting business in those countries. Where necessary, we adjust our country limits and exposures to reflect our risk appetite and mitigate risks as appropriate.
- We run internal stress tests and scenario analyses, including reverse stress tests, on our portfolios that take into account geopolitical scenarios, such as conflicts in countries where we have a significant presence, or political developments that could disrupt our operations, including the potential effect of a UK exit on our business model.

### Turning of the credit cycle

The long expected move by the United States Federal Reserve Board ('FRB') to raise interest rates and the slowdown in mainland China's economy which is expected to continue, have increased risk aversion in global markets. This tendency has deepened since the turn of 2016, with market volatility increasing. In 2015, emerging markets experienced net capital outflows for the first time since 1988, with several major currencies at decade-plus lows against the US dollar and global corporate defaults at the highest since 2009. 2016 could see an intensification of these trends and the appearance of stress in a wide array of credit segments, particularly if monetary policy is tightened quickly, sentiment regarding China worsens and oil prices fail to recover. Whilst Europe is less exposed to these factors than other regions, some contagion is expected to continue through 2016.

### Potential impact on the group

- Impairment allowances or losses could begin to rise from their historical lows in 2014 and 2015 if the credit quality of our customers is affected by less favourable global economic conditions in some markets.
- There may be impacts on the delinquency and losses in some portfolios which may be impacted by worsening macroeconomic conditions and their possible effects on particular geographies or industry sectors.
- Particular portfolios such as oil and gas may come under particular strain which is partly cyclical and partly driven by geopolitical concerns.

### Mitigating actions

- We closely monitor economic developments in key markets and sectors, taking portfolio actions where necessary including enhanced monitoring or reducing limits and exposures.
- We stress test those portfolios of particular concern to identify sensitivity to loss with management actions taken to control appetite where necessary.
- Where customers are either individually or collectively assessed, regular portfolio reviews are undertaken for sensitive portfolios to ensure that individual customer or portfolio risks are understood and that the level of facilities offered and our ability to manage through any downturn are appropriate.

### Regulatory developments with adverse impact on business model and profitability

Financial service providers continue to face stringent and costly regulatory and supervisory requirements, particularly in the areas of capital and liquidity management, conduct of business, financial crime, operational structures and the integrity of financial services delivery. Regulatory changes may affect our activities, both of the group as a whole and of some or all of our principal subsidiaries. These changes include:

- the UK's Financial Services (Banking Reform) Act 2013 which requires the ring-fencing of our UK retail banking activities from wholesale banking, together with the structural separation of other activities required by US legislation and rules (including the Volcker Rule implemented in December 2013 under the Dodd-Frank Act), and potential further changes under the European Commission's Banking Structural Reform Regulation which proposes similar structural reform for larger EU banks;
- revisions in the regime for the operation of capital markets, notably mandatory central clearing of over the counter ('OTC') derivatives and mandatory margin requirements for non-cleared derivatives under the Dodd-Frank Act and the EU's European Market Infrastructure Regulation ('EMIR');
- those arising from the Markets in Financial Instruments Regulation/Directive ('MiFID II'), which includes mandatory trading of derivatives on organised venues, enhanced transparency and reporting requirements, controls on high frequency and algorithmic trading, changes to the use of dealing commissions and potential future restrictions on the ability of non-EU Group companies to provide certain services to EU based clients. Aspects of MiFID II also further enhance protections for investors in line with many regulators' focus on the wider conduct of business and delivery of fair outcomes for customers;
- changes aimed at promoting effective competition in the interests of consumers, including investigations ordered by the UK Competition and Markets Authority and work to increase competition more generally;
- the recommendations arising out of the Final Report on the Fair and Effective Financial Markets Review undertaken by the BoE which include changes to market conduct rules and forward looking supervision in the operation of wholesale financial markets in the UK;
- continued focus in the UK on matters relating to management accountability, institutional culture,



## Report of the Directors: Risk (continued)

- employee conduct and increased obligations on market abuse and whistleblowing. This includes implementing the individual accountability regime and wider recommendations made by the Parliamentary Commission on Banking Standards and the activities of the Banking Standards Board;
- the Basel Committee on Banking Supervision ('Basel Committee') initiatives to enhance the risk sensitivity and robustness of the standardised approaches, to minimise reliance on internal models, and to incorporate capital floors in the Basel capital framework;
- the implementation of CRD IV, notably the UK application of the capital framework and its interaction with Pillar 2;
- proposals from the FSB for G-SIBs to hold minimum levels of capital and debt as total loss absorbing capacity ('TLAC'), together with the BoE's consultation on UK implementation of minimum requirement for own funds and eligible liabilities ('MREL');
- requirements flowing from arrangements for the resolution strategy of the Group and its individual operating entities, which may have different effects in different countries; and
- the continued risk of further changes to regulation relating to taxes affecting financial service providers, including financial transaction taxes and ongoing implementation of initiatives to share tax information such as the Common Reporting Standard introduced by the OECD.

### Potential impact on the group

- Proposed changes in and/or the implementation of regulations including mandatory central clearing of OTC derivatives, EMIR, ring-fencing and similar requirements, MiFID II, the Volcker Rule, recovery and resolution plans, tax information sharing initiatives and findings from competition orientated enquiries and investigations may affect the manner in which we conduct our activities and how the Group is structured.
- Requirements for higher levels of capital or TLAC may increase the funding costs for the Group and reduce our return on equity.
- Mandatory central clearing of OTC derivatives also brings new risks to HSBC in our role as a clearing member, as we will be required to underwrite losses incurred by central clearing counterparties from the default of other clearing members and their clients.
- Increased regulatory scrutiny of conduct of business and management accountability may affect the industry in areas such as employee recruitment and retention, product pricing and profitability in both retail and wholesale markets.
- These measures have the potential to increase our cost of doing business and curtail the types of business we can carry out, which may adversely affect future profitability.

### Mitigating actions

- We are engaged closely with governments and regulators in the countries in which we operate to help ensure that the new requirements are considered properly and can be implemented in an effective manner.

- We have enhanced our governance around central clearing counterparties and appointed specialists to manage the associated liquidity and collateral risks.
- We continue to enhance and strengthen governance and resourcing more generally around regulatory change management and the implementation of required measures to actively address this ongoing and significant agenda of regulatory change.

### Regulatory focus on conduct of business and financial crime

The incidence of regulatory proceedings against financial service firms has become more common-place and may increase in frequency due to increased media attention and higher expectations from prosecutors and the public, with a consequent increase also in civil litigation arising from or relating to issues which are subject to regulatory investigation, sanction or fine.

Regulators in the UK and other countries have continued to increase their focus on conduct matters relating to fair outcomes for customers and orderly and transparent operations in financial markets.

### Potential impact on the group

- HSBC may face regulatory censure or sanctions including fines and/or be exposed to legal proceedings and litigation.
- Regulators in the UK and other countries may identify future industry-wide mis-selling, market conduct or other issues that could affect the group. This may lead from time to time to significant direct costs or liabilities and/or changes in the practices of such businesses. Also, decisions taken by the Financial Ombudsman Service in the UK (or similar overseas bodies) could, if applied to a wider class or grouping of customers, have a material adverse effect on the operating results, financial condition and prospects of the group.

### Mitigating actions

- We have taken a number of steps including introduction of new global policies, enhancement to the product governance processes, establishment of a global conduct programme and review of sale processes and incentive schemes.

### US DPA and related agreements and consent orders

An independent compliance monitor ('the Monitor') was appointed in 2013 under the 2012 agreements entered into with the US DoJ and the UK FCA to produce annual assessments of the effectiveness of our AML and sanctions compliance programme. Additionally, the Monitor is serving as HSBC's independent consultant under the consent order of the FRB. HSBC Bank USA is also subject to an agreement entered into with the Office of the Comptroller of the Currency ('OCC') in December 2012, the Gramm-Leach-Bliley Act ('GLBA') Agreement and other consent orders. In January 2016, the Monitor delivered his second annual follow-up review report as required by the US DPA.

### Potential impact on HSBC

- The design and execution of AML and sanctions remediation plans are complex and require major investments in people, systems and other infrastructure. This complexity creates significant

## Report of the Directors: Risk (continued)

execution risk, which could affect our ability to effectively identify and manage financial crime risk and remedy AML and sanctions compliance deficiencies in a timely manner. This could, in turn, impact our ability to satisfy the Monitor or comply with the terms of the US DPA and related agreements and consent orders, and may require us to take additional remedial measures in the future.

- Under the terms of the US DPA, upon notice and an opportunity to be heard, the DoJ has sole discretion to determine whether HSBC has breached the US DPA. Potential consequences of breaching the US DPA could include the imposition of additional terms and conditions on HSBC, an extension of the agreement, including its monitorship, or the criminal prosecution of HSBC, which could, in turn, entail further financial penalties and collateral consequences.
- Breach of the US DPA or related agreements and consent orders could have a material adverse effect on our business, financial condition and results of operations, including loss of business and withdrawal of funding, restrictions on performing dollar-clearing functions through HSBC Bank USA or revocation of bank licences. Even if we are not determined to have breached these agreements, but the agreements are amended or their terms extended, our business, reputation and brand could suffer materially.

### Mitigating actions

- We are continuing to take concerted action to remedy AML and sanctions compliance deficiencies and to implement Global Standards. We are also working to implement the agreed recommendations flowing from the Monitor's 2013 and 2014 reviews, and will implement the agreed recommendations from the 2015 review.
- During 2015, we continued to make progress toward putting in place a robust and sustainable AML and sanctions compliance programme, including continuing to build a strong Financial Crime Compliance sub-function, rolling out improved systems and infrastructure to manage financial crime risk and improve transaction monitoring and enhancing internal audits.

### System resilience

HSBC and other public and private organisations continue to be the targets of cyber-attacks which, in some cases, disrupt services including the availability of our external facing websites, compromise organisational and customer information or expose security weaknesses. Management of cyber risks is coming under increased regulatory scrutiny.

### Potential impact on the group

- A major cyber attack, which could result from unauthorised access to our systems, may result in potential financial loss as well as significant reputational damage which could adversely affect customer and investor confidence in HSBC. Any loss of customer data would also trigger regulatory breaches which could result in fines and penalties being incurred.

### Mitigating actions

- The security of our information and technology infrastructure is crucial for maintaining our banking applications and processes and protecting our customers and the HSBC brand. We continue to strengthen our ability to prevent, detect and respond to the ever-increasing and sophisticated threat of cyber attacks by enhancing our governance and controls framework and technology infrastructure, processes and controls.
- We took part in the PRA's Cyber Vulnerability Testing exercise during 2015 and are making further enhancements to improve our resilience to, and ability to recover from, cyber-attacks.
- We have realigned the responsibilities and accountabilities for cyber and information risk management to align with the operational risk three lines of defence model and instigated a number of security improvement programmes within IT.

### Internally driven risks

#### People risk

Significant demands continue to be placed on our staff. The cumulative workload arising from regulatory reform and remediation programmes together with those related to the delivery of our strategy is hugely consumptive of human resources, placing increasingly complex and conflicting demands on a workforce where the expertise is often in short supply and globally mobile.

#### Potential impact on the group

- Changes in remuneration policy and practice resulting from CRD IV regulations, EBA Guidelines and PRA remuneration rules apply on a group-wide basis for any material risk takers. This presents significant challenges for HSBC because a significant number of our material risk takers are based outside the EU.
- The Senior Managers and Certification regimes and the related Rules of Conduct, which come into force in 2016 for other employees, set clear expectations of the accountabilities and behaviour of both senior and more junior employees.
- Organisational changes to support the group's strategy and/or implement regulatory reform programmes have the potential to lead to increased staff turnover.

#### Mitigating actions

- The changes in remuneration under the CRD IV regulations, EBA Guidelines and the PRA remuneration rules have necessitated a review of our remuneration policy, especially the balance between fixed and variable pay, to ensure we can remain globally competitive on a total compensation basis and retain our key talent.
- We continue to increase the level of specialist resources in key areas and to engage with our regulators as they finalise new regulations.
- Risks related to organisational change and disposals are subject to close management oversight, especially in those countries where staff turnover is particularly high.

## Report of the Directors: Risk (continued)

### Execution risk

Execution risk heightened during 2015 due to a number of factors. Significant programmes are under way to deliver the nine business actions to capture value from our global presence, announced at the Investor Update in June 2015. These, along with the regulatory reform agenda and our commitments under the US DPA require the management of complex projects that are resource demanding and time sensitive.

#### Potential impact on the group

- Risks arising from the number, magnitude and complexity of projects underway to meet these demands may include financial losses, reputational damage or regulatory censure.
- The potential risks of disposals include regulatory breaches, industrial action, loss of key personnel, and interruption to systems and processes during business transformation. They can have both financial and reputational implications.

#### Mitigating actions

- HSBC has strengthened its prioritisation and governance processes for significant projects, which are monitored by the Group Management Board.
- We have invested in our project implementation and IT capabilities and increased our focus on resource management.
- Risks related to disposals are carefully assessed and monitored and are subject to close management oversight.

### Data management

Regulators require more frequent and granular data submissions, which must be produced on a consistent, accurate and timely basis. As a G-SIB, HSBC must comply with the principles for effective risk data aggregation and risk reporting as set out by the Basel Committee.

#### Potential impact on the group

- Ineffective data management capabilities could impact our ability to aggregate and report complete, accurate and consistent data to regulators, investors and senior management on a timely basis.
- Financial institutions that fail to meet their Basel Committee data obligations by the required deadline may face supervisory measures.

#### Mitigating actions

- We have set a data strategy for the Group and defined Group-level principles, standards and policies to enable consistent data aggregation, reporting and management.
- We continue to focus on enhancing data governance, quality and architecture to support the Bank's objectives of ensuring reliability of information used in support of internal controls and external financial reporting.
- A number of key initiatives and projects to implement our data strategy and work towards meeting our Basel Committee data obligations are in progress.

## Report of the Directors: Risk (continued)

### Credit risk

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

There were no material changes to our policies and practices for the management of credit risk in 2015.

#### Credit Risk Management

*(Audited)*

Of the risks in which we engage, credit risk generates the largest regulatory capital requirements.

The principal objectives of our credit risk management are:

- to maintain across the group a strong culture of responsible lending and a robust risk policy and control framework;
- to both partner and challenge Global Businesses in defining, implementing, and continually re-evaluating our risk appetite under actual and scenario conditions; and
- to ensure there is independent, expert scrutiny of credit risks, their costs and mitigation.

Within the bank, the Credit Risk function is headed by the European Chief Risk Officer who reports to the Chief Executive Officer, with a functional reporting line to the Group Chief Risk Officer. Its responsibilities are:

- to formulate credit policy. Compliance, subject to approved dispensations, is mandatory for all operating companies which must develop local credit policies consistent with group policies that very closely reflect Group policy;
- to guide operating companies on the group's appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain higher-risk sectors;
- to undertake an independent review and objective assessment of risk. Credit risk assesses all commercial non-bank credit facilities and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken;
- to monitor the performance and management of portfolios across the group;
- to control exposure to sovereign entities, banks and other financial institutions, as well as debt securities which are not held solely for the purpose of trading;
- to set policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to the group's capital base, and remain within internal and regulatory limits;
- to maintain and develop the group's risk rating framework and systems through the Regional Model Oversight Committees ('RMOC'), for the wholesale businesses and the Credit Risk Analytical Oversight Committee ('CRAOC') for the retail businesses, both of which oversee risk rating system governance.

- to report on retail portfolio performance, high risk portfolios, risk concentrations, large impaired accounts, impairment allowances and stress testing results and recommendations to the group's RMM, the group's Risk Committee and the Board; and
- to act on behalf of the group as the primary interface, for credit-related issues, with the BoE, the PRA, local regulators, rating agencies, analysts and counterparts in major banks and non-bank financial institutions.

#### Credit quality of financial instruments

*(Audited)*

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

Our risk rating system facilitates the internal ratings-based approach under the Basel framework adopted by the Group to support calculation of the minimum credit regulatory capital requirement. For further details, see 'Credit quality classification of financial instruments' on page 32.

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

The Credit Review and Risk Identification team reviews the robustness and effectiveness of key management, monitoring and control activities.

#### Renegotiated loans and forbearance

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

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

## Report of the Directors: Risk (continued)

### Refinance risk

#### Personal Lending

Interest only mortgages lending incorporate bullet/balloon payments at the point of final maturity. In the UK, interest only lending is recognised as a niche product that meets a valid customer need. To reduce re-finance risk, an initial on-boarding assessment of customers' affordability is made on a capital repayment basis and every customer has a credible defined repayment strategy. Additionally the customer is contacted at least once during the mortgage term to check the status of the repayment strategy. In situations where it is identified that a borrower is expected not to be able either to repay a bullet/balloon payment then the customer will either default on the repayment or it is likely that HSBC may need to apply forbearance to the loan. In either circumstance this gives rise to a loss event and an impairment allowance will be considered where appropriate.

#### Wholesale Lending

Many types of wholesale lending incorporate bullet/balloon payments at the point of final maturity; often, the intention or assumption is that the borrower will take out a new loan to settle the existing debt. Where this is true the term refinance risk refers generally to the possibility that, at the point that such a repayment is due, a borrower cannot refinance by borrowing to repay existing debt. In situations where it is identified that a borrower is expected not to be able either to repay a bullet/balloon payment or to be capable of refinancing their existing debt on commercial terms then the customer will either default on the repayment or it is likely that HSBC may need to refinance the loan on terms it would not normally offer in the ordinary course of business. In either circumstance this gives rise to a loss event and an impairment allowance will be considered.

### Impairment assessment

*(Audited)*

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

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

When impairment losses occur, we reduce the carrying amount of loans and advances through the use of an allowance account. When impairment of available-for-sale financial assets and held-to-maturity financial investments occurs, the carrying amount of the asset is reduced directly. For further details on the accounting policy for impairment of available-for-sale debt and equity securities, see Note 1 on the Financial Statements.

### Write-off of loans and advances

*(Audited)*

For details of our accounting policy on the write-off of loans and advances, see Note 1 on the Financial Statements.

#### Personal lending

Property collateral for residential mortgages is repossessed and sold on behalf of the borrower only when all normal debt recovery procedures have been unsuccessful. The carrying amounts of residential mortgages in excess of net realisable value are fully provided for, from 150 days contractually past due in the UK and 180 days contractually past due for the rest of the group. We regularly obtain new appraisals for loans and adjust carrying value to the most recent appraisal as the best estimate of the cash flows that will be received on the disposal of the collateral for these collateral dependent loans.

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

In retail lending, final write-off should occur within 60 months of the default at the latest.

#### Wholesale Lending

Wholesale loans and advances are written off where normal collection procedures have been unsuccessful to the extent that there appears no realistic prospect of repayment. These procedures may include a referral of the business relationship to a Debt recovery company. Debt reorganisation will be considered at all times and may involve, in exceptional circumstances and in the absence of any viable alternative, a partial write-off in exchange for a commitment to repay the remaining balance.

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

## Report of the Directors: Risk (continued)

### Maximum exposure to credit risk

(Audited)

The following table presents the maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments, before taking into account any collateral held or other credit enhancements (where such credit enhancements do not meet offsetting requirements). For financial assets recognised on the

balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees granted, it is the maximum amount that the group would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, it is generally the full amount of the committed facilities.

Maximum exposure to credit risk

(Audited)

The group

	2015			2014		
	Maximum exposure £m	Offset £m	Exposure to credit risk (net) £m	Maximum exposure £m	Offset £m	Exposure to credit risk (net) £m
Cash and balances at central banks	39,749	–	39,749	42,853	–	42,853
Items in the course of collection from other banks	1,328	–	1,328	973	–	973
Trading assets <sup>1</sup>	70,002	–	70,002	85,885	–	85,885
treasury and other eligible bills	675	–	675	653	–	653
debt securities	37,367	–	37,367	49,996	–	49,996
loans and advances to banks	14,248	–	14,248	15,640	–	15,640
loans and advances to customers	17,712	–	17,712	19,596	–	19,596
Financial assets designated at fair value <sup>1</sup>	1,117	–	1,117	1,044	–	1,044
treasury and other eligible bills	–	–	–	3	–	3
debt securities	1,036	–	1,036	987	–	987
loans and advances to banks	81	–	81	54	–	54
Derivatives <sup>2</sup>	166,785	(150,960)	15,825	187,736	(174,118)	13,618
Loans and advances held at amortised cost <sup>3</sup>	281,728	(27,211)	254,517	282,514	(36,687)	245,827
loans and advances to banks	23,222	(36)	23,186	25,262	(37)	25,225
loans and advances to customers	258,506	(27,175)	231,331	257,252	(36,650)	220,602
Reverse repurchase agreements – non-trading <sup>3</sup>	30,537	(607)	29,930	41,945	(3,283)	38,662
Financial investments <sup>1</sup>	70,243	–	70,243	75,185	–	75,185
treasury and other similar bills	3,155	–	3,155	2,849	–	2,849
debt securities	67,088	–	67,088	72,336	–	72,336
Other assets	3,875	–	3,875	7,980	–	7,980
endorsements and acceptances	581	–	581	591	–	591
accrued income and other	3,294	–	3,294	7,389	–	7,389
Financial guarantees	13,735	–	13,735	13,452	–	13,452
Loan commitments and other credit-related commitments	131,633	–	131,633	135,522	–	135,522
At 31 December	810,732	(178,778)	631,954	875,089	(214,088)	661,001

## Report of the Directors: Risk (continued)

Maximum exposure to credit risk  
(Audited)  
The bank

	2015			2014		
	Maximum exposure £m	Offset £m	Exposure to credit risk (net) £m	Maximum exposure £m	Offset £m	Exposure to credit risk (net) £m
Cash and balances at central banks	38,725	-	38,725	41,424	-	41,424
Items in the course of collection from other banks	993	-	993	630	-	630
Trading assets <sup>1</sup>	51,396	-	51,396	55,858	-	55,858
treasury and other eligible bills	94	-	94	154	-	154
debt securities	21,935	-	21,935	25,150	-	25,150
loans and advances to banks	13,617	-	13,617	13,039	-	13,039
loans and advances to customers	15,750	-	15,750	17,515	-	17,515
Financial assets designated at fair value <sup>1</sup>	-	-	-	9	-	9
debt securities	-	-	-	9	-	9
loans and advances to banks	-	-	-	-	-	-
Derivatives <sup>2</sup>	150,454	(128,855)	21,599	160,232	(136,187)	24,045
Loans and advances held at amortised cost <sup>3</sup>	222,059	(26,485)	195,574	220,447	(35,607)	184,840
loans and advances to banks	16,661	-	16,661	18,776	-	18,776
loans and advances to customers	205,398	(26,485)	178,913	201,671	(35,607)	166,064
Reverse repurchase agreements – non-trading <sup>3</sup>	24,893	(518)	24,375	36,391	(628)	35,763
Financial investments <sup>1</sup>	39,336	-	39,336	48,001	-	48,001
treasury and other similar bills	1,909	-	1,909	2,081	-	2,081
debt securities	37,427	-	37,427	45,920	-	45,920
Other assets	2,655	-	2,655	6,126	-	6,126
endorsements and acceptances	478	-	478	364	-	364
accrued income and other	2,177	-	2,177	5,762	-	5,762
Financial guarantees	10,693	-	10,693	10,968	-	10,968
Loan commitments and other credit-related commitments	92,989	-	92,989	96,785	-	96,785
At 31 December	634,193	(155,858)	478,335	676,871	(172,422)	504,449

1 Reported amounts exclude equity instruments.

2 The derivative offset amount in the 'maximum exposure to credit risk table' relates to exposures where the counterparty has an offsetting derivative exposure with the group, a master netting agreement is in place and the credit risk exposure is managed on a net basis, or the position is specifically collateralised, normally in the form of cash. At 31 December 2015, the total amount of such offsets was £151 billion (2014: £174 billion), of which £126 billion (2014: £147 billion) were offsets under a master netting arrangement, £21 billion (2014: £24 billion) were received in cash and £4 billion (2014: £3 billion) were other collateral. These amounts do not qualify for net presentation for accounting purposes as settlement may not actually be made on a net basis.

3 The loans and advances offset adjustment primarily relates to customer loans and deposits, and balances arising from repo and reverse repo transactions. The offset relates to balances where there is a legally enforceable right of offset in the event of counterparty default, and where, as a result there is a net exposure for credit risk management purposes. As there is no intention to settle these balances on a net basis under normal circumstances, they do not qualify for net presentation for accounting purposes. No offset has been applied to off balance sheet collateral.

## Report of the Directors: Risk (continued)

### Concentration of exposures

The geographical diversification of our lending portfolio and our broad range of global businesses and products ensured that we did not overly depend on a few markets to generate growth in 2015. This diversification also supported our strategy for growth in faster-growing markets and those with international connectivity.

### Financial Investments

Our holdings of available-for-sale government and government agency debt securities, corporate debt securities, asset-backed securities ('ABSs') and other securities were spread across a wide range of issuers in 2015 with 59 per cent invested in government or government agency debt securities compared to 61 per cent in 2014.

### Trading assets

Trading securities remained the largest concentration within trading assets of the group at 71 per cent compared with 73 per cent in 2014.

### Derivatives

The group participates in transactions exposing it to counterparty credit risk. Counterparty credit risk is the risk of financial loss if the counterparty to a transaction defaults before completing the satisfactory settlement of the transaction, which varies in value by reference to a market factor such as interest rate, exchange rate or asset price. It arises principally from OTC derivatives and securities financing transactions ('SFTs') and is calculated in both the trading and non-trading books.

Derivative assets were £167 billion at 31 December 2015 (2014: £188 billion).

### Items in the course of collection from other banks

Settlement risk arises in any situations where a payment in cash, securities or equities is made with the expectation of a corresponding receipt of cash, securities or equities. Daily settlement limits are established for counterparties to cover the aggregate of transactions with each counterparty on any single day.

The group substantially mitigates settlement risk on many transactions, particularly those involving securities and equities, by settling through assured payment systems, or on a delivery-versus-payment basis.

### Loans and advances

The table on the following page analyses loans and advances by industry sector to show any concentration of credit risk exposures (please also refer below).

### Concentration of credit risk exposure

*(Audited)*

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

Wrong-way risk occurs when a counterparty's exposures are adversely correlated with its credit quality. There are two types of wrong-way risk:

- general wrong-way risk occurs when the probability of counterparty default is positively correlated with general risk factors such as, for example, where the counterparty is resident and/or incorporated in a higher-risk country and seeks to sell a non-domestic currency in exchange for its home currency; and
- specific wrong-way risk occurs when the exposure to a particular counterparty is positively correlated with the probability of counterparty default such as a reverse repo on the counterparty's own bonds. It is HSBC policy that specific wrong-way transactions are approved on a case-by-case basis.

We use a range of procedures to monitor and control wrong-way risk, including requiring entities to obtain prior approval before undertaking wrong-way risk transactions outside pre-agreed guidelines.



## Report of the Directors: Risk (continued)

### Gross loans and advances to customers by industry sector

(Audited)

#### The group

	2015		2014	
	Gross loans and advances to customers £m	Gross loans by industry sector as a % of total gross loans %	Gross loans and advances to customers £m	Gross loans by industry sector as a % of total gross loans %
<b>Personal</b>				
Residential mortgages	83,483	31.97	83,009	31.92
Other personal	24,285	9.30	24,381	9.38
	<b>107,768</b>	<b>41.27</b>	<b>107,390</b>	<b>41.30</b>
<b>Corporate and commercial</b>				
Commercial, industrial and international trade	67,987	26.04	74,003	28.46
Commercial real estate	17,568	6.73	17,899	6.88
Other property-related	4,940	1.89	4,572	1.75
Government	2,391	0.92	1,452	0.56
Other commercial	36,026	13.79	38,006	14.62
	<b>128,912</b>	<b>49.37</b>	<b>135,932</b>	<b>52.27</b>
<b>Financial</b>				
Non-bank financial institutions	24,093	9.23	16,085	6.19
Settlement accounts	336	0.13	645	0.24
	<b>24,429</b>	<b>9.36</b>	<b>16,730</b>	<b>6.43</b>
Total gross loans and advances to customers at 31 December	<b>261,109</b>	<b>100.00</b>	<b>260,052</b>	<b>100.00</b>
Impaired loans as a percentage of total	<b>2.44%</b>		<b>2.46%</b>	

#### The bank

	2015		2014	
	Gross loans and advances to customers £m	Gross loans by industry sector as a % of total gross loans %	Gross loans and advances to customers £m	Gross loans by industry sector as a % of total gross loans %
<b>Personal</b>				
Residential mortgages	76,701	37.04	76,847	37.77
Other personal	9,396	4.54	8,936	4.39
	<b>86,097</b>	<b>41.58</b>	<b>85,783</b>	<b>42.16</b>
<b>Corporate and commercial</b>				
Commercial, industrial and international trade	47,331	22.86	54,512	26.79
Commercial real estate	12,044	5.82	11,273	5.54
Other property-related	3,516	1.70	3,128	1.54
Government	1,094	0.53	964	0.47
Other commercial	25,369	12.24	26,849	13.21
	<b>89,354</b>	<b>43.15</b>	<b>96,726</b>	<b>47.55</b>
<b>Financial</b>				
Non-bank financial institutions	31,539	15.23	20,853	10.25
Settlement accounts	83	0.04	87	0.04
	<b>31,622</b>	<b>15.27</b>	<b>20,940</b>	<b>10.29</b>
Total gross loans and advances to customers at 31 December	<b>207,073</b>	<b>100.00</b>	<b>203,449</b>	<b>100.00</b>
Impaired loans as a percentage of total	<b>2.17%</b>		<b>2.09%</b>	

## Report of the Directors: Risk (continued)

### Credit quality of financial instruments

(Audited)

The five credit quality classifications defined below each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending business, as well as the external rating, attributed by external agencies to debt securities. There is no direct correlation between the internal and external ratings at granular level, except to the extent each falls within a single quality classification.

#### Quality classification definitions

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

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

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

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

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

#### Credit quality

Quality classification	Debt securities and other bills External credit rating	Wholesale lending and derivatives		Retail lending	
		Internal credit rating	Probability of default %	Internal credit rating	Expected loss %
Strong	A- and above	CRR1 to CRR2	0 – 0.169	EL1 to EL2	0 – 0.999
Good	BBB+ to BBB-	CRR3	0.170 – 0.740	EL3	1.000 – 4.999
Satisfactory	BB+ to B and unrated	CRR4 to CRR5	0.741 – 4.914	EL4 to EL5	5.000 – 19.999
Sub – standard	B- and below	CRR6 to CRR8	4.915 – 99.999	EL6 to EL8	20.000 – 99.999
Impaired	Impaired	CRR9 to CRR10	100	EL9 to EL10	100+ or defaulted <sup>1</sup>

<sup>1</sup> The EL percentage is derived through a combination of Probability of Default ('PD') and Loss Given Default ('LGD') and may exceed 100 per cent in circumstances where the LGD is above 100 per cent reflecting the cost of recoveries.

### Risk rating scales

The Customer Risk Rating ('CRR') 10-grade scale above summarises a more granular underlying 23-grade scale of obligor probability of default ('PD'). All distinct HSBC customers are rated using one of these two PD scales, depending on the degree of sophistication of the Basel II approach adopted for the exposure.

Each CRR band is associated with an external rating grade by reference to long-run default rates for that grade, represented by the average of issuer-weighted historical default rates. This mapping between internal and external ratings is indicative and may vary over time.

The Expected Loss ('EL') 10-grade scale for retail business summarises a more granular underlying EL scale for these customer segments; this combines obligor and facility/product risk factors in a composite measure. For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications based upon the mapping of related CRR to external credit grade.

For the purpose of the following disclosure, retail loans which are past due up to 89 days and are not otherwise classified as EL9 or EL10, are not disclosed within the EL grade to which they relate, but are separately classified as past due but not impaired. The following tables set out the group's distribution of financial instruments by measures of credit quality.

## Report of the Directors: Risk (continued)

### Distribution of financial instruments by credit quality (Audited)

#### The group

	2015							Total £m
	Neither past due nor impaired				Past due not impaired £m	Impaired £m	Impairment allowances £m	
	Strong £m	Medium £m		Sub- Standard £m				
		Good £m	Satisfactory £m					
Cash and balances at central banks	39,749	-	-	-				39,749
Items in the course of collection from other banks	1,328	-	-	-				1,328
Trading assets	52,059	10,453	7,231	259				70,002
- treasury and other eligible bills	368	283	24	-				675
- debt securities	30,113	4,390	2,725	139				37,367
- loans and advances to banks	9,282	2,706	2,174	86				14,248
- loans and advances to customers	12,296	3,074	2,308	34				17,712
Financial assets designated at fair value	580	279	251	7				1,117
- treasury and other eligible bills	-	-	-	-				-
- debt securities	580	279	170	7				1,036
- loans and advances to banks	-	-	81	-				81
Derivatives	147,444	15,953	2,756	632				166,785
Loans and advances held at amortised cost	169,886	47,069	53,946	5,756	1,302	6,372	(2,603)	281,728
- loans and advances to banks	19,975	1,833	1,351	63	-	-	-	23,222
- loans and advances to customers	149,911	45,236	52,595	5,693	1,302	6,372	(2,603)	258,506
Reverse repurchase agreement non-trading	22,328	6,248	1,613	19	-	329	-	30,537
Financial investments	62,072	4,563	1,788	931	-	889	-	70,243
- treasury and other eligible bills	2,159	946	50	-	-	-	-	3,155
- debt securities	59,913	3,617	1,738	931	-	889	-	67,088
Other assets	1,639	473	1,594	156	5	8	-	3,875
- endorsements and acceptances	110	27	444	-	-	-	-	581
- accrued income and other	1,529	446	1,150	156	5	8	-	3,294
At 31 December	497,085	85,038	69,179	7,760	1,307	7,598	(2,603)	665,364

## Report of the Directors: Risk (continued)

### The group

	2014							
	Neither past due nor impaired				Past due not impaired	Impaired	Impairment allowances	Total
	Strong	Medium		Sub-Standard				
£m	£m	£m	£m	£m	£m	£m	£m	
Cash and balances at central banks	42,853	-	-	-				42,853
Items in the course of collection from other banks	973	-	-	-				973
Trading assets	62,694	14,479	8,410	302				85,885
- treasury and other eligible bills	249	375	29	-				653
- debt securities	39,880	6,410	3,568	138				49,996
- loans and advances to banks	10,064	2,387	3,117	72				15,640
- loans and advances to customers	12,501	5,307	1,696	92				19,596
Financial assets designated at fair value	640	152	247	5				1,044
- treasury and other eligible bills	3	-	-	-				3
- debt securities	637	152	193	5				987
- loans and advances to banks	-	-	54	-				54
Derivatives	150,733	28,532	8,015	456				187,736
Loans and advances held at amortised cost	164,304	57,006	49,776	6,286	1,547	6,415	(2,820)	282,514
- loans and advances to banks	19,541	3,612	2,020	92	-	17	(20)	25,262
- loans and advances to customers	144,763	53,394	47,756	6,194	1,547	6,398	(2,800)	257,252
Reverse repurchase agreements non-trading	31,177	5,856	3,891	1,021	-	-	-	41,945
Financial investments	63,823	6,340	2,197	1,410	-	1,415	-	75,185
- treasury and other eligible bills	760	2,054	35	-	-	-	-	2,849
- debt securities	63,063	4,286	2,162	1,410	-	1,415	-	72,336
Other assets	5,711	442	1,670	147	6	4	-	7,980
- endorsements and acceptances	250	29	312	-	-	-	-	591
- accrued income and other	5,461	413	1,358	147	6	4	-	7,389
At 31 December	522,908	112,807	74,206	9,627	1,553	7,834	(2,820)	726,115

## Report of the Directors: Risk (continued)

### The bank

	2015							
	Neither past due nor impaired				Past due not impaired	Impaired	Impairment allowances	Total
	Strong	Medium		Sub-Standard				
£m	£m	£m	£m	£m	£m	£m	£m	
Cash and balances at central banks	38,725	-	-	-				38,725
Items in the course of collection from other banks	993	-	-	-				993
Trading assets	38,487	6,870	5,804	235				51,396
- treasury and other eligible bills	83	-	11	-				94
- debt securities	17,671	2,080	2,060	124				21,935
- loans and advances to banks	9,943	1,852	1,745	77				13,617
- loans and advances to customers	10,790	2,938	1,988	34				15,750
Financial assets designated at fair value	-	-	-	-				-
- debt securities	-	-	-	-				-
- loans and advances to banks	-	-	-	-				-
Derivatives	133,613	13,991	2,244	606				150,454
Loans and advances held at amortised cost	143,016	30,596	39,826	4,646	488	5,162	(1,675)	222,059
- loans and advances to banks	12,363	1,031	1,938	667	-	662	-	16,661
- loans and advances to customers	130,653	29,565	37,888	3,979	488	4,500	(1,675)	205,398
Reverse repurchase agreements non-trading	19,828	4,085	635	16	-	329	-	24,893
Financial investments	38,127	997	86	98	-	28	-	39,336
- treasury and other similar bills	1,039	870	-	-	-	-	-	1,909
- debt securities	37,088	127	86	98	-	28	-	37,427
Other assets	1,510	431	713	-	-	1	-	2,655
- endorsements and acceptances	34	17	427	-	-	-	-	478
- accrued income and other	1,476	414	286	-	-	1	-	2,177
At 31 December	414,299	56,970	49,308	5,601	488	5,520	(1,675)	530,511

## Report of the Directors: Risk (continued)

### The bank

	2014							Total £m
	Neither past due nor impaired				Past due not impaired £m	Impaired £m	Impairment allowances £m	
	Strong £m	Medium £m		Sub- Standard £m				
	Good £m	Satisfactory £m						
Cash and balances at central banks	41,424	-	-	-				41,424
Items in the course of collection from other banks	630	-	-	-				630
Trading assets	40,700	9,004	5,858	296				55,858
- treasury and other eligible bills	149	-	5	-				154
- debt securities	19,994	2,357	2,665	134				25,150
- loans and advances to banks	9,611	1,640	1,718	70				13,039
- loans and advances to customers	10,946	5,007	1,470	92				17,515
Financial assets designated at fair value	1	-	8	-				9
- debt securities	1	-	8	-				9
- loans and advances to banks	-	-	-	-				-
Derivatives	127,251	25,372	7,185	424				160,232
Loans and advances held at amortised cost	137,414	37,735	35,991	5,568	498	5,033	(1,792)	220,447
- loans and advances to banks	12,045	1,948	3,204	816	-	777	(14)	18,776
- loans and advances to customers	125,369	35,787	32,787	4,752	498	4,256	(1,778)	201,671
Reverse repurchase agreements non-trading	28,768	3,958	2,645	1,020	-	-	-	36,391
Financial investments	44,387	2,900	382	59	-	273	-	48,001
- treasury and other similar bills	183	1,895	3	-	-	-	-	2,081
- debt securities	44,204	1,005	379	59	-	273	-	45,920
Other assets	5,125	401	599	-	-	1	-	6,126
- endorsements and acceptances	51	19	294	-	-	-	-	364
- accrued income and other	5,074	382	305	-	-	1	-	5,762
At 31 December	425,700	79,370	52,668	7,367	498	5,307	(1,792)	569,118

## Report of the Directors: Risk (continued)

### Past due but not impaired gross financial instruments

(Audited)

Past due but not impaired are those loans where although customers have failed to make payments in accordance

with the contractual terms of their facilities, they have not met the impaired loan criteria described below.

### Ageing analysis of days past due but not impaired gross financial instruments

(Audited)

#### The group

	Up to 29 days £m	30-59 days £m	60-89 days £m	90-179 days £m	Over 180 days £m	Total £m
<b>At 31 December 2015</b>						
Loans and advances held at amortised cost	878	311	108	5	–	1,302
Personal	538	157	83	–	–	778
Corporate and commercial	334	150	25	5	–	514
Financial	6	4	–	–	–	10
Other assets	3	–	1	1	–	5
	<b>881</b>	<b>311</b>	<b>109</b>	<b>6</b>	<b>–</b>	<b>1,307</b>
<b>At 31 December 2014</b>						
Loans and advances held at amortised cost	1,202	230	112	2	1	1,547
Personal	466	183	95	–	–	744
Corporate and commercial	733	46	17	2	1	799
Financial	3	1	–	–	–	4
Other assets	3	1	–	–	2	6
	<b>1,205</b>	<b>231</b>	<b>112</b>	<b>2</b>	<b>3</b>	<b>1,553</b>

#### The bank

	Up to 29 days £m	30-59 days £m	60-89 days £m	90-179 days £m	Over 180 days £m	Total £m
<b>At 31 December 2015</b>						
Loans and advances held at amortised cost	340	91	57	–	–	488
Personal	308	86	53	–	–	447
Corporate and commercial	32	5	4	–	–	41
Financial	–	–	–	–	–	–
Other assets	–	–	–	–	–	–
	<b>340</b>	<b>91</b>	<b>57</b>	<b>–</b>	<b>–</b>	<b>488</b>
<b>At 31 December 2014</b>						
Loans and advances held at amortised cost	320	109	69	–	–	498
Personal	295	104	66	–	–	465
Corporate and commercial	25	5	3	–	–	33
Financial	–	–	–	–	–	–
Other assets	–	–	–	–	–	–
	<b>320</b>	<b>109</b>	<b>69</b>	<b>–</b>	<b>–</b>	<b>498</b>

### Impaired loans

(Audited)

Impaired loans and advances are those that meet any of the following criteria:

- wholesale loans and advances classified as CRR 9 or CRR 10. These grades are assigned when the bank considers that either the customer is unlikely to pay its credit obligations in full, without recourse to security, or when the customer is more than 90 days past due on any material credit obligation to HSBC.
- retail loans and advances classified as EL 9 or EL 10. These grades are assigned to retail loans and advances greater than 90 days past due unless individually they have been assessed as not impaired.
- renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet the

contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

#### Impairment and credit risk mitigation

The existence of collateral has an effect when calculating impairment on individually assessed impaired loans. When we no longer expect to recover the principal and interest due on a loan in full or in accordance with the original terms and conditions, it is assessed for impairment. If exposures are secured, the current net realisable value of the collateral will be taken into account when assessing the need for an impairment allowance. No impairment allowance is recognised in cases where all amounts due are expected to be settled in full on realisation of the security.

## Report of the Directors: Risk (continued)

### Impaired loans and advances to customers and banks by industry sector (Audited)

	2015			2014		
	Individually assessed	Collectively assessed	Total	Individually assessed	Collectively assessed	Total
	£m	£m	£m	£m	£m	£m
Banks	-	-	-	17	-	17
Customers	5,798	574	6,372	5,487	911	6,398
Personal <sup>1</sup>	1,142	499	1,641	683	878	1,561
Corporate and commercial	4,463	75	4,538	4,619	33	4,652
Financial	193	-	193	185	-	185
At 31 December	5,798	574	6,372	5,504	911	6,415

1) A review in 2015 resulted in an update to the classification of individually and collectively assessed personal loans; the review has not been reflected in the 2014 comparative numbers.

### Renegotiated loans and forbearance

The contractual terms of a loan may be modified for a number of reasons, including changes in market conditions, customer retention and other factors not related to the current or potential credit deterioration of a customer. 'Forbearance' describes concessions made on the contractual terms of a loan in response to an obligor's financial difficulties. We classify and report loans on which concessions have been granted under conditions of credit distress as 'renegotiated loans' when their contractual payment terms have been modified, because we have significant concerns about the borrowers' ability to meet contractual payments when due. On renegotiation, where the existing agreement is cancelled and a new agreement is made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument, the loan would be derecognised and recognised as a new loan, for accounting purposes. However, the newly recognised financial asset will retain the renegotiated loan classification.

#### Personal lending

For retail lending, our credit risk management policy sets out restrictions on the number and frequency of renegotiations, the minimum period an account must have been opened before any renegotiation can be considered and the number of qualifying payments that must be received. The application of this policy varies according to the nature of the market, the product and the management of customer relationships through the occurrence of exceptional events. When considering whether there is significant concern regarding a customer's ability to meet contractual loan repayments when due, we assess the customer's delinquency status, account behaviour, repayment history, current financial situation and continued ability to repay. If the customer is not meeting contractual repayments or it is evident that they will be unable to do so without the renegotiation, there will be a significant concern regarding their ability to meet contractual payments, and the loan will be disclosed as impaired, unless the concession granted is insignificant.

#### Wholesale lending

For loan restructurings in wholesale lending, indicators of significant concerns regarding a borrower's ability to pay include:

- the debtor is currently in default on any of its debt;
- the debtor has declared or is in the process of declaring bankruptcy or entering into a similar process;

- there is significant doubt as to whether the debtor will continue to be a going concern;
- currently, the debtor has securities that have been delisted, are in the process of being delisted, or are under threat of being delisted from an exchange as a result of trading or financial difficulties;
- based on estimates and projections that only encompass current business capabilities, the group forecasts that the debtor's entity-specific cash flows will be insufficient to service the debt (both interest and principal) in accordance with the contractual terms of the existing agreement through maturity. In this instance, actual payment default may not yet have occurred; and
- absent the modification, the debtor cannot obtain funds from sources other than its existing creditors at an effective interest rate equal to the current market interest rate for similar debt for a non-distressed debtor.

Where the modification of a loan's contractual payment terms represents a concession for economic or legal reasons relating to the borrower's financial difficulty, and is a concession that we would not otherwise consider, then the renegotiated loan is disclosed as impaired in accordance with our impaired loan disclosure convention unless the concession is insignificant.

#### Credit quality classification of renegotiated loans

A loan is impaired and an impairment allowance is recognised when there is objective evidence of a loss event that has an effect on the cash flows of the loan which can be reliably estimated. Granting a concession to a customer that we would not otherwise consider, as a result of their financial difficulty, is objective evidence of impairment and impairment losses are measured accordingly.

A renegotiated loan is presented as impaired when:

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

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

The renegotiated loan will continue to be disclosed as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future



## Report of the Directors: Risk (continued)

cash flows, and there are no other indicators of impairment. For loans that were assessed for impairment on a collective basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

For retail lending the minimum period of payment performance required depends on the nature of loans in the portfolio, but is typically not less than six months. Where portfolios have more significant levels of forbearance activity the minimum repayment performance period required may be substantially more. Payment performance periods are monitored to ensure they remain appropriate to the levels of recidivism observed within the portfolio. These performance periods are in addition to a minimum of two payments which must be received within a 60-day period for the customer to initially qualify for the renegotiation. The qualifying payments are required in order to demonstrate that the renegotiated terms are sustainable for the borrower.

For corporate and commercial loans, which are individually assessed for impairment and where non-monthly payments are more commonly agreed, the history of payment performance will depend on the underlying structure of payments agreed as part of the restructuring.

Renegotiated loans are classified as unimpaired where the renegotiation has resulted from significant concern about a borrower's ability to meet their contractual payment terms but the concession is not significant and the contractual cash flows are expected to be collected in full following the renegotiation.

### **Derecognition of renegotiated loans** (Audited)

Loans that have been identified as renegotiated retain this designation until maturity or derecognition. When a loan is restructured as part of a forbearance strategy and the restructuring results in derecognition of the existing loan, the new loan is disclosed as renegotiated.

When determining whether a loan that is restructured should be derecognised and a new loan recognised, we consider the extent to which the changes to the original contractual terms result in the renegotiated loan, considered as a whole, being a substantially different financial instrument. The following are examples of circumstances that individually are likely to result in this test being met and derecognition accounting being applied:

- an uncollateralised loan becomes fully collateralised or vice versa;
- removal or addition of debt-to-equity conversion features attached to the loan agreement that have substance;
- a change in the currency in which the principal or interest is denominated, other than a conversion at a current market rate; or
- a change in the obligor.

The following are examples of factors that we consider may indicate that the revised loan is a substantially different

financial instrument, but are unlikely to be conclusive in themselves:

- conditions added to the contract that substantially alter the credit risk of the loan (e.g. conditions on how the customer's business will be conducted in order to meet the revised terms of the loan);
- guarantees are put in place that are expected to substantially change the source of repayment and it is fully expected that the guarantees have value;
- rate structure changes (that are not existing contractual features) or debt consolidation where these changes are not purely a concession to allow the obligor to pay a monthly amount that is affordable given its credit distressed circumstances;
- a change in the liquidation preference or ranking of the instrument that is not a debt-to-equity conversion; or
- the collateral level (as a % of the loan) has doubled and the resulting coverage is more than 50 per cent.

### **Renegotiated loans and recognition of impairment allowances** (Audited)

For retail lending, renegotiated loans are segregated from other parts of the loan portfolio for collective impairment assessment to reflect the higher rates of losses often encountered in these segments. When empirical evidence indicates an increased propensity to default and higher losses on such accounts, the use of roll-rate methodology ensures these factors are taken into account when calculating impairment allowances by applying roll rates specifically calculated on the pool of loans subject to forbearance. When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, a basic formulaic approach based on historical loss rate experience is used. As a result of our roll-rate methodology, we recognise collective impairment allowances on homogeneous groups of loans, including renegotiated loans, where there is historical evidence that there is a likelihood that loans in these groups will progress through the various stages of delinquency, and ultimately prove irrecoverable as a result of events occurring before the balance sheet date. This treatment applies irrespective of whether or not those loans are presented as impaired in accordance with our impaired loans disclosure convention. When we consider that there are additional risk factors inherent in the portfolios that may not be fully reflected in the statistical roll rates or historical experience, these risk factors are taken into account by adjusting the impairment allowances derived solely from statistical or historical experience.

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

The following table shows the group's holding of renegotiated loans and advances to customers by industry sector and credit quality classification.

**Report of the Directors: Risk** (continued)*Renegotiated loans and advances to customers*

	2015				2014			
	Neither past due nor impaired	Past due but not impaired	Impaired	Total	Neither past due nor impaired	Past due but not impaired	Impaired	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Residential Mortgages	342	118	523	983	339	142	548	1,029
Other personal lending	87	34	77	198	102	26	64	192
Commercial real estate	291	1	779	1,071	378	1	875	1,254
Corporate and commercial	669	73	1,677	2,419	509	42	1,703	2,254
Financial	97	–	132	229	140	–	124	264
Total renegotiated loans and advances at 31 December	<b>1,486</b>	<b>226</b>	<b>3,188</b>	<b>4,900</b>	<b>1,468</b>	<b>211</b>	<b>3,314</b>	<b>4,993</b>
Impairment allowance on renegotiated loans				<b>(945)</b>				<b>(930)</b>
- renegotiated loans and advances as a % of total gross loans				<b>1.72%</b>				<b>1.77%</b>

**Impairment of loans and advances***(Audited)*

The tables below analyse the loan impairment charges for the year and the impairment allowances recognised for impaired loans and advances that are either individually assessed or collectively assessed, and collective impairment allowances on loans and advances classified as not impaired.

*Loan impairment charge to the income statement by industry sector*

	2015 £m	2014 £m
Personal	171	148
– residential mortgages	(6)	(45)
– other personal	177	193
Corporate and commercial	315	472
– manufacturing and international trade and services	137	306
– commercial real estate and other property-related	21	50
– other commercial	157	116
Financial	8	27
<b>Total loan impairment charge at 31 December</b>	<b>494</b>	<b>647</b>
Individually assessed impairment allowances	354	363
– new allowances	642	656
– release of allowances no longer required	(261)	(288)
– recoveries of amounts previously written off	(27)	(5)
Collectively assessed impairment allowances	140	284
– new allowances net of allowance releases	366	460
– recoveries of amounts previously written off	(226)	(176)
<b>Total loan impairment charge at 31 December</b>	<b>494</b>	<b>647</b>

## Report of the Directors: Risk (continued)

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

(Audited)

#### The group

	Banks		Customers		Total £m
	Individually assessed £m	Individually assessed £m	Collectively assessed £m	Collectively assessed £m	
Impairment allowance at 1 January 2015	20	1,874	926		2,820
Amounts written off	(14)	(420)	(425)		(859)
Recoveries of loans and advances written off in previous years	-	27	226		253
Loan impairment charge	(6)	360	140		494
Exchange and other movements	-	(53)	(52)		(105)
<b>At 31 December 2015</b>	<b>-</b>	<b>1,788</b>	<b>815</b>		<b>2,603</b>
Impairment allowance on loans and advances		1,788	815		2,603
- personal		161	474		635
- corporate and commercial		1,514	323		1,837
- financial		113	18		131
as a percentage of gross loans and advances <sup>1</sup>	0.00%	0.69%	0.31%		0.92%
Impairment allowance at 1 January 2014	21	2,402	934		3,357
Amounts written off	(1)	(827)	(457)		(1,285)
Recoveries of loans and advances written off in previous years	-	5	176		181
Loan impairment charge	2	361	284		647
Exchange and other movements	(2)	(67)	(11)		(80)
<b>At 31 December 2014</b>	<b>20</b>	<b>1,874</b>	<b>926</b>		<b>2,820</b>
Impairment allowance on loans and advances		1,874	926		2,800
- personal		186	511		697
- corporate and commercial		1,572	389		1,961
- financial		116	26		142
as a percentage of gross loans and advances <sup>1</sup>	0.08%	0.72%	0.36%		0.99%

<sup>1</sup> Net of reverse repo transactions, settlement accounts and stock borrowings.

#### The bank

	Banks		Customers		Total £m
	Individually assessed £m	Individually assessed £m	Collectively assessed £m	Collectively assessed £m	
Impairment allowance at 1 January 2015	14	1,219	559		1,792
Amounts written off	(14)	(296)	(269)		(579)
Recoveries of loans and advances written off in previous years	-	22	190		212
Loan impairment charge	-	233	17		250
Exchange and other movements	-	-	-		-
<b>At 31 December 2015</b>	<b>-</b>	<b>1,178</b>	<b>497</b>		<b>1,675</b>
Impairment allowance on loans and advances		1,178	497		1,675
- personal		63	237		300
- corporate and commercial		988	246		1,234
- financial		127	14		141
as a percentage of gross loans and advances <sup>1</sup>	0.00%	0.57%	0.24%		0.75%
Impairment allowance at 1 January 2014	16	1,648	539		2,203
Amounts written off	(1)	(668)	(255)		(924)
Recoveries of loans and advances written off in previous years	-	13	130		143
Loan impairment charge	-	212	146		358
Exchange and other movements	(1)	14	(1)		12
<b>At 31 December 2014</b>	<b>14</b>	<b>1,219</b>	<b>559</b>		<b>1,792</b>
Impairment allowance on loans and advances		1,219	559		1,778
- personal		86	239		325
- corporate and commercial		1,035	299		1,334
- financial		98	21		119
as a percentage of gross loans and advances <sup>1</sup>	0.08%	0.60%	0.27%		0.81%

<sup>1</sup> Net of reverse repo transactions, settlement accounts and stock borrowings.

## Report of the Directors: Risk (continued)

### Personal lending

#### Total personal lending

We provide a broad range of secured and unsecured personal lending products to meet customer needs. Personal lending includes advances to customers for asset purchases such as residential property where the loans are

#### Total personal lending

	UK £m	Continental Europe £m	Total £m
Residential mortgage lending	79,173	4,310	83,483
Of which:			
– Interest-only (including endowment) mortgages	27,273	22	27,295
– Affordability mortgages, including adjustable rate mortgages	–	241	241
Other personal lending	14,032	10,253	24,285
– personal loans and overdrafts	7,073	9,035	16,108
– credit cards	6,959	1,215	8,174
– motor vehicle finance	–	3	3
<b>Total gross loans at 31 December 2015</b>	<b>93,205</b>	<b>14,563</b>	<b>107,768</b>
Impairment allowances on personal lending			
Residential mortgages	(117)	(70)	(187)
Other personal lending	(199)	(249)	(448)
– personal loans and overdrafts	(147)	(121)	(268)
– credit cards	(52)	(127)	(179)
– motor vehicle finance	–	(1)	(1)
<b>Total impairment allowances at 31 December 2015</b>	<b>(316)</b>	<b>(319)</b>	<b>(635)</b>
	£m	£m	£m
Residential mortgage lending	79,066	3,941	83,007
Of which:			
– Interest-only (including endowment) mortgages	27,984	29	28,013
– Affordability mortgages, including adjustable rate mortgages	–	216	216
Other personal lending	13,489	10,894	24,383
– personal loans and overdrafts	6,655	9,411	16,066
– credit cards	6,834	1,479	8,313
– motor vehicle finance	–	4	4
<b>Total gross loans at 31 December 2014</b>	<b>92,555</b>	<b>14,835</b>	<b>107,390</b>
Impairment allowances on personal lending			
Residential mortgages	(155)	(41)	(196)
Other personal lending	(209)	(292)	(501)
– personal loans and overdrafts	(145)	(132)	(277)
– credit cards	(64)	(159)	(223)
– motor vehicle finance	–	(1)	(1)
<b>Total impairment allowances at 31 December 2014</b>	<b>(364)</b>	<b>(333)</b>	<b>(697)</b>

### Mortgage lending

We offer a wide range of mortgage products designed to meet customer needs, including capital repayment, interest-only, affordability and offset mortgages. Group credit policy prescribes the range of acceptable residential property LTV thresholds with the maximum upper limit for new loans set between 75 per cent and 95 per cent. Specific LTV thresholds and debt-to-income ratios are managed at regional and country levels and, although the parameters must comply with Group policy, strategy and risk appetite, they differ in the various locations in which we operate to reflect the local economic and housing market conditions, regulations, portfolio performance, pricing and other product features.

#### Exposure to UK interest-only mortgage loans

Interest-only mortgage products made up of £27 billion of total UK mortgage lending, including £11 billion of offset mortgages in First Direct and £1.1 billion of endowment mortgages.

The following information is presented for HSBC Bank UK interest-only mortgage loans with balances of £12 billion at the end of 2015. £151 million of interest-only mortgages

secured by the assets being acquired. We also offer loans secured on existing assets, such as first charges on residential property, and unsecured lending products such as overdrafts, credit cards and payroll loans. The following table shows the levels of personal lending products in the various portfolios in the UK and the rest of Europe.

matured during 2015. Of these, 2,636 loans with balances of £61 million were repaid in full, 164 loans with balances of £19 million had agreed future repayment plans and 550 loans with balances of £71 million were subject to ongoing individual assessments.

The profile of expiring UK interest-only loans are as follows:

	2015 £m
2015 expired interest-only mortgage loans	179
Interest-only mortgage loans by maturity years	
– 2016	212
– 2017	259
– 2018	488
– 2019	541
– 2020	543
– 2021 – 2025	2,697
– Post 2025	7,010
<b>Total UK interest-only mortgage loans 31 December</b>	<b>11,929</b>

## Report of the Directors: Risk (continued)

### Other personal lending

Other personal lending consists primarily of credit cards and personal loans, both of which are generally unsecured.

### Collateral and other credit enhancements held

(Audited)

The tables below show residential mortgage lending including off-balance sheet loan commitments by level of collateral. They provide a quantification of the value of fixed charges we hold over borrowers' specific assets where we have a history of enforcing, and are able to enforce, collateral in satisfying a debt in the event of the borrower failing to meet its contractual obligations, and where the collateral is cash or can be realised by sale in an established market. The LTV ratio is calculated as the gross on-balance sheet carrying amount of the loan and any off-balance sheet loan commitment at the balance sheet date divided by the

value of collateral. The value of collateral is determined using professional valuations and house price indices. The collateral valuation excludes any adjustments for obtaining and selling the collateral and, in particular, loans shown as not collateralised or partially collateralised may also benefit from other forms of credit mitigants. Valuations must be updated on a regular basis and, as a minimum, at intervals of every three years. More frequent revaluations are conducted where market conditions or portfolio performance are subject to significant change or where a loan is identified and assessed as impaired.

### Residential mortgage loans including loan commitments by level of collateral

(Audited)

#### The group

	2015 £m	2014 £m
Non-impaired loans and advances		
Fully collateralised	85,216	86,200
Less than 50% LTV	47,021	41,643
51% to 75% LTV	31,901	35,751
76% to 90% LTV	5,615	7,606
91% to 100% LTV	679	1,200
Partially collateralised greater than 100% LTV	365	278
- collateral value	294	199
Impaired loans and advances		
Fully collateralised	949	585
Less than 50% LTV	350	148
51% to 75% LTV	418	268
76% to 90% LTV	123	105
91% to 100% LTV	58	64
Partially collateralised greater than 100% LTV	120	31
- collateral value	107	26
At 31 December	86,650	87,094

#### The bank

	2015 £m	2014 £m
Non-impaired loans and advances		
Fully collateralised	80,323	80,872
Less than 50% LTV	45,460	39,984
51% to 75% LTV	29,535	33,196
76% to 90% LTV	5,006	7,087
91% to 100% LTV	322	605
Partially collateralised greater than 100% LTV	112	182
- collateral value	74	125
Impaired loans and advances		
Fully collateralised	764	421
Less than 50% LTV	318	112
51% to 75% LTV	318	193
76% to 90% LTV	95	89
91% to 100% LTV	33	27
Partially collateralised greater than 100% LTV	22	24
- collateral value	17	19
At 31 December	81,221	81,499

## Report of the Directors: Risk (continued)

### Wholesale lending

#### Total wholesale lending

	2015 £m	2014 £m
Corporate and commercial (A)	128,912	135,932
– manufacturing	26,269	25,271
– international trade and services	41,718	48,732
– commercial real estate	17,568	17,899
– other property-related	4,940	4,572
– government	2,391	1,452
– other commercial	36,026	38,006
Financial (non-bank financial institutions) (B)	24,429	16,730
Loans and advances to banks (C)	23,222	25,282
<b>Gross loans at 31 December (D)</b>	<b>176,563</b>	<b>177,944</b>
Impairment allowances on wholesale lending		
Corporate and commercial (a)	(1,837)	(1,961)
– manufacturing	(348)	(305)
– international trade and services	(548)	(562)
– commercial real estate	(413)	(584)
– other property-related	(160)	(130)
– government	(3)	(2)
– other commercial	(365)	(378)
Financial (non-bank financial institutions) (b)	(131)	(142)
Loans and advances to banks (c)	–	(20)
<b>Impairment allowances at 31 December (d)</b>	<b>(1,968)</b>	<b>(2,123)</b>
(a) as a percentage of (A)	1.43%	1.44%
(b) as a percentage of (B)	0.54%	0.85%
(c) as a percentage of (C)	–	0.08%
(d) as a percentage of (D)	1.11%	1.19%

#### Commercial real estate lending

Commercial real estate lending includes the financing of corporate, institutional and high net worth individuals investing primarily in income producing assets and, to a lesser extent construction and development of the same. The business focusses mainly on traditional core asset classes such as retail, offices, light industrial and residential building projects.

##### Commercial real estate lending

	2015 £m	2014 £m
Neither past due nor impaired	16,404	16,406
Past due but not impaired	60	11
Impaired loans	1,104	1,482
<b>Total gross loans and advances at 31 December</b>	<b>17,568</b>	<b>17,899</b>
Of which:		
– renegotiated loans	1,071	1,253
Impairment allowances	(413)	(584)

#### Refinance risk in commercial real estate

Commercial real estate lending tends to require the repayment of a significant proportion of the principal at maturity. Typically, a customer will arrange repayment through the acquisition of a new loan to settle the existing debt. Refinance risk is the risk that a customer, being unable to repay their debt on maturity, is unable to refinance the debt at commercial rates. We monitor our commercial real estate portfolio closely, assessing those drivers that may indicate potential issues with refinancing. The principal driver is the vintage of the loan, when origination reflected previous market norms which no longer apply in the current market. Examples might be higher LTV ratios and/or lower interest cover ratios. The range of refinancing sources in the local market is also an important consideration, with risk increasing when lenders

are restricted to banks and when bank liquidity is limited. In addition, underlying fundamentals such as the reliability of tenants, the ability to let and the condition of the property are important, as they influence property values.

We currently see significant liquidity in overall debt markets which is leading to pressure on pricing and terms. HSBC is maintaining its quality standards and appetite for higher quality proposals.

#### Collateral and other credit enhancement held (Audited)

It is the group's practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured.

For other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of a default, the group may utilise the collateral as a source of repayment. Depending on its form, collateral can have a significant financial effect in mitigating exposure to credit risk.

#### Collateral on loans and advances

Collateral held is analysed separately for commercial real estate and for other corporate and commercial and financial (non-bank) lending. This reflects the greater correlation between collateral performance and principal repayment in the commercial real estate sector than applies to other lending. In each case, the analysis includes off-balance sheet commitments, primarily undrawn credit lines.

The collateral measured in the tables below consists of fixed first charges on real estate and charges over cash and

## Report of the Directors: Risk (continued)

marketable financial instruments. The values in the tables represent the expected market value on an open market basis; no adjustment has been made to the collateral for any expected costs of recovery. Cash is valued at its nominal value and marketable securities at their fair value. The LTV ratios presented are calculated by directly associating loans and advances with the collateral that individually and uniquely supports each facility. Where collateral assets are shared by multiple loans and advances, whether specifically or, more generally, by way of an all monies charge, the collateral value is prorated across the loans and advances protected by the collateral.

Other types of collateral which are commonly taken for corporate and commercial lending such as unsupported

guarantees and floating charges over the assets of a customer's business are not measured in the tables below. While such mitigants have value, often providing rights in insolvency, their assignable value is not sufficiently certain and they are therefore assigned no value for disclosure purposes.

The value of commercial real estate collateral is determined by using a combination of professional and internal valuations and physical inspections. Due to the complexity of valuing collateral for commercial real estate, local valuation policies determine the frequency of review on the basis of local market conditions. Revaluations are sought with greater frequency as concerns over the performance of the collateral or the direct obligor increase.

### Commercial real estate loans and advances including loan commitments by level of collateral (Audited)

	2015 £m	2014 £m
Rated CRR <sup>1</sup> 1 to 7		
Not collateralised	3,035	3,433
Fully collateralised	17,241	16,414
Partially collateralised	2,041	888
- collateral value	1,422	662
	22,317	20,735
Rated CRR <sup>1</sup> 8 to 10		
Not collateralised	62	260
Fully collateralised	1,059	1,001
LTV ratio less than 50%	175	91
- 51% to 75%	543	522
- 76% to 90%	211	193
- 90% to 100%	130	195
Partially collateralised	563	929
- collateral value	326	616
	1,684	2,190
Total at 31 December	24,001	22,925

1 Customer risk rating ('CRR'). See page 32 for further information.

### Other corporate, commercial and financial (non-bank) lending (Audited)

Other corporate, commercial and financial (non-bank) lending is analysed separately below reflecting the difference in collateral held on the portfolios. For financing activities in corporate and commercial lending that are not predominantly commercial real estate-oriented, collateral value is not strongly correlated to principal repayment

performance. Collateral values are generally refreshed when an obligor's general credit performance deteriorates and we have to assess the likely performance of secondary sources of repayment should it prove necessary to rely on them.

The table includes off balance sheet loan commitments by level of collateralisation.

### Other corporate, commercial and financial (non-bank) loans and advances including loan commitments by level of collateral rated CRR/EL 8 to 10 only (Audited)

	2015 £m	2014 £m
Not collateralised	3,015	4,001
Fully collateralised	849	797
- LTV ratio less than 50%	234	184
- 51% to 75%	461	275
- 76% to 90%	84	140
- 90% to 100%	70	198
Partially collateralised	1,221	468
- collateral value	585	249
Total at 31 December	5,085	5,266

## Report of the Directors: Risk (continued)

### Loans and advances to banks

(Audited)

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

*Loans and advances to banks including loan commitments by level of collateral*

(Audited)

	2015	2014
	£m	£m
Not collateralised	23,295	25,607
Fully collateralised	43	67
Partially collateralised	-	3
- collateral value	-	2
Total at 31 December	23,338	25,677

### Other credit risk exposures

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

- some securities issued by governments, banks and other financial institutions benefit from additional credit enhancement provided by government guarantees that cover the assets;
- debt securities issued by corporates are primarily unsecured;
- debt securities issued by banks and financial institutions include ABS's and similar instruments which are supported by underlying pools of financial assets. Credit risk associated with ABS's is reduced through the purchase of credit default swap ('CDS') protection;
- trading assets include loans and advances held with trading intent. These mainly consist of cash collateral posted to satisfy margin requirements on derivatives, settlement accounts, reverse repos and stock borrowing. There is limited credit risk on cash collateral posted since in the event of default of the counterparty these would be set off against the related liability. Reverse repos and stock borrowing are by their nature collateralised; and
- the group's maximum exposure to credit risk includes financial guarantees and similar arrangements that we issue or enter into, and loan commitments that we are irrevocably committed to. Depending on the terms of the arrangement, we may have recourse to additional credit mitigation in the event that a guarantee is called upon or a loan commitment is drawn and subsequently defaults.

### Derivatives

HSBC participates in transactions exposing it to counterparty credit risk. Counterparty credit risk is the risk of financial loss if the counterparty to a transaction defaults before satisfactorily settling it. It arises principally from OTC derivatives and SFTs and is calculated in both the trading and non-trading books. Transactions vary in value by reference to a market factor such as interest rate, exchange rate or asset price. The counterparty risk from derivative transactions is taken into account when reporting the fair value of derivative positions. The adjustment to the fair value is known as the credit value adjustment ('CVA').

The International Swaps and Derivatives Association ('ISDA') Master Agreement is the group's preferred

collateral. The collateral used in the assessment relates primarily to cash and marketable securities. This analysis excludes reverse repo balances.

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

We manage the counterparty exposure arising from market risk on our OTC derivative contracts by using collateral agreements with counterparties and netting agreements. Currently, we do not actively manage our general OTC derivative counterparty exposure in the credit markets, although we may manage individual exposures in certain circumstances.

HSBC has historically placed strict policy restrictions on collateral types and as a consequence the types of collateral received and pledged are, by value, highly liquid and of a strong quality, being predominantly cash.

Where a collateral type is required to be approved outside the collateral policy (which includes collateral that includes wrong way risks), a submission to the Documentation Approval Committee ('DAC') for approval is required. The DAC requires the participation and sign-off of senior representatives from the Global Markets Chief Operating Officer, Legal and Risk.

The majority of the counterparties with whom we have a collateral agreement are European. The majority of the group's CSAs are with financial institutional clients.



## Report of the Directors: Risk (continued)

### Securitisation exposures and other structured products

This section contains information about our exposure to ABSs, some of which are held through consolidated structured entities and summarised in the table below.

*Carrying amount of HSBC Bank plc's consolidated holdings of ABSs*

	Trading £m	Available for sale £m	Designated at fair value through profit or loss £m	Loans and receivables £m	Total <sup>1</sup> £m	Of which held through consolidated SEs £m
Mortgage-related assets:						
Sub-prime residential	14	1,514	–	88	1,616	725
US Alt-A residential	–	1,291	–	–	1,291	1,212
Other residential	540	418	–	73	1,031	171
Commercial property	398	1,548	–	136	2,082	1,117
Leveraged finance-related assets	55	1,548	–	63	1,666	884
Student loan-related assets	47	2,002	–	17	2,066	1,808
Other assets	681	512	1	86	1,280	381
<b>At 31 December 2015</b>	<b>1,735</b>	<b>8,833</b>	<b>1</b>	<b>463</b>	<b>11,032</b>	<b>6,298</b>
Mortgage-related assets:						
Sub-prime residential	41	1,973	–	197	2,211	1,331
US Alt-A residential	61	1,881	–	23	1,965	1,547
Other residential	596	647	–	211	1,454	418
Commercial property	420	2,300	–	331	3,051	1,831
Leveraged finance-related assets	62	2,338	–	103	2,503	1,621
Student loan-related assets	100	2,259	–	76	2,435	2,107
Other assets	811	625	2	414	1,852	486
<b>At 31 December 2014</b>	<b>2,091</b>	<b>12,023</b>	<b>2</b>	<b>1,355</b>	<b>15,471</b>	<b>9,341</b>

<sup>1</sup> The asset backed securities are primarily US dollar ('USD') denominated. Principal and carrying amounts are converted into Sterling ('GBP') at the prevailing exchange rates at 31 December (2015: 1GBP: USD 1.48215; 2014: 1GBP: USD 1.5587).

Included in the above table are securities with a carrying amount of £2,098 million (2014: £4,205 million) held through the SICs, excluding Solitaire, that are consolidated by the group. Although the group includes these assets in full on its balance sheet, significant first loss risks are borne by the third party capital notes investors. The carrying amount of the capital notes liability at the year ended 31 December 2015 was £144 million (2014: £241 million).

Also included within this section is information on the GB&M legacy credit activities in respect of Solitaire and the securities investment conduits ('SICs'). For further information on structured entities please refer to note 36.

The available-for-sale reserve movement in relation to these ABSs for the year was a decrease of £24 million (2014: decrease of £68 million). The impairment write-back attributed to the group for the year was £16 million (2014: write-back of £67 million).

## Report of the Directors: Risk (continued)

### Liquidity and funding risk

Liquidity risk is the risk that the group does not have sufficient financial resources to meet its obligations as they fall due, or will have access to such resources only at an excessive cost. The risk arises from mismatches in the timing of cash flows. The risk materialises when the funding needed for illiquid asset positions cannot be obtained at the expected terms as and when required.

The objective of the group's liquidity and funding risk management framework ('LFRF') is to ensure resilience to very severe liquidity stresses. To this end, the group maintains a diversified funding base comprising core retail and corporate customer deposits and institutional balances. This is augmented with wholesale funding and portfolios of highly liquid assets diversified by currency and maturity that are held to enable the group to respond quickly and smoothly to unforeseen liquidity requirements.

The group requires its operating entities to maintain strong liquidity positions and to manage the liquidity profiles of their assets, liabilities and commitments with the objective of ensuring that their cash flows are balanced appropriately and that all their anticipated obligations can be met when due. The group adapts its LFRF in response to changes in the mix of business that it undertakes, and to changes in the nature of the markets in which it operates. The group also seeks to continuously evolve and strengthen its LFRF.

The group employs a number of measures to monitor liquidity risk. The group also manages its intra-day liquidity positions so that it is able to meet payment and settlement obligations on a timely basis. Payment flows in real time gross settlement systems, expected peak payment flows and large time-critical payments are monitored during the day and the intra-day collateral position is managed so that there is liquidity available to meet payments.

The management of liquidity and funding is primarily undertaken locally in the group's operating entities in compliance with policies and limits set by the RMM. These limits vary according to the depth and liquidity of the market in which the entities operate. It is the group's policy that each banking entity should manage its liquidity and funding risk on a stand-alone basis. The limits place formal restrictions on the transfer of resources between group entities and reflect the range of currencies, markets and time zones within which the group operates.

The group's liquidity and funding management process includes:

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

#### Primary sources of funding

*(Audited)*

Customer deposits in the form of current accounts and savings deposits payable on demand or at short notice form a significant part of our funding, and we place considerable importance on maintaining their stability. For deposits, stability depends upon maintaining depositor confidence in our capital strength and liquidity, and on competitive and transparent pricing.

We also access wholesale funding markets by issuing senior secured and unsecured debt securities (publicly and privately) and borrowing from the secured repo markets against high quality collateral, to align asset and liability maturities and currencies and to maintain a presence in local wholesale markets.

#### Liquidity and funding in 2015

The group maintained its strong liquidity position in 2015 and continued to enjoy inflows of customer deposits and maintained good access to wholesale markets. HSBC UK liquidity group recorded an increase in its ACF ratio to 101 per cent at 31 December 2015 (2014: 97 per cent). While core deposit growth exceeded lending growth, this was more than offset by decrease of debt in issue.

#### Liquidity regulation

Under European Commission ('EC') Delegated Regulation 2015/61, the consolidated Liquidity Coverage Ratio ('LCR') became a minimum regulatory standard from October 2015.

The European calibration of the net stable funding ratio ('NSFR') is still pending following the Basel Committee's final recommendation in October 2014, and therefore external disclosure of this metric is currently on hold.

#### Liquidity coverage ratio – EC LCR delegated regulation

The LCR delegated regulation contains elements that are open to interpretation, potentially compromising the comparability of the LCR across banks, albeit within regulatory oversight. One such element concerns the definition of operational deposits.

The Group currently defines operational deposits as transactional (current) accounts arising from the provision of custody services by HSBC Security Services ('HSS') or PCM, where the operational component is generally assessed to be the lower of the current balance, the total notional value of monthly debits across the account, and the total notional value of monthly credits across the account.

On the basis of this assumption, the LCRs as at 31 December 2015 for the key entities were as follows:

## Report of the Directors: Risk (continued)

### Liquidity Coverage Ratio

	At 31 December 2015 %
HSBC UK liquidity group <sup>1</sup>	107
HSBC France	127
HSBC Trinkaus & Burkhardt AG	120

<sup>1</sup> The HSBC UK liquidity group shown comprises: HSBC Bank plc (including all overseas branches), Marks and Spencer Financial Services Limited, HSBC Trust Company (UK) Limited and Private Bank (UK) Limited. It is managed as a single operating entity, in line with the application of UK liquidity regulation as agreed with the PRA.

### Forward Looking Framework

From 1 January 2016 the group will implement a new internal LFRF. The new internal framework uses the external LCR and NSFR regulatory framework as a foundation, but adds additional metrics/limits and overlays to address the risks that the group considers are not adequately reflected by the external regulatory framework.

The key aspects of the new internal LFRF are:

- I. Stand-alone management of Liquidity and Funding by operating entity;
- II. Operating entity classification by Inherent Liquidity Risk ('ILR') Categorisation;
- III. Minimum operating entity LCR requirement dependant on ILR categorisation (EU LCR Delegated Regulation basis);
- IV. Minimum operating entity NSFR requirement dependant on ILR categorisation (on the basis of Basel 295 publication, pending finalisation of the EC NSFR delegated regulation);
- V. Legal entity depositor concentration limit;
- VI. Operating entity three month & twelve month cumulative rolling term contractual maturity limits covering deposits from banks, deposits from non-bank financials and securities issued;
- VII. Annual Individual Liquidity Adequacy Assessment ('ILAA') by operating entity; and
- VIII. Minimum operating entity LCR requirement by currency to be introduced during 2016.

The new internal LFRF and the risk tolerance (limits) have been approved by the RMM of the Group Management Board ('Group RMM'), and by the Board of Directors of HSBC Holding plc on the basis of the recommendation given by the Group Risk Committee ('GRC').

The ILAA process has been designed to identify any risk that is not reflected in the Group framework and where additional limits are assessed to be required locally, and to validate the Risk Tolerance at the operating entity level.

The decision to create an internal framework modelled around the external regulatory framework was driven by the need to ensure that the external and internal frameworks are directionally aligned and to ensure that the Group's internal funds transfer pricing framework incentivises the Global Businesses within each operating entity to collectively comply with both the external (regulatory) and the internal risk tolerance.

### Management of liquidity and funding risk

HSBC's LFRF employs two key measures to define, monitor and control the liquidity and funding risk of our operating entities. The ACF ratio is used to monitor the structural

long-term funding position, and the stressed coverage ratio, incorporating Group-defined stress scenarios, is used to monitor the resilience to severe liquidity stresses. Although this has been the framework in place before and during 2015, this framework and accompanying metrics will be demised as the new framework outlined above is implemented.

### Inherent liquidity risk categorisation

The group categorises its operating entities into one of two categories to reflect its assessment of their inherent liquidity risk, considering political, economic and regulatory factors within the operating entities' host country, and also factors specific to the entity itself, such as the local footprint, market share, balance sheet strength and control framework. This assessment is used to determine the severity of the liquidity stress that the group expects its operating entities to be able to withstand.

### Core deposits

A key element of our internal framework is the classification of customer deposits into core and non-core based on the expectation of their behaviour during periods of liquidity stress. This characterisation takes into account the inherent liquidity risk categorisation of the operating entity originating the deposit, the nature of the customer and the size and pricing of the deposit. No deposit is considered to be core in its entirety unless it is contractually collateralising a loan. The core deposit base is considered to be a long-term source of funding and therefore is assumed not to be withdrawn in the liquidity stress scenario that we use to calculate our principal liquidity risk metrics.

The three filters considered in assessing whether a deposit in any operating entity is core are:

- *price*: any deposit priced significantly above market or benchmark rates is generally treated as entirely non-core;
- *size*: depositors with total funds above certain monetary thresholds are excluded. Thresholds are established by considering the business line and inherent liquidity risk categorisation; and
- *line of business*: the element of any deposit remaining after the application of the price and size filters is assessed on the basis of the line of business with which the deposit is associated. The proportion of any customer deposit that can be considered core under this filter is between 35 per cent and 90 per cent.

Repo transactions and bank deposits are not classified as core deposits.

### Advances to core funding ratio

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

ACF ratio limits are set by the RMM. The ratio describes current loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year.

## Report of the Directors: Risk (continued)

Non-trading reverse repurchase arrangements, where the group receives securities which are deemed to be liquid, are excluded from the ACF ratio.

ACF limits set for principal operating entities at 31 December 2015 ranged between 95 per cent and 115 per

*Advances to core funding ratios*<sup>1</sup>

### HSBC UK liquidity group<sup>2</sup>

Year end	101	97
Maximum	101	102
Minimum	96	97
Average	98	100

### HSBC France

Year end	98	101
Maximum	109	108
Minimum	98	100
Average	103	103

### HSBC Trinkaus & Burkhardt AG

Year end	78	65
Maximum	80	76
Minimum	65	55
Average	73	65

<sup>1</sup> This ratio measures loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year. The lower the percentage, the stronger the funding position.

<sup>2</sup> The HSBC UK liquidity group shown comprises: HSBC Bank plc (including all overseas branches), Marks and Spencer Financial Services Limited, HSBC Trust Company (UK) Limited and Private Bank (UK) Limited. It is managed as a single operating entity, in line with the application of UK liquidity regulation as agreed with the PRA.

Core funding represents the core component of customer deposits and any term wholesale funding with a residual contractual maturity beyond one year. Capital is excluded from our definition of core funding.

### Stressed coverage ratios

Stressed coverage ratios are derived from stressed cash flow scenario analyses and express stressed cash inflows as a percentage of stressed cash outflows over one-month and three-month time horizons.

The stressed cash inflows include:

- inflows (net of assumed haircuts) expected to be generated from the realisation of liquid assets; and
- contractual cash inflows from maturing assets that are not already reflected as a utilisation of liquid assets.

In line with the approach adopted for the ACF ratio, customer loans are generally assumed not to generate any cash inflows under stress scenarios and are therefore excluded from the numerator of the stressed coverage ratio, irrespective of the contractual maturity date.

A stressed coverage ratio of 100 per cent or higher reflects a positive cumulative cash flow under the stress scenario

cent. The table below shows the extent to which loans and advances to customers in our principal banking entities were financed by reliable and stable sources of funding. All banking entities were within risk appetite during 2015.

	At 31 December	
	2015 (%)	2014 (%)
HSBC UK liquidity group <sup>2</sup>		
Year end	101	97
Maximum	101	102
Minimum	96	97
Average	98	100
HSBC France		
Year end	98	101
Maximum	109	108
Minimum	98	100
Average	103	103
HSBC Trinkaus & Burkhardt AG		
Year end	78	65
Maximum	80	76
Minimum	65	55
Average	73	65

being monitored. Group operating entities are required to maintain a ratio of 100 per cent or greater up to three months under the combined market-wide and HSBC-specific stress scenario defined by the inherent liquidity risk categorisation of the operating entity concerned.

Compliance with operating entity limits is monitored by Asset Liability and Capital Management ('ALCM') teams and reported monthly to the RMM for the main operating entities and to the European Asset Liability Committee ('ALCO') for the smaller operating entities.

The stressed coverage ratios tabulated below express stressed cash inflows as a percentage of stressed cash outflows over a one-month and three-month time horizon.

Inflows included in the numerator of the stressed coverage ratio are generated from liquid assets net of assumed haircuts, and cash inflows related to assets contractually maturing within the time period.

At 31 December 2015, the one-month and three-month stressed coverage ratios for the principal entities shown in the table below were in excess of the 100 per cent target. All banking entities were within risk appetite during 2015.

## Report of the Directors: Risk (continued)

### Stressed one-month and three-month coverage ratios<sup>1</sup>

	Stressed one-month coverage ratios at 31 December		Stressed three-month coverage ratios at 31 December	
	2015 (%)	2014 (%)	2015 (%)	2014 (%)
<i>HSBC UK liquidity group</i>				
Year end	113	117	105	109
Maximum	127	117	114	109
Minimum	112	102	105	103
Average	117	107	108	104
<i>HSBC France</i>				
Year end	124	117	102	101
Maximum	124	117	102	106
Minimum	101	104	100	101
Average	108	107	101	102
<i>HSBC Trinkaus &amp; Burkhardt AG</i>				
Year end	102	109	102	109
Maximum	109	113	106	109
Minimum	102	99	102	101
Average	105	106	103	105

<sup>1</sup> This ratio measures the liquid assets available to meet net cash outflows over a 30 day / 90 day period. The higher the percentage, the greater the liquidity.

The one-month and three-month stressed coverage ratios for HSBC UK liquidity group decreased mainly due to lower non-core deposits, partially offset by a reduction in secured lending.

#### Stressed scenario analysis

The group uses a number of standard Group stress scenarios designed to model:

- combined market-wide and HSBC-specific liquidity crisis scenarios; and
- market-wide liquidity crisis scenarios.

The appropriateness of the assumptions for each scenario is reviewed by ALCM regularly and formally approved by the RMM and the Board annually as part of the liquidity and funding risk appetite approval process.

Stressed cash outflows are determined by applying a standard set of prescribed stress assumptions to the Group's cash flow model. The group's framework prescribes the use of two market-wide scenarios and two further combined market-wide and HSBC-specific stress scenarios of increasing severity. In addition to the group's standard stress scenarios, individual operating entities are required to design their own scenarios to reflect specific local market conditions, products and funding bases.

The two combined market-wide and HSBC-specific scenarios model a more severe scenario than the market-wide scenarios. The relevant combined market-wide and HSBC-specific stress scenario that an operating entity manages to is based upon its inherent liquidity risk categorisation. The key assumptions factored into the combined market-wide and HSBC-specific stress scenarios are summarised as follows:

- all non-core deposits are deemed to be withdrawn within three months (80 per cent within one month), with the level of non-core deposits dependent on the operating entity's inherent liquidity risk categorisation;
- the ability to access interbank funding and unsecured term debt markets ceases for the duration of the scenario;

- the ability to generate funds from illiquid asset portfolios (securitisation and secured borrowing) is restricted to 25-75 per cent of the lower of issues in the last six months or expected issues in the next six months. The restriction is based on current market conditions and is dependent on the operating entity's inherent liquidity risk categorisation;
- the ability to access repo funding ceases for any asset not classified as liquid under our liquid asset policy for the duration of the scenario;
- drawdowns on committed lending facilities must be consistent with the severity of the market stress being modelled and dependent on the inherent liquidity risk categorisation of the operating entity;
- outflows are triggered by a defined downgrade in long-term ratings. We maintain an ongoing assessment of the appropriate number of notches to reflect;
- customer loans are assumed to be renewed at contractual maturity;
- interbank loans and reverse repos are assumed to run off contractually; and
- assets defined as liquid assets are assumed to be realised in cash ahead of their contractual maturity, after applying a defined stressed haircut of up to 20 per cent.

#### Liquid assets

The table of the liquid assets shows the estimated liquidity value (before haircuts) of assets categorised as liquid used for the purposes of calculating the three month stressed coverage ratio, as defined under the Group's LFRF.

Unencumbered assets held as a consequence of a reverse repo transaction with a residual contractual maturity within the stressed coverage ratio time period and unsecured interbank loans maturing within three months are not included in liquid assets, but are treated as contractual cash inflows. This table is prepared on a different basis to the liquid asset disclosure for HSBC UK liquidity group in the Group Annual Report and Accounts ('ARA'), which shows the stock of unencumbered liquid

## Report of the Directors: Risk (continued)

assets as at the reporting date, adjusted for the impact of repos, reverse repos and collateral swaps maturing within three months, as for the Group ARA the liquidity value of these transactions is reflected as a contractual cash flow reported in the net contractual cash flow table.

Liquid assets are held and managed on a stand-alone operating entity basis. The vast majority of liquid assets shown are held directly by each operating entity's Balance Sheet Management ('BSM') function, primarily for the purpose of managing liquidity risk, in line with the LFRF.

Liquid assets also include any unencumbered liquid assets held outside BSM for any other purpose. The Group's LFRF gives ultimate control of all unencumbered assets and sources of liquidity to BSM.

### Liquid assets

	Estimated liquidity value at 31 December	
	2015 £m	2014 £m
<i>HSBC UK liquidity group</i>		
Level 1	91,040	94,478
Level 2	2,932	2,069
Level 3	16,941	20,091
	<b>110,913</b>	<b>116,638</b>
<i>HSBC France</i>		
Level 1	13,658	10,838
Level 2	1,100	241
Level 3	266	2,221
	<b>15,024</b>	<b>13,300</b>
<i>HSBC Trinkaus &amp; Burkhardt AG</i>		
Level 1	3,495	4,062
Level 2	308	465
Level 3	1,398	1,642
	<b>5,201</b>	<b>6,169</b>

The Group's liquid asset policy is to apply a more granular classification of liquid assets. These classifications are as follows:

- *Level 1* - Central banks, central government securities of countries and currencies with a highly liquid market and certain supnationals and multilateral development banks;
- *Level 2* – Local and regional governments, public sector entities, secured covered bonds, pass-through ABSs, and gold; and
- *Level 3* – Unsecured non-financial entity securities and equities listed on recognised exchanges and within liquid indices.

All assets held within the liquid asset portfolio are unencumbered.

Liquid assets held by HSBC UK liquidity group decreased as a result of lower lending in repo market and a decline in equities.

### Liquidity behaviouralisation

Liquidity behaviouralisation is applied to reflect our assessment of the expected period for which we are confident that we will have access to our liabilities, even under a severe liquidity stress scenario, and the expected period for which we must assume that we will need to fund our assets. Behaviouralisation is applied when the contractual terms do not reflect the expected behaviour.

Liquidity behaviouralisation is reviewed and approved by local ALCO in compliance with policies set by the RMM. Our approach to liquidity risk management will often mean different behaviouralisation assumptions are applied to assets and liabilities. For example, management may assume a shorter life for liabilities and a longer-term funding requirement for assets. All core deposits are assumed under the Group's core/non-core and ACF frameworks to have a liquidity behaviouralised life beyond one year and to represent a homogeneous source of core funding. The behaviouralisation of assets is more granular and seeks to differentiate the period for which we assume that we will need to fund the asset.

### Funds transfer pricing

Our funds transfer pricing policies give rise to a two-stage funds transfer pricing approach, reflecting the fact that we separately manage interest rate risk and liquidity and funding risk under different assumptions. They have been developed to be consistent with our risk management frameworks. Each operating entity is required to apply the Group's transfer pricing policy framework to determine for each material currency the most appropriate interest rate risk transfer pricing curve, a liquidity premium curve (which is a spread over the interest rate risk transfer pricing curve) and a liquidity recharge assessment (which is a spread under or over the interest rate risk transfer pricing curve).

The interest rate risk transfer pricing policy seeks to ensure that all market interest rate risk arising structurally from non-trading (banking book) assets and liabilities, which is capable of being neutralised externally in the market or neutralised internally by off-setting transfers, is transferred to BSM to be managed centrally as non-traded market risk. For each material currency, each operating entity employs a single interest rate risk transfer pricing curve. The transfer price curve used for this purpose reflects how BSM in each operating entity is best able to neutralise the interest rate risk in the market at the point of transfer. Where basis risk can be identified between the re-pricing basis of an external asset or external liability and the re-pricing basis of the interest rate risk transfer pricing curve, this basis risk may be transferred to BSM provided it can neutralise the basis risk in the market.

Liquidity and funding risk is transfer priced independently from interest rate risk because the liquidity and funding risk of an operating entity is transferred to ALCO to be managed centrally. ALCO monitors and manages the ACF ratio and delegates the management of the liquid asset portfolio and execution of the wholesale term debt funding plan to BSM, requiring BSM to ensure the group's stressed coverage ratios remain above 100 per cent up to three months. The liquidity and funding risk transfer price consists of two components:

- *Liquidity recharge*: the cost of holding the benchmark liquid asset (the yield under the transfer price) to meet stressed cash outflows. The benchmark liquid asset is decided by ALCO and based on the weighted average duration that can be achieved by investing in level 1 liquid assets, with a residual duration of up to one year.
- *Liquidity premium*: the assessed cost/value of term funding (the yield over the transfer price) to pay for term debt and core deposits.

## Report of the Directors: Risk (continued)

The assessed cost of holding liquid assets is allocated to the outflows modelled by the internal stressed coverage ratio framework.

### Contingent liquidity risk arising from committed lending facilities

(Audited)

The group provides customers with committed facilities, including committed backstop lines to conduit vehicles sponsored by the group and standby facilities to corporate customers. These facilities increase the funding requirements of the group when customers choose to raise drawdown levels above their normal utilisation rates. The liquidity risk consequences of increased levels of drawdown are analysed in the form of projected cash flows under different stress scenarios. The RMM sets limits for non-cancellable contingent funding commitments by entity after due consideration of each entity's ability to fund them. The limits are split according to the borrower, the liquidity of the underlying assets and the size of the committed line.

*The group's contractual exposures as at 31 December monitored under the contingent liquidity risk limit structure (Audited)*

	The group	
	2015 £bn	2014 £bn
<b>Commitments to conduits</b>		
Consolidated multi-seller conduits <sup>1</sup>		
– total lines	10.8	7.9
– largest individual lines	0.7	0.6
Consolidated securities investment conduits – total lines	5.5	7.1
<b>Commitments to customers</b>		
– five largest <sup>2</sup>	3.4	2.6
– largest market sector <sup>3</sup>	12.1	10.6

1. These exposures relate to the Regency multi-seller conduit. This vehicle provides funding to group customers by issuing debt secured by a diversified pool of customer-originated assets.

2. These figures represent the undrawn balance for the five largest committed liquidity facilities provided to customers, other than those facilities to conduits.

3. These figures represent the undrawn balance for the total of all committed liquidity facilities provided to the largest market sector, other than those facilities to conduits.

### Sources of funding

(Audited)

Our primary sources of funding are customer current accounts and customer savings deposits payable on demand or at short notice. The group issues wholesale securities (secured and unsecured), including subordinated debt to supplement its customer deposits and change the currency mix, maturity profile or location of liabilities. The 'Funding sources and uses' table below, which provides a consolidated view of how the group's balance sheet is funded, should be read in the light of the LFRF, which requires the group to manage liquidity and funding risk on

a stand-alone basis. The below table analyses the group consolidated balance sheet according to the assets that primarily arise from operating activities and the sources of funding primarily supporting these activities. The assets and liabilities that do not arise from operating activities are presented as a net balancing source or deployment of funds.

The group's consolidated securities investment conduits include Solitaire and Mazarin Funding Limited ('Mazarin') (see note 36). They issue asset-backed commercial paper ('CP') secured against the portfolio of securities held by them. Although the HSBC UK liquidity group provides a liquidity facility, Solitaire and Mazarin have no need to draw on it so long as HSBC purchases the CP issued, which it intends to do for the foreseeable future. At 31 December 2015, the CP issued by Solitaire and Mazarin was entirely held by HSBC UK liquidity group. Since HSBC controls the size of the portfolio of securities held by these conduits, no contingent liquidity risk exposure arises as a result of these undrawn committed lending facilities.

In relation to commitment to customers, the table below shows the level of undrawn commitments outstanding in terms of the five largest single facilities and the largest market sector.

The level of customer accounts continued to exceed the level of loans and advances to customers. The positive funding gap was predominantly deployed in liquid assets; cash and balances with central banks and financial investments, as required by the LFRF.

**Report of the Directors: Risk** (continued)**Funding sources and uses***The group*

	2015 £m	2014 £m		2015 £m	2014 £m
<b>Sources</b>			<b>Uses</b>		
Customer accounts	332,830	346,507	Loans and advances to customers	258,506	257,252
Deposits by banks	24,202	27,590	Loans and advances to banks	23,222	25,262
Repurchase agreements – non-trading	17,000	23,353	Reverse Repurchase agreements – non-trading	30,537	41,945
Debt securities issued	26,069	27,921	Trading assets	110,585	130,127
Subordinated liabilities	8,527	8,858	– reverse repos	295	444
Financial liabilities designated at fair value	19,001	22,552	– stock borrowing	4,823	5,137
Liabilities under insurance contracts	16,664	17,522	– settlement accounts	3,608	3,803
Trading liabilities	73,489	82,600	– other trading assets	101,859	120,743
– repos	332	2,339	Financial investments	71,352	76,194
– stock lending	13,013	11,617	Cash and balances with central banks	39,749	42,853
– settlement accounts	2,659	3,628	Net deployment in other balance sheet assets and liabilities	21,956	19,968
– other trading liabilities	57,485	65,016			
Total equity	38,125	36,698			
At 31 December	555,907	593,601	At 31 December	555,907	593,601

**Repos and stock lending**

GB&M provides collateralised security financing services to its clients, providing them with cash financing or specific securities. When cash is provided to clients against collateral in the form of securities, the cash provided is recognised on the balance sheet as a reverse repo. When securities are provided to clients against cash collateral the cash received is recognised on the balance sheet as a repo or, if the securities are equity securities, as stock lending.

Each operating entity manages its collateral through a central collateral pool, in line with the LFRF. When specific securities need to be delivered and the entity does not have them currently available within the central collateral pool, the securities are borrowed on a collateralised basis. When securities are borrowed against cash collateral the cash provided is recognised on the balance sheet as a reverse repo or, if the securities are equity securities, as stock borrowing.

Operating entities may also borrow cash against collateral in the form of securities, using the securities available in the central collateral pool. Repos and stock lending can be used in this way to fund the cash requirement arising from securities owned outright by Markets to facilitate client business, and the net cash requirement arising from financing client securities activity. Reverse repos, stock borrowing, repos and stock lending are reported net when the IFRSs offsetting criteria are met. In some cases transactions to borrow or lend securities are collateralised using securities. These transactions are off-balance sheet.

Any security accepted as collateral for a reverse repo or stock borrowing transaction must be of very high quality and its value subject to an appropriate haircut. Securities borrowed under reverse repo or stock borrowing transactions can only be recognised as part of the liquidity asset buffer for the duration of the transactions and only if the security received is eligible under the liquid asset policy within the LFRF.

Credit controls are in place to ensure that the fair value of any collateral received remains appropriate to collateralise the cash or fair value of securities given.

**Wholesale term debt maturity profile**

The maturity profile of the wholesale term debt obligations is set out in the table below 'Wholesale funding cash flows payable by the group under financial liabilities by remaining contractual maturities'.

The balances in the table will not agree directly with those in the consolidated balance sheet as the table presents gross cash flows relating to principal payments and not the balance sheet carrying value, which includes debt securities and subordinated liabilities measured at fair value.



## Wholesale funding cash flows payable by the group under financial liabilities by remaining contractual maturities

	Due within 1 month £m	Due between 1 and 3 months £m	Due between 3 and 6 months £m	Due between 6 and 9 months £m	Due between 9 months and 1 year £m	Due between 1 and 2 years £m	Due between 2 and 5 years £m	Due after 5 years £m	Total £m
Debt securities issued	9,588	3,292	8,231	2,828	2,996	5,515	11,945	9,989	54,384
– unsecured CDs and CP	2,037	2,555	5,102	1,524	770	–	–	–	11,988
– unsecured senior MTNs	1,462	504	2,740	1,071	1,155	2,584	6,591	5,728	21,835
– unsecured senior structured notes	364	233	389	233	1,071	1,532	3,536	2,503	9,861
– secured covered bonds	–	–	–	–	–	1,399	1,092	1,739	4,230
– secured ABCP	5,677	–	–	–	–	–	–	–	5,677
– secured ABS	–	–	–	–	–	–	726	–	726
– others	48	–	–	–	–	–	–	19	67
Subordinated liabilities	–	–	35	–	43	22	945	9,149	10,194
– subordinated debt securities	–	–	35	–	43	22	616	8,449	9,165
– preferred securities	–	–	–	–	–	–	329	700	1,029
<b>At 31 December 2015</b>	<b>9,588</b>	<b>3,292</b>	<b>8,266</b>	<b>2,828</b>	<b>3,039</b>	<b>5,537</b>	<b>12,890</b>	<b>19,138</b>	<b>64,578</b>
Debt securities issued	9,033	5,464	7,604	3,264	2,593	8,537	11,666	11,889	60,050
– unsecured CDs and CP	2,251	3,646	4,414	1,561	1,278	–	–	–	13,150
– unsecured senior MTNs	791	1,671	2,494	1,308	1,073	6,328	5,760	6,921	26,346
– unsecured senior structured notes	423	147	696	264	242	2,209	3,418	2,889	10,288
– secured covered bonds	–	–	–	131	–	–	1,774	1,888	3,793
– secured ABCP	5,519	–	–	–	–	–	–	–	5,519
– secured ABS	–	–	–	–	–	–	714	–	714
– others	49	–	–	–	–	–	–	191	240
Subordinated liabilities	–	–	–	2	14	74	102	11,210	11,402
– subordinated debt securities	–	–	–	2	14	74	102	8,699	8,891
– preferred securities	–	–	–	–	–	–	–	2,511	2,511
<b>At 31 December 2014</b>	<b>9,033</b>	<b>5,464</b>	<b>7,604</b>	<b>3,266</b>	<b>2,607</b>	<b>8,611</b>	<b>11,768</b>	<b>23,099</b>	<b>71,452</b>

## Report of the Directors: Risk (continued)

### Encumbered and unencumbered assets

The objective of this disclosure is to facilitate an understanding of available and unrestricted assets that could be used to support potential future funding and collateral needs.

An asset is defined as encumbered if it has been pledged as collateral against an existing liability, and as a result is no

longer available to the group to secure funding, satisfy collateral needs or be sold to reduce the funding requirement.

The disclosure is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

### Summary of assets available to support potential future funding and collateral needs (on and off-balance sheet)

	2015 £m	2014 £m
Total on-balance sheet assets at 31 December	727,941	797,289
Less:		
– reverse repo/ stock borrowing receivables and derivative assets	(202,440)	(235,262)
– other assets that cannot be pledged as collateral	(81,273)	(89,250)
Total on-balance sheet assets that can support funding and collateral needs at 31 December	444,228	472,777
Add: off-balance sheet assets		
– fair value of collateral received in relation to reverse repo/ stock borrowing / derivatives that is available to sell or repledge	84,473	110,514
Total assets that can support future funding and collateral needs	528,701	583,291
Less:		
– on-balance sheet assets pledged	(41,463)	(59,015)
– re-pledging of off-balance sheet collateral received in relation to reverse repo/ stock borrowing/ derivatives	(62,608)	(72,281)
<b>Assets available to support funding and collateral needs at 31 December</b>	<b>424,630</b>	<b>451,995</b>

### The effect of active collateral management

Collateral is managed on an operating entity basis, consistent with the approach adopted in managing liquidity and funding. Available collateral held by each operating entity is managed as a single collateral pool. In deciding which collateral to pledge, each operating entity seeks to optimise the use of the available collateral pool within the confines of the LFRF, irrespective of whether the collateral pledged is recognised on-balance sheet or was received in respect of reverse repo, stock borrowing or derivative transactions.

Managing collateral in this manner affects the presentation of asset encumbrance in that we may encumber on-balance sheet holdings while maintaining available unencumbered off-balance sheet holdings, even though we are not seeking to directly finance the on-balance sheet holdings pledged.

In quantifying the level of encumbrance of negotiable securities, the encumbrance is analysed by individual security. When a particular security is encumbered and we hold the security both on-balance sheet and off-balance sheet with the right to repledge, we assume for the purpose of this disclosure that the off-balance sheet holding received from third party is encumbered ahead of the on-balance sheet holding.

An on-balance sheet encumbered and off-balance sheet unencumbered asset will occur, for example, if we receive a specific security as a result of a reverse repo/stock borrowing transaction, but finance the cash lent by pledging a generic collateral basket, even if the security received is eligible for the collateral basket pledged. It will also occur if we receive a generic collateral basket as a result of a reverse repo transaction but finance the cash lent by pledging specific securities, even if the securities pledged are eligible for the collateral basket.

### Market risk

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

There were no material changes to our policies and practices for the management of market risk in 2015.

Exposure to market risk is separated into two portfolios.

- Trading portfolios comprise positions arising from market-making and warehousing of customer-derived positions.
- Non-trading portfolios including BSM comprise positions that primarily arise from the interest rate management of the group's retail and commercial banking assets and liabilities, financial investments designated as available-for-sale and held-to-maturity, and exposures arising from the group's insurance operations.

For market risk arising in our insurance business, refer to page 67.

#### Market risk management

Where appropriate, we apply similar risk management policies and measurement techniques to both trading and non-trading portfolios. Our objective is to manage and control market risk exposures to optimise return on risk while maintaining a market profile consistent with the status as one of the world's largest banking and financial services organisations.

The nature of the hedging and risk mitigation strategies performed across the group corresponds to the market risk management instruments available within each operating jurisdiction. These strategies range from the use of traditional market instruments, such as interest rate swaps, to more sophisticated hedging strategies to address a combination of risk factors arising at portfolio level.

## Report of the Directors: Risk (continued)

### Market risk governance

(Audited)

Market risk is managed and controlled through limits approved by the RMM of the Group Management Board ('GMB') for HSBC Holdings and the global businesses. These limits are allocated across business lines and agreed with the Group's legal entities, including HSBC Bank plc.

The management of market risk is principally undertaken in Markets using risk limits allocated from the risk appetite, which is subject to the Group RMM ratification. Limits are set for portfolios, products and risk types, with market liquidity being a primary factor in determining the level of limits set.

Global Risk is responsible for setting market risk management policies and measurement techniques. Each major operating entity has an independent market risk management and control function which is responsible for measuring market risk exposures in accordance with the policies defined by Global Risk, and monitoring and reporting these exposures against the prescribed limits on a daily basis.

Each operating entity is required to assess the market risks arising on each product in its business and to transfer them to either its local Markets unit for management, or to separate books managed under the supervision of the local ALCO.

The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to manage them professionally. In certain cases where the market risks cannot be fully transferred, the group identifies the impact of varying scenarios on valuations or on net interest income resulting from any residual risk positions.

Model risk is governed through Model Oversight Committees ('MOC's) at the regional and global Wholesale Credit and Market Risk levels. They have direct oversight and approval responsibility for all traded risk models utilised for risk measurement and management and stress testing. The MOCs prioritise the development of models, methodologies and practices used for traded risk management within the Group and ensure that they remain within our risk appetite and business plans. The Markets MOC reports into the Group MOC, which oversees all model risk types at Group level. Group MOC informs the Group RMM about material issues at least on a bi-annual basis. The RMM is the Group's 'Designated Committee' according to regulatory rules and has delegated day-to-day governance of all traded risk models to the Markets MOC.

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

### Market risk measures

#### Monitoring and limiting market risk exposure

Our objective is to manage and control market risk exposures while maintaining a market profile consistent with the group's risk appetite.

We use a range of tools to monitor and limit market risk exposures including sensitivity analysis, value at risk ('VaR'), and stress testing.

#### Sensitivity analysis

Sensitivity analysis measures the impact of individual market factor movements on specific instruments or portfolios including interest rates, foreign exchange rates and equity prices for example the impact of a one basis point change in yield. We use sensitivity measures to monitor the market risk positions within each risk type, for example, the present value of a basis point movement in interest rates for interest rate risk.

Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

#### Value at risk

VaR is a technique that estimates the potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. The use of VaR is integrated into market risk management and is calculated for all trading positions regardless of how the group capitalises those exposures. Where there is not an approved internal model, the group uses the appropriate local rules to capitalise exposures.

In addition, the group calculates VaR for non-trading portfolios in order to have a complete picture of risk. The models are predominantly based on historical simulation. VaR is calculated at a 99 per cent confidence level for a one-day holding period. Where VaR is not calculated explicitly, alternative tools are used.

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

The historical simulation models used incorporate the following features:

- historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities;
- potential market movements utilised for VaR are calculated with reference to data from the past two years; and
- VaR measures are calculated to a 99 per cent confidence level and use a one-day holding period.

The nature of the VaR models means that an increase in observed market volatility will lead to an increase in VaR without any changes in the underlying positions.

#### VaR model limitations

Although a valuable guide to risk, VaR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a holding period assumes that all positions can be liquidated or the risks offset during that period. This may not fully reflect the market risk arising at times

## Report of the Directors: Risk (continued)

- of severe illiquidity, when the holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition does not take into account losses that might occur beyond this level of confidence;
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and
- VaR is unlikely to reflect loss potential on exposures that only arise under significant market movements.

### *Risk not in VaR framework*

The group's VaR model is designed to capture significant basis risks such as credit default swaps versus Bond, asset swap spreads and cross-currency basis. Other basis risks which are not completely covered in VaR, such as the Libor tenor basis, are complemented by risk-not-in-VaR ('RNIV') calculations and are integrated into the capital framework.

The RNIV framework therefore aims to capture and capitalise material market risks that are not adequately covered in the VaR model. An example of this is Libor overnight index swap basis risk for minor currencies. In such instances the RNIV framework uses stress tests to quantify the capital requirement. On average in 2015, the capital requirement derived from these stress tests represented 1.45 per cent of the total internal model-based market risk requirement.

Risks covered by RNIV represent 24 per cent of market risk RWAs for models with regulatory approval and include those resulting from underlying risk factors which are not observable on a daily basis across asset classes and products, such as dividend risk and implied correlation risks.

Risk factors are reviewed on a regular basis and either incorporated directly in the VaR models, where possible, or quantified through the VaR -based RNIV approach or a stress test approach within the RNIV framework. The severity of the scenarios is calibrated to be in line with the capital adequacy requirements. The outcome of the VaR -based RNIV is included in the VaR calculation and back-testing; a stressed VaR RNIV is also computed for the risk factors considered in the VaR-based RNIV approach.

### **Level 3 assets**

The fair value of Level 3 assets and liabilities in trading portfolios represent only a small proportion of the overall trading portfolio. Market risk arising from Level 3 instruments is managed by various market risk techniques such as stress testing and notional limits.

### **Back-testing**

We routinely validate the accuracy of our VaR models by back-testing them against both actual, which replaced clean profit and loss from 1 August 2015, and hypothetical profit and loss against the corresponding VaR numbers. Hypothetical profit and loss excludes non-modelled items such as fees, commissions and revenues of intra-day transactions.

We would expect on average to see two or three profits and two or three losses in excess of VaR at the 99 per cent confidence level over a one-year period. The actual number of profits or losses in excess of VaR over this period can therefore be used to gauge how well the models are performing.

We back-test our Group VaR at various levels which reflect a full legal entity scope of HSBC, including entities that do not have local permission to use VaR for regulatory purposes.

In 2015, the Group experienced one profit exception due primarily to profits from increased volatility in foreign exchange currencies, arising from the sharp fall in the Chinese stock market and its effect on global markets. There was no evidence of model errors or control failures.

### **Stress testing**

Stress testing is an important tool that is integrated into the groups market risk management tool to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. In such abnormal scenarios, losses can be much greater than those predicted by VaR modelling.

Stress testing is implemented at the legal entity, regional and the overall Group levels. A standard set of scenarios is utilised consistently across all regions within the Group. Scenarios are tailored in order to capture the relevant events or market movements at each level. The risk appetite around potential stress losses for the Group is set and monitored against referral limits.

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

- single risk factor stress scenarios that are unlikely to be captured within the VaR models, such as the break of a currency peg;
- technical scenarios consider the largest move in each risk factor without consideration of any underlying market correlation;
- hypothetical scenarios consider potential macroeconomic events, for example, the slowdown in mainland China and the potential effects of a sovereign debt default, including its wider contagion effects; and
- historical scenarios incorporate historical observations of market movements during previous periods of stress which would not be captured within VaR.

Market Risk Reverse stress tests are undertaken based upon the premise that there is a fixed loss. The stress test process identifies which scenarios lead to this loss. The rationale behind the reverse stress test is to understand scenarios which are beyond normal business settings that could have contagion and systemic implications.

Stressed VaR and stress testing, together with reverse stress testing and the management of gap risk, provide management with insights regarding the 'tail risk' beyond VaR for which HSBC's appetite is limited.

## Report of the Directors: Risk (continued)

### Trading portfolios

#### Volcker Rule

On 2013, US regulators finalised the “Volcker Rule.” Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act and its final implementation rules (collectively referred to as the “Volcker Rule”) imposes broad restrictions on HSBC’s ability to engage in ‘proprietary trading’ or to own, sponsor, or have certain relationships with hedge funds, private equity funds, and certain other collective investment vehicles (broadly defined as “covered funds”). These restrictions are subject to a number of exemptions or exclusions, including market making, underwriting and risk-mitigating hedging, organising covered funds for customers and issuers of asset-backed securities, and underwriting of market making in covered fund interests.

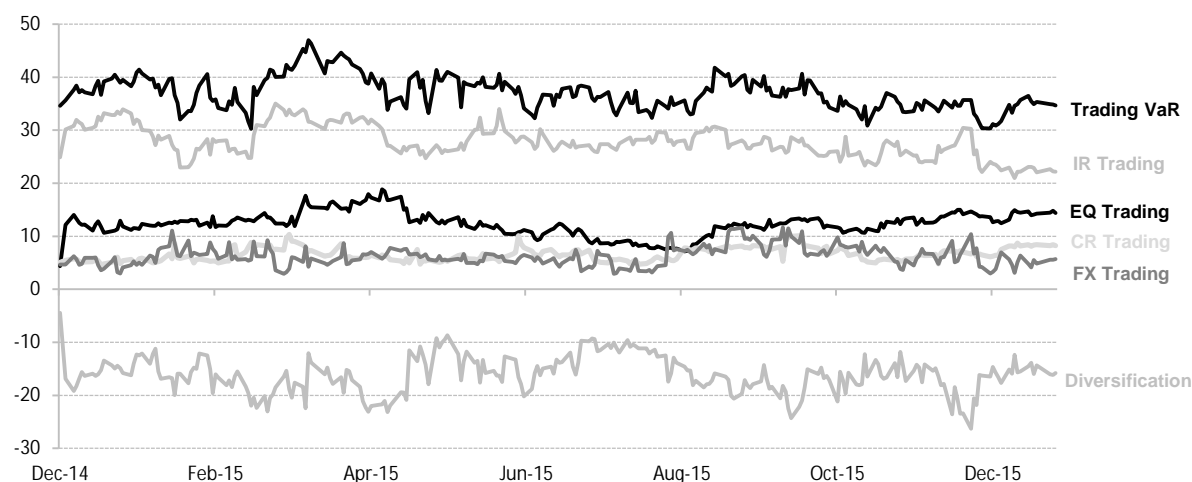
The Volcker Rule broadly went into effect on 22 July 2015, with the exception of certain legacy fund activities that are able to rely on an extension of the conformance date.

HSBC has implemented a program to comply with the Volcker Rule, including policies and procedures, internal controls, corporate governance, independent testing, training and record keeping and, eventually, calculation

*Daily VaR (trading portfolios), 99% 1 day (£m)*

*(Audited)*

The group’s trading VaR for the year is shown in the table below.



and reporting of quantitative metrics for certain trading activities.

HSBC has completed training for all affected front office and control personnel, has conformance plans for those covered funds to which the extension applies, and believes that it is in compliance with all material respects with the Volcker Rule.

#### Value at Risk of the trading portfolios

*(Audited)*

Trading VaR predominantly resides within Global Markets. The total VaR for trading activity remained consistent at 31 December 2015 in comparison to 31 December 2014. The RNIV framework captures risks from exposures in the HSBC trading book which are not captured well by the VaR model. For 2015, the VaR-based RNIVs are included within metrics for each asset class whereas in 2014 they were included within portfolio diversification. Adjusting for the impact of the RNIV reclassification, portfolio diversification reduced in comparison to 2014.

The daily levels of total trading VaR over the last year are set out in the graph below.

## Report of the Directors: Risk (continued)

Trading value at risk, 99% 1 day  
(Audited)

	Foreign exchange (FX) and commodity £m	Interest rate (IR) £m	Equity (EQ) £m	Credit Spread (CS) £m	Portfolio Diversification <sup>1</sup> £m	Total <sup>2</sup> £m
<b>At 31 December 2015</b>	5.7	22.2	14.4	8.2	(15.8)	34.7
Average	6.3	27.9	12.3	6.6	(16.1)	37.0
Maximum	11.7	35.0	18.9	10.3		47.0
Minimum	2.9	21.0	7.1	4.6		30.2
<b>At 31 December 2014</b>	4.7	24.9	4.4	5.1	(4.5)	34.6
Average	7.7	19.7	4.0	6.8	(6.0)	32.2
Maximum	16.9	26.6	9.8	11.1		44.1
Minimum	2.7	15.3	1.9	3.8		19.4

1 Portfolio diversification is the market risk dispersion effect of holding a portfolio containing different risk types. It represents the reduction in unsystematic market risk that occurs when combining a number of different risk types, for example, interest rate, equity and foreign exchange, together in one portfolio. It is measured as the difference between the sum of the VaR by individual risk type and the combined total VaR. A negative number represents the benefit of portfolio diversification. As the maximum occurs on different days for different risk types, it is not meaningful to calculate a portfolio diversification benefit for this measure.

2 The total VaR is non-additive across risk types due to diversification effect, and includes VaR RNIV.

### Gap risk

Certain products, such as non-recourse margin loans, are not exposed to small day-to-day moves in market rates or prices, but are exposed to large discontinuous moves. Such movements may occur, for example, when, in reaction to an adverse event or unexpected news announcement, some parts of the market move far beyond their normal volatility range and become temporarily illiquid. Products which exhibit exposure only to large discontinuous moves (gap risk) are not well captured by VaR measures or traditional market risk sensitivity measures. HSBC has implemented additional stress measurement and controls over such products. In 2015 gap risk exposure was primarily due to non-recourse loan transactions, mostly for corporate clients, where the collateral against the loan is limited to the posted assets. Upon occurrence of a gap event, the value of the collateral could fall below the outstanding loan amount.

We did not incur any material gap loss in 2015.

### De-peg risk

For certain currencies (pegged or managed) the spot exchange rate is pegged at a fixed rate (typically to USD or EUR), or managed within a predefined band around a pegged rate. De-peg risk is the risk of the peg or managed band changing or being abolished, and moving to a floating regime.

HSBC has extensive experience in managing fixed and managed currency regimes. Using stressed scenarios on

spot rates, we are able to analyse how de-peg events would impact the positions held by HSBC. We monitor such scenarios to pegged or managed currencies, such as the Hong Kong dollar, RMB and Middle Eastern currencies, and limit any potential losses that would occur. This historical VaR measures, which may not fully capture the risk involved in holding positions in pegged or managed currencies, as such currencies may not have experienced a de-peg event during the historical timeframe used for historical VaR calibration.

### ABS / Mortgage-backed securities ('MBS') exposures

The ABS/MBS exposures within the trading portfolios are managed within sensitivity and VaR limits and are included within the stress testing scenarios described above.

### Non-trading portfolios

#### Value at Risk of the non-trading portfolios

(Audited)

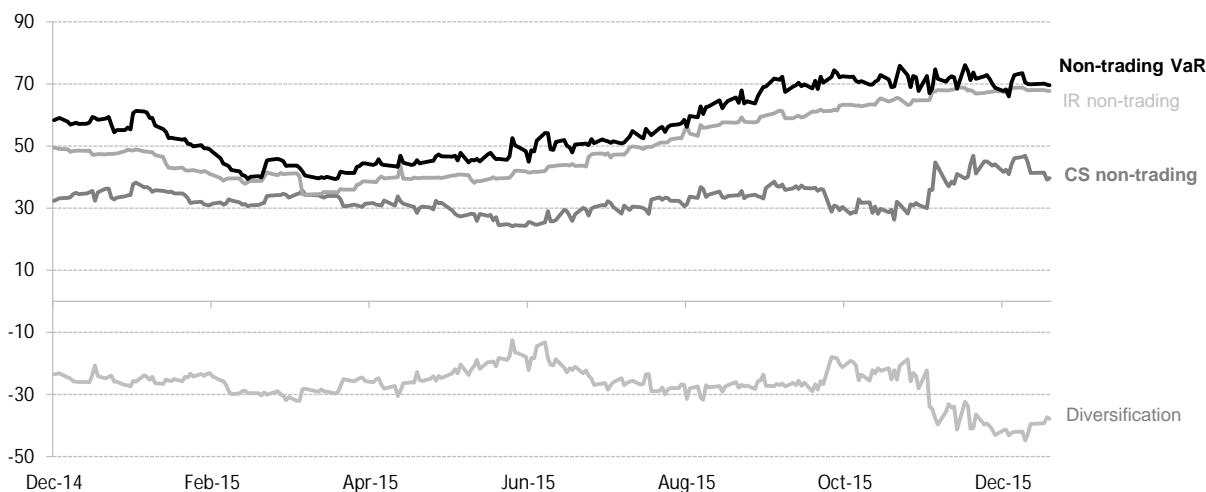
Non-trading VaR of the Group includes contributions from all global businesses. The higher non-trading VaR at the end of 2015 is an increase in interest rate and credit risk from an increase in positions. The increase in non-trading interest rate and credit spread VaR components were offset by an increase in portfolio diversification effects.

The daily levels of total non-trading VaR over the last year are set out in the graph below.

**Report of the Directors: Risk** (continued)

*Daily VaR (non-trading portfolios), 99% 1 day (£m)  
(Audited)*

The group's non-trading VaR for the year is shown in the table below.



*Non-trading value at risk, 99% 1 day  
(Audited)*

	Interest rate £m	Credit spread £m	Portfolio diversification £m	Total £m
<b>At 31 December 2015</b>	<b>67.8</b>	<b>39.7</b>	<b>(37.9)</b>	<b>69.6</b>
Average	50.4	33.0	(26.7)	56.7
Maximum	68.9	46.9		76.1
<b>At 31 December 2014</b>	<b>49.5</b>	<b>32.4</b>	<b>(23.5)</b>	<b>58.4</b>
Average	52.2	31.0	(26.2)	57.0
Maximum	60.1	39.6		63.1

Non-trading VaR also includes the interest rate risk of non-trading financial instruments held by the global businesses and transferred into portfolios managed by BSM or local treasury functions. In measuring, monitoring and managing risk in our non-trading portfolios, VaR is just one of the tools used. The management of interest rate risk in the banking book is described further in 'Non-trading interest rate risk' below, including the role of BSM.

Non-trading VaR excludes equity risk on available-for-sale securities, structural foreign exchange risk, and interest rate risk on fixed rate securities issued by the group, the scope and management of which are described in the relevant sections below.

The group's control of market risk in the non-trading portfolios is based on transferring the assessed market risk of non-trading assets and liabilities created outside BSM or Markets, to the books managed by BSM, provided the market risk can be neutralised. The net exposure is typically managed by BSM through the use of fixed rate government bonds (liquid asset held in available-for-sale books) and interest rate swaps. The interest rate risk arising from fixed rate government bonds held within available-for-sale portfolios is reflected within the group's non-traded VaR. Interest rate swaps used by BSM are typically classified as either a fair value hedge or a cash flow hedge and included within the group's non-traded VaR. Any market risk that cannot be neutralised in the market is managed by local ALCO in segregated ALCO books.

The funds transfer pricing policies give rise to a two stage funds transfer pricing approach. For details see page 52.

**Fixed-rate securities**

The principal non-trading risk which is not included in the VaR reported for GB&M arises out of Fixed Rate Subordinated Notes. The VaR related to these instruments was £28.6 million at 31 December 2015 (2014: £19.4 million); while the average and maximum during the year was £25.4 million and £28.6 million respectively (2014: £17.5 million and £23.9 million).

**Equity securities held as available-for-sale**

Potential new commitments are subject to risk appraisal to ensure that industry and geographical concentrations remain within acceptable levels for the portfolio. Regular reviews are performed to substantiate the valuation of the investments within the portfolio and investments held to facilitate on-going business, such as holdings in government-sponsored enterprises and local stock exchanges.

Market risk arises on equity securities held as available-for-sale. The fair value of these securities at 31 December 2015 was £1,109 million (2014: £1,009 million).

The fair value of the constituents of equity securities held as available-for-sale can fluctuate considerably. For details of the impairment incurred on available-for-sale equity securities see the accounting policies in Note 1(i).

## Report of the Directors: Risk (continued)

### Structural foreign exchange exposures

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

Unrealised gains or losses due to revaluations of structured foreign exchange exposures are recognised in other comprehensive income, whereas other unrealised gains or losses arising from revaluations of foreign exchange positions are reflected in the income statement.

The group's structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that the group's consolidated capital ratios and the capital ratios of individual banking subsidiaries are largely protected from the effect of changes in exchange rates. This is usually achieved by ensuring that, for each subsidiary bank, the ratio of structural exposures in a given currency to risk-weighted assets denominated in that currency is broadly equal to the capital ratio of the subsidiary in question.

For details of structural foreign exchange exposures see Note 31 '*Foreign exchange exposures*'.

### Non-trading interest rate risk

Non-trading interest rate risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts, and the re-pricing behaviour of managed rate products. These assumptions around behavioural features are captured in our interest rate risk behaviouralisation framework, which is described below.

We aim, through our management of market risk in non-trading portfolios, to mitigate the effect of prospective interest rate movements which could reduce future net interest income, while balancing the cost of such hedging activities on the current net revenue stream.

### Interest rate risk behaviouralisation

Unlike liquidity risk which is assessed on the basis of a very severe stress scenario, non-traded market interest rate risk is assessed and managed according to 'business-as-usual' conditions. In many cases the contractual profile of non-traded assets/liabilities arising from assets/liabilities created outside Markets or BSM does not reflect the behaviour observed. Behaviouralisation is therefore used to assess the market interest rate risk of non-traded assets/liabilities and this assessed market risk is transferred to BSM, in accordance with the rules governing the transfer of interest rate risk from the global businesses to BSM.

Behaviouralisation is applied in three key areas:

- the assessed re-pricing frequency of managed rate balances;
- the assessed duration of non-interest bearing balances, typically capital and current accounts; and

- the base case expected prepayment behaviour or pipeline take-up rate for fixed rate balances with embedded optionality.

Interest rate behaviouralisation policies have to be formulated in line with the Group's behaviouralisation policies and approved at least annually by local ALCO, regional ALCM and Group ALCM, in conjunction with local, regional and Group market risk monitoring teams.

The extent to which balances can be behaviouralised is driven by:

- the amount of the current balance that can be assessed as 'stable' under business-as-usual conditions; and
- for managed rate balances the historic market interest rate re-pricing behaviour observed; or
- for non-interest bearing balances the duration for which the balance is expected to remain under business-as-usual conditions.

### Balance sheet management

Effective governance across BSM is supported by the dual reporting lines it has to the CEO of GB&M and to the Group Treasurer. In each operating entity, BSM is responsible for managing liquidity and funding under the supervision of the local ALCO. It also manages the non-trading interest rate positions transferred to it within a Global Markets limit structure.

In executing the management of the liquidity risk on behalf of ALCO, and managing the non-trading interest rate positions transferred to it, BSM invests in highly-rated liquid assets in line with the Group's liquid asset policy. The majority of the liquidity is invested in central bank deposits and government, supranational and agency securities with most of the remainder held in short-term interbank and central bank loans.

Withdrawable central bank deposits are accounted for as cash balances. Interbank loans, statutory central bank reserves and loans to central banks are accounted for as loans and advances to banks. BSM's holdings of securities are accounted for as available-for-sale assets.

Statutory central bank reserves are not recognised as liquid assets. The statutory reserves that would be released in line with the Group's stressed customer deposit outflow assumptions are reflected as stressed inflows.

BSM is permitted to use derivatives as part of its mandate to manage interest rate risk. Derivative activity is predominantly through the use of vanilla interest rate swaps which are part of cash flow hedging and fair value hedging relationships.

Credit risk in BSM is predominantly limited to short-term bank exposure created by interbank lending, exposure to central banks and high quality sovereigns, supranationals or agencies which constitute the majority of BSM's liquidity portfolio. BSM does not manage the structural credit risk of any Group entity balance sheets.

BSM is permitted to enter into single name and index credit derivatives activity, but it does so to manage credit risk on the exposure specific to its securities portfolio in limited circumstances only. The risk limits are extremely limited and closely monitored. At 31 December 2015 BSM had no open credit derivative index risk.



## Report of the Directors: Risk (continued)

VaR is calculated on both trading and non-trading positions held in BSM. It is calculated by applying the same methodology used for the Markets business and utilised as a tool for market risk control purposes. BSM holds trading portfolio instruments in only very limited circumstances. Positions and the associated VaR were not significant during 2015.

### Sensitivity of net interest income

A principal element of the group's management of market risk in non-trading portfolios is monitoring the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling).

The group applies a combination of scenarios and assumptions relevant to their local businesses, and standard scenarios which are required throughout HSBC. The latter are consolidated to illustrate the combined pro forma effect on the consolidated net interest income.

Projected net interest income sensitivity figures represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and the current interest rate risk profile. This effect, however, does not incorporate actions which would probably be taken by BSM or in the business units to mitigate the effect of interest rate risk. In reality, BSM seeks actively to change the interest rate risk profile to minimise losses and optimise net revenues.

### Defined benefit pension scheme

Market risk also arises within the group's defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows. Refer to Pension Risk section on page 71 for additional information.

## Operational risk

Operational risk is the risk of achieving our strategy or objectives as a result of inadequate or failed internal processes, people and systems or from external events.

Responsibility for minimising operational risk lies with group's management and staff. Each country, global business and functional staff is required to manage the operational risks of the business and operational activities for which they are responsible.

### Operational risk management framework

The Operational Risk Management Framework ('ORMF') is the overarching approach for managing operational risk.

The ORMF ensures that operational risks are fully identified and managed effectively and targeted levels of operational risk within the Group's risk appetite are maintained.

Monitoring operational risk exposure against risk appetite on a regular basis and implementing risk governance drives risk awareness in a forward looking manner and assists management in determining whether further action is required.

Activity to strengthen risk culture and to better embed the use of ORMF continued in 2015. In particular, we continued to streamline operational risk management processes, procedures and tool sets to provide more forward looking risk insights and more effective operation of ORMF.

### Three lines of defence

HSBC has implemented an activity-based Three Lines of Defence model (an industry best practice approach) to underpin the approach in managing operational risk.

- The first line of defence owns the risk and is accountable for identifying, recording, reporting, managing the risks and ensuring that the right controls and assessments are in place to mitigate these risks.
- The second line of defence sets the policy and guidelines for managing risks and provides advice, guidance and challenge to the first line of defence on effective risk management.
- The third line of defence is internal audit which helps the Board and Executive Management to protect the assets, reputation and sustainability of the Group.

### Operational risk in 2015

During 2015, our operational risk profile continued to be dominated by compliance risks (mainly conduct-related) and we continued to see losses that relate to events from prior years (significant events are outlined in Note 27 on the Financial Statements). A number of mitigating actions are being undertaken to prevent future conduct-related incidents.

Other operational risks included:

- *compliance with regulatory agreements and orders*: failure to implement our obligations under the US DPA could have a material adverse effect on our results and operations. The work of the Monitor is discussed on page 20, with compliance risk described below;
- *level of change creating operational complexity*: the Global Risk function is engaged with business management in business transformation initiatives to ensure robust internal controls are maintained as we execute our change agenda;
- *fraud risks*: Our loss prevention performance remains strong in most markets, the introduction of new technologies and ways of banking mean that we continue to be subject to fraud attacks as new attack vectors are developed. We continue to increase monitoring and enhance detective controls to mitigate these risks in accordance with our risk appetite;
- *information security*: the security of our information and technology infrastructure is crucial for maintaining our banking services and protecting our customers and the HSBC brand. We continue to be a target of increasingly sophisticated cyber-attacks such as 'distributed denial of service', in common with other banks and multinational organisations, which can affect the availability of customer-facing websites. Programmes of work are ongoing to further strengthen security controls to prevent unauthorised access to our systems, including lessons learnt from attacks experienced within the industry and information sharing with other financial institutions, government agencies and external intelligence providers. Our UK operation participated in an external penetration testing scheme called CBEST developed by the PRA and aimed at assessing the ability of critical financial institutions to detect and defend against cyber-attacks;

## Report of the Directors: Risk (continued)

- *third-party risk management*: we are strengthening our third-party risk management capability, particularly the management of vendor risks, including the implementation of the supplier performance management programme with our most important suppliers. Attention is also being paid to the screening of suppliers to enable us to identify if any of them are on a sanctions list and we should therefore exit such relationships. Vendor risk management is a core element of third-party risk management.

Other operational risks are also monitored and managed through the use of ORMF.

Operational risks which are detailed in the section below include:

- compliance risk;
- legal risk;
- security and fraud risk; and
- fiduciary risk.

### Compliance risk

Compliance risk arises from activities subject to rules, regulations, policies and other formal standards including those relating to AML, counter-terrorist and proliferation financing, sanctions compliance, anti-bribery and corruption, conduct of business and other regulations.

#### AML and sanctions

Revised global AML and sanctions policies were approved in 2014. During 2015, global businesses and countries introduced new AML and sanctions procedures, arising from the new policies and focused on embedding the procedures required to effect these policies in our day to day business operations globally. This supported our ongoing effort to address the US DPA requirements. These actions were in line with our strategic target to implement the highest or most effective standards globally.

#### Anti-Bribery and Corruption ('ABC')

It is unethical, illegal, and contrary to good corporate governance to bribe or corrupt others. The Group is committed to preventing bribery and corruption, and to consistently applying the letter and spirit of applicable anti-bribery legislation in all markets and jurisdictions in which it operates. We have implemented a strategic programme to address bribery and corruption risks and are embedding a new global suite of policies that make it clear to all staff that Group members, employees or other associated persons or entities must not engage in, or otherwise facilitate, any form of bribery, whether direct or indirect.

The ABC programme, from training to risk assessment, emphasises the importance of consistent and standardised procedure to drive the principles of "detect, deter and protect" and ensure that they are incorporated in every aspect of business-as-usual activities.

#### Conduct of business

We recognise that delivering fair outcomes for our customers and upholding financial market integrity is critical to a sustainable business model. We have taken a number of steps to raise our standards and deal with historical incidents, including the following:

- we published a new Global Conduct Policy in 2015 (following the approval and implementation of the

global conduct approach and framework in 2014) for the management of conduct designed to ensure that we meet our strategic commitment to deliver fair outcomes for our customers, and not to disrupt the orderly and transparent operation of financial markets;

- we launched communications programmes and global mandatory training in respect of conduct and the Group's required values and behaviours;
- we enhanced the product governance process to further ensure products are designed to meet customers' needs and are sold to suitable customer groups. Post implementation and regular reviews are undertaken to ensure products remain appropriate;
- we reviewed the sales processes and sales incentive schemes, focusing on activity and rewards linked to values-based behaviour and good conduct;
- we enhanced our surveillance capabilities and tested new technologies to strengthen our capabilities to detect suspicious trading activity and misconduct;
- we undertook proactive internal reviews of our involvement in the benchmarking processes for rates and commodities; and
- we reviewed our insights on customer experience, our analysis of the root cause of complaints and our complaint handling to ensure we continually improve and deliver better outcomes for our customers.

Global businesses use a broad range of measures appropriate to their specific customer base and markets to assess ongoing effectiveness of the management of conduct, and enable actions to be taken where potential conduct issues arise. The measures include information relating to sales quality, customer experience and market behaviour.

The Conduct and Values Committee ('CVC') provides oversight on multiple efforts to raise standards of conduct and embed the behavioural values we stand for.

#### Whistleblowing

We actively encourage our employees to raise concerns and escalate issues so they can be dealt with effectively. In most cases, individuals will raise their concerns with line management or Human Resources. However, where an individual believes that their normal reporting channels are unavailable or inappropriate, it is important that they have alternative channels available to them to raise concerns confidentially without fear of personal repercussions. This is referred to as 'whistleblowing'.

To make whistleblowing simpler for our employees, we launched HSBC Confidential across the Group in August 2015 to provide a global platform offering telephone, email, web and mail options for whistle blowers and bring together all our other whistleblowing channels.

We also maintain an external email address for complaints regarding accounting and internal financial controls or auditing matters ([accountingdisclosures@hsbc.com](mailto:accountingdisclosures@hsbc.com)). Matters raised are independently investigated by appropriate subject matter teams and details of investigations and outcomes including remedial action taken are reported to the CVC. Matters raised in respect of audit, accounting and internal control over financial reporting are reported to the Audit Committee.

## Report of the Directors: Risk (continued)

### Legal risk

Each operating company is required to have processes and procedures to manage legal risk that conform to Group standards. Legal risk falls within the definition of operational risk and includes:

- contractual risk, which is the risk of a group company suffering financial loss, legal or regulatory action or reputational damage because its rights and/or obligations under a contract to which it is a party are technically defective;
- dispute adjudication risk, which is the risk of a group company suffering financial loss or reputational damage due to adverse dispute environment and/or mis-management of disputes;
- legislative risk, which is the risk that a group member fails to or is unable to identify, analyse, track, impact assess or correctly interpret applicable legislation, case law or regulation, or new regulatory legislative or doctrinal interpretation of existing laws or regulations or decisions in the Courts or regulatory bodies; and
- non-contractual rights risk, which is the risk that a group company's assets are not properly owned or protected or are infringed by others, or a group company infringes another party's rights.

The group has a legal function, headed by the General Counsel for Europe, to assist management in controlling legal risk. The function provides legal advice, including support in managing claims against the group's companies, as well as in respect of non-routine debt recoveries or other litigation against third parties.

There are legal departments in all the countries in which the group has significant operations.

The group's operating companies must notify the relevant legal department immediately of any actual or threatened litigation or contentious regulatory matter involving a group entity or an employee. Local legal departments must provide appropriate notifications and reports to their regional legal departments in relation to actual or threatened litigation, or contentious regulatory matters. Regional legal departments must provide appropriate notifications and reports to the Group legal function in relation to new contentious regulatory matters, new criminal proceedings, new actual or threatened litigation where the amount claimed is (or is likely to be) at or in excess of USD \$5 million and/or where there is significant reputational risk.

In addition, the group's operating companies are required to submit semi-annual returns detailing among other matters, outstanding claims where the claim (or group of similar claims) exceeds USD \$10 million, where the action is by a regulatory authority, where the proceedings are criminal or might materially affect the group's reputation. These returns are used for reporting to various committees within the group.

### Group security and fraud risk

Security and Fraud Risk, Europe, which has responsibility for physical risk, fraud, information and contingency risk, takes functional direction from Group Security and Fraud Risk. This enables management to identify and mitigate the permutations of these and other non-financial risks across the countries in which the group operates. All group companies manage their risk in accordance with standards set by Security and Fraud Risk, Europe, which also provide expert advice and support.

### Fiduciary risk

Business activities in which fiduciary risk is inherent are only permitted within designated lines of business. Fiduciary risk is managed within the designated businesses via a comprehensive policy framework and monitoring of key indicators. The Group's principal fiduciary businesses /activities are:

- HSBC Securities Services, where it is exposed to fiduciary risk via its Funds Services and Corporate Trust and loan agency activities;
- HSBC Global Asset Management, which is exposed to fiduciary risks via its investment management activities on behalf of clients;
- HSBC Global Private Banking, which is exposed to fiduciary risks via its Private Wealth Services division and discretionary investment management;
- HSBC Insurance, which is exposed to fiduciary risks via the investment management activities it undertakes when providing insurance products and services;
- RBWM Trust Investment Wrappers, required by regulation for the provision of normal RBWM Wealth Management products and services; and
- HSBC Employee Pension Scheme activities, where fiduciary duties may arise as part of carrying out a function of discretion or control over an HSBC Employee pension scheme's operations.

## Report of the Directors: Risk (continued)

### Risk management of insurance operations

*(Audited)*

The majority of the risk in our insurance business derives from manufacturing activities and can be categorised as financial risk and insurance risk. Financial risks include market risk, credit risk and liquidity risk. Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to the issuer (HSBC).

There were no material changes to our policies and practices for the management of risks arising in the insurance operations in 2015.

#### The group's bancassurance model

We operate an integrated bancassurance model which provides insurance products principally for customers with whom the group has a banking relationship. Insurance products are sold through all global businesses, but predominantly by RBWM and CMB, through branches and direct channels.

The insurance contracts the group sells relate to the underlying needs of the group's banking customers, which it can identify from its point-of-sale contacts and customer knowledge. The majority of sales are of savings and investment products and term and credit life contracts. By focusing largely on personal and SME lines of business, the group is able to optimise volumes and diversify individual insurance risks.

Where we have operational scale and risk appetite, mostly in life insurance, these insurance products are manufactured by the group's companies. Manufacturing insurance allows the group to retain the risks and rewards associated with writing insurance contracts by keeping part of the underwriting profit and investment income within the group.

Where we do not have the risk appetite or operational scale to be an effective insurance manufacturer, we engage with a handful of leading external insurance companies in order to provide insurance products to the group's customers through its banking network and direct channels. These arrangements are generally structured with the group's exclusive strategic partners and earn the group a combination of commissions, fees and a share of profits.

Insurance manufacturers set their own control procedures in addition to complying with guidelines issued by the Group Insurance. Country level oversight is exercised by local insurance risk management committees. Country Chief Risk Officers have reporting lines locally and functional reporting lines into the Group Insurance Chief Risk Officer, who has overall accountability for risk management in insurance operations. The Group Insurance Risk Management Committee oversees the framework globally and is accountable to the Group Risk Management Committee on risk matters.

In addition, local ALCOs monitor and review the duration and cash flow matching of insurance assets and liabilities.

All insurance products, whether manufactured internally or by a third party, are subjected to a product approval process prior to introduction.

There have been no material changes to our policies and practices for the management of risks arising in the insurance operations.

#### Risk management of insurance manufacturing operations in 2015

We measure the risk profile of our insurance manufacturing businesses using an economic capital approach, where assets and liabilities are measured on a market value basis and a capital requirement is held to ensure that there is less than a 1 in 200 chance of insolvency over the next year, given the risks that the businesses are exposed to. The methodology for the economic capital calculation is largely aligned to the new pan-European Solvency II insurance capital regulations, which are applicable from 2016.

The risk profile of our life insurance manufacturing businesses did not change materially during 2015 although the disposal of HSBC Life (UK)'s pension business, which was agreed in 2014, was completed in August 2015. This resulted in a reduction of £4 billion of total assets and £4 billion of total liabilities.

#### Financial risks of insurance operations

*(Audited)*

The group's insurance businesses are exposed to a range of financial risks which can be categorised into:

- Market risk – risk arising from changes in the fair values of financial assets or their future cash flows from fluctuations in variables such as interest rates, credit spreads, foreign exchange rates and equity prices;
- Credit risk – the risk of financial loss following the failure of third parties to meet their obligations; and
- Liquidity risk – the risk of not being able to make payments to policyholders as they fall due as there are insufficient assets that can be realised as cash.

Local regulatory requirements prescribe the type, quality and concentration of assets that the group's insurance manufacturing companies must maintain to meet insurance liabilities. These requirements complement Group-wide policies.

The following table analyses the assets held in the group's insurance manufacturing companies by type of contract, and provides a view of the exposure to financial risk. For unit-linked contracts, which pay benefits to policyholders determined by reference to the value of the investments supporting the policies, the group typically designate assets at fair value; for non-linked contracts, the classification of the assets is driven by the nature of the underlying contract.

**Report of the Directors: Risk** (continued)*Financial assets held by insurance manufacturing subsidiaries  
(Audited)*

	2015			
	Unit-linked contracts <sup>1</sup> £m	Non-linked contracts <sup>2</sup> £m	Other assets <sup>3</sup> £m	Total £m
Financial assets designated at fair value				
Debt securities	304	710	22	1,036
Equity securities	1,344	3,883	485	5,712
	<b>1,648</b>	<b>4,593</b>	<b>507</b>	<b>6,748</b>
Financial investments - available-for-sale				
Debt securities	-	9,176	713	9,889
Equity securities	-	-	-	-
	<b>-</b>	<b>9,176</b>	<b>713</b>	<b>9,889</b>
Derivatives	1	75	34	110
Other financial assets	147	1,445	152	1,744
At 31 December	<b>1,796</b>	<b>15,289</b>	<b>1,406</b>	<b>18,491</b>
	2014			
	Unit-linked contracts <sup>1</sup> £m	Non-linked contracts <sup>2</sup> £m	Other assets <sup>3</sup> £m	Total £m
Financial assets designated at fair value				
Debt securities	369	554	28	951
Equity securities	1,315	3,854	686	5,855
	<b>1,684</b>	<b>4,408</b>	<b>714</b>	<b>6,806</b>
Financial investments - available-for-sale				
Debt securities	-	10,157	716	10,873
Equity securities	-	-	-	-
	<b>-</b>	<b>10,157</b>	<b>716</b>	<b>10,873</b>
Derivatives	-	65	45	110
Other financial assets	215	1,538	209	1,962
At 31 December	<b>1,899</b>	<b>16,168</b>	<b>1,684</b>	<b>19,751</b>

1. Comprise unit-linked life insurance contracts and linked long-term investment contracts.

2. Comprise all insurance and long-term investment contracts other than those classified as unit-linked.

3. Comprise mainly loans and advances to banks, cash and intercompany balances with other non-insurance legal entities.

Approximately 59 per cent of financial assets were invested in debt securities at 31 December 2015 (2014: 60 per cent), with 31 per cent (2014: 30 per cent) invested in equity securities.

Under unit-linked contracts, premium income less charges levied is invested in a portfolio of assets. The group manages the financial risks of this product on behalf of the policyholders by holding appropriate assets in segregated funds or portfolios to which the liabilities are linked. These assets represented 10 per cent of the total financial assets of the group's insurance manufacturing companies at the end of 2015 (2014: 10 per cent).

The remaining financial risks are managed either solely on behalf of the shareholder, or jointly on behalf of the shareholder and policyholders where discretionary participation features exist.

**Market risk of insurance operations**

*(Audited)*

Market risk arises when mismatches occur between product liabilities and the investment assets which back them. For example, mismatches between asset and liability yields and maturities give rise to interest rate risk.

The main features of products manufactured by the group's insurance manufacturing companies which generate market risk, and the market risk to which these features expose the companies, are discussed below.

Long-term insurance or investment products may incorporate benefits that are guaranteed. Interest rate risk arises to the extent that yields on the assets supporting guaranteed investment returns are lower than the investment returns implied by the guarantees payable to policyholders.

## Report of the Directors: Risk (continued)

The following table illustrates the effect of selected interest rates and equity price scenarios on the profits for the year and total equity of insurance manufacturing subsidiaries.

Where appropriate, the impact of the stress on the present value of the in-force long-term insurance business asset ('PVIF') is included in the results of the sensitivity tests. The relationship between the profit and total equity and the risk factors is non-linear and, therefore, the results disclosed should not be extrapolated to measure sensitivities to different levels of stress. For the same reason, the impact of the stress is not symmetrical on the upside and downside. The sensitivities are stated before allowance for management actions which may mitigate the

effect of changes in the market environment. The sensitivities presented allow for adverse changes in policyholder behaviour that may arise in response to changes in market rates.

The effects of +/-100 basis points parallel shifts in yield curves have decreased from 2014 to 2015, driven mainly by rising yields and updates to interest rate parameters in France. In a low yield environment the projected cost of options and guarantees described above is particularly sensitive to yield curve movements. The market value of available-for-sale bonds is also sensitive to yield curve movements hence the larger opposite stresses on equity.

### Sensitivity of the group's insurance companies to market risk factors (Audited)

	2015		2014	
	Effect on profit after tax £m	Effect on total equity £m	Effect on profit after tax £m	Effect on total equity £m
+ 100 basis points parallel shift in yield curves	10	1	62	52
- 100 basis points parallel shift in yield curves <sup>1</sup>	(61)	(50)	(205)	(196)
10 per cent increase in equity prices	12	12	18	18
10 per cent decrease in equity prices	(12)	(12)	(20)	(20)

<sup>1</sup> Where a -100 basis point parallel shift in the yield curve would result in a negative interest rate, the effect on profit after tax and total equity has been calculated using a minimum rate of 0 per cent.

### Credit quality (Audited)

The following table presents an analysis of treasury bills, other eligible bills and debt securities within the group's insurance business by internal measures of credit quality. The five credit quality classifications are defined on page 32. Only assets supporting liabilities under non-linked

insurance and investment contracts and shareholders' funds are included in the table, as financial risk on assets supporting unit-linked liabilities is predominantly borne by the policyholder; 80 per cent (2014: 86 per cent) of the assets included in the table are invested in investments rated as 'Strong'.

### Treasury bills, other eligible bills and debt securities in the group's insurance manufacturing companies (Audited)

	2015			2014		
	Strong £m	Good/ Satisfactory £m	Total <sup>2</sup> £m	Strong £m	Good/ Satisfactory £m	Total <sup>2</sup> £m
Financial assets designated at fair value <sup>1</sup>	450	282	732	446	135	581
- treasury and other eligible bills	-	-	-	3	-	3
- debt securities	450	282	732	443	135	578
Financial investments	8,019	1,870	9,889	9,350	1,522	10,872
- treasury and other similar bills	-	-	-	-	-	-
- debt securities	8,019	1,870	9,889	9,350	1,522	10,872
At 31 December	8,469	2,152	10,621	9,796	1,657	11,453

<sup>1</sup> Impairment is not measured for debt securities designated at fair value, as assets in such portfolios are managed according to movements in fair value, and the fair value movement is taken directly through the income statement.

<sup>2</sup> Total is the maximum exposure to credit risk on the treasury bills, other eligible bills and debt securities in the group's insurance companies.

Credit risk also arises when assumed insurance risk is ceded to reinsurers. The split of liabilities ceded to reinsurers and outstanding reinsurance recoveries, analysed by credit quality, is shown below. The group's exposure to third parties under the reinsurance agreements is included in this table.

## Report of the Directors: Risk (continued)

### Reinsurers' share of liabilities under insurance contracts (Audited)

	Strong £m	Good/ Satisfactory £m	Past due not impaired £m	Total <sup>1,2</sup> £m
Unit-linked insurance contracts	56	–	–	56
Non-linked insurance contracts <sup>3</sup>	125	1	–	126
<b>At 31 December 2015</b>	<b>181</b>	<b>1</b>	<b>–</b>	<b>182</b>
Reinsurance debtors	6	–	5	11
Unit-linked insurance contracts	47	–	–	47
Non-linked insurance contracts <sup>3</sup>	140	2	–	142
<b>At 31 December 2014</b>	<b>187</b>	<b>2</b>	<b>–</b>	<b>189</b>
Reinsurance debtors	4	–	4	8

1 No amounts reported within Reinsurers' share of liabilities under insurance contracts were classified as sub-standard or impaired.

2 Total is the maximum exposure to credit risk in respect of reinsurers' share of liabilities under insurance contracts.

3 'Non-linked insurance' comprises all insurance contracts other than unit-linked.

### Liquidity risk of insurance operations

(Audited)

The following tables show the expected undiscounted cash flows for insurance contract liabilities and the remaining contractual maturity of investment contract liabilities at 31 December 2015. The liquidity risk exposure is borne in conjunction with policyholders for the majority of the business, and wholly borne by the policyholder in the case of unit-linked business.

The profile of the expected maturity of the insurance contracts at 31 December 2015 remained comparable with 2014.

### Expected maturity of insurance contract liabilities (Audited)

	Expected cash flows (undiscounted)				Total £m
	Within 1 year £m	1-5 years £m	5-15 years £m	Over 15 years £m	
Non-linked insurance <sup>1</sup>	55	140	203	149	547
Unit-linked insurance	157	294	344	251	1,046
<b>At 31 December 2015</b>	<b>212</b>	<b>434</b>	<b>547</b>	<b>400</b>	<b>1,593</b>
Non-linked insurance <sup>1</sup>	22	145	211	149	527
Unit-linked insurance	89	279	400	337	1,105
<b>At 31 December 2014</b>	<b>111</b>	<b>424</b>	<b>611</b>	<b>486</b>	<b>1,632</b>

1 'Non-linked insurance' comprises all insurance contracts other than unit-linked.

### Remaining contractual maturity of investment contract liabilities (Audited)

	Liabilities under investment contracts by insurance underwriting subsidiaries				
	Undated <sup>1</sup> £m	Within 1 year £m	1-5 years £m	Over 5 years £m	Total £m
Unit-linked investment contracts	–	267	78	583	928
Investment contracts with discretionary participation features ('DPFs')	15,254	–	–	–	15,254
<b>At 31 December 2015</b>	<b>15,254</b>	<b>267</b>	<b>78</b>	<b>583</b>	<b>16,182</b>
Unit-linked investment contracts	–	301	84	631	1,016
Investment contracts with discretionary participation features ('DPFs')	16,083	–	–	–	16,083
<b>At 31 December 2014</b>	<b>16,083</b>	<b>301</b>	<b>84</b>	<b>631</b>	<b>17,099</b>

1 In most cases, policyholders have the option to terminate their contracts at any time and receive the surrender values of their policies. These may be significantly lower than the amounts shown.

## Report of the Directors: Risk (continued)

### Insurance risk

Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to the issuer (i.e. HSBC). It is principally measured in terms of liabilities under the contracts in force.

The principal risk we face is that, over time, the cost of the contract, including claims and benefits may exceed the total amount of premiums and investment income received. The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, lapse and surrender rates. The following table analyses our life insurance risk exposures by geographical region and by type of business. The insurance risk profile and related exposures remain largely consistent with those observed at 31 December 2014.

#### Analysis of insurance risk – liabilities under insurance contracts (Audited)

	2015	2014
	£m	£m
Non-linked insurance <sup>1</sup>		
– Insurance contracts with DPF <sup>2</sup>	232	235
– Credit life	33	36
– Annuities	47	45
– Term assurance and other long-term contracts	194	215
Total non-linked insurance	506	531
Unit-linked insurance	904	908
Investment contracts with DPF <sup>2,3</sup>	15,254	16,083
Liabilities under insurance contracts	16,664	17,522

1 'Non-linked insurance' comprises all insurance contracts other than unit-linked.

2 Insurance contracts and investment contracts with discretionary participation features ('DPF's) can give policyholders the contractual right to receive, as a supplement to their guaranteed benefits, additional benefits that may be a significant portion of the total contractual benefits, but whose amount or timing is contractually at the discretion of the group. These additional benefits are contractually based on the performance of a specified pool of contracts or assets, or the profit of the company issuing the contracts.

3 Although investment contracts with DPFs are financial investments, the group continues to account for them as insurance contracts as required by IFRS 4 'Insurance Contracts'. The corresponding liabilities are therefore recorded as 'liabilities under insurance contracts'.

### Sensitivities to non-economic assumptions

The group's life insurance business is accounted for using the embedded value approach which, inter alia, provides a risk and valuation framework. The sensitivity of the PVIF asset to changes in economic and non-economic assumptions is described in Note 21.

### Other material risks

#### Reputational risk

Reputational risk is the failure to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by HSBC itself, our employees or those with whom we are associated, that might cause stakeholders to form a negative view of HSBC.

Reputational risk relates to perceptions, whether based on fact or otherwise. Stakeholders' expectations are

constantly changing and thus reputational risk is dynamic and varies between geographies, groups and individuals. As a global bank, HSBC shows unwavering commitment to operate, and be seen to be operating, to the high standards we have set for ourselves in every jurisdiction. Reputational risk might result in financial or non-financial impacts, loss of confidence, adverse effects on our ability to keep and attract customers, or other consequences. Any lapse in standards of integrity, compliance, customer service or operating efficiency represents a potential reputational risk.

A number of measures to address the requirements of the DPAs and otherwise to enhance our AML and sanctions compliance framework have been taken and/or are ongoing. These measures, which should also serve over time to enhance our reputational risk management, include the following:

- simplifying our business through the ongoing implementation of our Group strategy, including the adoption of a global financial crime risk filter, which should help to standardise our approach to doing business in higher risk countries;
- a substantial increase in resources and investment allocated to the two Compliance sub-functions;
- an increase in dedicated reputational risk resources in each region in which we operate and the introduction of a central case management and tracking process for reputational risk and client relationship matters; the creation of combined Reputational Risk and Client Selection committees within the global businesses with a clear process to escalate and address matters at the appropriate level;
- the continued roll-out of training and communication about the HSBC Values programme that defines the way everyone in the Group should act and seeks to ensure that the Values are embedded into our business as usual operations; and
- the ongoing development and implementation of the Global Standards around financial crime compliance, which underpin our businesses. This includes ensuring globally consistent application of policies that govern AML and sanctions compliance provisions.

In July 2014, the new Reputational Risk and Customer Selection policies were issued which defines a consistent and structured approach to managing these risks:

- *Reputational Risk (new policy)*: defines reputational risk and sets out HSBC's approach to managing it.
- *Customer Selection and Business Acceptance (new policy)*: outlines the risk factors to be considered when a new customer relationship is identified.
- *Customer Selection and Exit Management*: establishes the globally sustainable approach to customer selection and exit management for all accounts and relationships in all business lines. This details the criteria under which escalation or approval is required.
- *Sixth Filter*: customers operating in high risk jurisdictions carry particular financial crime risks and may require specific approvals, or be considered for an exit, if the relationship exceeds HSBC's global risk appetite.



## Report of the Directors: Risk (continued)

HSBC has a zero tolerance for knowingly engaging in any business, activity or association where foreseeable reputational damage has not been considered and mitigated. There must be no barriers to open discussion and the escalation of issues that could impact negatively on HSBC. While there is a level of risk in every aspect of business activity, appropriate consideration of potential harm to HSBC's good name must be a part of all business decisions.

Detecting and preventing illicit actors' access to the global financial system calls for constant vigilance and HSBC will continue to cooperate closely with all governments to achieve success. This is integral to the execution of our strategy, to HSBC Values and to preserving and enhancing our reputation.

### Pension risk

Pension risk is the risk that contributions from Group companies and members fail to generate sufficient funds to meet the cost of accruing benefits for the future service of active members, and the risk that the performance of assets held in pension funds is insufficient to cover existing pension liabilities. Pension risk arises from investments delivering an inadequate return, economic conditions leading to corporate failures, adverse changes in interest rates or inflation, or members living longer than expected (longevity risk).

The group operates a number of pension plans throughout Europe. Some of them are defined benefit plans, of which the largest is the HSBC Bank (UK) Pension Scheme ('the principal plan') which has both defined benefit and defined contribution sections. The principal plan accounts for approximately 97% of the obligations of the group's defined benefit pension plans.

The Global Pensions Oversight Committee oversees the running of all pension plans and is responsible for the global pension risk framework and accompanying policies on the management of risks in both defined benefit and defined contribution plans. In order to fund the benefits associated with these plans, group companies (and, in some instances, employees) make regular contributions in accordance with advice from actuaries and in consultation with the scheme's trustees (where relevant). The defined benefit plans invest these contributions in a range of investments designed to meet their long-term liabilities.

The level of these contributions has a direct impact on the group's cash flow and is set to ensure that there are sufficient funds to meet the cost of the accruing benefits for the future service of active members. Higher contributions will be required when plan assets are considered insufficient to cover the existing pension liabilities as a deficit exists. Contribution rates are typically revised annually or triennially, depending on the plan. The agreed contributions to the principal plan are revised triennially. A deficit in a defined benefit plan may arise from a number of factors, including:

- investments delivering a return below that required to provide the projected plan benefits. This could arise, for example, when there is a fall in the market value of equities, or when increases in long-term interest rates cause a fall in the value of fixed income securities held; the prevailing economic environment leading to

corporate failures, thus triggering write-downs in asset values (both equity and debt);

- a change in either interest rates or inflation which causes an increase in the value of the scheme liabilities; and
- scheme members living longer than expected (known as longevity risk).

A plan's investment strategy is determined after taking into consideration the market risk inherent in the investments and its consequential impact on potential future contributions. The long-term investment objectives of both the group and, where relevant and appropriate, the trustees are:

- to limit the risk of the assets failing to meet the liabilities of the plans over the long-term; and
- to maximise returns consistent with an acceptable level of risk so as to control the long-term costs of the defined benefit plans.

In pursuit of these long-term objectives, a benchmark is established for the allocation of the defined benefit plan assets between asset classes. In addition, each permitted asset class has its own benchmarks, such as stock market or property valuation indices and, where relevant, desired levels of out-performance. The benchmarks are reviewed at least triennially within 18 months of the date at which an actuarial valuation is made, or more frequently if required by local legislation or circumstances. The process generally involves an extensive asset and liability review.

Ultimate responsibility for investment strategy rests with either the trustees or, in certain circumstances, a management committee. The degree of independence of the trustees from the group varies in different jurisdictions. The principal is overseen by an independent corporate trustee who has a fiduciary responsibility for the operation of the pension plan. The investment strategy of the principal plan is to hold the majority of assets in bonds, with the remainder in a more diverse range of investments, and includes a portfolio of interest rate and inflation swaps in order to reduce interest rate risk and inflation risk.

The principal plan has both defined benefit and defined contribution sections. All new employees have joined the defined contribution section since 1996 and from 1 July 2015 the defined benefit section was fully closed to future accrual so that all future pension provision for all employees is provided by the defined contribution section. The principal plan is overseen by an independent corporate trustee who has a fiduciary responsibility for the operation of the pension plan. The trustee is responsible for monitoring and managing the investment strategy and administration of scheme benefits. The principal plan holds a diversified portfolio of investments to meet future cash flow liabilities arising from accrued benefits as they fall due to be paid. The trustee of the principal plan is required to produce a written Statement of Investment Principles which governs decision-making about how investments are made and the need for adequate diversification is taken into account in the choice of asset allocation and manager structure in the defined benefit section. Longevity risk in the principal plan is assessed as part of the measurement of the pension liability and managed through the funding process of the plan.

## Report of the Directors: Capital

### Capital management

#### Approach and policy

*(Audited)*

Our approach to capital management is driven by our strategic and organisational requirements, taking into account the regulatory, economic and commercial environment in which we operate.

It is our objective to maintain a strong capital base to support the development of our business and to exceed regulatory capital requirements at all times. To achieve this, we manage our capital within the context of an annual capital plan which is approved by the Board and which determines the optimal amount and mix of capital required to support planned business growth and meet local regulatory capital requirements.

Our policy on capital management is underpinned by the capital management framework and our internal capital adequacy assessment process, which enables the group to manage its capital in a consistent manner. The framework incorporates a number of different capital measures which govern the management and allocation of capital within the group. These capital measures include invested capital, economic capital and regulatory capital defined by the group as follows:

- invested capital is the equity capital provided to the bank by HSBC;
- economic capital is the internally calculated capital requirement which is deemed necessary by the group to support the risks to which it is exposed; and
- regulatory capital is the minimum level of capital which the group is required to hold in accordance with the rules established by the PRA for the bank and the group and by the local regulators for individual subsidiary companies.

The following risks managed through the capital management framework have been identified as material: credit, market, operational, interest rate risk in the banking book, pensions, insurance and residual risks.

#### Stress testing

Stress testing is incorporated into the capital management framework and is an important component of understanding the sensitivities of the core assumptions in the group's capital plans to the adverse effect of extreme, but plausible, events. Stress testing allows senior management to formulate its response, including risk mitigating actions, in advance of conditions starting to reflect the stress scenarios identified. The actual market stresses experienced by the financial system in recent years have been used to inform the capital planning process and further develop the stress scenarios employed by the group in its internal stress tests.

Other stress tests are also carried out, both at the request of regulators and by the regulators themselves using their prescribed assumptions. The group takes into account the results of all such regulatory stress testing when assessing its internal capital requirements.

#### Risks to capital

Outside of the stress-testing framework, a list of principal risks is regularly evaluated for their effect on our capital ratios. In addition, other risks may be identified which have

the potential to affect our RWAs and/or capital position. The downside or upside scenarios are assessed against our capital management objectives and mitigating actions are assigned as necessary.

The group's approach to managing its capital position has been to ensure the bank, its regulated subsidiaries and the group exceeded current regulatory requirements and it is well placed to meet expected future capital requirements.

#### Risk-weighted asset targets

RWA targets for our global businesses are established in accordance with the Group's strategic direction and risk appetite, and approved through the Group's annual planning process. As these targets are deployed to lower levels of management, action plans for implementation are developed. These may include growth strategies; active portfolio management; restructuring; business and/or customer-level reviews; RWA accuracy and allocation initiatives and risk mitigation.

Business performance against RWA targets is monitored through regular reporting to the Asset & Liability Management Committee.

#### Capital generation

HSBC Holdings plc is the sole provider of equity capital to the group and also provides non-equity capital where necessary. Capital generated in excess of planned requirements is returned to HSBC Holdings plc in the form of dividends.

#### Capital measurement

The PRA is the supervisor of the bank and lead supervisor of the group. The PRA sets capital requirements and receives information on the capital adequacy of the bank and the group. The bank and the group complied with the PRA's capital adequacy requirements throughout 2015.

Individual banking subsidiaries are directly regulated by their local banking supervisors, who set and monitor their capital adequacy requirements. Since 1 January 2014, our capital at group level is calculated under CRD IV and supplemented by the PRA Rulebook to effect the transposition of CRD IV directive requirements.

Our policy and practice in capital measurement and allocation at the group level is underpinned by the CRD IV rules. In most jurisdictions, non-banking financial subsidiaries are also subject to the supervision and capital requirements of local regulatory authorities.

The Basel III framework, similarly to Basel II, is structured around three 'pillars': minimum capital requirements, supervisory review process and market discipline. Basel III also introduces a number of capital buffers, including the Capital Conservation Buffer ('CCB'), Countercyclical Capital Buffer ('CCyB'), and other systemic buffers such as the Globally/Other Systemically Important Institutions ('G-SII'/'O-SII') buffer. CRD IV legislation implemented Basel III in the EU, and in the UK, the 'PRA Rulebook' for CRR Firms transposed the various national discretions under the CRD IV legislation into UK requirements.

## Report of the Directors: Capital (continued)

### Regulatory capital

Our capital base is divided into three main categories, namely common equity tier 1, additional tier 1 and tier 2, depending on their characteristics.

- Common equity tier 1 ('CET 1') capital is the highest quality form of capital, comprising shareholders' equity and related non-controlling interests (subject to limits). Under CRD IV various capital deductions and regulatory adjustments are made against these items, these include deductions for goodwill and intangible assets, deferred tax assets that rely on future profitability, negative amounts resulting from the calculation of expected loss amounts under internal ratings based ('IRB') approach and surplus defined benefit pension fund assets.
- Additional tier 1 capital comprises eligible non-common equity capital securities and any related share premium; it also includes other qualifying securities issued by subsidiaries subject to certain limits. Holdings of additional tier 1 securities of financial sector entities are deducted from our additional tier 1 capital.
- Tier 2 capital comprises eligible capital securities and any related share premium and other qualifying tier 2 capital securities issued by subsidiaries, subject to limits. Holdings of tier 2 capital securities of financial sector entities are deducted from our tier 2 capital.

### Pillar 1 capital requirements

Pillar 1 covers the capital resources requirements for credit risk, market risk and operational risk. Credit risk includes counterparty credit risk and securitisation requirements. These requirements are expressed in terms of RWAs.

#### Credit risk capital requirements

CRD IV applies three approaches of increasing sophistication to the calculation of Pillar 1 credit risk capital requirements. The most basic, the standardised approach, requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties. Other counterparties are grouped into broad categories and standardised risk weightings are applied to these categories. The next level, the IRB foundation approach, allows banks to calculate their credit risk capital requirements on the basis of their internal assessment of a counterparty's PD, but the estimates of exposure at default ('EAD') and loss given default ('LGD') are subject to standard supervisory parameters. Finally, the IRB advanced approach allows banks to use their own internal assessment in both determining PD and quantifying EAD and LGD.

The capital resources requirement, which is intended to cover unexpected losses, is derived from a formula specified in the regulatory rules which incorporates PD, LGD, EAD and other variables such as maturity and correlation. Expected losses are calculated by multiplying PD by EAD and LGD. Expected losses are deducted from capital to the extent that they exceed total accounting impairment allowances.

For credit risk we have adopted the IRB advanced approach for the majority of our portfolios, with the remainder on either IRB foundation or standardised approaches.

Under the Group's CRD IV roll-out plans, a number of subsidiary companies and portfolios are in transition to IRB

approaches. At the end of 2015, a number of portfolios in subsidiaries were on advanced IRB approaches as well as our sovereigns, banks and large corporate exposures. Other portfolios remain on the foundation, or standardised approach.

#### Counterparty credit risk ('CCR')

CCR arises for OTC derivatives and securities financing transactions. It is calculated in both the trading and non-trading books and is the risk that the counterparty to a transaction may default before completing the satisfactory settlement of the transaction. Three approaches to calculating CCR and determining exposure values are defined by CRD IV: standardised, mark-to-market and internal model method. These exposure values are used to determine capital requirements under one of the credit risk approaches: standardised, IRB foundation and IRB advanced.

We use the mark-to-market and internal model method approaches for CCR.

In addition, CRD IV applies a capital requirement for CVA risk. Where we have both specific risk VaR approval and internal model method approval for a product, the CVA VaR approach has been used to calculate the CVA capital requirement. Where we do not hold both approvals, the standardised approach has been applied. Certain counterparty exposures are exempt from CVA, such as non-financial counterparties and sovereign.

#### Securitisation

Securitisation positions are held in both the trading and non-trading books. For non-trading book securitisation positions, CRD IV specifies two methods for calculating credit risk requirements, the standardised and the IRB approaches. Both rely on the mapping of rating agency credit ratings to risk weights, which range from 7 per cent to 1,250 per cent.

Within the IRB approach, we use the ratings-based method for the majority of our non-trading book securitisation positions, and the internal assessment approach for exposures arising from asset-backed CP programmes, mainly related to liquidity facilities and programme wide enhancement.

The majority of securitisation positions in the trading book are risk weighted for capital purposes as though they are held in the non-trading book under the standardised or IRB approaches.

#### Market risk capital requirement

The market risk capital requirement is measured using internal market risk models where approved by the PRA, or the standard rules of CRD IV. Our internal market risk models comprise VaR, stressed VaR and incremental risk charge.

#### Operational risk capital requirement

CRD IV includes a capital requirement for operational risk, again utilising three levels of sophistication. The capital required under the basic indicator approach is a simple percentage of gross revenues, whereas under the standardised approach it is one of three different percentages of total operating income less insurance premiums allocated to each of eight defined business lines. Both these approaches use an average of the last three

## Report of the Directors: Capital (continued)

financial years' revenues. Finally, the advanced measurement approach uses banks' own statistical analysis and modelling of operational risk data to determine capital requirements. We have adopted the standardised approach in determining our operational risk capital requirements.

### Pillar 2 capital requirements

We conduct an internal capital adequacy assessment process ('ICAAP') to determine a forward looking assessment of our capital requirements given our business strategy, risk profile, risk appetite and capital plan. This process incorporates the group's risk management processes and governance framework. As part of our ICAAP, a range of stress tests are applied to our base capital plan. These, coupled with our economic capital framework and other risk management practices, are used to assess our internal capital adequacy requirements.

The ICAAP is examined by the PRA as part of its supervisory review and evaluation process ('SREP'), which occurs periodically to enable the regulator to define the individual capital guidance ('ICG') or minimum capital requirements for the group and our capital planning buffer where applicable. Under the PRA's revised Pillar 2 regime, which came into effect from 1 January 2016, the capital planning buffer was replaced with a PRA buffer. This is not intended to duplicate the CRD IV buffers, and where necessary will be set according to the vulnerability of a bank in stress scenario, as assessed through the annual PRA stress testing exercise.

### CRD IV capital buffers

CRD IV established a number of capital buffers which apply in addition to Pillar 1 and Pillar 2 requirements, and are broadly aligned with the Basel III framework. This includes the CCB, the CCyB and the G-SII/O-SII. With the exception of the CCyB which applies with immediate effect, CRD IV capital buffers are being phased in from 1 January 2016. CRD IV also introduced other capital buffers such as the systemic risk buffer ('SRB') which has not yet been fully implemented by the PRA.

- CCB – the capital conservation buffer is designed to ensure banks build up capital outside periods of stress that can be drawn down when losses are incurred and is set at 2.5 per cent of RWAs across all banks, which is to be phased in from 1 January 2016. At 1 January 2016, our CCB was 0.625 per cent.
- CCyB – the countercyclical capital buffer is set on an institution specific basis and is calculated according to the geographic location of relevant exposures. It is a macro-prudential tool designed to protect against future losses where unsustainable levels of leverage, debt or credit growth pose a systemic threat. In the UK, the CCyB was introduced from January 2014, and the FPC as the designated authority, sets the rate for UK exposures on a quarterly basis. Thus far, the CCyB rate for UK exposures has been set at 0 per cent. Our institution specific CCyB for the group is calculated as the weighted average of the CCyB rates that apply in the jurisdictions where relevant credit exposures are located. As at 31 December 2015, the CCyB rates in effect were 1 per cent set by Norway and Sweden with the relevant credit exposures located in Norway and Sweden being £844 million and £626 million

respectively. As at 31 December 2015, the group's institution specific CCyB rate is 0.005 per cent.

- G-SII – the HSBC Group is designated as a globally systemically important institution by the PRA, and is currently subject to a G-SII buffer requirement of 2.5 per cent of RWAs. The G-SII buffer is intended to address systemic risk, which is assessed on an annual basis according to a number of indicators such as the size of a bank, its interconnectedness, lack of readily available substitutes or financial information infrastructure for the services it provides, its global cross-jurisdictional activity, and the complexity of its business model. From 1 January 2016, the PRA will be responsible for identifying other systemically important institutions in the UK. However, institutions identified as O-SIIs are currently not subject to O-SII buffer.
- Automatic restrictions on distributions apply if a bank's CET1 capital falls below the level of its CRD IV combined buffer. The CRD IV combined buffer is defined as the total of the CCB, the CCyB, the G-SII or O-SII buffer and the SRB as these become applicable. As a result of the above requirements, as at 1 January 2016, the CRD IV combined buffer applicable to the group is estimated to be the sum of 0.625 per cent (for the CCB) and the CCyB.

### Leverage ratio requirements

The leverage ratio requirement was introduced into the Basel III framework as a non-risk-based limit, to supplement risk-based capital requirements. It aims to constrain the build-up of excess leverage in the banking sector, introducing additional safeguards against model risk and measurement errors. The Basel III leverage ratio is a volume-based measure calculated as tier 1 capital divided by total on- and off-balance sheet exposures. This ratio has been implemented in the EU for reporting and disclosure purposes but, at this stage, has not been set as a binding requirement. However, the PRA published rules on a UK leverage ratio framework, including binding requirements, in December 2015 which came into force on 1 January 2016. The PRA's leverage ratio requirement applies at the highest level of UK consolidation. For HSBC, this applies at the Group level and not at the HSBC Bank plc level.

The PRA's UK leverage ratio requirements are super equivalent to the Basel and EU regimes. However, it is anticipated that a Basel minimum leverage ratio requirement will be consulted by Basel in 2016 and become a formal Pillar 1 measure by 1 January 2018.

### Pillar 3 disclosure requirements

Pillar 3 of the Basel regulatory framework is related to market discipline and aims to increase market transparency by requiring them to publish, at least annually, wide-ranging information on their risks and capital, and how these are managed. Our *Pillar 3 Disclosures 2015* are published on HSBC's website, [www.hsbc.com](http://www.hsbc.com), under 'Investor Relations'.

## Report of the Directors: Capital (continued)

### Regulation and Supervision

Since 1 January 2014, our capital and RWAs are calculated and presented according to the group's interpretation of CRD IV legislation and the PRA's rules as set out in the PRA Rulebook.

The capital and RWAs on a CRD IV basis incorporate the effect of the PRA's rules as set out in the PRA Rulebook for CRR firms. This transposed various areas of national discretion within the final CRD IV legislation into UK law. Whilst CRD IV allows for the majority of regulatory adjustments and deductions from CET1 to be implemented on a gradual basis from 1 January 2014 to 1 January 2018, the PRA has largely decided not to make use of these transitional provisions. From 1 January 2015, unrealised gains on investment property and available-for-sale securities are to be recognised in CET1 capital. As a result our end point and transitional CET1 capital and ratios are now aligned.

For additional tier 1 and tier 2 capital, the PRA followed the transitional provisions timing as set out in CRD IV to apply the necessary regulatory adjustments and deductions. The effect of these adjustments is being phased in at 20 per cent per annum from 1 January 2014 to 1 January 2018.

Furthermore, non-CRD IV compliant additional tier 1 and tier 2 instruments also benefit from a grandfathering period. This progressively reduces the eligible amount of these instruments by 10 per cent annually, following an initial reduction of 20 per cent on 1 January 2014, until they are fully phased out by 1 January 2022.

Under CRD IV, as implemented in the UK, banks are required to meet a minimum CET1 ratio of 4.5 per cent of RWAs and a minimum tier 1 ratio of 6 per cent of RWAs from 1 January 2015, and a total capital ratio of 8 per cent of RWAs. In addition to the Pillar 1 minimum capital ratios, the PRA sets Pillar 2A capital requirements, which together with the Pillar 1 requirements, are considered the

minimum level of regulatory capital to be maintained at all times. The PRA's Pillar 2A capital requirement is to be met with at least 56 per cent CET1 capital.

Despite the rules published to date, there remains continued uncertainty around the amount of capital that UK banks will be required to hold. In particular, in December 2015, the FPC published its view of the capital framework as applicable to UK banks, which set out expectations in relation to Tier 1 capital across the industry. However, requirements applicable to individual banks are subject to PRA determination under the PRA's Pillar 2 framework. While there is emerging clarity around the interaction of the capital buffers and the PRA's Pillar 2 framework, uncertainty remains around the broader capital framework, including Basel revisions to the RWA framework and capital floors. Furthermore, there remains a number of draft and unpublished EBA technical and implementation standards due in 2016.

#### Key capital numbers

	At 31 December	
	2015	2014
<b>Capital resources (£m)</b>		
Common equity tier 1 capital	21,939	21,091
Tier 1 capital	27,017	25,138
Total regulatory capital	35,603	33,556
<b>Risk Weighted Assets (£m)</b>		
Counterparty Credit Risk	25,549	30,364
Non-Counterparty Credit Risk	160,517	168,600
- IRB	127,970	137,206
- Standardised	32,547	31,394
Market Risk	20,654	22,437
Operational Risk	22,662	22,251
Total Risk Weighted Assets	229,382	243,652
<b>Capital Ratios (%)</b>		
Common equity tier 1	9.6	8.7
Total tier 1	11.8	10.3
Total capital	15.5	13.8

## Report of the Directors: Capital (continued)

### Capital structure at 31 December

(Audited)

	CRD IV transitional 2015 £m	CRD IV transitional 2014 £m
<b>Composition of regulatory capital</b>		
<b>Tier 1 capital</b>		
Shareholders' equity <sup>1</sup>	32,548	32,367
Shareholders' equity per balance sheet	37,497	36,079
Foreseeable interim dividend	(272)	(315)
Preference share premium	(431)	(431)
Other equity instruments <sup>2</sup>	(3,584)	(2,195)
Deconsolidation of special purpose entities	(67)	(86)
Deconsolidation of insurance entities	(595)	(685)
Non-controlling interests	241	353
Non-controlling interests per balance sheet	628	620
Preference share non-controlling interest	(150)	(150)
Surplus non-controlling interest disallowed in CET 1	(237)	(117)
Regulatory adjustments to the accounting basis	(2,825)	(3,249)
Unrealised gains on available-for-sale debt and equity securities <sup>3</sup>	–	(837)
Own credit spread	62	245
Debit valuation adjustment	(148)	(88)
Defined benefit pension fund adjustment	(2,688)	(2,400)
Cash flow hedging reserve	(51)	(163)
Other regulatory adjustments	–	(6)
Deductions	(8,025)	(8,380)
Goodwill capitalised & intangible assets	(6,451)	(6,822)
Deferred Tax assets that rely on future profitability (excludes those arising from temporary differences)	(34)	(21)
Additional valuation adjustment (referred to as PVA)	(527)	(588)
Excess of expected losses over impairment allowances	(1,013)	(949)
<b>Common equity tier 1 capital</b>	<b>21,939</b>	<b>21,091</b>
<b>Additional tier 1 capital</b>		
Other tier 1 capital before deductions	5,191	4,047
Preference shares & related premium	581	464
Other tier 1 capital securities	4,610	3,583
Deductions	(113)	–
Unconsolidated investments	(73)	–
Holding of own additional tier 1 instruments	(40)	–
<b>Tier 1 capital</b>	<b>27,017</b>	<b>25,138</b>
<b>Tier 2 capital</b>		
Total qualifying tier 2 capital before deductions	8,784	8,628
Perpetual subordinated debt	2,989	2,844
Term subordinated debt	5,795	5,784
Total deductions other than from tier 1 capital	(198)	(210)
Unconsolidated investments	(171)	(210)
Holdings of own tier 2 instruments	(27)	–
<b>Total regulatory capital</b>	<b>35,603</b>	<b>33,556</b>

<sup>1</sup> Includes externally verified profits for the year to 31 December 2015 and the interim dividend of £272 million declared by the Board of Directors after 31 December 2015.

<sup>2</sup> This was previously presented under regulatory adjustments.

<sup>3</sup> Effective 1 January 2015, under CRD IV transitional rules, unrealised gains on available-for-sale securities are no longer deducted.

## Report of the Directors: Capital (continued)

### Reconciliation of regulatory capital from CRD IV transitional basis to an estimated CRD IV end point basis

	At 31 Dec 2015 £m	At 31 Dec 2014 £m
<b>Common equity tier 1 capital on a transitional basis</b>	<b>21,939</b>	<b>21,091</b>
Unrealised gains in available for sale reserves	–	837
<b>Common equity tier 1 capital end point basis</b>	<b>21,939</b>	<b>21,928</b>
<b>Additional tier 1 capital on a transitional basis</b>	<b>5,078</b>	<b>4,047</b>
Grandfathered instruments:		
Preference share premium	(581)	(345)
Other tier 1 capital securities	(1,026)	(1,507)
Transitional adjustments:		
Unconsolidated investments	73	–
<b>Additional tier 1 capital end point basis</b>	<b>3,544</b>	<b>2,195</b>
<b>Tier 1 capital end point basis</b>	<b>25,483</b>	<b>24,123</b>
<b>Tier 2 capital on a transitional basis</b>	<b>8,586</b>	<b>8,418</b>
Grandfathered instruments:		
Perpetual subordinated debt	(12)	(13)
Term subordinated debt	(1,353)	(2,313)
Transitional adjustments:		
Unconsolidated investments	(73)	–
<b>Tier 2 capital end point basis</b>	<b>7,148</b>	<b>6,092</b>
<b>Total regulatory capital end point basis</b>	<b>32,631</b>	<b>30,215</b>

### Risk Weighted Assets ('RWAs')

#### RWA movement by business by key driver – non-counterparty credit risk – IRB only

	RBWM £bn	CMB £bn	GB&M £bn	GPB £bn	Other £bn	Total £bn
<b>RWAs at 1 January 2015 on</b>						
CRD IV basis	14.3	49.0	69.2	2.7	2.0	137.2
Foreign exchange movement	(0.1)	(0.5)	–	–	(0.1)	(0.7)
Acquisitions and disposals	–	–	–	–	–	–
Book size	0.8	7.8	(1.0)	(0.4)	(0.4)	6.8
Book quality	(1.9)	1.5	(12.2)	0.2	(0.2)	(12.6)
Model new/updated	1.1	0.3	(0.1)	–	–	1.3
Methodology and policy	–	(1.2)	(2.8)	–	–	(4.0)
– internal updates	–	(1.2)	(4.3)	–	–	(5.5)
– external updates – regulatory	–	–	1.5	–	–	1.5
– CRD IV impact	–	–	–	–	–	–
– NCOA moving from STD to IRB	–	–	–	–	–	–
<b>Total RWA movement</b>	<b>(0.1)</b>	<b>7.9</b>	<b>(16.1)</b>	<b>(0.2)</b>	<b>(0.7)</b>	<b>(9.2)</b>
<b>RWAs at 31 December 2015 on</b>						
CRD IV basis	14.2	56.9	53.1	2.5	1.3	128.0
<b>RWAs at 1 January 2014 on</b>						
Basel 2.5 basis	14.6	38.7	42.7	3.3	0.9	100.2
Foreign exchange movement	(0.1)	(0.6)	0.9	–	–	0.2
Acquisitions and disposals	–	–	(0.1)	–	(0.2)	(0.3)
Book size	0.6	4.2	(1.8)	(0.6)	(0.2)	2.2
Book quality	(1.4)	0.7	(1.9)	(0.2)	0.4	(2.4)
Model new/updated	(0.1)	–	–	–	–	(0.1)
Methodology and policy	0.7	6.0	29.4	0.2	1.1	37.4
– external updates – regulatory	–	7.6	5.2	0.2	–	13.0
– CRD IV impact	(0.6)	(1.9)	23.6	–	0.1	21.2
– NCOA moving from STD to IRB	1.3	0.3	0.6	–	1.0	3.2
<b>Total RWA movement</b>	<b>(0.3)</b>	<b>10.3</b>	<b>26.5</b>	<b>(0.6)</b>	<b>1.1</b>	<b>37.0</b>
<b>RWAs at 31 December 2014 on</b>						
CRD IV basis	14.3	49.0	69.2	2.7	2.0	137.2

The rise in RWAs as a result of External Methodology Updates during 2015 mainly relates to an EBA Q&A response clarifying the treatment of unrated securitisation positions and the publication of the European Commission's decision 2014/908/EU regarding supervisory & regulatory equivalence.

The movement as a result of Internal Methodology Updates combines a number of changes including:

- more extensive use of exemptions from the IRB approach – e.g. European Economic Area ('EEA') Sovereign exposure where it receives a zero per cent risk weight under the standard approach;
- more accurate measurement of effective maturity;

## Report of the Directors: Capital (continued)

- application of the SME Support Factor – particularly to qualifying Corporate exposures;
- use of reduced LGDs – notably for exposure secured by mortgage on commercial real estate; and
- changes relating to securitisation, and to items moving to or from Trading Book.

The improvement in Book Quality mainly stems from the disposal of higher weighted Securitisation assets and changes in the use of collateral.

### RWA movements by key driver – basis of preparation and supporting notes

#### Credit risk drivers – definitions and quantification

The causal analysis of RWA movements splits the total movement in IRB RWAs into six drivers, described below. The first four relate to specific, identifiable and measurable changes. The remaining two, book size and book quality, are derived after accounting for movements in the first four specific drivers.

#### 1. Foreign exchange movements

This is the movement in RWAs as a result of changes in the exchange rate between the functional currency of the HSBC company owning each portfolio and Sterling, being our presentation currency for consolidated reporting. Our structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that our consolidated capital ratios and the capital ratios of individual banking subsidiaries are largely protected from the effect of changes in exchange rates. This is usually achieved by ensuring that, for each subsidiary bank, the ratio of structural exposures in a given currency to risk-weighted assets denominated in that currency is broadly equal to the capital ratio of the subsidiary in question. We hedge structural foreign exchange exposures only in limited circumstances.

#### 2. Acquisitions and disposals

This is the movement in RWAs as a result of the disposal or acquisition of business operations. This can be whole businesses or parts of a business. The movement in RWAs is quantified based on the credit risk exposures as at the end of the month preceding a disposal or following an acquisition.

#### 3. Model updates

RWA movements arising from the implementation of new models and from changes to existing parameter models are allocated to this driver. This figure will also include changes which arise following review of modelling assumptions. Where a model recalibration reflects an update to more recent performance data, the resulting RWA changes are not assigned here, but instead reported under book quality.

RWA changes are estimated based on the impact assessments made in the testing phase prior to implementation. These values are used to simulate the effect of new or updated models on the portfolio at the point of implementation, assuming there were no major changes in the portfolio from the testing phase to implementation phase.

RWA movements arising from portfolios moving from the standardised approach to the IRB approach are also allocated to this driver. The RWA movement by key driver statement shows the increase in IRB RWAs, but does not show the corresponding reduction in standardised approach RWAs as its scope is limited to IRB only.

The movement in RWAs is quantified at the date at which the IRB approach is applied, and not during the testing phase as with a new/updated model.

#### 4. Methodology and policy

##### Internal updates

This captures the effect on RWAs of changing the internal treatment of exposures. This may include, but is not limited to, a portfolio or a part of one moving from an existing IRB model onto a standardised model, identification of netting and credit risk mitigation.

##### External updates - regulatory

This specifies the effect of additional or changing regulatory requirements. This includes, but is not limited to, regulatory-prescribed changes to the RWA calculation. The movement in RWAs is quantified by comparing the RWAs calculated for that portfolio under the old and the new requirements.

#### 5. Book size

RWA movements attributed to this driver are those we would expect to experience for the given movement in exposure, as measured by EAD, assuming a stable risk profile. These RWA movements arise in the normal course of business, such as growth in credit exposures or reduction in book size from run-offs and write-offs.

The RWA movement is quantified as follows:

- RWA and EAD changes captured in the four drivers above are excluded from the total movements to create an adjusted movement in EAD and RWA for the period.
- The average RWA to EAD percentage is calculated for the opening position and is applied to the adjusted movement in EAD. This results in an estimated book size RWA movement based on the assumption that the EAD to RWA percentage is constant throughout the period.

As the calculation relies on averaging, the output is dependent upon the degree of portfolio aggregation and the number of discrete time periods for which the calculation is undertaken. For each quarter of 2015 this calculation was performed for each HSBC company with an IRB portfolio by global businesses, split by the main Basel categories of credit exposures.

#### 6. Book quality

This represents RWA movements resulting from changes in the underlying credit quality of customers. These are caused by changes to IRB risk parameters which arise from actions such as, but not limited to, model recalibration, change in counterparty external rating, or the influence of new lending on the average quality of the book. The change in RWAs attributable to book quality is calculated as the balance of RWA movements after taking account of all drivers described above.

The RWA movement by key driver statement includes only movements which are calculated under the IRB approach. Certain classes of credit risk exposure are treated as capital deductions and therefore reductions are not shown in this statement. If the treatment of a credit risk exposure changes from RWA to capital deduction in the period, then only the reduction in RWAs would appear in the RWA movement by key driver tables. In this instance, a reduction in RWAs does not necessarily indicate an improvement in the capital position.



## Report of the Directors: Capital (continued)

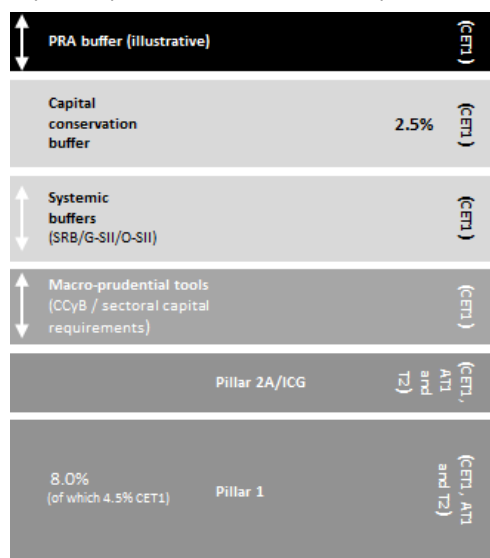
### Regulatory developments

#### Regulatory requirement

Elements of the capital requirements that are known or quantified to date are set out in the diagram below.

The requirements comprised of a Pillar 1 minimum, the ICG set by the PRA in the form of Pillar 2A, a number of capital buffers established by CRD IV and any PRA buffer that the PRA may set in addition to the ICG.

#### Capital requirements framework (end point)



The Pillar 1 minimum ratio and the CCB rates are certain. The macro-prudential tools, Pillar 2A, the PRA buffer and the systemic buffers are time-varying elements and subject to change.

In December 2015, the FPC published its end point view on the calibration of the capital framework as applicable to UK banks. This set out the FPC's expectations in relation to the levels of capital across the industry, while specific requirements for individual banks will vary upon the PRA determination. These expectations do not include time-varying additional requirements such as the CCyB and are based on the assumption that existing deficiencies in the definition and measurement of RWAs under Pillar 1 requirements will be addressed over time. These deficiencies in Pillar 1 are currently compensated through additional Pillar 2 requirements. The FPC stated its expectation that by 2019, once such deficiencies were corrected, Pillar 2A requirements would reduce.

In addition to the above, consideration of the finalised FSB proposals in relation to TLAC requirements, and the UK implementation of the EU's MREL will also be required.

#### CRD IV capital buffers

CRD IV established a number of capital buffers, to be met with CET1 capital, which is broadly aligned with the Basel III framework. In the UK, with the exception of the CCyB which applied with immediate effect, CRD IV capital buffers are being phased in from 1 January 2016.

#### Countercyclical capital buffer ('CCyB')

At 31 December 2015 the CCyB rates in effect were 1 per cent set by Norway and Sweden. The CCyB rates introduced by Norway and Sweden will increase to 1.5 per cent from June 2016.

The CCyB rate of 0.625 per cent set by the Hong Kong Monetary Authority ('HKMA') came into effect on 27 January 2016 in respect of Hong Kong exposures. In addition, in 2016, the HKMA also announced that the CCyB rate applied to exposures in Hong Kong will be increased to 1.25 per cent from 1 January 2017.

In December 2015, the FPC maintained a 0 per cent CCyB rate for UK exposures. At the same time, the FPC published the final calibration of the capital framework for UK banks. Within this, the FPC indicated that going forward it intends to publish a revised policy statement on the use of CCyB in March 2016. The FPC also noted that it expects to set a countercyclical buffer rate for UK exposures, in the region of 1 per cent when risks are judged to be neither subdued nor elevated. The CCyB rate will be informed by the annual PRA concurrent stress test of major UK banks. If a rate change is introduced, it is expected to come into effect 12 months later.

#### Systemic risk buffer ('SRB')

In January 2016, the FPC published its consultation paper on its proposed framework for the SRB. It is proposed that a SRB of between 0 per cent to 2.5 per cent will apply to ring-fenced banks and large building societies. The SRB will be implemented from 1 January 2019.

#### Pillar 2 and the 'PRA buffer'

The Pillar 2 framework requires banks to hold capital in respect of risks not captured in the Pillar 1 framework and risks which banks may become exposed to over a forward-looking planning horizon. The PRA's assessment results in the determination of an ICG / Pillar 2A and Pillar 2B respectively.

Pillar 2A was previously required to be met by total capital, but since 1 January 2015, must be met with at least 56 per cent CET1 capital. Furthermore, the PRA expects firms not to meet the CRD IV buffers with any CET1 capital required to meet its ICG.

The Pillar 2A requirement is a point in time assessment of the amount of capital the PRA considers that a bank should hold to meet the overall financial adequacy rule. It is therefore subject to change as part of the PRA's supervisory review process.

In July 2015, the PRA published a final policy statement PS17/15, setting out amendments to the PRA Rulebook and Supervisory Statements in relation to the Pillar 2 Framework. This revised framework became effective on 1 January 2016. The PRA Statement of Policy sets out the methodologies that the PRA will use to inform its setting of firms' Pillar 2 capital requirements, including new approaches for determining Pillar 2 requirements for credit risk, operational risk, credit concentration risk and pension obligation risk.

In parallel, in July 2015, the PRA also issued its supervisory statement SS31/15 in which it introduced a PRA buffer, to replace the capital planning buffer ('CPB') under Pillar 2B, from 1 January 2016. The PRA buffer where applicable, is to be met with CET1 capital.

The supervisory statement sets out that the PRA buffer is intended to avoid duplication with CRD IV buffers and will be set for a particular firm depending on its vulnerability in a stress scenario. In order to address weaknesses in risk management and governance, a scalar may be applied to firms' CET1 Pillar 1 and Pillar 2A capital requirements. This will also form part of the PRA buffer.

## Report of the Directors: Capital (continued)

Where the PRA considers there is an overlap between the CRD IV buffers and the PRA buffer assessment, the PRA buffer will be set as the excess capital required over and above the CRD IV combined buffer. From 1 January 2016, the CCB and the systemic buffers are permitted to offset against the PRA buffer with the exception of any risk management and governance scalar where applicable. The use of the PRA buffer will not result in automatic restrictions to distributions.

### RWA developments

Throughout 2015, UK, EU and international regulators issued a series of recommendations and consultations designed to revise the various components of the RWA regime and increase related reporting and disclosures. In particular, the Basel Committee on Banking Supervision ('Basel Committee') published proposals relating to certain Pillar 1 risk types to update standardised, non-modelled approaches for calculating capital requirements. Details of the most significant consultations are set out below.

In December 2015, the Basel Committee published its second consultation paper on a revised standardised approach for credit risk. This included proposals to reintroduce external credit ratings, moderated by internal due diligence as the basis for calculating risk weights for banks and corporates. The risk weights for other asset classes are to be determined by a variety of treatments tailored for each exposure class, which are designed to increase risk sensitivity and comparability.

In January 2016, the Basel Committee published the final rules arising from the Fundamental Review of the Trading Book. The new regime includes amendments to the trading book boundary and new market risk capital calculations for both the modelled and standardised approaches. Basel implementation is planned for 1 January 2019.

The Basel Committee acknowledges that there is considerable work ongoing which could require further revisions to the framework. This residual work includes the final changes to the CVA capital charge which are expected to be published in second quarter of 2016. Following finalisation of the Basel CVA capital regime, the EU is expected to review the exemptions to the CVA charge currently applied to corporates, sovereigns and intra-group exposures. In the interim, the EU is consulting upon a methodology for calculating a Pillar 2 charge for excessive CVA risk resulting from exempted transactions.

Revised Basel consultation papers for Standardised Operational Risk and for the design and calibration of a capital floor based on the standardised approach are expected by the end of 2016.

All Basel consultation papers will need to be transposed into EU law before coming into effect. This includes the finalised changes that relate to the counterparty risk and securitisation regimes.

### UK leverage ratio framework

Following consultations in 2014, secondary legislation came into force in April 2015 to provide the FPC with direction powers in relation to the UK leverage ratio framework. In July 2015, the FPC published its final policy statement setting out its intention to use its new powers of direction. As a result, the PRA issued a consultation paper to introduce requirements for the UK leverage ratio framework. This established a minimum tier 1 leverage ratio of 3 per cent, an additional leverage ratio buffer ('ALRB') for G-SIBs and a

countercyclical leverage ratio buffer ('CCLB') – which was implemented on 1 January 2016. The ALRB and CCLB are to be met purely with CET1 capital and will be set at 35 per cent of the relevant buffers in the risk-weighted capital framework.

It is anticipated that a minimum leverage ratio requirement, including potential buffers for G-SIBs, will be consulted upon by the Basel Committee in 2016 and finalise a formal Pillar 1 measure by 1 January 2018.

### Total loss absorbency capacity proposals

As part of the Recovery and Resolution frameworks both in the EU and internationally, there have been various developments in relation to TLAC. In the EU, the Bank Recovery and Resolution Directive ('BRRD') introduced MREL.

In July 2015, the EBA published a final draft Regulatory Technical Standards ('RTS') for MREL which seeks to provide additional clarity on the criteria that resolution authorities should take into account when setting a firm specific MREL requirement. The EBA notes that it aims to implement the MREL in a way which is consistent with the finalised international standard on TLAC.

In November 2015, the FSB published finalised proposals on TLAC for G-SIBs. This set out the minimum TLAC requirement at the higher of 16 per cent of RWAs, or 6 per cent of the Basel III leverage exposure measure from 1 January 2022. The FSB's proposals also required that at least 33 per cent of the TLAC requirement is to be met by non CET1 capital. Furthermore, existing regulatory capital buffers will need to be met in addition to the minimum TLAC requirement, in effect treating a breach of TLAC as severely as a breach of minimum capital requirements. The TLAC requirement is to be applied in accordance with individual bank resolution strategies.

In November 2015 the Basel Committee also published a consultation paper on the treatment of banks' holdings of TLAC instruments issued by a G-SIB, which may require banks to undertake new deductions from regulatory capital. Once finalised, any additional requirements in relation to TLAC are expected to be reflected in MREL and to be implemented in the UK.

In December 2015, the BoE published a consultation paper on the UK's implementation of MREL. The BoE stated that it intends to set MREL consistent with both TLAC and the final EBA RTS expected to be published later this year. The MREL requirement is expected to comprise a loss absorption amount which reflects existing regulatory capital requirements and a recapitalisation amount, which reflects the capital that a firm is likely to need post resolution. The latter can be met with both regulatory capital and eligible liabilities.

While MREL is to be set on an individual bank basis, the BoE generally expects MREL for banks whose appropriate resolution strategy is bail-in, to be equivalent to twice the current minimum capital requirements. A finalised Statement of Policy is expected by mid-2016. The BoE is also expected to provide firms with an indication of their prospective 2020 MREL requirement during 2016, and will set MREL on a transitional basis until 1 January 2020. For G-SIBs, MREL is proposed to apply from 2019, consistent with FSB timelines.

In parallel to the above, the PRA separately published a consultation paper on the interaction between MREL and capital buffers and how it would treat a breach of MREL

## Report of the Directors: Capital (continued)

requirements. This proposed that firms should not be able to meet MREL requirements with CET1 capital used to meet existing capital and leverage ratio buffers.

### Banking structural reform

Globally there have been a number of developments relating to banking structural reform and the introduction of recovery and resolution regimes. As part of recovery and resolution planning, some regulators and national authorities have also required changes to the corporate structures of banks. These include requiring local incorporation of banks or ring-fencing of certain businesses. In the UK, ring-fencing legislation has been enacted requiring the separation of retail and small and SME deposits from significant trading activity.

In 2013 and 2014, UK legislation was enacted requiring large banking groups to ring-fence UK retail and SME banking activity in a separately incorporated banking subsidiary (a 'ring-fenced bank') that is prohibited from engaging in significant trading activity. Ring fencing is to be completed 1 January 2019. The legislation also detailed the applicable individual customers to be transferred to the ring-fenced bank by reference to gross assets and enterprises to be transferred based on turnover, assets, or number of employees. In addition, the legislation places restrictions on the activities and geographical scope of ring-fenced banks.

Throughout 2015, the PRA published a number of consultation papers on the implementation of ring-fencing requirements and the finalisation of rules is expected to continue in 2016.

In May 2015, the PRA published a policy statement containing near final rules on legal structure, corporate governance, and continuity of services and facilities.

Additionally in October 2015, the PRA issued a consultation on the application of capital and liquidity rules for ring-fenced banks, management of intra-group exposures, and use of financial market infrastructures.

The PRA intends to undertake a further consultation in 2016 in respect of reporting and disclosure, and publish finalised rules and supervisory statements thereafter, with implementation by 1 January 2019.

In the EU, discussions on the Banking Structural Reform Regulation continue to progress. In January 2014, the European Commission published legislative proposals on ring-fencing trading activities from deposit taking and prohibiting proprietary trading in financial instruments and commodities. In June 2015, the Council published its negotiating position on the regulation, which will need to be agreed with the European Parliament before being finalised.

## Report of the Directors: Corporate Governance

### Corporate Governance Report

The statement of corporate governance practices set out on pages 82 to 90 and information incorporated by reference constitutes the Corporate Governance Report of HSBC Bank plc.

The Directors serving as at the date of this report are set out below.

### Directors

#### **Jonathan Symonds, 56** Chairman and Independent non-executive Director

*Chairman of the Nominations and Remuneration Committee.*

**Appointed to the Board:** April 2014

Jonathan is an independent non-executive director of HSBC Holdings plc. He is Chairman of the Group Audit Committee and a member of the Conduct & Values Committee. He is Chairman of Innocoll AG and a non-executive director of Genomics England Limited and Proteus Digital Health Inc. Former appointments include: a partner and managing director of Goldman Sachs; a partner of KPMG; Chief Financial Officer of Novartis AG and AstraZeneca plc; and a non-executive director and Chairman of the Audit Committee of Diageo plc.

#### **John Trueman, 73** Deputy Chairman and Independent non-executive Director

*Member of the Audit Committee, the Risk Committee and the Chairman's Nominations and Remuneration Committee.*

**Appointed to the Board:** 2004. Deputy Chairman since December 2013

John is Chairman of HSBC Private Bank (UK) Limited and HSBC Global Asset Management Limited. He also serves on certain global business risk and audit committees within the HSBC Group. Former appointments include: Deputy Chairman of S.G. Warburg & Co Ltd.

#### **Antonio Simoes, 40** Chief Executive

*Chairman of the Executive Committee*

**Appointed to the Board:** 2012, Chief Executive since 1 September 2015

Antonio joined HSBC in 2007 and became a Group Managing Director of HSBC Holdings plc on 1 February 2016. He is Chief Executive of Europe and a director of HSBC France. Former appointments include: Chief Executive Officer, UK; Chairman of HSBC Global Asset Management (UK) Limited; director of HSBC Bank A.S.; Head of Retail Banking and Wealth Management, Europe; and Group Head of Strategy and Planning.

#### **Samir Assaf, 55**

**Appointed to the Board:** March 2014

Samir joined HSBC in 1994. A Group Managing Director of HSBC Holdings plc since 2011. Chief Executive, Global Banking and Markets, HSBC Holdings plc. He is Chairman of HSBC France and a director of HSBC Trinkaus & Burkhardt AG. He is Chairman of the Global Financial Markets Association (GFMA). Former appointments include: a director of HSBC Global Asset Management Limited and HSBC Bank Egypt S.A.E.; Head of Global Markets; and Head of Global Markets for Europe, Middle East and Africa.

#### **James Coyle, 59** Independent non-executive Director

*Member of the Audit Committee and Risk Committee.*

**Appointed to the Board:** 3 August 2015

James is a non-executive director of Marks and Spencer Financial Services plc, Marks and Spencer Savings and Investments Limited and Marks & Spencer Unit Trust Management Limited. He is a non-executive director of the Scottish Building Society and a member of the Financial Reporting Council's Financial Review Reporting Panel and Monitoring Committee and a member of the Board and chairman of the Audit Committee of Honeycomb Investment Trust Plc. Former appointments include: Group Financial Controller for Lloyds Banking Group; Group Chief Accountant of Bank of Scotland; member of the Audit Committee of the British Bankers Association; a director of Scottish Financial Enterprise; and a member of the Board and chairman of the Audit Committee of Vocalink Plc.

#### **Dame Denise Holt, 66** Independent non-executive Director

*Member of the Risk Committee.*

**Appointed to the Board:** 2011

Denise is Chairman of Marks and Spencer Financial Services plc, Marks and Spencer Savings and Investments Limited and Marks & Spencer Unit Trust Management Limited. She is a non-executive director of Iberdrola SA and Nuffield Health. Former appointments include: a senior British Ambassador with 40 years' experience of working in Government including postings in Ireland, Mexico, Brazil and Spain.

#### **Simon Leathes, 68** Independent non-executive Director

*Chairman of the Risk Committee and a member of the Audit Committee and the Chairman's Nominations and Remuneration Committee.*

**Appointed to the Board:** 2012

Simon is a director of HSBC Trinkaus & Burkhardt AG and a member of its Audit and Risk Committees. He also serves on certain global business risk and audit committees within the HSBC Group.

## Report of the Directors: Corporate Governance (continued)

He is Chairman of Assured Guaranty (Europe) Limited and Assured Guaranty (UK) Limited and a non-executive director of Assured Guaranty Limited and HSB Engineering Insurance Limited. Former appointments include: Vice Chairman of Barclays Capital and Group Finance Director of S.G. Warburg Group plc.

**David Lister, 57**  
**Independent non-executive Director**

*Member of the IT Infrastructure Committee.*

**Appointed to the Board:** 1 September 2015

David is a non-executive director of the Department for Work and Pensions and Co-operative Insurance, a mutual society; and a member of the Board of Governors at Nuffield Health. Former appointments include: director of Interxion, The Tech Partnership and IXEurope; and Chief Information Officer at each of National Grid, Royal Bank of Scotland, Reuters, Boots and GlaxoSmithKline plc.

**Dame Mary Marsh, 69**  
**Independent non-executive Director**

*Member of the IT Infrastructure Committee.*

**Appointed to the Board:** 2009

Mary is a director of the Holts Academy of Jewellery Limited and a member of the Governing Body at the London Business School. Former appointments include: founding director of the Clore Social Leadership Programme, a co-opted non-director member of the Corporate Sustainability Committee of HSBC Holdings plc and Chief Executive of the National Society for the Prevention of Cruelty to Children.

**Rosemary Martin, 55**  
**Independent non-executive Director**

*Chairman of the IT Infrastructure Committee and a member of the Chairman's Nominations and Remuneration Committee.*

**Appointed to the Board:** 2005

Rosemary is General Counsel and Company Secretary of Vodafone Group plc and a member of the Financial Conduct Authority's Listing Group Advisory Panel. Former appointments include: Chief Executive of the Practical Law Group.

**Thierry Moulouquet, 64**  
**Independent non-executive Director**

*Chairman of the Audit Committee and a member of the Risk Committee and the Chairman's Nominations and Remuneration Committee.*

**Appointed to the Board:** 2012

Thierry is a director of HSBC France and Chairman of its Audit Committee and a member of its Risk Committee. He is a director of Fimalac; Groupe Lucien Barrière; Valéo; and the Prodways Group. Former appointments include: Executive Vice-President; and Chief Financial Officer of Renault Group.

## Secretary

**Nicola Black, 49**  
**Company Secretary**

Nicola joined HSBC in 2000 and was appointed Company Secretary in April 2014. She previously served as Assistant Group Company Secretary, HSBC Holdings plc.

## Board of Directors

The objectives of the management structures within the bank, headed by the Board of Directors and led by the Chairman, are to deliver sustainable value to shareholders. Implementation of the strategy set by the Board is delegated to the bank's Executive Committee.

The Board meets regularly and Directors receive information between meetings about the activities of committees and developments in the bank's business. All Directors have full and timely access to all relevant information and may take independent professional advice if necessary.

The names of Directors serving at the date of this report and brief biographical particulars for each of them are set out on pages 82 to 83.

All Directors, including those appointed by the Board to fill a casual vacancy, are subject to annual re-election at the bank's Annual General Meeting. Non-executive Directors have no service contracts.

Alan Keir retired as a Director on 1 September 2015 and as Chief Executive Officer on 30 September 2015. Antonio Simoes was appointed Chief Executive Officer on 1 September 2015.

James Coyle was appointed a non-executive Director and as a member of the Audit Committee and Risk Committee on 3 August 2015. David Lister was appointed a non-executive Director and as a member of the IT Infrastructure Committee on 1 September 2015. Dame Mary Marsh was appointed as a member of the IT Infrastructure Committee on 1 October 2015. Simon Cooper resigned as a Director on 17 December 2015.

## Directors' emoluments

Details of the emoluments of the Directors of the bank for 2015, disclosed in accordance with the Companies Act, are shown in Note 5 'Employee compensation and benefits'.

## Board committees

The Board has established a number of committees, the membership of which comprise certain Directors and, where appropriate, senior executives. The Chairman of each non-executive Board committee reports to each meeting of the Board on the activities of the Committee since the previous Board meeting.

All of the members of the Audit Committee, Risk Committee, Chairman's Nominations and Remuneration Committee and IT Infrastructure Committee which, on 30 July 2015, was reconstituted as a committee of the Board, were independent non-executive Directors.

As at the date of this report, the following are the principal committees:

## Report of the Directors: Corporate Governance (continued)

### Audit Committee

The Audit Committee is accountable to the Board and has non-executive responsibility for oversight of and advice to the Board on financial reporting related matters and internal controls over financial reporting.

The Audit Committee meets regularly with the bank's senior financial and internal audit management and the external auditor to consider, inter alia, the bank's financial reporting, the nature and scope of audit reviews and the effectiveness of the systems of internal control relating to financial reporting.

The current members of the Audit Committee are Thierry Moulouquet (Chairman), James Coyle, Simon Leathes and John Trueman.

### Risk Committee

The Risk Committee is accountable to the Board and has non-executive responsibility for oversight of and advice to the Board on high level risk related matters and risk governance.

The Risk Committee meets regularly with the bank's senior financial, risk, internal audit and compliance management and the external auditor to consider, inter alia, risk reports and internal audit reports and the effectiveness of compliance.

The current members of the Risk Committee are Simon Leathes (Chairman), James Coyle, Denise Holt, Thierry Moulouquet and John Trueman.

### IT Infrastructure Committee

The IT Infrastructure Committee, originally a sub-committee of the Risk Committee, was reconstituted as a Committee of the Board on 30 July 2015. The Committee has responsibility for reviewing the risks associated with the bank's IT infrastructure, its performance, appropriateness, resilience, recovery and resolution plans, plus the capability of the organisation and its management, and the material risks arising therefrom.

The current members of the IT Infrastructure Committee are Rosemary Martin (Chairman), David Lister, Mary Marsh and Thierry Moulouquet.

### Chairman's Nominations and Remuneration Committee

The Chairman's Nominations and Remuneration Committee has responsibility for: (i) leading the process for Board appointments and for identifying and nominating, for the approval of the Board, candidates for appointment to the Board; (ii) the endorsement of the appointment of the chairman and any director to the Board of certain subsidiaries of the bank; and (iii) reviewing the implementation and appropriateness of the Group's remuneration policy and the remuneration of the bank's senior executives.

The current members of the Chairman's Nominations and Remuneration Committee are Jonathan Symonds (Chairman), Simon Leathes, Rosemary Martin, Thierry Moulouquet and John Trueman.

### Executive Committee

The Executive Committee meets regularly and operates as a general management committee under the direct authority of the Board, exercising all of the powers, authorities and discretions of the Board in so far as they concern the management and day to day running of the bank, in accordance with such policies and directions as the Board may from time to time determine. The bank's Chief Executive Officer Antonio Simoes, chairs the Executive Committee.

Regular RMMs of the Executive Committee, chaired by the Chief Risk Officer, Europe, are held to establish, maintain and periodically review the policy and guidelines for the management of risk within the bank.

To strengthen the governance framework in anticipation of structural and regulatory changes that affect the bank, the following sub-committees of the Executive Committee were established on 1 December 2015:

- Conduct & Values Committee;
- International Executive Committee;
- International Risk Management Committee;
- HSBC UK Executive Committee; and
- HSBC UK Risk Management Meeting.

The Conduct and Values Committee is responsible for the oversight and management of all conduct-related matters; with a particular focus on embedding conduct, culture and values in line with the bank's vision and improving customer outcomes.

The International Executive Committee is responsible for monitoring, and where appropriate, implementing and driving, execution of the Group's strategy as it pertains to the portion of HSBC Group's operations designated as International.

The International Risk Management Committee is responsible for the oversight and management of all risks impacting HBEU International.

The HSBC UK Executive Committee is responsible for the oversight of HSBC's UK operations.

The HSBC UK Risk Management Meeting is responsible for the oversight and management of all risks impacting HSBC's UK operations.

### Internal control

The Directors are responsible for maintaining and reviewing the effectiveness of risk management and internal control systems and for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. To meet this requirement and to discharge its obligations under the FCA Handbook and PRA Handbook, procedures have been designed for safeguarding assets against unauthorised use or disposal; for maintaining proper accounting records; and for ensuring the reliability and usefulness of financial information used within the business or for publication. These procedures can only provide reasonable but not absolute assurance against material mis-statement, errors, losses or fraud.

## Report of the Directors: Corporate Governance (continued)

These procedures are designed to provide effective internal control within the group and accord with the Financial Reporting Council's guidance for directors issued in 2014, internal control and related financial and business reporting. They have been in place throughout the year and up to 22 February 2016, the date of approval of the Annual Report and Accounts 2015.

In the case of companies acquired during the year, the risk management and internal controls in place are being reviewed against HSBC's benchmarks and integrated into HSBC's processes.

Key risk management and internal control procedures include the following:

- **Group standards.** The Global Standards Manual ('GSM') brings together the common standards and principles used in the conduct of all businesses, whatever its location or nature. The GSM overlays all other manuals throughout the Group and is a fundamental component of the Group's risk management structure. It establishes the high level standards and policies by which, and within which, all members of the Group conduct their businesses. The GSM is mandatory and applies to, and must be observed by, all businesses within the Group, regardless of the nature or location of their activities.
- **Delegation of authority within limits set by the Board.** Authority to manage the day to day running of the bank is delegated within limits set by the Board to the Chief Executive who has responsibility for overseeing the establishment and maintenance of systems of control appropriate to the business and who has the authority to delegate such duties and responsibilities as he sees fit. Appointments to the most senior positions within the group require the approval of the Board of Directors of HSBC Holdings plc.
- **Risk identification and monitoring.** Systems and procedures are in place to identify, control and report on the major risks facing the group as set out below:
  - wholesale credit risk;
  - retail credit risk;
  - insurance risk;
  - asset, liability and capital management risk;
  - market risk;
  - financial management risk;
  - model risk;
  - reputational risk;
  - pension risk;
  - strategic risk;
  - sustainability risk; and
  - operational risk (including accounting, tax, legal, regulatory compliance, financial crime compliance, fiduciary, political, physical, internal, external, contingency, information security systems, operations, project and people risks).

Exposure to these risks is monitored by risk management committee, asset, liability and capital management committees and executive committees in subsidiaries and, for the bank, in RMM of the Executive Committee which are chaired by Chief Risk Officer. The RMM also monitors

the group's operational risk profile and the effective implementation of the group's operational risk management framework.

- **Changes in market conditions/practices.** Processes are in place to identify new risks arising from changes in market conditions/practices or customer behaviours, which could expose the group to heightened risk of loss or reputational damage. The Group employs a top and emerging risks framework at all levels of the organisation, which enables it to identify current and forward-looking risks and to take action which either prevents them materialising or limits their impact. During 2015, attention was focused on:
  - economic outlook and capital flows;
  - geopolitical risk;
  - turning of the credit cycle;
  - regulatory developments affecting the business model and profitability;
  - regulatory focus on conduct of business and financial crime;
  - US DPA and related agreements and consent orders;
  - system resilience;
  - people risk;
  - execution risk; and
  - data management.
- **Strategic plans.** Periodic strategic plans are prepared for global businesses, global functions and certain geographical regions within the framework of the Group's strategy. The bank also prepares and adopts an Annual Operating Plan, which is informed by detailed analysis of risk appetite, describing the types and quantum of risk that we are prepared to take in executing our strategy and sets out the key business initiatives and the likely financial effects of those initiatives.
- **Disclosure Committee.** The Disclosure Committee reviews material public disclosures made by the bank for any material errors, misstatements or omissions. The integrity of disclosures is underpinned by structures and processes within the Global Finance and Global Risk functions that support expert and rigorous analytical review of financial reporting complemented by certified reviews by heads of global businesses, global functions and certain legal entities.
- **Financial reporting.** The group's financial reporting process for preparing the consolidated Annual Report and Accounts 2015 is controlled using documented accounting policies and reporting formats, supported by a chart of accounts with detailed instructions and guidance on reporting requirements, issued by Global Finance to the bank and all reporting entities within the group in advance of each reporting period end. The submission of financial information from each reporting entity is subject to certification by the responsible financial officer, and analytical review procedures at reporting entity and group levels.
- **Responsibility for risk management.** Management of global businesses and global functions are primarily

## Report of the Directors: Corporate Governance (continued)

accountable for measuring, monitoring, mitigating and managing their risks and controls. Processes are in place to ensure weaknesses are escalated to senior management and addressed, supported by our three lines of defence model.

- **IT operations.** Centralised functional control is exercised over all IT developments and operations. Common systems are employed for similar business processes wherever practicable.
- **Global function management.** Management of the Global Functions are responsible for setting policies, procedures and standards to control the principal risks detailed under 'Risk identification and monitoring' above. Authorities to enter into credit and market risk exposures are delegated with limits to line management of group companies. The concurrence of the appropriate Global Function is required, however, to credit proposals with specified higher risk characteristics. Credit and market risks are measured and reported at subsidiary company level and aggregated for risk concentration analysis on a Group-wide basis.
- **Internal audit.** The establishment and maintenance of appropriate systems of risk management and internal control is primarily the responsibility of business management. The Global Internal Audit function, which is centrally controlled, provides independent and objective assurance in respect of the adequacy of the design and operating effectiveness of the Group's framework of risk management, control and governance processes across the Group, focusing on the areas of greatest risk to HSBC using a risk-based approach. Executive management is responsible for ensuring that recommendations made by the Global Internal Audit function are implemented within an appropriate and agreed timetable. Confirmation to this effect must be provided to Global Internal Audit.

During the year, the Risk Committee and the Audit Committee have kept under review the effectiveness of this system of internal control and have reported regularly to the Board. In carrying out their reviews, the Audit Committee and Risk Committee receive regular business and operational risk assessments; regular reports from the heads of key risk functions, which cover all internal controls, both financial and non-financial; internal audit reports; external audit reports; prudential reviews; and regulatory reports.

The Risk Committee monitors the status of principal risks and considers whether the mitigating actions put in place are appropriate. In addition, when unexpected losses have arisen or when incidents have occurred which indicate gaps in the control framework or in adherence to Group policies, the Risk Committee and the Audit Committee review special reports, prepared at the instigation of management, which analyse the cause of the issue, the lessons learned and the actions proposed by management to address the issue.

### Health and safety

The maintenance of appropriate health and safety standards remains a key responsibility of all managers and the bank is committed to proactively managing all health

and safety risks associated with its business. The bank's objectives are to identify, remove and mitigate material risks relating to fires and accidents or injuries to employees, customers and visitors.

Group policies, standards and guidance for the management of health and safety are set by Global Corporate Real Estate. Achieving these in each country in which the Group operates is the responsibility of the Chief Operating Officer of that country with support and coordination provided by the Health and Safety Coordinator.

In terms of physical and geopolitical risk, Global Security and Fraud Risk provide regular Security Risk Assessments to assist management in judging the level of terrorist and violent criminal threat. Regional Security and Fraud Risk functions conduct regular security reviews of all Group buildings to ensure measures to protect staff, buildings, assets and information are appropriate to the level of threat.

HSBC remains committed to maintaining its preparedness and to ensuring the highest standards of health and safety wherever in the world the Group operates.

### Diversity and inclusion

HSBC is committed to creating a more inclusive and diverse organisation. We believe that the best performing and truly customer focused businesses will be those which encourage different ways of thinking from people with a mix of backgrounds and beliefs that reflect today's society.

Oversight of the Group's diversity and inclusion agenda and related activities resides with executives on the Group Diversity Committee, complemented by the Group People Committee and local People/Diversity Committees as well as our diversity and inclusion team.

In the UK, the executives form the People Committee and each executive leads diversity and inclusion in their business and sponsor an Employee Resource Group. These employee-led voluntary networks help raise awareness, build understanding of inclusion issues and opportunities, and provide support to help us create a more inclusive environment, so HSBC people can better connect with our colleagues and our diverse customer base. In the UK HSBC has groups covering disability, ethnicity, faith, gender, gender identity and sexual orientation and working parents. In 2015 the overall approach to diversity was rewarded with the Diversity Team of the Year award at the European Diversity Awards.

#### Inclusivity in 2015:

To help us achieve better inclusion at HSBC, we made a public commitment to achieve parity in our hiring for senior management roles for our new headquarters in Birmingham by 2020. This means that we will seek to ensure that the employees hired are 50/50 female/male, reflecting our customer base. Gender parity is an issue across the financial sector and we believe that this move to a new headquarters represents an unprecedented opportunity for change.

Supporting our ability to make the target are several programmes announced in 2015. We announced that we will operate gender-blind recruiting for junior and senior roles, including for our graduates and apprentices. We



## Report of the Directors: Corporate Governance (continued)

began to offer shared parental leave at 19 weeks full pay for each parent and maintained our guarantee that staff returning from parental leave can do so part time while maintaining their career band and basic terms and conditions. In addition, we launched parental leave coaching for our managers and their managers to ensure a strong return to work from leave. These initiatives have helped us to be listed in The Times Top 50 Best Employers for Females.

We have also launched a new self-nominated career development programme designed to support the progression of ambitious underrepresented females and black, Asian and ethnic minority employees into our senior management. The programme is a 12 month journey that will include focussed individual coaching, group and individual learning and networking opportunities for the participants.

In Stonewall's annual ranking of the best employers for lesbian, gay and bisexual people in Britain, HSBC was listed as one of the Top 10 Global Employers and improved its ranking in the UK Top 100. Antonio Simoes, European CEO, was listed as the most influential LGBT person in Business in The Telegraph's Out at Work Top 50, and we were proud to take part in Pride in London, with over 220 staff members, their partners, family and friends joining the #HSBCPride bus for the parade.

### Diverse representation at HSBC in the UK

Female representation by management level:

- All grades – 55%
- Clerical Grades – 71%
- Junior Management – 46%
- Management – 33%
- Senior Management – 27%
- Executive Management – 13%

From our people survey:

- Employees who shared that they were disabled: 3.2%
- Employees who reported that they belonged to an ethnic minority: 9.1%
- Employees who shared that they were LGBT: 2.6%

Case Study: Balance

Our Employee Resource Group Balance launched in October 2010 and was set up to help drive HSBC's diversity & inclusion aim to increase senior female representation. Balance's vision is to support the recruitment, development, advancement and engagement of a gender-balanced workforce within HSBC. The network now has 3000 members in the UK and over 23 branches worldwide.

When defining and designing Balance it was strongly felt that traditional "women's networks" were not necessarily the right approach to impact gender diversity, and that to make a difference, both men and women had to be included from the start. So Balance was set up as a network to impact gender diversity, but that was gender-neutral in how it behaved, appealing to and including both men and women equally. In 2015 Balance hosted a wide range of events around the country; from soft skills training, senior leadership 1:1s, networking and community support. Their innovative approach was rewarded by the Excellence in

Diversity Awards, where they won Outstanding Diversity Network of the Year.

### Improving youth employment

HSBC apprenticeship programmes are open to all from new starters to longer serving employees. Since the programme started in 2011, over 2300 employees have enrolled, of whom 65% are female. HSBC believes that a major contributory factor is meeting the needs of mothers returning to work who want to gain professional qualifications.

For 14-19 year old individuals, HSBC offers 500 work experience placements per year. In 2015 HSBC started to work with The Big Choice and My Kinda Future to deepen its links with 4000 schools and colleges in the UK to help ensure applications are received from students from as many diverse backgrounds as possible. HSBC produced for the first time a brochure that can be used in schools providing advice on work experience and career opportunities.

In 2013, HSBC established the Opportunity Partnership - a three year £30 million UK programme with four charities (Catch 22, St Giles, Tomorrow's People and The Prince's Trust), which aims to provide 25,000 unemployed young people with training and work opportunities by 2016. In the first two years of the partnership, HSBC had helped 37,500 young people, with 17,430 getting into education, training or employment.

Through the Prince's Trust, HSBC connects with young people not in education, employment or training, to provide training in our 'Get into Customer Service' programme. In 2015 the programme was extended to run nationwide and the number of placements available increased by 200 per cent to 300.

HSBC is also a founding partner in Movement to Work, a nationwide programme to encourage the country's largest employers to provide training or work opportunities to 100,000 young people not currently in work. UK CEO Antonio Simoes is one of the trustees. In October 2015 HSBC organised a roadshow in Birmingham to promote tackling youth unemployment and also supported a national event in London to increase supply chain involvement in the initiative.

### Employees with disabilities

HSBC continues to work to become the employer of choice for all employees. The Group recruits, trains and develops people with disabilities, and makes the appropriate workplace adjustments to employment terms and working environments that may be needed for employees who are disabled or who become disabled during their employment. In 2015 we launched a new 'workplace adjustment' process for all computer related adjustments, to ensure all employees are able to work to the best of their abilities, with access to the resources that will make their lives easier.

HSBC is also continuing its recruiting work in line with the "two tick symbol" employability campaign, to interview disabled candidates who meet the minimum criteria for any job. This symbol is a recognition given by Jobcentre Plus to employers like HSBC who have agreed to make certain positive commitments regarding the employment,

## Report of the Directors: Corporate Governance (continued)

retention, training and career development of people with disabilities.

HSBC is accredited Bronze status by the Business Disability Forum, for performing above the industry benchmark. We also received their Disability Smart award for Communications, in recognition of our internal communications campaign, which calls on colleagues to 'Focus on Ability', rather than disability. The message is about focusing on the person rather than their condition, appreciating everyone's contribution, and normalising disabled colleagues as an integral part of the HSBC team. Stories have been shared globally, with UK colleagues leading the way.

### Employee involvement

To help achieve our business goals, it is vital that we involve and inspire our employees.

Coordinated communications to employees is one way we do this. A dedicated global team is responsible for strategy, coordination and delivery of all central communications to employees and supporting teams are in place.

Global and country staff websites are most used by employees and are the primary platform for efficient dissemination of news and video content related to HSBC's strategy, values and policies, as well as people matters and industry activity. Feedback and ways to listen to each other - most notably HSBC Exchange - ensure communications and certain business activities capture and respond to employee views, concerns and ideas.

In the UK, HSBC works with a number of employee representative bodies, including trade union Unite, for consultation purposes and negotiation where appropriate, for specific groups of employees. Within individual European countries there are a variety of consultation mechanisms through employee representative bodies including, in some countries, with Trade Unions.

Subject to fulfilment of a service requirement, employees in the UK have received an annual invitation to participate in HSBC Holdings' Sharesave plan. The Sharesave plan provides employees with an opportunity to buy shares in HSBC Holdings plc at a future date at a discounted option price set immediately prior to the invitation period. Contributions to the Sharesave plan are made from post-tax salary. However, employees are able to buy shares from their pre-tax salary via the Share Incentive Plan up to a maximum of £150 per month. Both of these HMRC tax advantaged plans provide an accessible way for employees to have a stake in the business and the wider HSBC Group through share ownership and actively encourage employees to engage with the company's performance.

To help achieve HSBC's goals, the association between individual, team, business area and company performances must be demonstrated. Therefore, in addition to HSBC's day-to-day communications, specific mechanisms are in place to explain and familiarise employees with internal and external factors affecting the company's performance. These include business reviews by senior managers, financial news stories and a share price tracker. Focus is particularly given internally to HSBC's Annual and Interim Results, with dedicated communications and online content designed to provide relevance and understanding for employees.

### Employee engagement

HSBC recognises that strong employee engagement leads to positive commercial outcomes, and underpins improved business performance, increased customer satisfaction, higher productivity, talent retention and reduced absenteeism.

We regularly monitor and assess employees' engagement through our Global People Surveys, held annually from 2007 to 2011 and now bi-annually. In the UK, we also use numerous complementary programmes to involve and seek views and ideas from employees, including: Best Place to Suggest, Idea of the Month, My Health & Wellbeing, a social networking tool and regular Exchange meetings with senior managers where employees set the discussion agenda. Employees can also participate via many of HSBC's internal blogs and communications. Antonio Simoes runs his "Connected" online discussion forum, where employees hear from him on a variety of topics and are able to post their own views, ideas and comments in a lively interactive debate.

This range of feedback opportunities gives HSBC employees a voice that is heard and acted upon. Gathering and reviewing people's views enables managers and leaders to gain insights that better inform ongoing business and people decisions, actions and engagement in delivering the business goals.

### Sustainability

Sustainability underpins HSBC's strategic priorities and enables the Group to fulfil its purpose as an international bank.

The way the Group does business is as important as what it does. For HSBC, sustainability means building the Group's business for the long term by balancing social, environmental and economic considerations in the decisions it makes. This enables HSBC to help businesses thrive and contribute to the health and growth of communities.

#### Approach to Corporate Sustainability

Corporate Sustainability is governed by the Conduct & Values Committee, a sub-committee of the HSBC Holdings Board which oversees and advises on a range of issues including adherence to HSBC's values and ensuring we respond to the changing expectations of society and key stakeholders.

Sustainability priorities are set and programmes are led by the Global Corporate Sustainability function. HSBC's country operations, global functions and global businesses work together to ensure sustainability is embedded into the Group's business and operations and properly implemented. Executives within the Risk function hold a specific remit to deliver aspects of the sustainability programme for the Group. HSBC's sustainability programme focuses on three areas: sustainable finance; sustainable operations, and sustainable communities.

#### Sustainable Finance

HSBC anticipates and manages the risks and opportunities associated with a changing climate, environment and economy. In a rapidly changing world, HSBC recognises the need to ensure the business anticipates and prepares for shifts in environmental priorities and societal expectations.

## Report of the Directors: Corporate Governance (continued)

### Sustainability Risk Framework

HSBC manages the potential risk that the financial services which it provides to customers may have unacceptable effects on people or the environment. Sustainability risk can also lead to commercial risk for customers, credit risk for the Group and significant reputational risk.

For over 10 years HSBC has been working with its business customers to help them understand and manage their environmental and social impact in relation to sensitive sectors and themes. HSBC assesses and supports customers using the Group's own policies which are regularly reviewed and refined. The Group has policies covering agricultural commodities, chemicals, defence, energy, forestry, freshwater infrastructure, mining and metals, World Heritage Sites and Ramsar Wetlands and also applies the Equator Principles.

The policies and updates on HSBC's implementation of them can be found online at [hsbc.com/sus-risk](http://hsbc.com/sus-risk).

### Climate Business

HSBC understands that in response to climate change there is a shift required towards a lower-carbon economy. HSBC is committed to accelerating that shift by supporting customers involved in 'climate business' by seeking long-term low-carbon commercial business opportunities. HSBC's climate business includes clients in the solar, wind, biomass, energy efficiency, low-carbon transport and water sectors. In 2015, HSBC's Climate Change Research team was recognised as the top team in the industry.

### Sustainable Operations

Managing HSBC's own environmental footprint supports business efficiency and is part of the Group's long-term contribution to society. HSBC is working with its suppliers to find new ways to reduce the impact of its operations on the environment. The Group has committed to cut its annual per employee carbon dioxide emissions from 3.5 to 2.5 tonnes by 2020. HSBC's operational sustainability strategy includes ten goals to reduce energy consumption, support and use new renewable energy capacity, design and operate our buildings and data centres more efficiently, reduce waste and increase recycling. More than 1,000 senior managers as well as executives from 50 of our biggest vendor companies have participated in our Sustainability Leadership Programme, which aims to establish a culture of ownership for the ten goals. We have made good progress towards meeting our goal to increase the proportion of HSBC's electricity from renewables from zero in 2012 to 25% by 2020. HSBC has already signed power purchase agreements with renewable energy suppliers in the UK and India, which will meet 9% of our global electricity needs. We are working to take forward a pipeline of projects in the US and Mexico that will take us to our 25% target.

### Sustainable Communities

HSBC has chosen through a staff vote to target the majority of its donations budget at three themes: supporting education, the environment and health. HSBC provides financial contributions to community projects, and thousands of employees across the world get involved by volunteering their time and sharing their skills. Every year, HSBC's UK Young People Programme donates £14 million to charities working on education, life skills and

entrepreneurship. The programme helps more than 50,000 young people each year and provides volunteering opportunities for more than 2,000 employees. As part of this programme, in April 2013 HSBC launched a three-year, £30 million Opportunity Partnership to help young people to get into education, work or training. HSBC is working with charity partners Catch22, St Giles Trust, The Prince's Trust and Tomorrow's People, which specialise in the employment, training and education of disadvantaged 16 to 25 year-olds who face difficulty at school, college or work because they lack confidence, skills or the support of a stable home. In the first two years of the partnership, 37,500 16-25 year olds have been helped, with 17,430 getting into education, training or employment, against a target of 25,000 across three years.

The five-year US\$100 million HSBC Water Programme aims to provide safe water to 1.1 million people and sanitation for 1.9 million people in South Asia and West Africa by working with WaterAid; protect rivers and freshwater resources in five regions with WWF; and engage a further 100,000 people in learning about the global water challenge with Earthwatch.

In Europe, HSBC is funding a further ten water-related projects. With the charity Global Action Plan, for example, the US\$4.3 million Water Explorer education programme aims to engage and educate school children in 11 countries about the importance of water. In the UK, HSBC is funding projects with both the Wildfowl and Wetlands Trust (USD\$1.6m) and Thames21 (USD\$0.8m) that aim to reach over 90,000 school children, teaching them about the importance of rivers and wetlands and their role in protecting these vital resources.

As part of our 150th anniversary celebrations in 2015, HSBC donated US\$150m to a number of community projects around the world. In the UK, six charities will benefit, including US\$25m for Cancer Research UK for the Francis Crick Institute, a state-of-the-art bio-medical research facility to tackle diseases which pose the greatest threat to humanity; and the University of Aberdeen, where one scholarship each year will be awarded for the next three years in honour of Sir Thomas Sutherland, who studied there and went on to found The Hongkong and Shanghai Banking Corporation.

### Volunteering and Donations

Thousands of HSBC employees globally are involved every year by volunteering for the Group's Community Investment programmes. Further detail on these programmes is available at [hsbc.com](http://hsbc.com) and will be updated with information for 2015 in spring 2016.

In 2015, UK employees volunteered over 38,700 hours, supporting communities' activities in work time. In 2015, the UK business gave £10.8 million in charitable donations and in addition the Group Community Investment spend in the UK was £25.2 million.

### Auditor

Following a competitive tender process for the audit of HSBC Holdings plc and its subsidiaries in 2013, PricewaterhouseCoopers LLP ('PwC') was formally appointed as the bank's auditors at the 2015 Annual General Meeting ('AGM'). PwC has expressed its willingness to continue in office and the Board

## Report of the Directors: Corporate Governance (continued)

recommends that PwC be re-appointed as the bank's auditor. A resolution proposing the re-appointment of PwC as the bank's auditor and giving authority to the Audit Committee to determine its remuneration will be submitted to the forthcoming AGM.

### Conflicts of interest and indemnification of Directors

The bank's Articles of Association give the Board authority to approve Directors' conflicts and potential conflicts of interest. The Board has adopted a policy and procedures for the approval of Directors' conflicts or potential conflicts of interest. The Board's powers to authorise conflicts are operating effectively and the procedures are being followed. A review of situational conflicts which have been authorised, including the terms of authorisation, is undertaken by the Board annually.

The Articles of Association provide that Directors are entitled to be indemnified out of the assets of the company against claims from third parties in respect of certain liabilities arising in connection with the performance of their functions, in accordance with the provisions of the UK Companies Act 2006. Such indemnity provisions have been in place during the financial year but have not been utilised by the Directors. All Directors have the benefit of directors' and officers' liability insurance.

### Statement on going concern

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

Further information relevant to the assessment is provided in the 'Strategic Report' and 'Report of the Directors', in particular:

- A description of the group's strategic direction and principal risks and uncertainties.
- A summary of financial performance and review of business performance.
- The group's approach to capital management and allocation.

In addition, the objectives, policies and processes for managing credit, liquidity and market risk are set out in the '*Report of the Directors: Risk*'.

The Directors have also considered future projections of profitability, cash flows and capital resources in making their assessment.

### Disclosure of information to the Auditor

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the bank's auditors are unaware; and each Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

## Statement of Directors' Responsibilities in Respect of the *Annual Report and Accounts 2015* and the Financial Statements

The Directors are responsible for preparing the *Annual Report and Accounts 2015*, comprising the consolidated financial statements of HSBC Bank plc and its subsidiaries (the 'group') and parent company financial statements for HSBC Bank plc (the 'bank') in accordance with applicable laws and regulations.

Company law requires the Directors to prepare a Strategic Report, a Report of the Directors and group and parent company ('Company') financial statements for each financial year. The Directors are required to prepare the group financial statements in accordance with IFRSs as adopted by the European Union and have elected to prepare the bank's financial statements on the same basis.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and Company and of their profit or loss for that period. In preparing each of these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the European Union; and
- prepare the financial statements on the going concern basis unless it is not appropriate. Since the Directors are satisfied that the group has the resources to continue in business for the foreseeable future, the financial statements continue to be prepared on a going concern basis.

The Directors have responsibility for ensuring that sufficient accounting records are kept that disclose with reasonable accuracy at any time the financial position of the bank and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for safeguarding the assets of the Company and the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors have responsibility for the maintenance and integrity of the *Annual Report and Accounts* as they appear on the bank's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors, the names of whom are set out in the '*Report of Directors: Governance*' section on pages 82 and 83 of this *Annual Report and Accounts 2015*, confirm to the best of their knowledge:

- in accordance with rule 4.1.12(3)(a) of the Disclosure Rules and Transparency Rules, the consolidated financial statements, which have been prepared in accordance with IFRSs as issued by the IASB and as endorsed by the European Union, have been prepared in accordance with the applicable set of accounting standards and give a true and fair view of the assets, liabilities, financial position and profit or loss of the bank and the undertakings included in the consolidation taken as a whole; and
- the management report represented by the Strategic Report and the Report of the Directors has been prepared in accordance with rule 4.1.12(3)(b) of the Disclosure Rules and Transparency Rules, and includes a fair review of the development and performance of the business and the position of the bank and the undertakings included in the consolidation as a whole, together with a description of the principal risks and uncertainties that the group faces.

## Independent Auditors' Report to the Member of HSBC Bank plc

### Report on the financial statements

#### Our opinion

In our opinion:

- HSBC Bank plc's group financial statements and parent company financial statements (the 'financial statements') give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2015 and of the group's profit and the group's and the parent company's cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of IAS Regulation.

#### What we have audited

The financial statements, included within the Annual Report and Accounts 2015 (the 'Annual Report'), comprise:

- the group and parent company statements of financial position as at 31 December 2015;
- the group income statement and statement of comprehensive income for the year then ended;
- the group and parent company cash flow statements for the year then ended;
- the group and parent company statement of changes in equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

#### Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements.

#### Other matters on which we are required to report by exception

##### Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have no exceptions to report arising from this responsibility.

##### Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

## Independent Auditors' Report to the Member of HSBC Bank plc (continued)

### Responsibilities for the financial statements and the audit

#### Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ('ISAs (UK & Ireland)'). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only the parent company's member as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

#### What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

#### Matthew Falconer, Senior Statutory Auditor

*for and on behalf of PricewaterhouseCoopers LLP*  
Chartered Accountants and Statutory Auditors  
London, England

22 February 2016

#### Notes

a The maintenance and integrity of the HSBC website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

b Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

## Financial Statements

### Consolidated income statement for the year ended 31 December 2015

	2015	2014
	Total	Total
	£m	£m
Interest income	9,218	9,438
Interest expense	(2,400)	(2,809)
Net interest income	6,818	6,629
Fee income	4,175	4,568
Fee expense	(1,312)	(1,302)
Net fee income	2,863	3,266
Trading income excluding net interest income	2,315	1,142
Net interest income on trading activities	436	467
Net trading income	2,751	1,609
Net income from financial instruments designated at fair value	376	371
Gains less losses from financial investments	150	321
Dividend income	10	20
Net insurance premium income	1,613	1,823
Other operating income	337	163
<b>Total operating income</b>	<b>14,918</b>	<b>14,202</b>
Net insurance claims, benefits paid and movement in liabilities to policyholders	(2,048)	(2,316)
<b>Net operating income before loan impairment charges and other credit risk provisions</b>	<b>12,870</b>	<b>11,886</b>
Loan impairment charges and other credit risk provisions	(481)	(449)
<b>Net operating income</b>	<b>12,389</b>	<b>11,437</b>
Employee compensation and benefits	(4,331)	(4,144)
General and administrative expenses	(4,566)	(4,811)
Depreciation and impairment of property, plant and equipment	(264)	(321)
Amortisation and impairment of intangible assets	(259)	(211)
<b>Total operating expenses</b>	<b>(9,420)</b>	<b>(9,487)</b>
<b>Operating profit</b>	<b>2,969</b>	<b>1,950</b>
Share of profit in associates and joint ventures	2	3
<b>Profit before tax</b>	<b>2,971</b>	<b>1,953</b>
Tax expense	(997)	(564)
<b>Profit for the year</b>	<b>1,974</b>	<b>1,389</b>
Profit attributable to shareholders of the parent company	1,942	1,354
Profit attributable to non-controlling interests	32	35

The accompanying notes on pages 102 to 186 and the audited sections of the 'Report of the Directors: Risk' on pages 19 to 71 and the 'Report of the Directors: Capital Management' on pages 72 to 81 form an integral part of these financial statements.



## Financial Statements (continued)

### Consolidated statement of comprehensive income for the year ended 31 December 2015

	2015	2014
	Total	Total
	£m	£m
Profit for the year	1,974	1,389
<b>Other comprehensive income/(expense)</b>		
<b>Items that will be reclassified subsequently to profit or loss when specific conditions are met</b>		
Available-for-sale investments		
– fair value gains	36	1,033
– fair value gains reclassified to the income statement on disposal	(164)	(407)
– amounts reclassified to the income statement in respect of impairment losses	5	36
– income taxes	26	(218)
Cash flow hedges		
– fair value gains	168	838
– fair value gains reclassified to the income statement	(352)	(575)
– income taxes	51	(74)
Exchange differences and other	(786)	(820)
<b>Items that will not be reclassified subsequently to profit or loss</b>		
Actuarial gains on defined benefit plans		
– before income taxes	79	1,638
– income taxes	(14)	(322)
Other comprehensive income for the year, net of tax	(951)	1,129
<b>Total comprehensive income for the year</b>	<b>1,023</b>	<b>2,518</b>
Total comprehensive income for the year attributable to:		
– shareholders of the parent company	1,018	2,504
– non-controlling interests	5	14
<b>Total comprehensive income for the year</b>	<b>1,023</b>	<b>2,518</b>

1 Movements in the cash flow hedging reserve include amounts transferred to the income statement of £ 352 million (2014: £575 million) comprising a £245 million gain (2014: £250 million gain) taken to 'Net interest income' and a £107 million gain (2014: £325 million gain) taken to 'Net trading income'.

The accompanying notes on pages 102 to 186 and the audited sections of the 'Report of the Directors: Risk' on pages 19 to 71 and the 'Report of the Directors: Capital Management' on pages 72 to 81 form an integral part of these financial statements.

**Financial Statements** (continued)**Consolidated statement of financial position at 31 December 2015**

	<i>Notes</i>	2015 £m	2014 £m
<b>Assets</b>			
Cash and balances at central banks		39,749	42,853
Items in the course of collection from other banks		1,328	973
Trading assets	11	110,585	130,127
Financial assets designated at fair value	14	6,829	6,899
Derivatives	15	166,785	187,736
Loans and advances to banks	29	23,222	25,262
Loans and advances to customers	29	258,506	257,252
Reverse repurchase agreements – non-trading	16	30,537	41,945
Financial investments	17	71,352	76,194
Prepayments, accrued income and other assets	19	11,732	20,319
Current tax assets		126	190
Interests in associates and joint ventures	20	69	69
Goodwill and intangible assets	21	7,011	7,294
Deferred tax assets	8	110	176
<b>Total assets</b>		<b>727,941</b>	<b>797,289</b>
<b>Liabilities and equity</b>			
<b>Liabilities</b>			
Deposits by banks	29	24,202	27,590
Customer accounts	29	332,830	346,507
Repurchase agreements – non-trading	16	17,000	23,353
Items in the course of transmission to other banks		583	667
Trading liabilities	23	73,489	82,600
Financial liabilities designated at fair value	24	19,001	22,552
Derivatives	15	162,864	188,278
Debt securities in issue	29	26,069	27,921
Accruals, deferred income and other liabilities	25	5,775	12,417
Current tax liabilities		249	255
Liabilities under insurance contracts issued	26	16,664	17,522
Provisions	27	2,057	1,707
Deferred tax liabilities	8	506	364
Subordinated liabilities	28	8,527	8,858
<b>Total liabilities</b>		<b>689,816</b>	<b>760,591</b>
<b>Equity</b>			
Called up share capital	32	797	797
Share premium account		20,733	20,733
Other equity instruments	32	3,584	2,196
Other reserves		(216)	772
Retained earnings		12,599	11,580
<b>Total shareholders' equity</b>		<b>37,497</b>	<b>36,078</b>
Non-controlling interests		628	620
<b>Total equity</b>		<b>38,125</b>	<b>36,698</b>
<b>Total equity and liabilities</b>		<b>727,941</b>	<b>797,289</b>

The accompanying notes on pages 102 to 186 and the audited sections of the 'Report of the Directors: Risk' on pages 19 to 71 and the 'Report of the Directors: Capital Management' on pages 72 to 81 form an integral part of these financial statements.

**Financial Statements** (continued)**Consolidated cash flow statement for the year ended 31 December 2015**

	<i>Notes</i>	2015 £m	2014 £m
<b>Cash flows from operating activities</b>			
Profit before tax		2,971	1,953
Adjustments for:			
– non-cash items included in profit before tax	33	2,515	2,918
– change in operating assets	33	17,158	19,031
– change in operating liabilities	33	(33,087)	(58,960)
– elimination of exchange differences <sup>1</sup>		1,845	2,828
– net gain from investing activities		(174)	(359)
– share of profit in associates and joint ventures		(2)	(3)
– contributions paid to defined benefit plans		(260)	(254)
– tax paid		(711)	(579)
Net cash used in operating activities		<u>(9,745)</u>	<u>(33,425)</u>
<b>Cash flows from investing activities</b>			
Purchase of financial investments		(30,540)	(26,890)
Proceeds from the sale and maturity of financial investments		33,876	26,132
Purchase of property, plant and equipment		(431)	(411)
Proceeds from the sale of property, plant and equipment		30	414
Purchase of goodwill and intangible assets		(217)	(231)
Proceeds from the sale of intangible assets		2	2
Net cash outflow from acquisition of businesses and subsidiaries		–	(61)
Proceeds from disposal of subsidiaries		91	112
Cash outflow from disposal of associates		(1)	23
Net cash disposed of on sale of subsidiaries		–	(457)
Purchases of HSBC Holdings plc shares to satisfy share-based payment transactions		–	(11)
Net cash generated from/(used in) investing activities		<u>2,810</u>	<u>(1,378)</u>
<b>Cash flows from financing activities</b>			
Issue of ordinary share capital		–	306
Issue of capital securities		1,388	2,196
Subordinated liabilities issued		1,140	203
Subordinated liabilities repaid		(2,399)	(2,242)
Net cash inflow from change in stake of subsidiaries		20	77
Dividends paid to shareholders		(1,027)	(1,274)
Dividends paid to non-controlling interests		(15)	(16)
Net cash used in financing activities		<u>(893)</u>	<u>(750)</u>
<b>Net decrease in cash and cash equivalents</b>		<u>(7,828)</u>	<u>(35,553)</u>
Cash and cash equivalents at 1 January		71,500	108,769
Effect of exchange rate changes on cash and cash equivalents		(677)	(1,716)
Cash and cash equivalents at 31 December	33	<u>62,995</u>	<u>71,500</u>

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

The accompanying notes on pages 102 to 186 and the audited sections of the 'Report of the Directors: Risk' on pages 19 to 71 and the 'Report of the Directors: Capital Management' on pages 72 to 81 form an integral part of these financial statements.

## Financial Statements (continued)

### Consolidated statement of changes in equity for the year ended 31 December 2015

	Called up Share capital	Share premium	Other equity instru- ments	Retained earnings	Other reserves			Total share- holders' equity	Non- controlling interests	Total equity
					Available- for-sale fair value reserve	Cash flow hedging reserve	Foreign exchange reserve			
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2015	797	20,733	2,196	11,580	1,070	176	(474)	36,078	620	36,698
Profit for the year	-	-	-	1,942	-	-	-	1,942	32	1,974
Other comprehensive income (net of tax)	-	-	-	64	(91)	(133)	(764)	(924)	(27)	(951)
Available-for-sale investments	-	-	-	-	(91)	-	-	(91)	(6)	(97)
Cash flow hedges	-	-	-	-	-	(133)	-	(133)	-	(133)
Actuarial gains on defined benefit plans	-	-	-	64	-	-	-	64	1	65
Exchange differences and other	-	-	-	-	-	-	(764)	(764)	(22)	(786)
Total comprehensive income for the year	-	-	-	2,006	(91)	(133)	(764)	1,018	5	1,023
Capital securities issued <sup>1</sup>	-	-	1,388	-	-	-	-	1,388	-	1,388
Dividends to shareholders	-	-	-	(1,027)	-	-	-	(1,027)	(15)	(1,042)
Net impact of equity-settled share-based payments	-	-	-	44	-	-	-	44	-	44
Change in business combinations and other movements	-	-	-	(4)	-	-	-	(4)	18	14
<b>At 31 December 2015</b>	<b>797</b>	<b>20,733</b>	<b>3,584</b>	<b>12,599</b>	<b>979</b>	<b>43</b>	<b>(1,238)</b>	<b>37,497</b>	<b>628</b>	<b>38,125</b>
At 1 January 2014	797	20,427	-	10,225	634	(13)	300	32,370	549	32,919
Profit for the year	-	-	-	1,354	-	-	-	1,354	35	1,389
Other comprehensive income (net of tax)	-	-	-	1,321	436	189	(796)	1,150	(21)	1,129
Available-for-sale investments	-	-	-	-	436	-	-	436	8	444
Cash flow hedges	-	-	-	-	-	189	-	189	-	189
Actuarial gains/(losses) on defined benefit plans	-	-	-	1,321	-	-	-	1,321	(5)	1,316
Exchange differences and other	-	-	-	-	-	-	(796)	(796)	(24)	(820)
Total comprehensive income for the year	-	-	-	2,675	436	189	(796)	2,504	14	2,518
Share capital issued, net of costs <sup>1</sup>	-	306	-	-	-	-	-	306	-	306
Capital securities issued <sup>1</sup>	-	-	2,196	-	-	-	-	2,196	-	2,196
Dividends to shareholders	-	-	-	(1,274)	-	-	-	(1,274)	(16)	(1,290)
Net impact of equity-settled share-based payments	-	-	-	15	-	-	-	15	-	15
Acquisitions and disposals	-	-	-	-	-	-	22	22	-	22
Change in business combinations and other movements	-	-	-	(61)	-	-	-	(61)	73	12
<b>At 31 December 2014</b>	<b>797</b>	<b>20,733</b>	<b>2,196</b>	<b>11,580</b>	<b>1,070</b>	<b>176</b>	<b>(474)</b>	<b>36,078</b>	<b>620</b>	<b>36,698</b>

<sup>1</sup> All new capital subscribed during the year was issued to HSBC Holdings plc. See Note 32 for further details.

The accompanying notes on pages 102 to 186 and the audited sections of the 'Report of the Directors: Risk' on pages 19 to 71 and the 'Report of the Directors: Capital Management' on pages 72 to 81 form an integral part of these financial statements.

**Financial Statements** (continued)**HSBC Bank plc statement of financial position at 31 December 2015**

	<i>Notes</i>	2015 £m	2014 £m
<b>Assets</b>			
Cash and balances at central banks		38,725	41,424
Items in the course of collection from other banks		993	630
Trading assets	11	90,244	97,757
Financial assets designated at fair value	14	–	9
Derivatives	15	150,454	160,232
Loans and advances to banks	29	16,661	18,776
Loans and advances to customers	29	205,398	201,671
Reverse repurchase agreements – non-trading	16	24,893	36,391
Financial investments	17	39,899	48,438
Prepayments, accrued income and other assets	19	9,309	12,908
Current tax assets		93	125
Interests in associates and joint ventures	20	62	62
Investments in subsidiary undertakings	22	11,230	11,339
Goodwill and intangible assets	21	922	948
Deferred tax assets	8	7	5
<b>Total assets</b>		<b>588,890</b>	<b>630,715</b>
<b>Liabilities and equity</b>			
<b>Liabilities</b>			
Deposits by banks	29	29,073	31,383
Customer accounts	29	271,526	282,687
Repurchase agreements – non-trading	16	11,275	18,293
Items in the course of transmission to other banks		236	336
Trading liabilities	23	57,436	59,039
Financial liabilities designated at fair value	24	11,813	16,127
Derivatives	15	148,249	161,442
Debt securities in issue	29	12,356	14,950
Accruals, deferred income and other liabilities	25	3,566	5,289
Current tax liabilities		136	160
Provisions	27	1,702	1,345
Deferred tax liabilities	8	493	345
Subordinated liabilities	28	7,497	7,854
<b>Total liabilities</b>		<b>555,358</b>	<b>599,250</b>
<b>Equity</b>			
Called up share capital	32	797	797
Share premium account		20,733	20,733
Other equity instruments	32	3,584	2,196
Other reserves		364	389
Retained earnings		8,054	7,350
<b>Total equity</b>		<b>33,532</b>	<b>31,465</b>
<b>Total equity and liabilities</b>		<b>588,890</b>	<b>630,715</b>

The accompanying notes on pages 102 to 186 and the audited sections of the 'Report of the Directors: Risk' on pages 19 to 71 and the 'Report of the Directors: Capital Management' on pages 72 to 81 form an integral part of these financial statements.

**Financial Statements** (continued)**HSBC Bank plc cash flow statement for the year ended 31 December 2015**

	<i>Notes</i>	2015 £m	2014 £m
<b>Cash flows from operating activities</b>			
Profit before tax		2,252	1,367
Adjustments for:			
– non-cash items included in profit before tax	33	2,033	2,527
– change in operating assets	33	19,029	18,204
– change in operating liabilities	33	(30,397)	(43,561)
– elimination of exchange differences <sup>1</sup>		1,045	1,703
– net gain from investing activities		(139)	(433)
– contributions paid to defined benefit plans		(241)	(242)
– tax paid		(536)	(308)
Net cash used in operating activities		<u>(6,954)</u>	<u>(20,743)</u>
<b>Cash flows from investing activities</b>			
Purchase of financial investments		(17,551)	(19,253)
Proceeds from the sale and maturity of financial investments		20,415	16,188
Purchase of property, plant and equipment		(297)	(260)
Proceeds from the sale of property, plant and equipment		8	401
Purchase of goodwill and intangible assets		(198)	(182)
Net cash outflow from acquisition of businesses and subsidiaries		(2)	(61)
Proceeds from disposal and liquidation of businesses		97	112
Net cash generated from/(used in) investing activities		<u>2,472</u>	<u>(3,055)</u>
<b>Cash flows from financing activities</b>			
Issue of ordinary share capital		–	306
Issue of capital securities		1,388	2,196
Subordinated liabilities issued		1,073	–
Subordinated liabilities repaid		(2,371)	(2,203)
Net cash outflow from increase in stake of subsidiaries		–	(244)
Dividends paid to shareholders		(1,024)	(1,271)
Net cash used in financing activities		<u>(934)</u>	<u>(1,216)</u>
<b>Net decrease in cash and cash equivalents</b>		<b>(5,416)</b>	<b>(25,014)</b>
Cash and cash equivalents at 1 January		61,942	88,017
Effect of exchange rate changes on cash and cash equivalents		(436)	(1,061)
Cash and cash equivalents at 31 December	33	<u>56,090</u>	<u>61,942</u>

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

The accompanying notes on pages 102 to 186 and the audited sections of the 'Report of the Directors: Risk' on pages 19 to 71 and the 'Report of the Directors: Capital Management' on pages 72 to 81 form an integral part of these financial statements.

## Financial Statements (continued)

### HSBC Bank plc statement of changes in equity for the year ended 31 December 2015

	Called up share capital £m	Share premium £m	Other equity instruments £m	Retained earnings £m	Other reserves			Total equity £m
					Available- for-sale fair value reserve £m	Cash flow hedging reserve £m	Foreign exchange reserve £m	
At 1 January 2015	797	20,733	2,196	7,350	339	100	(50)	31,465
Profit for the year	-	-	-	1,609	-	-	-	1,609
Other comprehensive income (net of tax)	-	-	-	70	76	(67)	(34)	45
Available-for-sale investments	-	-	-	-	76	-	-	76
Cash flow hedges	-	-	-	-	-	(67)	-	(67)
Actuarial gains on defined benefit plans	-	-	-	70	-	-	-	70
Exchange differences and other	-	-	-	-	-	-	(34)	(34)
Total comprehensive income for the year	-	-	-	1,679	76	(67)	(34)	1,654
Capital securities issued <sup>1</sup>	-	-	1,388	-	-	-	-	1,388
Dividends to shareholders	-	-	-	(1,024)	-	-	-	(1,024)
Net impact of equity-settled share-based payments	-	-	-	47	-	-	-	47
Change in business combinations and other movements	-	-	-	2	-	-	-	2
<b>At 31 December 2015</b>	<b>797</b>	<b>20,733</b>	<b>3,584</b>	<b>8,054</b>	<b>415</b>	<b>33</b>	<b>(84)</b>	<b>33,532</b>
At 1 January 2014	797	20,427	-	6,342	(317)	(8)	(47)	27,194
Profit for the year	-	-	-	975	-	-	-	975
Other comprehensive income (net of tax)	-	-	-	1,353	656	108	(3)	2,114
Available-for-sale investments	-	-	-	-	656	-	-	656
Cash flow hedges	-	-	-	-	-	108	-	108
Actuarial gains on defined benefit plans	-	-	-	1,353	-	-	-	1,353
Exchange differences and other	-	-	-	-	-	-	(3)	(3)
Total comprehensive income for the year	-	-	-	2,328	656	108	(3)	3,089
Share capital issued, net of costs <sup>1</sup>	-	306	-	-	-	-	-	306
Capital securities issued <sup>1</sup>	-	-	2,196	-	-	-	-	2,196
Dividends to shareholders	-	-	-	(1,271)	-	-	-	(1,271)
Net impact of equity-settled share-based payments	-	-	-	12	-	-	-	12
Change in business combinations and other movements	-	-	-	(61)	-	-	-	(61)
<b>At 31 December 2014</b>	<b>797</b>	<b>20,733</b>	<b>2,196</b>	<b>7,350</b>	<b>339</b>	<b>100</b>	<b>(50)</b>	<b>31,465</b>

1 All new capital subscribed during the year was issued to HSBC Holdings plc. See Note 32 for further details.

The accompanying notes on pages 102 to 186 and the audited sections of the 'Report of the Directors: Risk' on pages 19 to 71 and the 'Report of the Directors: Capital Management' on pages 72 to 81 form an integral part of these financial statements.

## Notes on the Financial Statements

### 1 Basis of preparation and significant accounting policies

#### (a) Compliance with International Financial Reporting Standards

International Financial Reporting Standards ('IFRSs') comprise accounting standards issued or adopted by the International Accounting Standards Board ('IASB') and interpretations issued or adopted by the IFRS Interpretations Committee ('IFRS IC').

The consolidated financial statements of the group and the separate financial statements of HSBC Bank plc have been prepared in accordance with IFRSs as issued by the IASB and as endorsed by the EU. EU-endorsed IFRSs could differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs were not to be endorsed by the EU.

At 31 December 2015, there were no unendorsed standards effective for the year ended 31 December 2015 affecting these consolidated and separate financial statements and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group. Accordingly, the group's financial statements for the year ended 31 December 2015 are prepared in accordance with IFRSs as issued by the IASB.

#### Standards adopted during the year ended 31 December 2015

There were no new standards applied during the year ended 31 December 2015.

During 2015, the group adopted a number of interpretations and amendments to standards which had an insignificant effect on the consolidated financial statements of the group and the separate financial statements of HSBC Bank plc.

#### (b) Future accounting developments

In addition to completing its projects on revenue recognition, financial instrument accounting and leasing, discussed below, the IASB is working on a project on insurance accounting which could represent significant changes to accounting requirements in the future.

#### Minor amendments to IFRSs

The IASB has published a number of minor amendments to IFRSs through the Annual Improvements to IFRSs 2012–2014 cycle and in a series of stand-alone amendments, one of which has not yet been endorsed for use in the EU. HSBC has not early applied any of the amendments effective after 31 December 2015 and it expects they will have an insignificant effect, when applied, on the consolidated financial statements of group and the separate financial statements of HSBC Bank plc.

#### Major new IFRSs

The IASB has published IFRS 9 'Financial Instruments', IFRS 15 'Revenue from Contracts with Customers' and IFRS 16 'Leases'. None of these IFRSs have yet been endorsed for use in the EU.

#### IFRS 9 'Financial Instruments'

In July 2014, the IASB issued IFRS 9 'Financial Instruments', which is the comprehensive standard to replace IAS 39 'Financial Instruments: Recognition and Measurement', and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

#### Classification and measurement

The classification and measurement of financial assets will depend on how these are managed (the entity's business model) and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income ('FVOCI') or fair value through profit or loss ('FVPL'). In many instances, the classification and measurement outcomes will be similar to IAS 39, although differences will arise. For example, under IFRS 9, embedded derivatives are not separated from host financial assets and equity securities are measured at FVPL or, in limited circumstances, fair value movements will be shown in OCI. The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of financial assets measured at amortised cost or fair value compared with IAS 39. The classification of financial liabilities is essentially unchanged. For certain liabilities measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in other comprehensive income.

The group conducted an assessment of potential classification and measurement changes to financial assets based on the composition of the balance sheet as at 31 December 2014. This may not be fully representative of the impact as at 1 January 2018 because IFRS 9 requires that business models be assessed based on the facts and circumstances from the date of initial application. In addition, the contractual terms and conditions of the financial assets assessed as at 31 December 2014 may not reflect the contractual terms and conditions of the group's financial assets at transition. However, based on the assessment of financial assets as at 31 December 2014 and expectations around changes to balance sheet composition, the group expects that generally:

- Loans and advances to banks and to customers and non-trading reverse repurchase agreements that are classified as loans and receivables under IAS 39 will be measured at amortised cost under IFRS 9;
- Financial assets designated at FVPL will remain at FVPL, because it is required under IFRS 9 or designation will continue;
- Debt securities classified as available for sale will primarily be measured at amortised cost or FVOCI, with a small minority at FVPL either because of their contractual cash flow characteristics or the business model within which they are held;



## Notes on the Financial Statements (continued)

- Treasury and other eligible bills classified as available for sale will be measured at amortised cost or FVOCI depending upon the business model in which they are held; and
- All equity securities will remain measured at fair value. A significant majority will have fair value movements shown in profit or loss, while a minority will have fair value movements presented in other comprehensive income ('OCI'). The equity securities for which fair value movements will be shown in OCI are business facilitation and other similar investments where the group holds the investments other than to generate a capital return.

### Impairment

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, and lease receivables and certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of commitments and guarantees) is required for expected credit losses ('ECL') resulting from default events that are possible within the next 12 months ('12-month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in 'stage 3'.

The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument, rather than by considering an increase in ECL.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted and should incorporate all available information which is relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under IAS 39 and the resulting impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

### Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks. The standard does not explicitly address macro hedge accounting strategies, which are being considered in a separate project. To remove the risk of any conflict between existing macro hedge accounting practice and the new general hedge accounting requirements, IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting.

Based on the analysis performed to date, the group expects to exercise the accounting policy choice to continue IAS 39 hedge accounting and therefore is not currently planning to change hedge accounting, although the group will implement the revised hedge accounting disclosures required by the related amendments to IFRS 7 'Financial Instruments: Disclosures'.

### Transition

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods.

The mandatory application date for the standard as a whole is 1 January 2018, but it is possible to apply the revised presentation for certain liabilities measured at fair value from an earlier date. The group intends to revise the presentation of fair value gains and losses relating to the entity's own credit risk on certain liabilities as soon as permitted by EU law. If this presentation were applied at 31 December 2015, the effect would be to decrease profit before tax with the opposite effect on other comprehensive income based on the change in fair value attributable to changes in the group's credit risk for the year, with no effect on net assets. Further information on change in fair value attributable to changes in credit risk, including the group's credit risk, is disclosed in Note 24.

The group is assessing the impact that the financial asset classification and impairment requirements will have on the financial statements.

### IFRS 15 'Revenue from Contracts with Customers'

In May 2014, the IASB issued IFRS 15 'Revenue from Contracts with Customers'. The original effective date of IFRS 15 has been delayed by one year and the standard is now effective for annual periods beginning on or after 1 January 2018 with early application permitted. IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied. The standard should be applied retrospectively, with certain practical expedients available. The group has assessed the impact of IFRS 15 and it expects that the standard will have no significant effect, when applied, on the consolidated financial statements of the group and the separate financial statements of HSBC Bank plc.

### IFRS 16 'Leases'

In January 2016, the IASB issued IFRS 16 'Leases' with an effective date of annual periods beginning on or after 1 January 2019. IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which

## Notes on the Financial Statements (continued)

finance leases are currently accounted for under IAS 17 'Leases'. Lessees will recognise a 'right of use' asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as in IAS 17. The group is currently assessing the impact of IFRS 16 and it is not practicable to quantify the effect as at the date of the publication of these financial statements.

### (c) Presentation of information

Disclosures under IFRS 4 'Insurance Contracts' and IFRS 7 'Financial Instruments: Disclosures' concerning the nature and extent of risks relating to insurance contracts and financial instruments are included in the audited sections of the 'Report of the Directors: Risk' on pages 19 to 71.

Capital disclosures under IAS 1 'Presentation of Financial Statements' are included in the audited sections of 'Report of the Directors: Capital' on pages 72 to 81.

Disclosures relating to the group's securitisation activities and structured products are included in the audited section of 'Report of the Directors: Risk' on page 47.

In publishing the parent company financial statements together with the group financial statements, the bank has taken advantage of the exemption in section 408(3) of the Companies Act 2006 not to present its individual income statement and related notes.

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

### (d) Critical accounting estimates and judgements

The preparation of financial information requires the use of estimates and judgements about future conditions. In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of items listed below, it is possible that the outcomes in the next financial year could differ from those on which management's estimates are based, resulting in materially different conclusions from those reached by management for the purposes of the 2015 Financial Statements. Management's selection of the group's accounting policies which contain critical estimates and judgements is listed below; it reflects the materiality of the items to which the policies are applied, the high degree of judgement and estimation uncertainty involved:

- Impairment of loans and advances: Note 1(i);
- Valuation of financial instruments: Note 12;
- Goodwill impairment: Note 21;
- Provisions: Note 27.

### (e) Going concern

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

### (f) Consolidation and related disclosures

The group controls and consequently consolidates an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Control is initially assessed based on consideration of all facts and circumstances, and is subsequently reassessed when there are significant changes to the initial setup.

Where an entity is governed by voting rights, the group would consolidate when it holds, directly or indirectly, the necessary voting rights to pass resolutions by the governing body. In all other cases, the assessment of control is more complex and requires judgement of other factors, including having exposure to variability of returns, power over the relevant activities or holding the power as agent or principal.

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured at the fair value of the consideration, including contingent consideration, given at the date of exchange. Acquisition-related costs are recognised as an expense in the income statement in the period in which they are incurred. The acquired identifiable assets, liabilities and contingent liabilities are generally measured at their fair values at the date of acquisition. Goodwill is measured as the excess of the aggregate of the consideration transferred, the amount of non-controlling interest and the fair value of the group's previously held equity interest, if any, over the net of the amounts of the identifiable assets acquired and the liabilities assumed. The amount of non-controlling interest is measured either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. For acquisitions achieved in stages, the previously held equity interest is remeasured at the acquisition-date fair value with the resulting gain or loss recognised in the income statement.

All intra-group transactions are eliminated on consolidation.

## Notes on the Financial Statements (continued)

The consolidated financial statements of the group also include the attributable share of the results and reserves of joint ventures and associates, based on either financial statements made up to 31 December or pro-rated amounts adjusted for any material transactions or events occurring between the date of financial statements available and 31 December.

### (g) Foreign currencies

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

In the consolidated financial statements, the assets and liabilities of branches, subsidiaries, joint ventures and associates whose functional currency is not Sterling, are translated into the group's presentation currency at the rate of exchange at the balance sheet date, while their results are translated into Sterling at the average rates of exchange for the reporting period. Exchange differences arising from the retranslation of opening foreign currency net assets, and the retranslation of the results for the reporting period from the average rate to the exchange rate at the period end, are recognised in other comprehensive income. Exchange differences on a monetary item that is part of a net investment in a foreign operation are recognised in the income statement of the separate financial statements and in other comprehensive income in consolidated financial statements. On disposal of a foreign operation, exchange differences previously recognised in other comprehensive income are reclassified to the income statement as a reclassification adjustment.

### (h) Loans and advances to banks and customers

These include loans and advances originated by the group, not classified as held for trading or designated at fair value. They are recognised when cash is advanced to a borrower and are derecognised when either the borrower repays its obligations, or the loans are sold, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment allowance.

Loans and advances are reclassified to 'Assets held for sale' when they meet the criteria presented in Note 19; though their measurement remains in accordance with this policy.

The group may commit to underwrite loans on fixed contractual terms for specified periods of time. When the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative. On drawdown, the loan is classified as held for trading. When the group intends to hold the loan, a provision on the loan commitment is only recorded where it is probable that the group will incur a loss. On inception of the loan, the loan to be held is recorded at its fair value and subsequently measured at amortised cost. For certain transactions, such as leveraged finance and syndicated lending activities, the cash advanced may not be the best evidence of the fair value of the loan. For these loans, where the initial fair value is lower than the cash amount advanced, the difference is charged to the income statement in other operating income. The write-down is recovered over the life of the loan, through the recognition of interest income, unless the loan becomes impaired.

### (i) Impairment of loans and advances and available-for-sale financial assets

#### Critical accounting estimates and judgements

##### Impairment of loans and advances

Loan impairment allowances represent management's best estimate of losses incurred in the loan portfolios at the balance sheet date. Management is required to exercise judgement in making assumptions and estimates when calculating loan impairment allowances on both individually and collectively assessed loans and advances. See the 'Movement in impairment allowances by industry sector table' on page 38 for a breakdown of individual and collective impairment allowances.

Collective impairment allowances are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan basis due to the large number of individually insignificant loans in the portfolio. The estimation methods include the use of statistical analyses of historical information, supplemented with significant management judgement, to assess whether current economic and credit conditions are such that the actual level of incurred losses is likely to be greater or less than historical experience.

Where changes in economic, regulatory or behavioural conditions result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models, risk factors are taken into account by adjusting the impairment allowances derived solely from historical loss experience.

Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographical concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations and other influences on customer payment patterns. Different factors are applied in different regions and countries to reflect local economic conditions, laws and regulations. The methodology and the assumptions used in calculating impairment losses are

## Notes on the Financial Statements (continued)

reviewed regularly in the light of differences between loss estimates and actual loss experience. For example, roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

For individually assessed loans, judgement is required in determining whether there is objective evidence that a loss event has occurred and, if so, the measurement of the impairment allowance. In determining whether there is objective evidence that a loss event has occurred, judgement is exercised in evaluating all relevant information on indicators of impairment, including the consideration of whether payments are contractually past-due and the consideration of other factors indicating deterioration in the financial condition and outlook of borrowers affecting their ability to pay. A higher level of judgement is required for loans to borrowers showing signs of financial difficulty in market sectors experiencing economic stress, particularly where the likelihood of repayment is affected by the prospects for refinancing or the sale of a specified asset. For those loans where objective evidence of impairment exists, management determine the size of the allowance required based on a range of factors such as the realisable value of security, the likely dividend available on liquidation or bankruptcy, the viability of the customer's business model and the capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations.

The group might provide loan forbearance to borrowers experiencing financial difficulties by agreeing to modify the contractual payment terms of loans in order to improve the management of customer relationships, maximise collection opportunities or avoid default or repossession. Where forbearance activities are significant, higher levels of judgement and estimation uncertainty are involved in determining their effects on loan impairment allowances. Judgements are involved in differentiating the credit risk characteristics of forbearance cases, including those which return to performing status following renegotiation. Where collectively assessed loan portfolios include significant levels of loan forbearance, portfolios are segmented to reflect the different credit risk characteristics of forbearance cases, and estimates are made of the incurred losses inherent within each forbearance portfolio segment. Forbearance activities take place in both retail and wholesale loan portfolios.

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

### Impairment of loans and advances

Losses for impaired loans are recognised promptly when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances that are calculated on individual loans or on groups of loans assessed collectively, are recorded as charges to the income statement and are recorded against the carrying amount of impaired loans on the balance sheet. Losses which may arise from future events are not recognised.

#### Individually assessed loans and advances

The factors considered in determining whether a loan is individually significant for the purposes of assessing impairment include the size of the loan, the number of loans in the portfolio, and the importance of the individual loan relationship, and how this is managed. Loans that are determined to be individually significant based on the above and other relevant factors will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective methodology.

Loans considered as individually significant are typically to corporate and commercial customers, are for larger amounts and are managed on an individual basis. For these loans, the group considers on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired. The criteria used to make this assessment include:

- known cash flow difficulties experienced by the borrower;
- contractual payments of either principal or interest being past due for more than 90 days;
- the probability that the borrower will enter bankruptcy or other financial realisation;
- a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and
- there has been deterioration in the financial condition or outlook of the borrower such that its ability to repay is considered doubtful.

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

- the group's aggregate exposure to the customer;
- the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors' commitments ranking ahead of, or *pari passu* with, the group and the likelihood of other creditors continuing to support the company;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;

## Notes on the Financial Statements (continued)

- the realisable value of security (or other credit mitigants) and likelihood of successful repossession;
- the likely costs of obtaining and selling collateral as part of foreclosure;
- the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and
- when available, the secondary market price of the debt.

The determination of the realisable value of security is based on the market value at the time the impairment assessment is performed. The value is not adjusted for expected future changes in market prices, though adjustments are made to reflect local conditions such as forced sale discounts.

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

### Collectively assessed loans and advances

Impairment is assessed collectively to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment or for homogeneous groups of loans that are not considered individually significant.

Retail lending portfolios are generally assessed for impairment collectively as the portfolios are generally large homogeneous loan pools.

#### *Incurred but not yet identified impairment*

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

The collective impairment allowance is determined after taking into account:

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

The period between an impairment occurring and its identification is estimated by local management for each identified portfolio based on economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. As it is assessed empirically on a periodic basis the estimated period may vary over time as these factors change.

#### *Homogeneous groups of loans and advances*

Statistical methods are used to determine collective impairment losses for homogeneous groups of loans not considered individually significant. The methods that are used to calculate collective allowances are:

- When appropriate empirical information is available, the group utilises roll-rate methodology, which employs statistical analyses of historical data and experience of delinquency and default to reliably estimate the amount of the loans that will eventually be written off as a result of the events occurring before the balance sheet date but which the group is not able to identify individually. Individual loans are grouped using ranges of past due days; statistical analysis is then used to estimate the likelihood that loans in each range will progress through the various stages of delinquency and become irrecoverable. Additionally, individual loans are segmented based on their credit characteristics as described above. In applying this methodology, adjustments are made to estimate the periods of time between a loss event occurring and its discovery, for example through a missed payment, (known as the emergence period) and the period of time between discovery and write-off (known as the outcome period). Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss. In certain highly developed markets, sophisticated models also take into account behavioural and account management trends as revealed in, for example, bankruptcy and rescheduling statistics.
- When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, the group adopts a basic formulaic approach based on historical loss rate experience, or a discounted cash flow model. Where a basic formulaic approach is undertaken, the period between a loss event occurring and its identification is explicitly estimated by local management and it is typically between six and twelve months.

The inherent loss within each portfolio is assessed on the basis of statistical models using historical data observations, which are updated periodically to reflect recent portfolio and economic trends. When the most recent trends arising from changes in

## Notes on the Financial Statements (continued)

economic, regulatory or behavioural conditions are not fully reflected in the statistical models, they are taken into account by adjusting the impairment allowances derived from the statistical models to reflect these changes as at the balance sheet date.

### Write-off of loans and advances

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

### Reversals of impairment

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

### Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans as part of an orderly realisation are recorded as 'Assets held for sale' and reported in 'Other assets' if those assets are classified as held for sale. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan (net of impairment allowance) at the date of exchange. No depreciation is charged in respect of assets held for sale. Write-downs of the acquired asset to fair value less cost to sell and any reversals of previous write-downs are recognised in the income statement, in 'Other operating income', together with any realised gains or losses on disposal.

### Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as up to date loans for measurement purposes once a minimum number of payments required have been received. Where collectively assessed loan portfolios include significant levels of renegotiated loans, these loans are segregated from other parts of the loan portfolio for the purposes of collective impairment assessment, to reflect their risk profile. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired. The carrying amounts of loans that have been classified as renegotiated retain this classification until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument. Any new loans that arise following derecognition events will continue to be disclosed as renegotiated loans and are assessed for impairment as above.

### Impairment of available-for-sale financial assets

Available-for-sale financial assets are assessed at each balance sheet date for objective evidence of impairment. If such evidence exists as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event has an impact, which can be reliably measured, on the estimated future cash flows of the financial asset an impairment loss is recognised.

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

Impairment losses are recognised in the income statement within 'Loan impairment charges and other credit risk provisions' for debt instruments and within 'Gains less losses from financial investments' for equities. The impairment methodologies for available-for-sale financial assets are set out as follows:

- **Available-for-sale debt securities.** In assessing objective evidence of impairment at the reporting date, the group considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in the recovery of future cash flows. Financial difficulties of the issuer, as well as other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment.

In addition, the performance of underlying collateral and the extent and depth of market price declines is relevant when assessing objective evidence of impairment of available-for-sale ABSs. The primary indicators of potential impairment are considered to be adverse fair value movements and the disappearance of an active market for a security, while changes in credit ratings are of secondary importance.

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

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

## Notes on the Financial Statements (continued)

Once an impairment loss has been recognised, the subsequent accounting treatment for changes in the fair value of that asset depends on the type of asset:

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

### (j) Non-trading reverse repurchase and repurchase agreements

When securities are sold subject to a commitment to repurchase them at a predetermined price ('repos'), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to resell ('reverse repos') are not recognised on the balance sheet and an asset is recorded in respect of the initial consideration paid.

Non-trading repos and reverse repos are measured at amortised cost. The difference between the sale and repurchase price or between the purchase and resale price is treated as interest and recognised in net interest income over the life of the agreement.

### (k) Operating income

#### Interest income and expense

Interest income and expense for all financial instruments except for those classified as held for trading or designated at fair value (except for debt securities issued by the group and derivatives managed in conjunction with those debt securities) are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

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

#### Non-interest income and expense

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

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

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

**Net income from financial instruments designated at fair value** includes:

- all gains and losses from changes in the fair value of financial assets and liabilities designated at fair value through profit or loss, including liabilities under investment contracts;
- all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets or liabilities designated at fair value through profit or loss; and
- interest income, interest expense and dividend income in respect of
  - financial assets and liabilities designated at fair value through profit or loss; and
  - derivatives managed in conjunction with the above,
  - except for interest arising from the group's issued debt securities and derivatives managed in conjunction with those debt securities, which is included in 'Interest expense'.

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

The accounting policies for **net insurance premium income** are disclosed in Note 2.

## Notes on the Financial Statements (continued)

### 2 Net insurance premium income

#### Accounting policy

Premiums for life insurance contracts are accounted for when receivable, except in unit-linked insurance contracts where premiums are accounted for when liabilities are established.

Reinsurance premiums are accounted for in the same accounting period as the premiums for the direct insurance contracts to which they relate.

#### Net earned insurance premium income

	Non-linked insurance <sup>1</sup>	Linked life insurance	Investment contracts with DPF <sup>2</sup>	Total
	£m	£m	£m	£m
Gross insurance premium income	220	135	1,375	1,730
Reinsurers' share of gross premium income	(113)	(4)	–	(117)
<b>Year ended 31 December 2015</b>	<b>107</b>	<b>131</b>	<b>1,375</b>	<b>1,613</b>
Gross insurance premium income	262	183	1,498	1,943
Reinsurers' share of gross premium income	(116)	(4)	–	(120)
<b>Year ended 31 December 2014</b>	<b>146</b>	<b>179</b>	<b>1,498</b>	<b>1,823</b>

<sup>1</sup> Includes non-life insurance.

<sup>2</sup> Discretionary participation features.

### 3 Net insurance claims, benefits paid and movement in liabilities to policyholders

#### Accounting policy

Gross insurance claims for life insurance contracts reflect the total cost of claims arising during the year, including claim handling costs and any policyholder bonuses allocated in anticipation of a bonus declaration.

Maturity claims are recognised when due for payment. Surrenders are recognised when paid or at an earlier date on which, following notification, the policy ceases to be included within the calculation of the related insurance liabilities. Death claims are recognised when notified.

Reinsurance recoveries are accounted for in the same period as the related claim.

#### Net insurance claims, benefits paid and movement in liabilities to policyholders

	Non-linked insurance	Linked life insurance	Investment Contracts with DPF <sup>1</sup>	Total
	£m	£m	£m	£m
Claims, benefits and surrenders paid	129	294	1,375	1,798
Movement in liabilities	56	(108)	419	367
Gross claims, benefits paid and movement in liabilities	185	186	1,794	2,165
Reinsurers' share of claims, benefits and surrenders paid	(72)	(4)	–	(76)
Reinsurers' share of movement in liabilities	(32)	(9)	–	(41)
Reinsurers' share of claims, benefits paid and movement in liabilities	(104)	(13)	–	(117)
<b>Year ended 31 December 2015</b>	<b>81</b>	<b>173</b>	<b>1,794</b>	<b>2,048</b>
Claims, benefits and surrenders paid	140	247	1,407	1,794
Movement in liabilities	83	37	526	646
Gross claims, benefits paid and movement in liabilities	223	284	1,933	2,440
Reinsurers' share of claims, benefits and surrenders paid	(80)	(3)	–	(83)
Reinsurers' share of movement in liabilities	(37)	(4)	–	(41)
Reinsurers' share of claims, benefits paid and movement in liabilities	(117)	(7)	–	(124)
<b>Year ended 31 December 2014</b>	<b>106</b>	<b>277</b>	<b>1,933</b>	<b>2,316</b>

<sup>1</sup> Discretionary participation features.



## Notes on the Financial Statements (continued)

### 4 Operating profit

Operating profit is stated after the following items of income, expense, gains and losses, and loan impairment charges and other credit risk provisions:

	2015 £m	2014 £m
<b>Income</b>		
Interest recognised on impaired financial assets	60	70
Interest income on loans and advances to customers	7,431	7,250
Interest income on financial investments	888	1,019
Fees earned on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	2,592	2,822
Fees earned on trust and other fiduciary activities where the group holds or invests assets on behalf of its customers	706	680
<b>Expense</b>		
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated at fair value	2,090	2,508
–on customer accounts	1,504	1,677
–on debt securities in issue and subordinated liabilities, excluding interest on financial liabilities held for trading or designated at fair value	292	434
–other	294	397
Fees payable on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	456	523
Fees payable on trust and other fiduciary activities where the group holds or invests assets on behalf of its customers	1	1
Payments under lease and sublease agreements	174	174
–minimum lease payments	171	172
–contingent rents and sublease payments	3	2
<b>Gains/(losses)</b>		
Impairment of available-for-sale equity securities	(13)	(26)
Gains/(losses) on disposal or settlement of loans and advances	(2)	–
Gains/(losses) on financial liabilities measured at amortised cost	4	60
Losses recognised on assets held for sale	(9)	(8)
Gains/(losses) on disposal of property, plant and equipment, intangible assets and non-financial investments	16	11
<b>Loan impairment charges and other credit risk provisions</b>	<b>(481)</b>	<b>(449)</b>
Net impairment charge on loans and advances	(494)	(647)
Net impairment of available-for-sale debt securities	32	203
Net impairment in respect of other credit risk provisions	(19)	(5)

### 5 Employee compensation and benefits

#### Total employee compensation

	2015 £m	2014 £m
Wages and salaries	3,584	3,357
Social security costs	460	468
Post-employment benefits	287	319
<b>Year ended 31 December</b>	<b>4,331</b>	<b>4,144</b>

#### Average number of persons employed by the group during the year

	2015	2014
Retail Banking and Wealth Management	29,298	29,763
Commercial Banking	8,603	8,717
Global Banking and Markets	7,072	6,795
Global Private Banking	824	833
Other	21,493	21,927
<b>Year ended 31 December</b>	<b>67,290</b>	<b>68,035</b>

In the last quarter of 2015, 12,065 employees included in 'other' were transferred to the ServCo Group (see page 3). Their remuneration and numbers have been included in the tables above as they have been seconded back to group employers on an interim basis.

## Notes on the Financial Statements (continued)

### Post-employment benefit plans

#### Accounting policy

The group operates a number of pension and other post-employment benefit plans throughout the world. These plans include both defined benefit and defined contribution plans and various other post-employment benefits such as post-employment healthcare.

Payments to defined contribution plans and state-managed retirement benefit plans, where the group's obligations under the plans are equivalent to a defined contribution plan, are charged as an expense as the employees render service.

The defined benefit pension costs and the present value of defined benefit obligations are calculated at the reporting date by the schemes' actuaries using the Projected Unit Credit Method. The net charge to the income statement mainly comprises the service cost and the net interest on the net defined benefit liability and is presented in operating expenses.

The past service cost, which is charged immediately to the income statement, is the change in the present value of the defined benefit obligation for employee service in prior periods resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or curtailment (a significant reduction by the entity in the number of employees covered by a plan). A settlement is a transaction that eliminates all further legal and constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions.

Re-measurements of the net defined benefit liability, which comprise actuarial gains and losses, return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognised immediately in other comprehensive income.

Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred), as well as the effects of changes in actuarial assumptions.

The defined benefit asset or liability represents the present value of defined benefit obligations reduced by the fair value of plan assets. Any net defined benefit surplus is limited to the present value of available refunds and reductions in future contributions to the plan.

The cost of obligations arising from other post-employment defined benefit plans, such as defined benefit health-care plans, are accounted for on the same basis as defined benefit pension plans.

#### Income statement charge

	2015 £m	2014 £m
Defined benefit pension plans		
- HSBC Bank (UK) Pension Scheme	(3)	96
- Other plans	22	20
Defined contribution pension plans	258	196
Pension plans	277	312
Defined benefit healthcare plans	10	7
<b>Year ended 31 December</b>	<b>287</b>	<b>319</b>

#### Net assets/(liabilities) recognised on the balance sheet in respect of defined benefit plans

	Fair value of plan assets £m	Present value of defined benefit obligations <sup>1</sup> £m	Total £m
<b>At 31 December 2015</b>			
HSBC Bank (UK) Pension Scheme	21,876	(18,506)	3,370
Other defined benefit pension plans	366	(559)	(193)
Defined benefit healthcare plans	-	(101)	(101)
<b>Total</b>	<b>22,242</b>	<b>(19,166)</b>	<b>3,076</b>
Total employee benefit liabilities (within 'Accruals, deferred income and other liabilities')			(300)
Total employee benefit assets (within 'Prepayments, accrued income and other assets')			3,376
<b>At 31 December 2014</b>			
HSBC Bank (UK) Pension Scheme	22,611	(19,555)	3,056
Other defined benefit pension plans	364	(581)	(217)
Defined benefit healthcare plans	-	(113)	(113)
<b>Total</b>	<b>22,975</b>	<b>(20,249)</b>	<b>2,726</b>
Total employee benefit liabilities (within 'Accruals, deferred income and other liabilities')			(333)
Total employee benefit assets (within 'Prepayments, accrued income and other assets')			3,059

<sup>1</sup> the defined benefit obligation was calculated based on the census data used for the 2014 Triennial valuation (2014: updated data from the 2011 Triennial valuation).

#### Cumulative actuarial gains/(losses) recognised in other comprehensive income

	2015 £m	2014 £m
At 1 January	273	(1,365)
HSBC Bank (UK) Pension Scheme	70	1,678
Other plans	(2)	(52)
Healthcare plans	11	12
Total actuarial gains/(losses) recognised in other comprehensive income for the year	79	1,638
<b>At 31 December</b>	<b>352</b>	<b>273</b>

## Notes on the Financial Statements (continued)

### Pension plans

Defined benefit pension arrangements for bank employees who are members of defined benefit pension plans, as well as certain other employees of the group and HSBC, are provided principally by the HSBC Bank (UK) Pension Scheme (the 'Scheme'), the assets of which are held in a separate trust fund. The Pension Scheme is administered by a corporate trustee, HSBC Bank Pension Trust (UK) Limited (the 'Trustee'), whose Board is comprised of 13 Directors, four of whom are elected by employees and two by pensioners. The Trustee Directors of the Pension Scheme are required to act in the best interest of the Scheme's beneficiaries.

### Post-employment defined benefit plans' principal actuarial assumptions

The principal actuarial financial assumptions used to calculate the group's obligations under its UK defined benefit pension and post-employment healthcare plans at 31 December were as follows. These assumptions will also form the basis for measuring periodic costs under the plans in the following year:

	Discount rate %	Inflation rate %	Rate of increase for pensions %	Rate of pay Increase %	Healthcare cost trend rates %
2015	3.70	3.20	3.00	3.70	6.70
2014	3.70	3.20	3.00	3.70	6.90

The group determines the discount rates to be applied to its obligations in consultation with the plans' local actuaries, on the basis of the current average yield of high quality (AA rated or equivalent) debt instruments, with maturities consistent with those of the defined benefit obligations.

The mortality tables used and implied average life expectancy at 65 in the UK at 31 December were as follows:

	Mortality table	Life expectancy at age 65 for a male member currently:		Life expectancy at age 65 for a female member currently:	
		Aged 65	Aged 45	Aged 65	Aged 45
2015	SAPS S1 <sup>1</sup>	23.6	25.0	24.9	26.7
2014	SAPS S1 <sup>1</sup>	23.6	25.2	25.0	26.9

<sup>1</sup> Self-Administered Pension Scheme ('SAPS') with Continuous Mortality Investigation 2015 improvements (2014: 2014 improvements) and a 1.25 per cent long-term annual improvement. Light table with 1.01 rating for male pensioners and 1.02 rating for female pensioners.

### Actuarial assumption sensitivities

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

	HSBC Bank (UK) Pension Scheme	
	2015 £m	2014 £m
<b>Discount rate</b>		
Change in pension obligation at year end from a 25bps increase	(739)	(911)
Change in pension obligation at year end from a 25bps decrease	789	977
Change in following year pension cost from a 25bps increase	(37)	(48)
Change in following year pension cost from a 25bps decrease	36	47
<b>Rate of inflation</b>		
Change in pension obligation at year end from a 25bps increase	500	658
Change in pension obligation at year end from a 25bps decrease	(571)	(760)
Change in following year pension cost from a 25bps increase	19	28
Change in following year pension cost from a 25bps decrease	(22)	(31)
<b>Rate of increase for pensions in payment and deferred pensions</b>		
Change in pension obligation at year end from a 25bps increase	687	762
Change in pension obligation at year end from a 25bps decrease	(651)	(723)
Change in following year pension cost from a 25bps increase	27	32
Change in following year pension cost from a 25bps decrease	(25)	(29)
<b>Rate of pay increase</b>		
Change in pension obligation at year end from a 25bps increase	51	152
Change in pension obligation at year end from a 25bps decrease	(51)	(149)
Change in following year pension cost from a 25bps increase	2	8
Change in following year pension cost from a 25bps decrease	(2)	(7)
<b>Mortality</b>		
Change in pension obligation from each additional year of longevity assumed	448	493

## Notes on the Financial Statements (continued)

## Defined benefit pension plans

## Net asset/(liability) under defined benefit pension plans

	Fair value of plan assets		Present value of defined benefit obligations		Net benefit asset/(liability)	
	HSBC Bank (UK) Pension Scheme	Other plans	HSBC Bank (UK) Pension Scheme	Other plans	HSBC Bank (UK) Pension Scheme	Other plans
	£m	£m	£m	£m	£m	£m
<b>At 1 January 2015</b>	22,611	364	(19,555)	(581)	3,056	(217)
Current service cost	-	-	(79)	(18)	(79)	(18)
Past service cost and (gains)/ losses from settlements	-	-	(35)	1	(35)	1
Service cost	-	-	(114)	(17)	(114)	(17)
Net interest (income)/cost on the net defined benefit liability	828	6	(711)	(10)	117	(4)
Re-measurement effects recognised in other comprehensive income	(996)	4	1,066	(6)	70	(2)
- return on plan assets (excluding interest income)	(996)	4	-	-	(996)	4
- actuarial gains/(losses)	-	-	1,066	(6)	1,066	(6)
- other changes	-	-	-	-	-	-
Exchange differences	-	(3)	-	17	-	14
Transfer to another HSBC scheme <sup>1</sup>	(160)	-	160	-	-	-
Contributions by the group	241	19	-	-	241	19
- normal	203	19	-	-	203	19
- special	38	-	-	-	38	-
Contributions by employees	11	-	(11)	(1)	-	(1)
Benefits paid	(638)	(24)	638	39	-	15
Administrative costs paid by the plan	(21)	-	21	-	-	-
<b>At 31 December 2015</b>	<b>21,876</b>	<b>366</b>	<b>(18,506)</b>	<b>(559)</b>	<b>3,370</b>	<b>(193)</b>

Present value of defined benefit obligation relating to :

actives	-	-	(4,092)	(341)	-	-
deferreds	-	-	(5,342)	(91)	-	-
pensioners	-	-	(9,072)	(127)	-	-

1 A transfer was made to the ServCo section (page 3) in respect of the pension benefits arising from future salary increase above CPI for employees transferred to ServCo during the year.

	Fair value of plan assets		Present value of defined benefit obligations		Net benefit asset/(liability)	
	HSBC Bank (UK) Pension Scheme	Other plans	HSBC Bank (UK) Pension Scheme	Other plans	HSBC Bank (UK) Pension Scheme	Other plans
	£m	£m	£m	£m	£m	£m
<b>At 1 January 2014</b>	19,156	354	(17,922)	(547)	1,234	(193)
Current service cost	-	-	(138)	(18)	(138)	(18)
Past service cost and (gains)/ losses from settlements	-	-	(16)	1	(16)	1
Service cost	-	-	(154)	(17)	(154)	(17)
Net interest (income)/cost on the net defined benefit liability	842	11	(784)	(16)	58	(5)
Re-measurement effects recognised in other comprehensive income	2,954	10	(1,276)	(62)	1,678	(52)
- return on plan assets (excluding interest income)	2,954	10	-	-	2,954	10
- actuarial losses	-	-	(1,408)	(55)	(1,408)	(55)
- other changes	-	-	132	(7)	132	(7)
Exchange differences	-	(24)	-	49	-	25
Contributions by the group	240	14	-	-	240	14
- normal	160	14	-	-	160	14
- special	80	-	-	-	80	-
Contributions by employees	23	-	(23)	(7)	-	(7)
Benefits paid	(580)	(1)	580	19	-	18
Administrative costs paid by the plan	(24)	-	24	-	-	-
<b>At 31 December 2014</b>	<b>22,611</b>	<b>364</b>	<b>(19,555)</b>	<b>(581)</b>	<b>3,056</b>	<b>(217)</b>

Present value of defined benefit obligation relating to :

actives			(6,276)	(374)		
deferreds			(5,645)	(73)		
pensioners			(7,634)	(134)		

## Notes on the Financial Statements (continued)

Benefits expected to be paid from the HSBC UK Pension Scheme to retirees over each of the next five years and in aggregate for the five years thereafter, are as follows:

	2016 £m	2017 £m	2018 £m	2019 £m	2020 £m	2021–2025 £m
HSBC Bank (UK) Pension Scheme	679	701	724	746	810	4,312

### Fair value of plan assets by asset classes

	31 December 2015				31 December 2014			
	Fair value	Quoted market price in active market	No quoted market price in active market	Thereof HSBC	Fair value	Quoted market price in active market	No quoted market price in active market	Thereof HSBC
	£m	£m	£m	£m	£m	£m	£m	£m
HSBC Bank (UK) Pension Scheme								
Fair value of plan assets	21,876				22,611			
Equities	3,866	3,366	500	–	3,530	2,924	606	–
Bonds	15,318	15,318	–	–	14,776	14,776	–	–
Derivatives	682	–	682	335	878	33	845	597
Other	2,010	1,008	1,002	–	3,427	2,378	1,049	–

The actual return on plan assets for the year ended 31 December 2015 was a negative return £158 million (2014: positive return of £3,817 million). The group expects to make £216 million of normal contributions to defined benefit pension plans during 2016.

### Triennial valuation

UK regulation requires that pension schemes be valued formally every three years and a funding plan agreed between the trustee and scheme sponsor. The most recent triennial actuarial valuation of the UK Scheme performed by the Scheme Actuary on behalf of the Trustee has been carried out as at 31 December 2011. At that date, the market value of the Scheme's assets was £17.2 billion. The market value of the plan represented 100 per cent of the amount expected to be required, on the basis of the assumptions adopted, to provide the benefits accrued to members after allowing for expected future increases in earnings, and resulted in neither surplus nor deficit. The method adopted for this valuation was the projected unit method.

As part of the 31 December 2011 valuation, calculations were also carried out as to the amount of assets that might be needed to meet the liabilities if the Scheme was discontinued and the members' benefits bought out with an insurance company (although in practice this may not be possible for a plan of this size) or the Trustee continued to run the plan without the support of the bank. The amount required under this approach was estimated to be £26.2 billion as at 31 December 2011. In estimating the solvency position for this purpose, a more prudent assumption about future mortality was made than for the assessment of the ongoing.

The 31 December 2014 valuation has been agreed in principle, and is expected to be finalised by its statutory deadline of 31 March 2016. The final agreement should result in a surplus of circa £500 million.

## Notes on the Financial Statements (continued)

### Directors' emoluments

The aggregate emoluments of the Directors of the bank, computed in accordance with the Companies Act 2006 as amended by statutory instrument 2008 No.410, were:

	2015 £000	2014 £000
Fees <sup>1</sup>	1,407	1,393
Salaries and other emoluments <sup>2</sup>	4,095	3,966
Annual incentives <sup>3</sup>	2,009	1,053
Long term incentives <sup>4</sup>	1,359	1,872
<b>Year ended 31 December</b>	<b>8,870</b>	<b>8,284</b>

1 Fees included fees paid to non-executive directors.

2 Salaries and other emoluments include Fixed Pay Allowances.

3 Discretionary annual incentives for directors are based on a combination of individual and corporate performance and are determined by the Remuneration Committee of the bank's parent company, HSBC Holdings plc. Incentive awards made to executive directors are delivered in the form of cash and HSBC Holdings plc shares. The total amount shown of £2,009,574 is comprised of £954,464 (2014: £526,420) in cash and £1,055,110 (2014: £526,420) in Restricted Shares, which is the upfront portion of the annual incentive granted in respect of performance year 2015. The total above also includes deferred awards of £644,134 awarded to one director who retired as a director during 2015 and which is considered to be attributable to his qualifying services in 2015.

4 The amount shown is comprised of £483,836 in deferred cash, £472,781 in deferred Restricted Shares, and £402,073 in shares under the Group Performance Share Plan ('GPSP'). These amounts relate to the portion of the awards that will vest following the substantial completion of the vesting condition attached to these awards in 2015. For 2014, the amounts include £789,629 in deferred cash awards, £789,629 in deferred Restricted Shares awards, and £292,455 awarded under the GPSP and other long-term deferred awards under the HSBC Share Plan 2011. The total vesting period of deferred cash and share awards is no less than three years, with 33% of the award vesting on each of the first and second anniversaries of the date of the award and the balance vesting on the third anniversary of the date of the award. The deferred share awards are subject to a six month retention period upon vesting. GPSP awards are subject to a five year vesting period and a retention requirement until cessation of employment upon vesting. Details of the Plans are contained within the Directors' Remuneration Report of HSBC Holdings plc. The cost of any awards subject to service conditions under the HSBC Share Plan 2011 are recognised through an annual charge based on the fair value of the awards, apportioned over the period of service to which the award relates.

One Director exercised share options over HSBC Holdings plc ordinary shares during the year.

Awards were made to three Directors under long-term incentive plans in respect of qualifying services rendered in 2015 (2014: four Directors). During 2015, four Directors received shares in respect of awards under long term incentive plans that vested during the year (2014: four Directors).

Retirement benefits are accruing to two Directors under money purchase schemes in respect of Directors' qualifying services. Contributions of £42,150 were made during the year to money purchase arrangements in respect of Directors' qualifying services (2014: £48,715).

In addition, there were payments under retirement benefit agreements with former Directors of £801,187 (2014: £805,005), including payments in respect of unfunded pension obligations to former Directors of £679,551 (2014: £684,104). The provision as at 31 December 2015 in respect of unfunded pension obligations to former Directors amounted to £10,099,902 (2014: £10,849,954).

Of these aggregate figures, the following amounts are attributable to the highest paid Director:

	2015 £000	2014 £000
Fees	-	-
Salaries and other emoluments	1,185	1,340
Annual incentives <sup>1</sup>	600	339
Long term incentives <sup>2</sup>	501	602
<b>Year ended 31 December</b>	<b>2,286</b>	<b>2,281</b>

1 Awards made to the highest paid Director are delivered in the form of cash and HSBC Holdings plc shares. The amount shown is comprised of £300,052 (2014: £169,416) in cash, £300,052 (2014: £169,416) in Restricted Shares.

2 The amount shown is comprised of £166,909 in deferred cash, £163,182 in deferred Restricted Shares and £170,758 in shares under the GPSP. These amounts relate to a portion of the awards that will vest following the substantial completion of the vesting condition attached to these awards in 2015. For 2014, the amounts include £254,124 in deferred cash awards, £254,124 in deferred Restricted Shares awards, and £94,120 awarded under other long-term deferred awards under the HSBC Share Plan 2011. The total vesting period of deferred cash and share awards is no less than three years, with 33% of the award vesting on each of the first and second anniversaries of the date of the award and the balance vesting on the third anniversary of the date of the award. The share awards are subject to a six month retention period upon vesting. GPSP awards are subject to a five year vesting period and a retention requirement until cessation of employment upon vesting.

The highest paid Director received shares in respect of qualifying services under a long term incentive scheme.

Pension contributions of £35,838 were made by the bank in respect of services by the highest paid Director during the year.

## Notes on the Financial Statements (continued)

### 6 Share-based payments

#### Accounting policy

The group enters into both equity-settled and cash-settled share-based payment arrangements with its employees as compensation for services provided by employees. The cost of share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted and recognised as an expense on a straight-line basis over the vesting period, with a corresponding credit to 'Retained Earnings'.

For cash-settled share based payment arrangements, the services acquired and the liability incurred are measured at the fair value of the liability and recognised as the employees render services. Until settlement, the fair value of the liability is re-measured over the vesting period with a corresponding credit to 'Retained earnings'.

Fair value is determined by using appropriate valuation models. Vesting conditions include service conditions and performance conditions; any other features of the arrangement are non-vesting conditions. Market performance conditions and non-vesting conditions are taken into account when estimating the fair value of the award at the date of the award. Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction.

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

HSBC Holdings plc is the grantor of its equity instrument for all share awards and share options across the group. The credit to 'Retained earnings' over the vesting period on expensing an award represents the effective capital contribution from HSBC Holdings plc. To the extent the group will be, or has been, required to fund a share-based payment arrangement, this capital contribution is reduced and the fair value of shares expected to be released to employees is recorded within 'Other liabilities'.

#### Income statement charge

The share-based payment income statement charge is recognised in wages and salaries (Note 5) as follows:

	2015	2014
	£m	£m
Restricted share awards	188	147
Savings-related and other share option plans	24	15
<b>Year ended 31 December</b>	<b>212</b>	<b>162</b>

#### HSBC Share Awards

Award	Policy	Purpose
Restricted share awards (including annual incentive awards delivered in shares) and GPSP awards	<ul style="list-style-type: none"> <li>An assessment of performance over the relevant period ending on 31 December is used to determine the amount of the award to be granted.</li> <li>Deferred awards generally require employees to remain in employment over the vesting period and are not subject to performance conditions after the grant date.</li> <li>Deferred share awards generally vest over a period of three years and GPSP awards vest after five years.</li> <li>Vested shares may be subject to a retention requirement (restriction) post-vesting. GPSP awards are retained until cessation of employment.</li> <li>Awards granted from 2010 onwards are subject to a malus provision prior to vesting.</li> <li>Awards granted to Material Risk Takers from 2015 onwards are subject to clawback post vesting.</li> </ul>	<ul style="list-style-type: none"> <li>To drive and reward performance consistent with strategy and align to shareholder interests.</li> <li>Deferral provides an incentive for a longer-term commitment and the ability to apply malus.</li> </ul>
International Employee Share Purchase Plan ("ShareMatch")	<ul style="list-style-type: none"> <li>The plan was first introduced in Hong Kong in 2013 and now includes employees in other participating countries.</li> <li>Shares are purchased in the market each quarter up to a maximum value of £750, or the equivalent in local currency.</li> <li>Matching awards are added at a ratio of one free share for every three purchased.</li> <li>Matching awards vest subject to continued employment and the retention of purchased shares for three years beyond the start of the plan year.</li> </ul>	<ul style="list-style-type: none"> <li>To align the interest of employees with the creation of shareholder value.</li> </ul>

## Notes on the Financial Statements (continued)

### Movement on HSBC share awards

	Restricted share awards	
	2015	2014 <sup>1</sup>
	Number	Number
	000s	000s
Outstanding at 1 January	38,262	38,148
Additions during the year	25,272	28,857
Released in the year	(28,533)	(27,375)
Forfeited in the year	(728)	(1,368)
Outstanding at 31 December	34,273	38,262
Weighted average fair value of awards granted (£)	6.17	6.19

<sup>1</sup> Revised to only present share-based awards. Restricted awards previously reported included deferred performance awards payable in cash.

### HSBC Share Option Plans

Main plans	Policy	Purpose
Savings-related share option plans	<ul style="list-style-type: none"> <li>Two plans: the UK Plan and the International Plan. The last grant of options under the International Plan was in 2012.</li> <li>From 2014, eligible employees can save up to £500 per month, with the choice to use the savings to acquire shares.</li> <li>Exercisable within six months following either the third or fifth anniversaries of the commencement of a three-year or five-year contract, respectively.</li> <li>The exercise price is set at a 20% (2014: 20%) discount to the market value immediately preceding the date of invitation.</li> </ul>	To align the interests of all employees with the creation of shareholder value.

### Calculation of fair values

The fair values of share options are calculated using a Black-Scholes model. The fair value of a share award is based on the share price at the date of the grant.

### Movement on HSBC share option plans

	Savings-related share option plans		HSBC Holdings Group share option plan	
	Number (000s)	WAEP <sup>1</sup> (£)	Number (000s)	WAEP <sup>1</sup> (£)
<b>2015</b>				
Outstanding at 1 January	51,319	4.98	4,837	7.29
Granted during the year	45,259	4.05	-	-
Exercised during the year	(14,806)	4.50	-	-
Expired/cancelled during the year	(18,511)	5.16	(4,837)	7.29
Outstanding at 31 December	63,261	4.35	-	-
Weighted average remaining contractual life (years)	3.46			
<b>2014</b>				
Outstanding at 1 January	53,305	4.21	25,969	7.23
Granted during the year	26,396	5.19	-	-
Exercised during the year	(24,416)	3.51	-	-
Transferred during the year	(337)	4.42	(359)	7.26
Expired during the year	(3,629)	4.90	(20,773)	7.22
Outstanding at 31 December	51,319	4.98	4,837	7.29
Weighted average remaining contractual life (years)	2.44			

<sup>1</sup> Weighted average exercise price



## Notes on the Financial Statements (continued)

### 7 Auditors' remuneration

	2015 £m	2014 £m
Audit fees payable by the group to PwC/KPMG <sup>1</sup>	9.6	6.9
Audit fees payable by other HSBC Group companies <sup>2</sup>	2.8	–
Other audit fees payable	0.5	0.6
Year ended 31 December	<b>12.9</b>	<b>7.5</b>

The following fees were payable by the group to the group's principal auditor, PwC<sup>1</sup>:

	2015 £m	2014 £m
Audit fees for HSBC Bank plc's statutory audit <sup>3</sup> :	4.3	3.7
– fees relating to current year	4.3	3.4
– fees relating to prior year	–	0.3
Fees for other services provided to the group	10.6	8.4
– audit of the group's subsidiaries <sup>4</sup>	5.3	3.1
– audit-related assurance services <sup>5</sup>	2.2	4.0
Tax services		
– taxation compliance services	0.1	0.1
– taxation advisory services	0.1	0.1
All other services		
Other assurance services	0.1	0.4
Other non-audit services	2.8	0.7
Total fees payable	<b>14.9</b>	<b>12.1</b>

<sup>1</sup> PwC became the group's principal auditor in 2015. KPMG was the principal auditor through 2014.

<sup>2</sup> Audit fees in 2015 include an allocation of amounts paid by other HSBC Group companies for which the audit work undertaken benefits the group.

<sup>3</sup> Fees payable to PwC (2014: KPMG Audit Plc) for the statutory audit of the consolidated financial statements of the group and the separate financial statements of the HSBC Bank plc. They exclude amounts payable for the statutory audit of the bank's subsidiaries which have been included in 'Fees payable to PwC (2014: KPMG) for other services provided to the group'.

<sup>4</sup> Including fees payable to PwC (2014: KPMG) for the statutory audit of the bank's subsidiaries.

<sup>5</sup> Including services for assurance and other services that relate to statutory and regulatory filings, including comfort letters and interim reviews.

Fees payable to PwC for non-audit services for HSBC Bank plc are not disclosed separately because such fees are disclosed on a consolidated basis for the group.

## Notes on the Financial Statements (continued)

### 8 Tax

#### Accounting policy

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

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

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

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

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

	2015	2014
	£m	£m
<b>Current tax</b>	<b>795</b>	<b>598</b>
– for this year	803	569
– adjustment in respect of prior years	(8)	29
<b>Deferred tax</b>	<b>202</b>	<b>(34)</b>
– origination and reversal of temporary differences	123	(2)
– effect of changes in tax rates	82	(13)
– adjustment in respect of prior years	(3)	(19)
<b>Total tax expense for the year ended 31 December</b>	<b>997</b>	<b>564</b>

The UK corporation tax rate applying to HSBC Bank plc and its subsidiaries was 20.25 per cent (2014: 21.5 per cent). Other overseas subsidiaries and overseas branches provided for taxation at the appropriate rates in the countries in which they operate.

The main rate of corporation tax in the UK was reduced from 21% to 20% on 1 April 2015 and will be gradually reduced to 18% by 1 April 2020. From 1 January 2016, there will also be an 8% supplementary surcharge on bank profits, therefore the group's effective tax rate is expected to increase going forward.

The tax charged to the income statement differs from the tax expense which would apply if all profits had been taxed at the UK corporation tax rate as follows:

	2015		2014	
	£m	%	£m	%
Taxation at UK corporation tax rate of 20.25% (2014: 21.5%)	602	20.25	420	21.5
Effect of taxing overseas profit at different rates	104	3.5	15	0.8
Non-taxable income and gains subject to tax at a lower rate	(28)	(0.9)	(30)	(1.5)
Deferred tax assets written off	31	1.0	–	–
Deferred tax assets previously not recognised	(11)	(0.4)	(43)	(2.2)
Permanent disallowables	206	6.9	198	10.1
Changes in tax rates	82	2.8	13	0.7
Local taxes and overseas withholding taxes	54	1.8	30	1.5
Other items	(32)	(1.0)	(49)	(2.5)
Adjustment in respect of prior years	(11)	(0.4)	10	0.5
<b>Total tax charged/(credited) to the income statement</b>	<b>997</b>	<b>33.6</b>	<b>564</b>	<b>28.9</b>

The Group's profits are taxed at different rates depending on the country in which the profits arise. The key applicable tax rates include UK (20%) and France (38%). If the Group's profits were taxed at the statutory rates of the countries in which the profits arise then the tax rate for the year would have been 23.75% (2014: 22.3%). The effective tax rate for the year was 33.6% (2014: 28.9%). The effective tax rate has increased since 2014 primarily due to the introduction of the 8% surcharge on UK banking profits, which increased the value of deferred tax liabilities, and increased profits in France, which had a statutory tax rate of 38%.

Accounting for taxes involves some estimation because the tax law is uncertain and the application requires a degree of judgement, which authorities may dispute. Liabilities are recognised based on best estimates of the probable outcome, taking

## Notes on the Financial Statements (continued)

into account external advice where appropriate. We do not expect significant liabilities to arise in excess of the amounts provided. The current tax asset includes an estimate of tax recoverable from HMRC with regards to past dividends received from EU resident companies. The ultimate resolution of this matter involves litigation for which the outcome is uncertain and is unlikely to be resolved in the short term.

### Movement of net deferred tax assets/(liabilities) before offsetting balances within countries

#### The group

	Retirement benefits £m	Loan impairment allowances £m	Property, plant and equipment £m	Available- for-sale investments £m	Goodwill and intangibles £m	Other <sup>1</sup> £m	Total £m
Assets	-	78	269	-	99	104	550
Liabilities	(542)	-	-	(114)	(14)	(68)	(738)
At 1 January	(542)	78	269	(114)	85	36	(188)
Income statement	(223)	(11)	67	1	31	(67)	(202)
Other comprehensive income	(12)	-	-	-	-	33	21
Equity	-	-	-	-	-	2	2
Foreign exchange and other	(4)	(7)	(20)	28	1	(27)	(29)
<b>At 31 December</b>	<b>(781)</b>	<b>60</b>	<b>316</b>	<b>(85)</b>	<b>117</b>	<b>(23)</b>	<b>(396)</b>
Assets	-	68	316	-	121	178	683
Liabilities	(781)	(8)	-	(85)	(4)	(201)	(1,079)
2014							
Assets	-	88	292	-	71	90	541
Liabilities	(186)	-	(3)	(92)	(14)	(48)	(343)
At 1 January	(186)	88	289	(92)	57	42	198
Income statement	(30)	(6)	(15)	-	14	71	34
Other comprehensive income	(322)	-	-	(29)	-	(74)	(425)
Equity	-	-	-	-	-	(9)	(9)
Foreign exchange and other	(4)	(4)	(5)	7	14	6	14
At 31 December	(542)	78	269	(114)	85	36	(188)
Assets	-	78	269	-	99	104	550
Liabilities	(542)	-	-	(114)	(14)	(68)	(738)

<sup>1</sup> Other deferred tax assets and liabilities relate to unused tax losses, share based payments and cash flow hedges.

#### The bank

	Retirement benefits £m	Property, plant and equipment £m	Goodwill and intangibles £m	Other <sup>1</sup> £m	Total £m
Assets	-	163	98	45	306
Liabilities	(614)	-	-	(32)	(646)
At 1 January	(614)	163	98	13	(340)
Income statement	(223)	60	30	(1)	(134)
Other comprehensive income	(11)	-	-	(2)	(13)
Equity	-	-	-	2	2
Foreign exchange and other	-	-	-	(1)	(1)
<b>At 31 December</b>	<b>(848)</b>	<b>223</b>	<b>128</b>	<b>11</b>	<b>(486)</b>
Assets	-	223	128	64	415
Liabilities	(848)	-	-	(53)	(901)
2014					
Assets	-	176	87	70	333
Liabilities	(246)	-	-	(1)	(247)
At 1 January	(246)	176	87	69	86
Income statement	(30)	(13)	11	(19)	(51)
Other comprehensive income:	(338)	-	-	(27)	(365)
Equity	-	-	-	(9)	(9)
Foreign exchange and other	-	-	-	(1)	(1)
At 31 December	(614)	163	98	13	(340)
Assets	-	163	98	45	306
Liabilities	(614)	-	-	(32)	(646)

<sup>1</sup> Other deferred tax assets and liabilities relate to loan impairment allowances, unused tax losses, share based payments and cash flow hedges.

## Notes on the Financial Statements (continued)

After netting off balances within countries, the balances as disclosed in the accounts are as follows:

	The group		The bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Deferred tax assets	110	176	7	5
Deferred tax liabilities	(506)	(364)	(493)	(345)
	<b>(396)</b>	<b>(188)</b>	<b>(486)</b>	<b>(340)</b>

The amount of temporary differences, unused tax losses and tax credits for which no deferred tax asset is recognised in the group balance sheet was £476 million (2014: £1,088 million). These amounts include unused tax losses and tax credits arising in the US branch of £472 million (2014: £1,036 million).

The amount of temporary differences, unused tax losses and tax credits for which no deferred tax asset is recognised in the bank balance sheet was £473 million (2014: £1,036 million). These amounts include unused tax losses and tax credits arising in the US branch of £472 million (2014: £1,036 million).

The unrecognised losses in group and bank expire after 10 years.

There are no unrecognised deferred tax liabilities arising from the Group's investments in subsidiaries and branches.

### 9 Dividends

Dividends to shareholders of the parent company were as follows:

	2015		2014	
	£ per share	£m	£ per share	£m
<b>Dividends declared on ordinary shares</b>				
Second interim dividend in respect of the previous year	0.40	315	0.79	630
First interim dividend in respect of the current year	0.67	540	0.75	600
	<b>1.07</b>	<b>855</b>	<b>1.54</b>	<b>1,230</b>
<b>Dividends on preference shares classified as equity</b>				
Dividend on HSBC Bank plc non-cumulative third dollar preference shares	1.23	43	1.16	41
	<b>1.23</b>	<b>43</b>	<b>1.16</b>	<b>41</b>

A second interim dividend for 2015 of £272 million to shareholders of the parent company was declared by the Directors after 31 December 2015 (Note 39). The total dividend declared on ordinary shares in respect of 2015 was £812 million (2014: £915 million).

### Other equity instruments

	First call date	2015	2014
		£m	£m
<b>Total coupons on capital securities classified as equity</b>			
Undated Subordinated additional Tier 1 instruments			
- £1,096m	Dec 2019	62	-
- £1,100m	Dec 2024	64	-
		<b>126</b>	<b>-</b>

## Notes on the Financial Statements (continued)

### 10 Segment analysis

#### Accounting policy

Measurement of segmental assets, liabilities, income and expenses is in accordance with the group's accounting policies. Segmental income and expenses include transfers between segments and these transfers are conducted on arm's length terms and conditions. Shared costs are included in segments on the basis of the actual recharges made.

The types of products and services from which each reportable segment derives its revenue are discussed in the 'Report of the Directors: Operating and Financial Review – Products and Services'.

#### Profit/(loss) for the year

	Year ended 31 December 2015						
	RBWM £m	CMB £m	GB&M £m	GPB £m	Other £m	Inter- segment £m	Total £m
Net interest income	3,352	2,245	1,174	233	(63)	(123)	6,818
Net fee income	1,091	1,101	563	107	1	–	2,863
Net trading income	71	19	2,470	13	55	123	2,751
Other income	39	23	143	15	314	(96)	438
<b>Net operating income<sup>1</sup></b>	<b>4,553</b>	<b>3,388</b>	<b>4,350</b>	<b>368</b>	<b>307</b>	<b>(96)</b>	<b>12,870</b>
Loan impairment charges and other credit risk provisions	(171)	(311)	10	(10)	1	–	(481)
<b>Net operating income</b>	<b>4,382</b>	<b>3,077</b>	<b>4,360</b>	<b>358</b>	<b>308</b>	<b>(96)</b>	<b>12,389</b>
Employee compensation and benefits	(995)	(624)	(1,135)	(93)	(1,484)	–	(4,331)
General and administrative expenses	(2,421)	(822)	(2,506)	(119)	1,206	96	(4,566)
Depreciation and impairment of property, plant and equipment	(6)	(10)	(3)	(1)	(244)	–	(264)
Amortisation and impairment of intangible assets	(95)	(24)	(83)	–	(57)	–	(259)
<b>Total operating expenses</b>	<b>(3,517)</b>	<b>(1,480)</b>	<b>(3,727)</b>	<b>(213)</b>	<b>(579)</b>	<b>96</b>	<b>(9,420)</b>
<b>Operating profit</b>	<b>865</b>	<b>1,597</b>	<b>633</b>	<b>145</b>	<b>(271)</b>	<b>–</b>	<b>2,969</b>
Share of profit in associates and joint ventures	1	–	1	–	–	–	2
<b>Profit before tax</b>	<b>866</b>	<b>1,597</b>	<b>634</b>	<b>145</b>	<b>(271)</b>	<b>–</b>	<b>2,971</b>
<b>Cost efficiency ratio</b>	<b>77.25%</b>	<b>43.68%</b>	<b>85.68%</b>	<b>57.88%</b>			<b>73.19%</b>

<sup>1</sup> Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue.

	Year ended 31 December 2014						
	RBWM £m	CMB £m	GB&M £m	GPB £m	Other £m	Inter- segment £m	Total £m
Net interest income	3,158	2,195	1,180	203	(42)	(65)	6,629
Net fee income	1,356	1,153	643	112	2	–	3,266
Net trading income	(149)	21	1,637	11	24	65	1,609
Other income	(157)	65	219	(2)	340	(83)	382
<b>Net operating income<sup>1</sup></b>	<b>4,208</b>	<b>3,434</b>	<b>3,679</b>	<b>324</b>	<b>324</b>	<b>(83)</b>	<b>11,886</b>
Loan impairment charges and other credit risk provisions	(162)	(308)	16	4	1	–	(449)
<b>Net operating income</b>	<b>4,046</b>	<b>3,126</b>	<b>3,695</b>	<b>328</b>	<b>325</b>	<b>(83)</b>	<b>11,437</b>
Employee compensation and benefits	(1,020)	(564)	(1,070)	(98)	(1,392)	–	(4,144)
General and administrative expenses	(2,730)	(940)	(2,582)	(114)	1,472	83	(4,811)
Depreciation and impairment of property, plant and equipment	(6)	(9)	(2)	(1)	(303)	–	(321)
Amortisation and impairment of intangible assets	(78)	(22)	(61)	–	(50)	–	(211)
<b>Total operating expenses</b>	<b>(3,834)</b>	<b>(1,535)</b>	<b>(3,715)</b>	<b>(213)</b>	<b>(273)</b>	<b>83</b>	<b>(9,487)</b>
<b>Operating profit</b>	<b>212</b>	<b>1,591</b>	<b>(20)</b>	<b>115</b>	<b>52</b>	<b>–</b>	<b>1,950</b>
Share of profit in associates and joint ventures	1	1	1	–	–	–	3
<b>Profit before tax</b>	<b>213</b>	<b>1,592</b>	<b>(19)</b>	<b>115</b>	<b>52</b>	<b>–</b>	<b>1,953</b>
<b>Cost efficiency ratio</b>	<b>91.11%</b>	<b>44.70%</b>	<b>100.98%</b>	<b>65.74%</b>			<b>79.82%</b>

<sup>1</sup> Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue.

## Notes on the Financial Statements (continued)

### Other information about the profit/(loss) for the year

	RBWM £m	CMB £m	GB&M £m	GPB £m	Other £m	Inter- segment £m	Total £m
<b>Year ended 31 December 2015</b>							
Net operating income:	4,382	3,077	4,360	358	308	(96)	12,389
– external	3,976	3,214	5,090	324	(215)	–	12,389
– inter-segment	406	(137)	(730)	34	523	(96)	–
<b>Year ended 31 December 2014</b>							
Net operating income:	4,046	3,126	3,695	328	325	(83)	11,437
– external	3,724	3,294	4,401	308	(290)	–	11,437
– inter-segment	322	(168)	(706)	20	615	(83)	–

### Balance sheet information

	RBWM £m	CMB £m	GB&M £m	GPB £m	Other £m	Inter- segment £m	Total £m
<b>Year ended 31 December 2015</b>							
Loans and advances to customers (net)	105,358	74,633	70,822	7,479	214	–	258,506
Investment in associates and joint venture	21	18	30	–	–	–	69
Total assets	150,270	80,919	543,803	15,044	10,484	(72,579)	727,941
Customer accounts	135,234	89,686	95,046	12,543	321	–	332,830
Total liabilities	140,573	73,096	528,784	14,247	5,695	(72,579)	689,816
<b>Year ended 31 December 2014</b>							
Loans and advances to customers (net)	105,929	68,225	75,044	7,811	243	–	257,252
Investment in associates and joint venture	21	18	30	–	–	–	69
Total assets	153,325	74,996	608,140	15,905	14,811	(69,888)	797,289
Customer accounts	129,841	87,148	116,558	12,778	182	–	346,507
Total liabilities	143,616	67,141	593,122	15,107	11,493	(69,888)	760,591

### Information by country

	31 December 2015		31 December 2014	
	External net Operating income <sup>1,3</sup>	Non-current assets <sup>2</sup>	External net Operating income <sup>1,3</sup>	Non-current assets <sup>2</sup>
	£m	£m	£m	£m
United Kingdom	9,618	4,310	8,817	4,760
France	1,768	5,786	1,532	6,046
Germany	487	163	509	171
Turkey	457	57	559	71
Other countries	540	204	469	209
<b>Total</b>	<b>12,870</b>	<b>10,520</b>	<b>11,886</b>	<b>11,257</b>

1 Net operating income is attributed to countries on the basis of the customers' location.

2 Non-current assets consist of property, plant and equipment, goodwill, other intangible assets and certain other assets expected to be recovered more than twelve months after the reporting period.

3 Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue.

## Notes on the Financial Statements (continued)

### 11 Trading assets

#### Accounting policy

Financial assets are classified as held for trading if they have been acquired principally for the purpose of selling in the near term, or form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. They are recognised on trade date, when the group enters into contractual arrangements with counterparties, and are normally derecognised when sold. They are initially measured at fair value, with transaction costs taken to the income statement. Subsequent changes in their fair values are recognised in the income statement in 'Net trading income'.

#### Trading assets

	The group		The bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Trading assets:				
– which may be repledged or resold by counterparties	14,957	24,182	5,578	9,555
– not subject to repledge or resale by counterparties	95,628	105,945	84,666	88,202
	<b>110,585</b>	<b>130,127</b>	<b>90,244</b>	<b>97,757</b>
Treasury and other eligible bills	675	653	94	154
Debt securities	37,367	49,996	21,935	25,150
Equity securities	40,583	44,242	38,848	41,899
Loans and advances to banks	14,248	15,640	13,617	13,039
Loans and advances to customers	17,712	19,596	15,750	17,515
	<b>110,585</b>	<b>130,127</b>	<b>90,244</b>	<b>97,757</b>

1 Included within the above figures for the group are debt securities issued by banks and other financial institutions of £8,211 million (2014: £11,278 million), of which £597 million (2014: £1,857 million) are guaranteed by various governments.

2 Included within the above figures for the bank are debt securities issued by banks and other financial institutions of £5,662 million (2014: £7,228 million), of which nil (2014: nil) are guaranteed by governments.

### 12 Fair values of financial instruments carried at fair value

#### Accounting policy

All financial instruments are recognised initially 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 at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, sometimes the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the group recognises a trading gain or loss at inception ('day 1 gain or loss'), being the difference between the transaction price and the fair value. When significant unobservable parameters are used, the entire day 1 gain or loss is deferred and is recognised in the income statement over the life of the transaction until the transaction matures or is closed out, the valuation inputs become observable or the group enters into an offsetting transaction. The fair value of financial instruments is generally measured on an individual basis. However, in cases where the group manages a group of financial assets and liabilities according to its net market or credit risk exposure, the fair value of the group of financial instruments is measured on a net basis but the underlying financial assets and liabilities separately in the financial statements, unless they satisfy the IFRS offsetting criteria as described in Note 30.

#### Critical accounting estimates and judgements

##### Valuation of financial instruments

The best evidence of fair value is a quoted price in an actively traded principal market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. When a financial instrument has a quoted price in an active market, the fair value of the total holding of the financial instrument is calculated as the product of the number of units and quoted price. The judgement as to whether a market is active may include, but is not restricted to, consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. Valuation techniques may incorporate assumptions about factors that other market participants would use in their valuations, including:

- the likelihood and expected timing of future cash flows on the instrument. Judgement may be required to assess the counterparty's ability to service the instrument in accordance with its contractual terms. Future cash flows may be sensitive to changes in market rates;
- selecting an appropriate discount rate for the instrument. Judgement is required to assess what a market participant would regard as the appropriate spread of the rate for an instrument over the appropriate risk-free rate;
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

A range of valuation techniques is employed, dependent on the instrument type and available market data. Most valuation techniques are based upon discounted cash flow analyses, in which expected future cash flows are calculated and discounted to present value using a discounting curve. Prior to considering credit risk, the expected future cash flows may be known, as would be the case for the fixed leg of an interest rate swap, or may be uncertain and require projection, as would be the case for the floating leg of an interest rate swap. 'Projection' utilises market forward curves, if available. In option models, the probability of different potential future outcomes must be considered. In addition, the value of some products is dependent on more than one market factor, and in these cases it will typically be necessary to consider how movements in one market factor may affect the other market factors. The model inputs necessary to perform

## Notes on the Financial Statements (continued)

such calculations include interest rate yield curves, exchange rates, volatilities, correlations and prepayment and default rates. For interest rate derivatives with collateralised counterparties and in significant currencies, the group uses a discounting curve that reflects the overnight interest rate.

The majority of valuation techniques employ only observable market data. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them the measurement of fair value is more judgemental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's inception profit or greater than 5% of the instrument's valuation is driven by unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

### Control framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk-taker.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets the group will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors that are considered in this regard are, *inter alia*:

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

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

### Financial liabilities measured at fair value

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

Structured notes issued and certain other hybrid instrument liabilities are included within trading liabilities and are measured at fair value. The credit spread applied to these instruments is derived from the spreads at which the group issues structured notes.

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

Changes in fair value are generally subject to a profit and loss analysis process. This process disaggregates changes in fair value into three high level categories: (i) portfolio changes, such as new transactions or maturing transactions, (ii) market movements, such as changes in foreign exchange rates or equity prices, and (iii) other, such as changes in fair value adjustments, discussed below.

### Fair value hierarchy

Fair values of financial assets and liabilities are determined according to the following hierarchy:

- *Level 1 – valuation technique using quoted market price*: financial instruments with quoted prices for identical instruments in active markets that the group can access at the measurement date.
- *Level 2 – valuation technique using observable inputs*: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.



## Notes on the Financial Statements (continued)

- Level 3 – valuation technique with significant unobservable inputs: financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

The following table sets out the financial instruments by fair value hierarchy.

Financial instruments carried at fair value and bases of valuation

### The group

	Valuation techniques			Total £m
	Level 1 quoted market price £m	Level 2 using observable inputs £m	Level 3 with significant unobservable inputs £m	
<b>Recurring fair value measurements at 31 December 2015</b>				
<b>Assets</b>				
Trading assets	67,879	40,264	2,442	110,585
Financial assets designated at fair value	6,516	311	2	6,829
Derivatives	549	164,778	1,458	166,785
Financial investments: available-for-sale	55,682	14,205	1,465	71,352
<b>Liabilities</b>				
Trading liabilities	18,343	54,649	497	73,489
Financial liabilities at fair value	2,972	16,027	2	19,001
Derivatives	922	161,197	745	162,864
<b>Recurring fair value measurements at 31 December 2014</b>				
<b>Assets</b>				
Trading assets	83,749	44,225	2,153	130,127
Financial assets designated at fair value	6,618	276	5	6,899
Derivatives	1,949	184,173	1,614	187,736
Financial investments: available-for-sale	56,996	17,652	1,546	76,194
<b>Liabilities</b>				
Trading liabilities	22,669	58,638	1,293	82,600
Financial liabilities at fair value	1,107	21,440	5	22,552
Derivatives	1,935	185,122	1,221	188,278

### The bank

	Valuation techniques			Total £m
	Level 1 quoted market price £m	Level 2 using observable inputs £m	Level 3 with significant un-observable inputs £m	
<b>Recurring fair value measurement at 31 December 2015</b>				
<b>Assets</b>				
Trading assets	51,032	36,780	2,432	90,244
Financial assets designated at fair value	–	–	–	–
Derivatives	218	148,735	1,501	150,454
Financial investments: available-for-sale	33,864	4,257	1,778	39,899
<b>Liabilities</b>				
Trading liabilities	11,125	45,980	331	57,436
Financial liabilities at fair value	–	11,813	–	11,813
Derivatives	420	146,912	917	148,249
<b>Recurring fair value measurement at 31 December 2014</b>				
<b>Assets</b>				
Trading assets	56,908	38,717	2,132	97,757
Financial assets designated at fair value	–	9	–	9
Derivatives	1,900	156,711	1,621	160,232
Financial investments: available-for-sale	36,276	9,801	2,361	48,438
<b>Liabilities</b>				
Trading liabilities	11,433	46,370	1,236	59,039
Financial liabilities at fair value	–	16,127	–	16,127
Derivatives	1,920	158,145	1,377	161,442

## Notes on the Financial Statements (continued)

Transfers between Level 1 and Level 2 fair values:

	Assets				Liabilities			
	Available for sale £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m	
<b>At 31 December 2015</b>								
Transfers from Level 1 to Level 2	-	45	-	37	1,055	-	67	
Transfers from Level 2 to Level 1	-	329	-	2	348	1	-	
<b>At 31 December 2014</b>								
Transfers from Level 1 to Level 2	1,641	11,024	-	-	18,989	-	-	
Transfers from Level 2 to Level 1	-	-	-	-	-	-	-	

Transfers from Level 1 to Level 2 in the held for trading liabilities category reflect reclassification of notes issued by the group bearing a return closely linked to a referenced asset.

### Fair value adjustments

Fair value adjustments are adopted when the group considers that there are additional factors that would be considered by a market participant which are not incorporated within the valuation model. The group classifies fair value adjustments as either 'risk-related' or 'model-related'. The majority of these adjustments relate to GB&M.

Movements in the level of fair value adjustments do not necessarily result in the recognition of profits or losses within the income statement. For example, as models are enhanced, fair value adjustments may no longer be required. Similarly, fair value adjustments will decrease when the related positions are unwound, but this may not result in profit or loss.

### Risk-related adjustments

#### *Bid-offer*

IFRS 13 requires use of the price within the bid-offer spread that is most representative of fair value. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the extent to which bid-offer costs would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the position.

#### *Uncertainty*

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, there exists a range of possible values that the financial instrument or market parameter may assume and an adjustment may be necessary to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model.

#### *Credit valuation adjustment*

The credit valuation adjustment ('CVA') is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the counterparty may default and that the group may not receive the full market value of the transactions (see below).

#### *Debit valuation adjustment*

The debit valuation adjustment ('DVA') is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the group may default, and that the group may not pay the full market value of the transactions (see below).

#### *Funding fair value adjustment*

The funding fair value adjustment ('FFVA') is calculated by applying future market funding spreads to the expected future funding exposure of any uncollateralised component of the OTC derivative portfolio. This includes the uncollateralised component of collateralised derivatives in addition to derivatives that are fully uncollateralised. The expected future funding exposure is calculated by a simulation methodology, where available. The expected future funding exposure is adjusted for events that may terminate the exposure such as the default of the group or the counterparty. The FFVA and DVA are calculated independently.

### Model-related adjustments

#### *Model limitation*

Models used for portfolio valuation purposes may be based upon a simplifying set of assumptions that do not capture all material market characteristics. Additionally, markets evolve, and models that were adequate in the past may require

## Notes on the Financial Statements (continued)

development to capture all material market characteristics in current market conditions. In these circumstances, model limitation adjustments are adopted. As model development progresses, model limitations are addressed within the valuation models and a model limitation adjustment is no longer needed.

### *Inception profit (Day 1 P&L reserves)*

Inception profit adjustments are adopted when the fair value estimated by a valuation model is based on one or more significant unobservable inputs. The accounting for inception profit adjustments is discussed on page 125.

### Credit valuation adjustment/debit valuation adjustment methodology

The group calculates a separate CVA and DVA for each group legal entity, and within each entity for each counterparty to which the entity has exposure. The group calculates the CVA by applying the probability of default ('PD') of the counterparty, conditional on the non-default of the group, to the group's expected positive exposure to the counterparty and multiplying the result by the loss expected in the event of default. Conversely, the group calculates the DVA by applying the PD of the group, conditional on the non-default of the counterparty, to the expected positive exposure of the counterparty to the group and multiplying the result by the loss expected in the event of default. Both calculations are performed over the life of the potential exposure.

For most products, the group uses a simulation methodology to calculate the expected positive exposure to a counterparty. This incorporates a range of potential exposures across the portfolio of transactions with the counterparty over the life of the portfolio. The simulation methodology includes credit mitigants such as counterparty netting agreements and collateral agreements with the counterparty.

For certain types of exotic derivatives where the products are not currently supported by the simulation, or for derivative exposures in smaller trading locations where the simulation tool is not yet available, the group adopts alternative methodologies.

The methodologies do not, in general, account for 'wrong-way risk'. Wrong-way risk arises where the underlying value of the derivative prior to any CVA is positively correlated to the probability of default of the counterparty. When there is significant wrong-way risk, a trade-specific approach is applied to reflect the wrong-way risk within the valuation.

With the exception of certain central clearing parties, the group includes all third party counterparties in the CVA and DVA calculations and does not net these adjustments across group entities. The group reviews and refines the CVA and DVA methodologies on an ongoing basis.

### Fair value valuation bases

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

#### *The group*

	Assets				Liabilities		
	Available-for-sale £m	Held for trading £m	At fair value £m	Derivatives £m	Held for trading £m	At fair value £m	Derivatives £m
Private equity investments	737	24	–	–	24	–	–
Asset-backed securities	706	250	–	–	–	–	–
Structured notes	–	3	–	–	473	–	–
Derivatives	–	–	–	1,458	–	–	745
Other portfolios	22	2,165	2	–	–	2	–
<b>At 31 December 2015</b>	<b>1,465</b>	<b>2,442</b>	<b>2</b>	<b>1,458</b>	<b>497</b>	<b>2</b>	<b>745</b>
Private equity investments	595	96	–	–	28	–	–
Asset-backed securities	934	275	–	–	–	–	–
Structured notes	–	–	–	–	1,265	–	–
Derivatives	–	–	–	1,614	–	–	1,221
Other portfolios	17	1,782	5	–	–	5	–
<b>At 31 December 2014</b>	<b>1,546</b>	<b>2,153</b>	<b>5</b>	<b>1,614</b>	<b>1,293</b>	<b>5</b>	<b>1,221</b>

## Notes on the Financial Statements (continued)

### The bank

	Assets				Liabilities		
	Available-for-sale £m	Held for trading £m	At fair value £m	Derivatives £m	Held for trading £m	At fair value £m	Derivatives £m
Private equity investments	474	-	-	-	-	-	-
Asset-backed securities	1,304	267	-	-	-	-	-
Structured notes	-	-	-	-	331	-	-
Derivatives	-	-	-	1,501	-	-	917
Other portfolios	-	2,165	-	-	-	-	-
<b>At 31 December 2015</b>	<b>1,778</b>	<b>2,432</b>	<b>-</b>	<b>1,501</b>	<b>331</b>	<b>-</b>	<b>917</b>
Private equity investments	415	68	-	-	-	-	-
Asset-backed securities	1,946	275	-	-	-	-	-
Structured notes	-	7	-	-	1,236	-	-
Derivatives	-	-	-	1,621	-	-	1,377
Other portfolios	-	1,782	-	-	-	-	-
<b>At 31 December 2014</b>	<b>2,361</b>	<b>2,132</b>	<b>-</b>	<b>1,621</b>	<b>1,236</b>	<b>-</b>	<b>1,377</b>

Level 3 instruments are present in both ongoing and legacy businesses. Loans held for securitisation, certain derivatives and predominantly all Level 3 asset-backed securities are legacy. The group has the capability to hold these positions.

### Private equity including strategic investments

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

### Asset-backed securities

While quoted market prices are generally used to determine the fair value of these securities, valuation models are used to substantiate the reliability of the limited market data available and to identify whether any adjustments to quoted market prices are required. For ABSs including residential MBSs, the valuation uses an industry standard model and the assumptions relating to prepayment speeds, default rates and loss severity based on collateral type, and performance, as appropriate. The valuations output is benchmarked for consistency against observable data for securities of a similar nature.

### Loans, including leveraged finance and loans held for securitisation

Loans held at fair value are valued from broker quotes and/or market data consensus providers when available. In the absence of an observable market, the fair value is determined using alternative valuation techniques. These techniques include discounted cash flow models, which incorporate assumptions regarding an appropriate credit spread for the loan, derived from other market instruments issued by the same or comparable entities.

### Structured notes

The fair value of structured notes valued using a valuation technique with significant unobservable inputs is derived from the fair value of the underlying debt security, and the fair value of the embedded derivative is determined as described in the paragraph below on derivatives.

Level 3 structured notes principally comprise equity-linked notes which are issued by the group and provide the counterparty with a return that is linked to the performance of certain equity securities, and other portfolios. The notes are classified as Level 3 due to the unobservability of parameters such as long-dated equity volatilities and correlations between equity prices, between equity prices and interest rates and between interest rates and foreign exchange rates.

### Derivatives

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

## Notes on the Financial Statements (continued)

Derivative products valued using valuation techniques with significant unobservable inputs include certain types of correlation products, such as foreign exchange basket options, equity basket options, foreign exchange interest rate hybrid transactions and long-dated option transactions. Examples of the latter are equity options, interest rate and foreign exchange options and certain credit derivatives. Credit derivatives include certain tranching CDS transactions.

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

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

#### The group

	Assets				Liabilities			
	Available-for-sale £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m	
<b>At 1 January 2015</b>	1,546	2,153	5	1,614	1,293	5	1,221	
Total gains or losses recognised in profit or loss	(3)	64	-	157	(226)	-	(171)	
- trading income excluding net interest income	-	64	-	157	(226)	-	(171)	
- gains less losses from financial investments	(3)	-	-	-	-	-	-	
Total gains or losses recognised in other comprehensive income <sup>1</sup>	263	(8)	-	(2)	(2)	-	(13)	
- available-for-sale investments: fair value gains/(losses)	250	-	-	-	-	-	-	
- cash flow hedges: fair value gains/(losses)	-	-	-	10	-	-	(11)	
- exchange differences	13	(8)	-	(12)	(2)	-	(2)	
Purchases	232	1,049	-	-	2	-	-	
Issues	-	-	-	-	15	-	-	
Sales	(252)	(763)	(3)	-	(43)	(3)	-	
Settlements	(21)	(63)	-	(65)	(180)	-	(187)	
Transfer out	(825)	(132)	-	(516)	(506)	-	(166)	
Transfer in	525	142	-	270	144	-	61	
<b>At 31 December 2015</b>	1,465	2,442	2	1,458	497	2	745	
Unrealised gains/(losses) recognised in profit or loss relating to and liabilities held at 31 December 2014	(19)	(3)	(3)	(26)	(207)	(1)	224	
- trading income excluding net interest income	-	(3)	-	(26)	(207)	-	224	
- net income/(expenses) from other financial instruments	-	-	(3)	-	-	(1)	-	
- loan impairment charges and other credit risk provisions	(19)	-	-	-	-	-	-	

<sup>1</sup> Included in 'Available-for-sale investments: fair value gains/(losses)' and 'Exchange differences' in the consolidated statement of comprehensive income.

Movement of Level 3 available-for-sale assets are driven by ABS activity, predominantly in the securities investment conduits. Transfers out of Level 3 available-for-sale assets demonstrates increased confidence in pricing and price coverage, and transfers in reflect limited availability of third-party prices. Increase in Level 3 held for trading assets is driven by an increase in recently-issued syndicated loans. The decline in Level 3 held for trading liabilities reflects a decline in the outstanding balance of Level 3 equity-linked notes, both as a result of market movement and reduced issuance. The decline in Level 3 derivative assets and liabilities reflects market movement.

## Notes on the Financial Statements (continued)

	Assets				Liabilities		
	Available-for-sale £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m
At 1 January 2014	1,653	1,562	-	1,072	1,361	-	1,297
Total gains or losses recognised in profit or loss	(7)	123	-	734	57	-	193
- trading income excluding net interest income	-	123	-	734	57	-	193
- gains less losses from financial investments	(7)	-	-	-	-	-	-
Total gains or losses recognised in other comprehensive income	104	(2)	-	-	(4)	-	(2)
- available-for-sale investments: fair value gains/(losses)	66	-	-	-	-	-	-
- exchange differences	38	(2)	-	-	(4)	-	(2)
Purchases	666	27	5	-	-	5	-
Issues	-	-	-	-	439	-	-
Sales	(259)	(204)	-	-	-	-	-
Settlements	(79)	(16)	-	15	(385)	-	(90)
Transfer out	(1,023)	(58)	-	(281)	(202)	-	(233)
Transfer in	491	721	-	74	27	-	56
At 31 December 2014	1,546	2,153	5	1,614	1,293	5	1,221
Unrealised gains/(losses) recognised in profit or loss relating to and liabilities held at 31 December	(1)	5	-	612	(108)	-	118
- trading income excluding net interest income	-	5	-	612	(108)	-	118
- loan impairment charges and other credit risk provisions	(1)	-	-	-	-	-	-

*The bank*

	Assets				Liabilities		
	Available-for-sale £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m
At 1 January 2015	2,361	2,132	-	1,621	1,236	-	1,377
Total gains or losses recognised in profit or loss	122	80	-	154	(232)	-	(151)
- trading income excluding net interest income	-	80	-	154	(232)	-	(151)
- gains less losses from financial investments	122	-	-	-	-	-	-
Total gains or losses recognised in other comprehensive income	329	(7)	-	10	-	-	-
- available-for-sale investments: fair value gains/(losses)	329	-	-	-	-	-	-
- cash flow hedges: fair value gains/(losses)	-	-	-	10	-	-	-
- exchange differences	-	(7)	-	-	-	-	-
Purchases	89	1,102	-	-	-	-	-
Issues	-	-	-	-	3	-	-
Sales	(1,012)	(822)	-	-	(38)	-	-
Settlements	(5)	(60)	-	(20)	(170)	-	(189)
Transfer out	(176)	(132)	-	(312)	(504)	-	(154)
Transfer in	70	139	-	48	36	-	34
At 31 December 2015	1,778	2,432	-	1,501	331	-	917
Unrealised gains/(losses) recognised in profit or loss relating to and liabilities held at 31 December	-	(3)	-	(219)	(212)	-	202
- trading income excluding net interest income	-	(3)	-	(219)	(212)	-	202
- loan impairment charges and other credit risk provisions	-	-	-	-	-	-	-

## Notes on the Financial Statements (continued)

	Assets				Liabilities			
	Available-for-sale £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m	
At 1 January 2014	2,717	1,563	-	1,083	1,290	-	1,367	
Total gains or losses recognised in profit or loss	(4)	136	-	649	21	-	268	
- trading income excluding net interest income	-	136	-	649	21	-	268	
- gains less losses from financial investments	(4)	-	-	-	-	-	-	
Total gains or losses recognised in other comprehensive income	576	-	-	-	-	-	-	
- available-for-sale investments: fair value gains/(losses)	572	-	-	-	-	-	-	
- exchange differences	4	-	-	-	-	-	-	
Purchases	208	74	-	-	-	-	-	
Issues	-	-	-	-	432	-	-	
Sales	(1,042)	(254)	-	-	-	-	-	
Settlements	(7)	(19)	-	9	(305)	-	(127)	
Transfer out	(126)	(58)	-	(202)	(202)	-	(197)	
Transfer in	39	690	-	82	-	-	66	
At 31 December 2014	2,361	2,132	-	1,621	1,236	-	1,377	
Unrealised gains/(losses) recognised in profit or loss relating to and liabilities held at 31 December	(1)	11	-	542	(108)	-	147	
- trading income excluding net interest income	-	11	-	542	(108)	-	147	
- loan impairment charges and other credit risk provisions	(1)	-	-	-	-	-	-	

## Effect of changes in significant unobservable assumptions to reasonably possible alternatives

The following table shows the sensitivity of Level 3 fair values to reasonably possible alternative assumptions:

*The group*

	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes £m	Unfavourable changes £m	Favourable changes £m	Unfavourable changes £m
<b>At 31 December 2015</b>				
Derivatives/trading assets/trading liabilities <sup>1</sup>	98	(82)	-	-
Financial assets and liabilities designated at fair value	-	(1)	-	-
Financial investments: available-for-sale	7	(4)	86	(86)
<b>At 31 December 2014</b>				
Derivatives/trading assets/trading liabilities <sup>1</sup>	161	(140)	-	-
Financial assets and liabilities designated at fair value	-	(1)	-	-
Financial investments: available-for-sale	11	(7)	73	(95)

*The bank*

	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes £m	Unfavourable changes £m	Favourable changes £m	Unfavourable changes £m
<b>At 31 December 2015</b>				
Derivatives/trading assets/trading liabilities <sup>1</sup>	123	(114)	-	-
Financial assets and liabilities designated at fair value	-	-	-	-
Financial investments: available-for-sale	-	-	43	(43)
<b>At 31 December 2014</b>				
Derivatives/trading assets/trading liabilities <sup>1</sup>	162	(150)	-	-
Financial assets and liabilities designated at fair value	-	-	-	-
Financial investments: available-for-sale	-	-	76	(90)

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

## Notes on the Financial Statements (continued)

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

	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes £m	Unfavourable changes £m	Favourable changes £m	Unfavourable changes £m
<b>At 31 December 2015</b>				
Private equity investments	4	(4)	52	(52)
Asset-backed securities	8	(3)	34	(34)
Structured notes	7	(7)	–	–
Derivatives	13	(13)	–	–
Other portfolios	73	(60)	–	–
<b>At 31 December 2014</b>				
Private equity investments	6	(6)	38	(60)
Asset-backed securities	28	(11)	35	(35)
Structured notes	6	(6)	–	–
Derivatives	69	(75)	–	–
Other portfolios	63	(50)	–	–

Favourable and unfavourable changes are determined on the basis of sensitivity analysis. The sensitivity analysis aims to measure a range of fair values consistent with the application of a 95% confidence interval. Methodologies take account of the nature of the valuation technique employed, as well as the availability and reliability of observable proxy and historical data. When the available data is not amenable to statistical analysis, the quantification of uncertainty is judgemental, but remains guided by the 95% confidence interval.

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

### Key unobservable inputs to Level 3 financial instruments

The table below lists key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 31 December 2015. The core range of inputs is the estimated range within which 90% of the inputs fall. A further description of the categories of key unobservable inputs is given below.

	Fair value		Valuation technique	Key unobservable inputs	Full range of inputs		Core range of inputs	
	Assets £m	Liabilities £m			Lower	Higher	Lower	Higher
<b>At 31 December 2015</b>								
Private equity	761	24	See notes below	See notes below	n/a	n/a	n/a	n/a
Asset-backed securities	956	–						
CLO/CDO <sup>1</sup>	238	–	Market proxy	Bid quotes	0	99	35	77
Other ABSs	718	–	Market proxy	Bid quotes	0	100	50	78
Structured notes	3	473						
Equity-linked notes	–	268	Model – Option model	Equity volatility	10%	72%	16%	54%
Fund-linked notes	–	9	Model – Option model	Equity correlation	39%	87%	45%	80%
FX-linked notes	–	48	Model – Option model	Fund volatility	6%	8%	6%	8%
Other	3	148	Model – Option model	FX volatility	5%	35%	5%	35%
Derivatives	1,458	745						
Interest rate derivatives:								
– securitisation swaps	257	325	Model – DCF <sup>2</sup>	Prepayment rate	0%	90%	10%	73%
– long-dated swaptions	832	80	Model – Option model	IR volatility	8%	66%	14%	42%
– other	24	15						
Foreign exchange derivatives:								
– foreign exchange options	138	100	Model – Option model	FX volatility	0%	35%	0%	26%
Equity derivatives:								
– long-dated single stock options	46	89	Model – Option model	Equity volatility	10%	104%	16%	70%
– other	141	134						
Credit derivatives:	20	2						
Other portfolios	2,189	2						
– structured certificates	1,053	–	Model – DCF <sup>2</sup>	Credit volatility	2%	4%	2%	4%
– other	1,136	2						
	<b>5,367</b>	<b>1,244</b>						

<sup>1</sup> Collateralised loan obligation/collateralised debt obligation

<sup>2</sup> Discounted cash flow



## Notes on the Financial Statements (continued)

At 31 December 2014	Fair value		Valuation technique	Key unobservable inputs	Full range of inputs		Core range of inputs	
	Assets £m	Liabilities £m			Lower	Higher	Lower	Higher
Private equity	691	28	See notes below	See notes below	n/a	n/a	n/a	n/a
Asset-backed securities	1,209	–						
CLO/CDO <sup>1</sup>	600	–	Market proxy	Bid quotes	–	101	55	85
Other ABSs	609	–	Market proxy	Bid quotes	–	96	25	53
Structured notes	–	1,265						
Equity-linked notes	–	601	Model – Option model	Equity volatility	10%	66%	16%	43%
			Model – Option model	Equity correlation	38%	88%	44%	79%
Fund-linked notes	–	362	Model – Option model	Fund volatility	6%	8%	6%	8%
FX-linked notes	–	182	Model – Option model	FX volatility	3%	70%	3%	70%
Other	–	120						
Derivatives	1,614	1,221						
Interest rate derivatives:								
– securitisation swaps	288	655	Model – DCF <sup>2</sup>	Prepayment rate	0%	50%	6%	18%
– long-dated swaptions	667	123	Model – Option model	IR volatility	8%	59%	17%	38%
– other	309	84						
Foreign exchange derivatives:								
– foreign exchange options	64	29	Model – Option model	FX volatility	0%	70%	7%	26%
Equity derivatives:								
– long-dated single stock options	87	112	Model – Option model	Equity volatility	10%	66%	14%	38%
– other	132	188						
Credit derivatives:	67	30						
Other portfolios	1,804	5						
– structured certificates	1,001	5	Model – DCF <sup>2</sup>	Credit volatility	1%	3%	1%	3%
– other	803	–						
	<u>5,318</u>	<u>2,519</u>						

<sup>1</sup> Collateralised loan obligation/collateralised debt obligation

<sup>2</sup> Discounted cash flow

### Private equity

Given the bespoke nature of the analysis in respect of each holding, it is not practical to quote a range of key unobservable inputs.

### Market proxy

Market proxy pricing may be used for an instrument for which specific market pricing is not available, but evidence is available in respect of instruments that have some characteristics in common. In some cases it might be possible to identify a specific proxy, but more generally evidence across a wider range of instruments will be used to understand the factors that influence current market pricing and the manner of that influence. The range of prices used as inputs into a market proxy pricing methodology may therefore be wide. This range is not indicative of the uncertainty associated with the price derived for an individual security.

### Volatility

Volatility is a measure of the anticipated future variability of a market price. Volatility tends to increase in stressed market conditions, and decrease in calmer market conditions. Volatility is an important input in the pricing of options. In general, the higher the volatility, the more expensive the option will be. This reflects both the higher probability of an increased return from the option and the potentially higher costs that the group may incur in hedging the risks associated with the option. If option prices become more expensive, this will increase the value of the group's long option positions (i.e. the positions in which the group has purchased options), while the group's short option positions (i.e. the positions in which the group has sold options) will suffer losses.

Volatility varies by underlying reference market price, and by strike and maturity of the option. Volatility also varies over time. As a result, it is difficult to make general statements regarding volatility levels.

Certain volatilities, typically those of a longer-dated nature, are unobservable. The unobservable volatility is then estimated from observable data. The range of unobservable volatilities quoted in the table reflects the wide variation in volatility inputs by reference market price. The core range is significantly narrower than the full range because these examples with extreme volatilities occur relatively rarely within the group's portfolio. For any single unobservable volatility, the uncertainty in the volatility determination is significantly less than the range quoted above.

## Notes on the Financial Statements (continued)

### Correlation

Correlation is a measure of the inter-relationship between two market prices and is expressed as a number between minus one and one. A positive correlation implies that the two market prices tend to move in the same direction, with a correlation of one implying that they always move in the same direction. A negative correlation implies that the two market prices tend to move in opposite directions, with a correlation of minus one implying that the two market prices always move in opposite directions.

Correlation is used to value more complex instruments where the payout is dependent upon more than one market price. There is a wide range of instruments for which correlation is an input, and consequently a wide range of both same-asset correlations (e.g. equity-equity correlation) and cross-asset correlations (e.g. foreign exchange rate-interest rate correlation) are used. In general, the range of same-asset correlations will be narrower than the range of cross-asset correlations.

Correlation may be unobservable. Unobservable correlations may be estimated based upon a range of evidence, including consensus pricing services, group trade prices, proxy correlations and examination of historical price relationships.

The range of unobservable correlations quoted in the table reflects the wide variation in correlation inputs by market price pair. For any single unobservable correlation, the uncertainty in the correlation determination is likely to be less than the range quoted above.

### Credit spread

Credit spread is the premium over a benchmark interest rate required by the market to accept a lower credit quality. In a discounted cash flow model, the credit spread increases the discount factors applied to future cash flows, thereby reducing the value of an asset. Credit spreads may be implied from market prices. Credit spreads may not be observable in more illiquid markets.

### Inter-relationships between key unobservable inputs

Key unobservable inputs to Level 3 financial instruments may not be independent of each other. As described above, market variables may be correlated. This correlation typically reflects the manner in which different markets tend to react to macro-economic or other events. Furthermore, the effect of changing market variables upon the group's portfolio will depend upon the group's net risk position in respect of each variable.

## Notes on the Financial Statements (continued)

## 13 Fair values of financial instruments not carried at fair value

## The group

	Fair values				Total £m
	Carrying amount £m	Valuation techniques			
		Level 1 – quoted market price £m	Level 2 - using observable inputs £m	Level 3 - with significant unobservable inputs £m	
<b>Assets and liabilities not held for sale at 31 December 2015</b>					
Assets					
Loans and advances to banks	23,222	–	22,605	617	23,222
Loans and advances to customers	258,506	–	764	257,979	258,743
Reverse repurchase agreements – non-trading	30,537	–	29,894	643	30,537
Liabilities					
Deposits by banks	24,202	–	24,202	–	24,202
Customer accounts	332,830	–	332,226	649	332,875
Repurchase agreements – non-trading	17,000	–	17,000	–	17,000
Debt securities in issue	26,069	–	26,067	–	26,067
Subordinated liabilities	8,527	–	8,251	–	8,251
<b>Assets and liabilities not held for sale at 31 December 2014</b>					
Assets					
Loans and advances to banks	25,262	–	24,061	1,201	25,262
Loans and advances to customers	257,252	–	2,130	257,384	259,514
Reverse repurchase agreements – non-trading	41,945	–	39,055	2,890	41,945
Liabilities					
Deposits by banks	27,590	–	27,590	–	27,590
Customer accounts	346,507	–	345,721	824	346,545
Repurchase agreements – non-trading	23,353	–	23,353	–	23,353
Debt securities in issue	27,921	–	27,691	234	27,925
Subordinated liabilities	8,858	–	8,695	–	8,695

## The bank

	Fair values				Total £m
	Carrying amount £m	Valuation techniques			
		Level 1 – quoted market price £m	Level 2 - using observable inputs £m	Level 3 - with significant unobservable inputs £m	
<b>Assets and liabilities not held for sale at 31 December 2015</b>					
Assets					
Loans and advances to banks	16,661	–	16,562	99	16,661
Loans and advances to customers	205,398	–	582	205,988	206,570
Reverse repurchase agreements – non-trading	24,893	–	24,893	–	24,893
Liabilities					
Deposits by banks	29,073	–	29,073	–	29,073
Customer accounts	271,526	–	271,526	–	271,526
Repurchase agreements – non-trading	11,275	–	11,275	–	11,275
Debt securities in issue	12,356	–	12,356	–	12,356
Subordinated liabilities	7,497	–	7,190	–	7,190
<b>Assets and liabilities not held for sale at 31 December 2014</b>					
Assets					
Loans and advances to banks	18,776	–	18,536	240	18,776
Loans and advances to customers	201,671	–	1,513	202,632	204,145
Reverse repurchase agreements – non-trading	36,391	–	36,391	–	36,391
Liabilities					
Deposits by banks	31,383	–	31,383	–	31,383
Customer accounts	282,687	–	282,687	–	282,687
Repurchase agreements – non-trading	18,293	–	18,293	–	18,293
Debt securities in issue	14,950	–	14,950	–	14,950
Subordinated liabilities	7,854	–	7,654	–	7,654

Fair values are determined according to the hierarchy set out in Note 12.

Other financial instruments not carried at fair value are typically short-term in nature and reprice to current market rates frequently. Accordingly, their carrying amount is a reasonable approximation of fair value.

## Notes on the Financial Statements (continued)

### Valuation

The fair value measurement is the group's estimate of the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It does not reflect the economic benefits and costs that the group expects to flow from the instruments' cash flows over their expected future lives. Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available.

Fair values of the assets and liabilities set out below are estimated for the purpose of disclosure as described below:

#### Loans and advances to banks and customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using valuation models that incorporate a range of input assumptions. These assumptions may include value estimates from third-party brokers which reflect over-the-counter trading activity, forward looking discounted cash flow models using assumptions which the group believes are consistent with those which would be used by market participants in valuing such loans, and trading inputs from other market participants which include observed primary and secondary trades.

Loans are grouped, as far as possible, into homogeneous groups and stratified by loans with similar characteristics to improve the accuracy of estimated valuation outputs. The stratification of a loan book considers all material factors including vintage, origination period, estimates of future interest rates, prepayment speeds, delinquency rates, loan-to-value ratios, the quality of collateral, default probability, and internal credit risk ratings.

The fair value of a loan reflects both loan impairments at the balance sheet date and estimates of market participants' expectations of credit losses over the life of the loans, and the fair value effect of re-pricing between origination and the balance sheet date.

#### Financial investments

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

#### Deposits by banks and customer accounts

Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is approximated by its carrying value.

#### Debt securities in issue and subordinated liabilities

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

#### Repurchase and reverse repurchase agreements – non-trading

Fair values are estimated using discounted cash flows, applying current rates. Fair values approximate carrying amounts as their balances are generally short dated.

## 14 Financial assets designated at fair value

### Accounting policy

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

- eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial instruments, or recognising gains and losses on different bases from related positions. Under this criterion, the main class of financial assets designated by the group are financial assets under unit-linked insurance and unit-linked investment contracts. Liabilities to customers under linked contracts are determined based on the fair value of the assets held in the linked funds. If no fair value designation was made for the related assets, the assets would be classified as available for sale, with changes in fair value recorded in other comprehensive income. The related financial assets and liabilities are managed and reported to management on a fair value basis. Designation at fair value of the financial assets and related liabilities allows the changes in fair values to be recorded in the income statement and presented in the same line;
- applies to groups of financial instruments that are managed, and their performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, and where information about the groups of financial instruments is reported to management on that basis. For example, certain financial assets are held to meet liabilities under non-linked insurance contracts. The group has documented risk management and investment strategies designed to manage and monitor market risk of those assets on net basis, after considering non-linked liabilities. Fair value measurement is also consistent with the regulatory reporting requirements under the appropriate regulations for those insurance operations;
- relates to financial instruments containing one or more non-closely related embedded derivatives.

Designated financial assets are recognised at fair value when the group enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when sold. Subsequent changes in fair values are recognised in the income statement in 'Net income from financial instruments designated at fair value'.

**Notes on the Financial Statements** (continued)*Financial assets designated at fair value*

	The group		The bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Financial assets designated at fair value:				
– not subject to repledge or resale by counterparties	6,829	6,899	–	9
Treasury and other eligible bills	–	3	–	–
Debt securities	1,036	987	–	9
Equity securities	5,712	5,855	–	–
Securities designated at fair value	6,748	6,845	–	9
Loans and advances to banks	81	54	–	–
<b>At 31 December</b>	<b>6,829</b>	<b>6,899</b>	<b>–</b>	<b>9</b>

**15 Derivatives****Accounting policy****Derivatives**

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, bonds, interest rates, foreign exchange, credit spreads, commodities and equity or other indices.

Derivatives are initially recognised, and are subsequently re-measured, at fair value. Fair values of derivatives are obtained either from quoted market prices or by using valuation techniques.

Embedded derivatives are bifurcated from the host contract when their economic characteristics and risks are not clearly and closely related to those of the host non-derivative contract, their contractual terms would otherwise meet the definition of a stand-alone derivative and the combined contract is not held for trading or designated at fair value. The bifurcated embedded derivatives are measured at fair value with changes therein recognised in the income statement.

Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative.

Derivative assets and liabilities arising from different transactions are only offset for accounting purposes if the offsetting criteria presented in Note 30 are met.

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

**Hedge accounting**

When derivatives are designated as hedges, the group classifies them as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedges'); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ('cash flow hedges'); or (iii) a hedge of a net investment in a foreign operation ('net investment hedges').

At the inception of a hedging relationship, the group documents the relationship between the hedging instruments and the hedged items, its risk management objective and its strategy for undertaking the hedge. The group requires documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items.

*Fair value hedge*

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement, along with changes in the fair value of the hedged assets, liabilities or group attributable to the hedged risk. If a hedging relationship no longer meets the criteria for hedge accounting, the hedge accounting is discontinued; the cumulative adjustment to the carrying amount of the hedged item is amortised to the income statement on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised, in which case it is recognised in the income statement immediately.

*Cash flow hedge*

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income; the ineffective portion of the change in fair value is recognised immediately in the income statement, within 'Net trading income'.

The accumulated gains and losses recognised in other comprehensive income are reclassified to the income statement in the periods in which the hedged item affects profit or loss. In hedges of forecast transactions that result in recognition of a non-financial asset or liability, previous gains and losses recognised in other comprehensive income are included in the initial measurement of the asset or liability.

When a hedging relationship is discontinued, any cumulative gain or loss recognised in other comprehensive income remains in equity until the forecast transaction is recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss previously recognised in other comprehensive income is immediately reclassified to the income statement.

*Net investment hedge*

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

**Hedge effectiveness testing**

To qualify for hedge accounting, IAS 39 requires that at the inception of the hedge and throughout its life each hedge must be expected to be highly effective, both prospectively and retrospectively, on an ongoing basis.

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

## Notes on the Financial Statements (continued)

must be expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated, with the effectiveness range being defined as 80% to 125%. Hedge ineffectiveness is recognised in the income statement in 'Net trading income'.

*Derivatives that do not qualify for hedge accounting*

Non-qualifying hedges are derivatives entered into as economic hedges of assets and liabilities for which hedge accounting was not applied.

### Fair values of derivatives by product contract type held by

The group	Assets			Liabilities		
	Trading £m	Hedging £m	Total £m	Trading £m	Hedging £m	Total £m
Foreign exchange	45,220	499	45,719	(45,799)	(123)	(45,922)
Interest rate	166,236	884	167,120	(160,623)	(1,549)	(162,172)
Equities	6,684	–	6,684	(7,555)	–	(7,555)
Credit	3,882	–	3,882	(3,891)	–	(3,891)
Commodity and other	1,531	–	1,531	(1,475)	–	(1,475)
Gross total fair values	<u>223,553</u>	<u>1,383</u>	<u>224,936</u>	<u>(219,343)</u>	<u>(1,672)</u>	<u>(221,015)</u>
Offset			(58,151)			58,151
At 31 December 2015			<u>166,785</u>			<u>(162,864)</u>
Foreign exchange	43,265	378	43,643	(44,754)	(53)	(44,807)
Interest rate	275,371	1,037	276,408	(271,602)	(2,068)	(273,670)
Equities	7,379	–	7,379	(8,916)	–	(8,916)
Credit	4,650	–	4,650	(5,214)	–	(5,214)
Commodity and other	1,826	–	1,826	(1,841)	–	(1,841)
Gross total fair values	<u>332,491</u>	<u>1,415</u>	<u>333,906</u>	<u>(332,327)</u>	<u>(2,121)</u>	<u>(334,448)</u>
Offset			(146,170)			146,170
At 31 December 2014			<u>187,736</u>			<u>(188,278)</u>
The bank	Assets			Liabilities		
	Trading £m	Hedging £m	Total £m	Trading £m	Hedging £m	Total £m
Foreign exchange	44,990	422	45,412	(45,709)	(121)	(45,830)
Interest rate	143,963	671	144,634	(140,276)	(1,096)	(141,372)
Equities	6,504	–	6,504	(7,191)	–	(7,191)
Credit	3,880	–	3,880	(3,887)	–	(3,887)
Commodity and other	1,540	–	1,540	(1,485)	–	(1,485)
Gross total fair values	<u>200,877</u>	<u>1,093</u>	<u>201,970</u>	<u>(198,548)</u>	<u>(1,217)</u>	<u>(199,765)</u>
Offset			(51,516)			51,516
At 31 December 2015			<u>150,454</u>			<u>(148,249)</u>
Foreign exchange	43,315	336	43,651	(44,865)	(43)	(44,908)
Interest rate	192,861	680	193,541	(189,841)	(1,402)	(191,243)
Equities	6,869	–	6,869	(8,545)	–	(8,545)
Credit	4,650	–	4,650	(5,209)	–	(5,209)
Commodity and other	1,843	–	1,843	(1,859)	–	(1,859)
Gross total fair values	<u>249,538</u>	<u>1,016</u>	<u>250,554</u>	<u>(250,319)</u>	<u>(1,445)</u>	<u>(251,764)</u>
Offset			(90,322)			90,322
At 31 December 2014			<u>160,232</u>			<u>(161,442)</u>

### Use of derivatives

The group transacts derivatives for three primary purposes: to create risk management solutions for clients, to manage the portfolio risks arising from client business and to manage and hedge the group's own risks.

The group's derivative activities give rise to significant open positions in portfolios of derivatives. These positions are managed constantly to ensure that they remain within acceptable risk levels. When entering into derivative transactions, the group employs the same credit risk management framework to assess and approve potential credit exposures that it uses for traditional lending.

### Trading derivatives

Most of the group's derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities include market-making and risk management. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume. Risk management activity is undertaken to manage the risk arising from client transactions, with the principal purpose of retaining client margin.

## Notes on the Financial Statements (continued)

Other derivatives classified as held for trading include non-qualifying hedging derivatives, ineffective hedging derivatives and the components of hedging derivatives that are excluded from assessing hedge effectiveness.

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

	The group		The bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Foreign exchange	2,633,560	2,520,473	2,644,406	2,539,975
Interest rate	7,528,704	11,609,407	6,909,494	9,024,790
Equities	346,769	362,678	341,507	358,081
Credit	287,755	269,376	287,549	269,366
Commodity and other	29,063	40,030	27,131	40,173
<b>At 31 December</b>	<b>10,825,851</b>	<b>14,801,964</b>	<b>10,210,087</b>	<b>12,232,385</b>

### Derivatives valued using models with unobservable inputs

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

### Unamortised balance of derivatives valued using models with significant unobservable inputs

	The group		The bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Unamortised balance at 1 January	59	85	56	81
Deferral on new transactions	92	76	91	76
Recognised in the income statement during the year:				
– amortisation	(57)	(56)	(55)	(56)
– subsequent to unobservable inputs becoming observable	–	(8)	–	(8)
– maturity, termination or offsetting derivative	(37)	(45)	(37)	(44)
Other	–	7	–	7
<b>Unamortised balance at 31 December<sup>1</sup></b>	<b>57</b>	<b>59</b>	<b>55</b>	<b>56</b>

<sup>1</sup> This amount is yet to be recognised in the consolidated income statement.

### Hedge accounting derivatives

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

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

### Notional contract amounts of derivatives held for hedge accounting purposes by product type

	The group			
	2015		2014	
	Cash flow hedge £m	Fair value hedge £m	Cash flow hedge £m	Fair value hedge £m
Foreign exchange	6,985	215	6,386	72
Interest rate	44,476	34,468	82,077	29,722
<b>At 31 December</b>	<b>51,461</b>	<b>34,683</b>	<b>88,463</b>	<b>29,794</b>

	The bank			
	2015		2014	
	Cash flow hedge £m	Fair value hedge £m	Cash flow hedge £m	Fair value hedge £m
Foreign exchange	6,691	–	5,782	–
Interest rate	27,871	25,766	44,977	23,363
<b>At 31 December</b>	<b>34,562</b>	<b>25,766</b>	<b>50,759</b>	<b>23,363</b>

## Notes on the Financial Statements (continued)

### Fair value hedges

HSBC's fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates.

#### *Fair value of derivatives designated as fair value hedges*

	2015		2014	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
<b>The group</b>				
Foreign exchange	16	–	–	(1)
Interest rate	333	(1,449)	196	(1,841)
<b>At 31 December</b>	<b>349</b>	<b>(1,449)</b>	<b>196</b>	<b>(1,842)</b>
<b>The bank</b>				
Interest rate	395	(1,090)	272	(1,321)
<b>At 31 December</b>	<b>395</b>	<b>(1,090)</b>	<b>272</b>	<b>(1,321)</b>

#### *Gains or losses arising from fair value hedges*

	The group		The bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Gains/(losses):				
– on hedging instruments	160	(1,013)	152	(673)
– on the hedged items attributable to the hedged risk	(156)	1,033	(152)	687
<b>Year ended 31 December</b>	<b>4</b>	<b>20</b>	<b>–</b>	<b>14</b>

The gains and losses on ineffective portions of fair value hedges are recognised immediately in 'Net trading income'.

### Cash flow hedges

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

#### *Fair value of derivatives designated as cash flow hedges*

	2015		2014	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
<b>The group</b>				
Foreign exchange	483	(123)	378	(52)
Interest rate	551	(100)	841	(227)
<b>At 31 December</b>	<b>1,034</b>	<b>(223)</b>	<b>1,219</b>	<b>(279)</b>
<b>The bank</b>				
Foreign exchange	422	(121)	336	(43)
Interest rate	276	(6)	408	(81)
<b>At 31 December</b>	<b>698</b>	<b>(127)</b>	<b>744</b>	<b>(124)</b>



## Notes on the Financial Statements (continued)

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

	3 months or less £m	More than 3 months but less than 1 year £m	5 years or less but more than 1 year £m	More than 5 years £m
<b>The group</b>				
Net cash inflows/(outflows) exposure				
Assets	40,226	38,697	28,923	130
Liabilities	(5,282)	(5,106)	(4,161)	(1,451)
<b>At 31 December 2015</b>	<b>34,944</b>	<b>33,591</b>	<b>24,762</b>	<b>(1,321)</b>
<b>The bank</b>				
Net cash inflows/(outflows) exposure				
Assets	34,661	33,355	26,961	41
Liabilities	-	-	-	-
<b>At 31 December 2015</b>	<b>34,661</b>	<b>33,355</b>	<b>26,961</b>	<b>41</b>
<b>The group</b>				
Net cash inflows/(outflows) exposure				
Assets	59,995	54,091	33,947	251
Liabilities	(17,824)	(13,609)	(10,388)	(3,380)
<b>At 31 December 2014</b>	<b>42,171</b>	<b>40,482</b>	<b>23,559</b>	<b>(3,129)</b>
<b>The bank</b>				
Net cash inflows/(outflows) exposure				
Assets	44,485	44,458	30,842	41
Liabilities	(5,315)	(5,226)	(4,741)	(1,235)
<b>At 31 December 2014</b>	<b>39,170</b>	<b>39,232</b>	<b>26,101</b>	<b>(1,194)</b>

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

The gains and losses on ineffective portions of derivatives designated as cash flow hedges are recognised immediately in 'Net trading income'. During the year to 31 December 2015 a net loss of £1 million (2014: gain of £8 million) was recognised due to hedge ineffectiveness. Additionally, £103 million was transferred from the cash flow hedging reserve to the income statement in respect of cash flow hedges determined not to meet all the hedge accounting criteria of IAS 39.

### 16 Non-trading reverse repurchase and repurchase agreement

#### Accounting policy

When securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to resale are not recognised on the balance sheet and the right to receive back the initial consideration paid is recorded in 'Loans and advances to banks', 'Loans and advances to customers' or 'Trading assets' as appropriate. The difference between the sale and repurchase price or between the purchase and resale price is treated as interest and recognised in net interest income over the life of the agreement for loans and advances to banks and customers. Securities lending and borrowing transactions are generally secured against cash or non-cash collateral. Securities lent or borrowed do not normally result in derecognition or recognition on the balance sheet. Cash collateral advanced or received is recorded as an asset or a liability respectively. Repos and reverse repos measured at amortised cost, or non-trading, are presented as separate lines in the balance sheet.

The extent to which non-trading reverse repos and repos represent amounts with customers and banks is set out below.

	The group		The bank	
	2015 £m	2014 £m	2015 £m	2014 £m
<b>Assets</b>				
Banks	10,756	22,477	8,364	20,713
Customers	19,781	19,468	16,529	15,678
<b>At 31 December</b>	<b>30,537</b>	<b>41,945</b>	<b>24,893</b>	<b>36,391</b>
<b>Liabilities</b>				
Banks	8,825	9,793	4,080	6,302
Customers	8,175	13,560	7,195	11,991
<b>At 31 December</b>	<b>17,000</b>	<b>23,353</b>	<b>11,275</b>	<b>18,293</b>

## Notes on the Financial Statements (continued)

### 17 Financial investments

#### Accounting policy: financial investments

Treasury bills, debt securities and equity securities intended to be held on a continuing basis, other than those designated at fair value, are classified as available for sale or held to maturity. They are recognised on trade date when the group enters into contractual arrangements to purchase those instruments, and are normally derecognised when either the securities are sold or redeemed.

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

Interest income is recognised over the debt asset's expected life. Premiums and/or discounts arising on the purchase of dated debt securities are included in the interest recognised. Dividends from equity assets are recognised in the income statement when the right to receive payment is established.

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

The accounting policy relating to impairments of available-for-sale securities is presented in Note 1(h).

#### Financial investments:

	The group		The bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Financial investments:				
– which may be repledged or resold by counterparties	3,314	14,831	2,395	13,552
– not subject to repledge or resale by counterparties	68,038	61,363	37,504	34,886
<b>At 31 December</b>	<b>71,352</b>	<b>76,194</b>	<b>39,899</b>	<b>48,438</b>
Treasury and other eligible bills – available for sale	3,155	2,849	1,909	2,081
Debt securities – available for sale	67,088	72,336	37,427	45,920
Equity securities – available for sale <sup>1</sup>	1,109	1,009	563	437
<b>At 31 December</b>	<b>71,352</b>	<b>76,194</b>	<b>39,899</b>	<b>48,438</b>

<sup>1</sup> The fair value of the group's interest in Visa Europe has been assessed against the expected cash consideration of £291 million to be received from the proposed sale to Visa Inc to be completed in 2016.

For the group, £9,213 million (2014: £6,172 million), and for the bank, £5,947 million (2014: £4,131 million), of the debt securities issued by banks and other financial institutions are guaranteed by various governments.

### 18 Assets transferred, assets charged as security for liabilities, and collateral accepted as security for assets

#### Accounting policy

##### Derecognition of financial assets

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

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

#### Financial assets not qualifying for full derecognition and associated financial liabilities

##### The group

	Carrying amount of assets before transfer	Carrying amount of transferred assets £m	Carrying amount of associated liabilities £m	Fair value of transferred assets £m	Fair value of associated liabilities £m	Net position £m
<b>At 31 December 2015</b>						
Repurchase agreements		14,513	14,615			
Securities lending agreements		3,112	3,048			
Other sales (recourse to transferred asset only)		502	537	503	503	–
Securitisations recognised to the extent of continuing involvement	3,776	3	2	3	2	1
<b>At 31 December 2014</b>						
Repurchase agreements		31,030	31,550			
Securities lending agreements		6,992	5,872			
Other sales (recourse to transferred asset only)		389	564	533	533	–
Securitisations recognised to the extent of continuing involvement	3,590	7	3	7	3	4

## Notes on the Financial Statements (continued)

## The bank

	Carrying amount of assets before transfer £m	Carrying amount of transferred assets £m	Carrying amount of associated liabilities £m	Fair value of transferred assets £m	Fair value of associated liabilities £m	Net position £m
<b>At 31 December 2015</b>						
Repurchase agreements		4,926	4,926			
Securities lending agreements		3,047	3,047			
Other sales (recourse to transferred asset only)		502	537	503	503	–
Securitisations recognised to the extent of continuing involvement	3,776	3	2	3	2	1
<b>At 31 December 2014</b>						
Repurchase agreements		16,073	16,674			
Securities lending agreements		6,963	5,863			
Other sales (recourse to transferred asset only)		389	564	533	533	–
Securitisations recognised to the extent of continuing involvement	3,590	7	3	7	3	4

## Continuing involvement in financial assets and associated financial liabilities qualifying for full derecognition

## The group and the bank

	At 31 December				For the year			
	Carrying amount of continuing involvement in statement of financial position		Fair value of continuing involvement		Maximum exposure to loss £m	Gain or loss recognised at transfer date £m	Income/ (expenses) recognised in reporting period £m	Income/ (expenses) recognised cumulatively £m
	Assets £m	Liabilities £m	Assets £m	Liabilities £m				
Interest in structured entities								
<b>31 December 2015</b>	–	–	–	–	–	–	–	–
31 December 2014	98	–	98	–	98	–	–	43

The assets in the table above represent our continuing involvement in securitisations where the group has transferred assets to an unconsolidated structured entity, but has retained some of the notes issued by the structured entity. These notes are reported in loans and advances to customers. The maximum exposure to loss is the carrying amount of the notes.

## Financial assets pledged to secure liabilities

	Group assets pledged at 31 December		Bank assets pledged at 31 December	
	2015 £m	2014 £m	2015 £m	2014 £m
Treasury bills and other eligible securities	703	160	–	–
Loans and advances to banks	8,625	9,608	4,957	6,240
Loans and advances to customers	43,056	35,972	19,374	15,061
Debt securities	27,738	53,978	14,302	27,694
Equity shares	3,131	7,051	3,047	6,963
Other	100	3,264	55	3,247
<b>Assets pledged at 31 December</b>	<b>83,353</b>	<b>110,033</b>	<b>41,735</b>	<b>59,205</b>

The table above shows assets where a charge has been granted to secure liabilities on a legal and contractual basis. The amount of such assets may be greater than the book value of assets utilised as collateral for funding purposes or to cover liabilities. This is the case for securitisations and covered bonds where the amount of liabilities issued, plus any mandatory over-collateralisation, is less than the book value of financial assets available for funding or collateral purposes in the relevant pool of assets. This is also the case where financial assets are placed with a custodian or settlement agent which has a floating charge over all the financial assets placed to secure any liabilities under settlement accounts.

These transactions are conducted under terms that are usual and customary to collateralised transactions including, where relevant, standard securities lending and repurchase agreements.

The financial assets shown above include amounts transferred to third parties that do not qualify for derecognition, notably debt securities held by counterparties as collateral under repurchase agreements and equity securities lent under securities lending agreements. As the substance of these transactions is secured borrowings the asset collateral continues to be recognised in full and the related liability reflecting the group's obligation to repurchase the transferred assets for a fixed price at a future date is recognised on the balance sheet. As a result of these transactions, the group is unable to use, sell or pledge

**Notes on the Financial Statements** (continued)

the transferred assets for the duration of the transaction. The group remains exposed to interest rate risk and credit risk on these pledged instruments. The counterparty's recourse is not limited to the transferred assets.

**Collateral accepted as security for assets**

The fair value of financial assets accepted as collateral that the group is permitted to sell or repledge in the absence of default is £80,118 million (2014: £107,775 million) (the bank: 2015 £53,721 million; 2014 £76,602 million). The fair value of any such collateral that has been sold or repledged is £57,295 million (2014: £66,080 million) (the bank: 2015 £37,239 million; 2014 £40,468 million). The group is obliged to return equivalent securities.

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

## Notes on the Financial Statements (continued)

### 19 Prepayments, accrued income and other assets

#### Accounting policy

##### Assets held for sale

Assets and liabilities of disposal groups and non-current assets are classified as held for sale ('HFS') when their carrying amounts will be recovered principally through sale rather than through continuing use. HFS assets are generally measured at the lower of their carrying amount and fair value less cost to sell, except for those assets and liabilities that are not within the scope of the measurement requirements of IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations'.

Immediately before the initial classification as held for sale, the carrying amounts of the relevant assets and liabilities are measured in accordance with applicable IFRSs. On subsequent remeasurement of a disposal group, the carrying amounts of any assets and liabilities that are not within the scope of the measurement requirements of IFRS 5, but are included in a disposal group classified as held for sale, shall be remeasured under applicable IFRSs before the fair value less costs to sell of the disposal group is determined.

##### Property, plant and equipment

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

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

Equipment, fixtures and fittings (including equipment on operating leases where the group is the lessor) are stated at cost less impairment losses and depreciation over their useful lives, which are generally between 5 years and 20 years.

Property, plant and equipment is subject to an impairment review if their carrying amount may not be recoverable.

HSBC holds certain properties as investments to earn rentals or for capital appreciation, or both, and those investment properties are included on balance sheet at fair value.

#### Prepayments, accrued income and other assets

	The group		The bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Prepayments and accrued income	2,078	2,353	1,127	1,184
Assets held for sale	27	4,378	17	15
Bullion	2,226	2,736	2,221	2,733
Reinsurers' share of liabilities under insurance contracts	182	189	-	-
Endorsements and acceptances	581	591	478	364
Employee benefit assets	3,376	3,059	3,373	3,059
Other accounts <sup>1</sup>	1,504	5,399	1,191	4,741
Property, plant and equipment	1,758	1,614	902	812
<b>At 31 December</b>	<b>11,732</b>	<b>20,319</b>	<b>9,309</b>	<b>12,908</b>

<sup>1</sup> Variation margin balances meeting the offset criteria have been reported as a deduction from derivative balances (Note 30)

#### Assets held for sale

	The group		The bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Non-current assets held for sale:				
- property, plant and equipment	27	25	17	15
- Assets of disposal groups held for sale <sup>1</sup>	-	4,353	-	-
- other	-	-	-	-
<b>Total assets classified as held for sale</b>	<b>27</b>	<b>4,378</b>	<b>17</b>	<b>15</b>

<sup>1</sup> The sale of the UK pension insurance business was completed in 2015.

Also included within property, plant and equipment classified as held for sale is repossessed property that had been pledged as collateral by customers. These repossessed assets are expected to be disposed of within 12 months of acquisition.

#### Property, plant and equipment – selected information

	The group		The bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Cost or fair value	3,597	4,400	2,085	2,930
Accumulated depreciation and impairment	(1,839)	(2,786)	(1,183)	(2,118)
<b>Net carrying amount at 31 December</b>	<b>1,758</b>	<b>1,614</b>	<b>902</b>	<b>812</b>
Additions - cost	431	411	297	260
Disposals - cost	(12)	(148)	(6)	(100)
Property plant and equipment includes				
Land and buildings	1,042	913	441	390
Freehold	741	661	136	132
Long leasehold	132	101	134	105
Short leasehold	169	151	171	153
Investment properties <sup>1</sup>	429	344	-	-

<sup>1</sup> Investment properties are valued on a market value basis as at 31 December each year by independent professional valuers who have recent experience in the location and type of property.

## Notes on the Financial Statements (continued)

### 20 Interests in associates and joint ventures

#### Accounting policy

Investments in which the group, together with one or more parties, has joint control of an arrangement set up to undertake an economic activity are classified as joint ventures. The group classifies investments in entities over which it has significant influence, and that are neither subsidiaries (Note 22) nor joint ventures, as associates.

Investments in associates and interests in joint ventures are recognised using the equity method. Under this method, such investments are initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in the group's share of net assets. Goodwill arises on the acquisition of interests in joint ventures and associates when the cost of investment exceeds the group's share of the net fair value of the associate's or joint venture's identifiable assets and liabilities.

An investment in an associate is tested for impairment when there is an indication that the investment may be impaired. Goodwill on acquisitions of interests in joint ventures and associates is not tested separately for impairment.

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

#### Principal associates of the group and the bank

VocaLink Holdings Ltd ('VocaLink') is a principal associate of the bank and the group. VocaLink is incorporated in England and its principal activity is that of providing electronic payments and transaction services. At 31 December 2015, the group had a 15.91% interest in the equity capital of VocaLink (2014: 15.91%). The carrying amount of the group's interest was £60 million at 31 December 2015 (2014: £61 million). VocaLink is accounted for as an associate due to the group's involvement in the operational activities, policy-making decisions and representation on the board of directors.

#### Interests in significant joint ventures

Vaultex UK Limited is a joint venture of the bank and the group. Vaultex UK Limited is incorporated in England and its principal activity is that of cash management services. At 31 December 2015 and 31 December 2014, the group had a 50% interest in the £10 million issued equity capital.

### 21 Goodwill and other intangible assets

	The group		The bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Goodwill	5,818	6,140	347	342
Present value of in-force long-term assurance business ('PVIF')	546	456	–	–
Other intangible assets	647	698	575	606
<b>At 31 December</b>	<b>7,011</b>	<b>7,294</b>	<b>922</b>	<b>948</b>

#### Goodwill

##### Accounting policy

Goodwill arises on the acquisition of subsidiaries, when the aggregate of the fair value of the consideration transferred, the amount of any non-controlling interest and the fair value of any previously held equity interest in the acquiree exceed the amount of the identifiable assets and liabilities acquired. If the amount of the identifiable assets and liabilities acquired is greater, the difference is recognised immediately in the income statement.

Intangible assets are recognised separately from goodwill when they are separable or arise from contractual or other legal rights, and their fair value can be measured reliably.

Goodwill is allocated to cash-generating units ('CGU's) for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. The group's CGUs are based on global businesses. Impairment testing is performed at least annually, or whenever there is an indication of impairment, by comparing the recoverable amount of a CGU with its carrying amount.

The carrying amount of a CGU is based on its assets and liabilities, including attributable goodwill. The recoverable amount of an asset is the higher of its fair value less cost to sell and its value in use. Value in use ('VIU') is the present value of the expected future CGU cash flows. If the recoverable amount is less than the carrying value, an impairment loss is charged to the income statement. Goodwill is carried on balance sheet at cost less accumulated impairment losses.

At the date of disposal of a business, attributable goodwill is included in the group's share of net assets in the calculation of the gain or loss on disposal.

#### Critical accounting estimates and judgements

##### Goodwill impairment

The review of goodwill for impairment reflects management's best estimate of the future cash flows of the CGUs and the rates used to discount these cash flows, both of which are subject to uncertain factors as follows:

- the future cash flows of the CGUs are sensitive to the cash flows projected for the periods for which detailed forecasts are available and to assumptions regarding the long-term pattern of sustainable cash flows thereafter. Forecasts are compared with actual performance and verifiable economic data, but they reflect management's view of future business prospects at the time of the assessment; and
- the rates used to discount future expected cash flows can have a significant effect on their valuation and are based on the costs of capital assigned to individual CGUs. The cost of capital percentage is generally derived from a Capital Asset Pricing Model, which incorporates inputs reflecting a number of financial and economic variables, including the risk-free interest rate in the country concerned and a premium for the risk of the business being evaluated. These variables are subject to fluctuations in external market rates and economic conditions beyond management's control, are subject to uncertainty and require the exercise of significant judgment.

## Notes on the Financial Statements (continued)

The accuracy of forecasted cash flows is subject to a high degree of uncertainty in volatile market conditions. In such market conditions, management retests goodwill for impairment more frequently than annually to ensure that the assumptions on which the cash flow forecasts are based continue to reflect current market conditions and management's best estimate of future business prospects.

### The group

	2015 £m	2014 £m
<b>Gross amount and Carrying amount</b>		
At 1 January	6,140	6,526
Acquisitions/(disposals)	–	(5)
Exchange differences and other movements	(322)	(381)
<b>At 31 December</b>	<b>5,818</b>	<b>6,140</b>

### The bank

	2015 £m	2014 £m
At 1 January	342	298
Acquisitions/(disposals)	–	49
Exchange differences and other movements	5	(5)
<b>At 31 December</b>	<b>347</b>	<b>342</b>

### Impairment testing

The group's impairment test in respect of goodwill allocated to each CGU is performed as at 1 July each year, with a review for indicators of impairment at 31 December. At 31 December 2015, this review did not identify any indicators of impairment. As a result, no impairment tests have been performed for as at 31 December 2015. For all CGUs the annual test performed as at 1 July remains the latest impairment test and the disclosures given are as at 1 July. The testing at 1 July resulted in no impairment of goodwill.

### Basis of the recoverable amount

The recoverable amount of all CGUs to which goodwill has been allocated was equal to its VIU at each respective testing date for 2014 and 2015.

For each significant CGU, the VIU is calculated by discounting management's cash flow projections for the CGU. The discount rate used is based on the cost of capital that the group allocates to investments in the countries within which the CGU operates. The long-term growth rate is used to extrapolate the cash flows in perpetuity because of the long-term perspective within the group of the business units making up the CGUs. For the goodwill impairment test conducted at 1 July 2015, management's cash flow projections until the end of 2019 were used.

During 2015 the allocation of goodwill to CGUs used by the group was aligned to that used by the HSBC Group, reflecting that such balances originated from the same acquisitions.

### Key assumptions in the VIU calculation

	Goodwill at 1 July 2015 £m	Discount rate %	Nominal growth rate beyond initial cash flow projections %
<b>2015</b>			
Retail Banking and Wealth Management	1,753	7%	3.8%
Commercial Banking	1,474	9%	3.8%
Global Banking and Markets	1,847	10%	3.8%
Other	577		
<b>Total Goodwill</b>	<b>5,651</b>		
	Previous allocation £m	Revised allocation £m	
<b>2014</b>		%	%
Retail Banking and Wealth Management	1,260	9%	4.2%
Commercial Banking	630	10%	4.3%
Global Banking and Markets	4,409	11%	4.2%
Other	–		
<b>Total goodwill in the CGUs listed above</b>	<b>6,299</b>		

**Management's judgement in estimating the cash flows of a CGU:** the cash flow projections for each CGU are based on plans approved by the Board.

**Nominal long-term growth rate:** this growth rate reflects GDP and inflation for the countries within which the CGU operates or derives revenue from. The rates are based on IMF forecast growth rates as they represent an objective estimate of likely future trends. The rates used for 2014 and 2015 do not exceed the long-term growth rates for the countries within which the CGUs operate or derive revenue from.

## Notes on the Financial Statements (continued)

**Discount rate:** the discount rate used to discount the cash flows is based on the cost of capital assigned to each CGU, which is derived using a CAPM. The CAPM depends on inputs reflecting a number of financial and economic variables including the risk-free rate and a premium to reflect the inherent risk of the business being evaluated. These variables are based on the market's assessment of the economic variables and management's judgement. The discount rates for each CGU are refined to reflect the rates of inflation for the countries within which the CGU operates. In addition, for the purposes of testing goodwill for impairment, management supplements this process by comparing the discount rates derived using the internally generated CAPM with cost of capital rates produced by external sources for businesses operating in similar markets. For 2014 and 2015, internal cost of capital rates were consistent with externally sourced rates. For the purpose of goodwill testing during 2015, internal rates were adjusted to reflect the uncertainty of the cash flows used in the test.

### Sensitivities of key assumptions in calculating VIU

At 1 July 2015 Global Banking and Markets was sensitive to reasonably possible changes in the key assumptions supporting the recoverable amount. In making an estimate of reasonably possible changes to assumptions management considers the available evidence in respect of each input to the model such as: the external range of discount rates observable; historical performance against forecast; risks attaching to the key assumptions underlying cash flow projections; and economic cyclicity affecting long-term growth rates. It would have required reasonably possible adverse changes in more than one assumption to cause an impairment.

The following table presents a summary of the key assumptions underlying the most sensitive inputs to the model for each CGU; the key risks attaching to each; and details of a reasonably possible change to assumptions where, in the opinion of management, these could result in an impairment.

#### Reasonably possible changes in key assumptions

Cash-generating unit	Input	Key assumptions	Associated risks	Reasonably possible change
Retail Banking and Wealth Management and Commercial Banking	Cash flow projections	Level of interest rates; Competitors' positions within the market; and Level and change in unemployment rates.	Uncertain regulatory environment; and Customer remediation and regulatory actions.	Management has determined that a reasonably possible change in any of the key assumptions would not cause an impairment to be recognised.
Global Banking and Markets	Cash flow projections	Level of interest rates; and Recovery of European markets over the forecast period.	Deferral or non-occurrence of forecast interest rate rises; Lower than expected growth in key markets; and The impact of regulatory changes, including the ring fencing of the UK retail bank.	Cash flow projections decrease by 20%.
	Discount rate	Discount rate used is a reasonable estimate of a suitable market rate for the profile of the business.	External evidence arises to suggest that the rate used is not appropriate to the business.	Discount rate increases by 110 basis points, based on the high end of the range of broker estimates for comparator European banks with significant investment banking operations.
	Long-term growth rates	Business growth will reflect GDP growth rates in the long term.	Growth does not match GDP or GDP forecasts fall.	Real GDP growth does not occur or is not reflected in performance.

The following table presents, the change required to the current assumptions to reduce headroom to nil (breakeven).

#### Changes to current assumptions to achieve nil headroom as at 1 July 2015

Cash-generating unit	Increase/(decrease)		
	Discount rate bps	Cash flow %	Long-term growth rate bps
Global Banking and Markets	157	(20.1)	(203)



## Notes on the Financial Statements (continued)

### The present value of in-force long-term assurance business

#### Movement in PVIF

##### The group

	2015	2014
	£m	£m
At 1 January	456	700
Addition from current year new business	51	55
Movement from in-force business (including investment return variances and changes in investment assumptions)	34	(192)
Transfer to assets classified as held for sale <sup>1</sup>	–	(77)
Exchange differences and other movements	5	(30)
At 31 December	546	456

<sup>1</sup> The transfer relates to the UK pensions business which was classified as held for sale in the first half of the year.

The group's life insurance business is accounted for using the embedded value approach which, inter alia, provides a comprehensive risk and valuation framework. The PVIF asset represents the present value of the shareholders' interest in the profits expected to emerge from the book of in-force policies.

#### PVIF-specific assumptions

The key assumptions used in the computation of PVIF for the group's main life insurance operations were:

	2015		2014	
	France	UK Life	France	UK Life
Weighted average risk free rate	1.57%	1.75%	1.21%	1.65%
Risk discount rate	2.55%	2.25%	1.73%	2.15%
Expenses inflation	1.70%	4.56%	2.00%	4.67%

The calculation of the PVIF is based upon assumptions that take into account risk and uncertainty. To project these cash flows, a variety of assumptions regarding future experience is made by each insurance operation which reflects local market conditions and management's judgement of local future trends.

The following table shows the effect on the PVIF of reasonably possible changes in the main economic assumption, risk-free rates, across all insurance manufacturing subsidiaries.

#### Sensitivity of PVIF to changes in economic assumptions

	PVIF	
	2015	2014
	£m	£m
+ 100 basis points shift in risk-free rate	–	84
– 100 basis points shift in risk-free rate <sup>1</sup>	(85)	(298)

<sup>1</sup> Where a – 100 basis point shift in the risk free rate results in a negative rate, the effect on PVIF has been calculated using a minimum rate of 0%.

Due to certain characteristics of the contracts, the relationships may be non-linear and the results of the sensitivity-testing should not be extrapolated to higher levels of stress. In calculating the scenario, the shift in the risk-free rate results in changes to investment returns, risk discount rates and bonus rates which are incorporated. The sensitivities shown are before actions that could be taken by management to mitigate impacts and before resultant changes in policyholder behaviour.

#### Non-economic assumptions

The group determines the policyholder liabilities for non-life manufacturers by reference to non-economic assumptions including claims costs and expense rates.

Policyholder liabilities and PVIF for life manufacturers are determined by reference to non-economic assumptions including mortality and/or morbidity, lapse rates and expense rates. The table below shows the sensitivity of profit for 2015 and total equity at 31 December 2015 to reasonably possible changes in these non-economic assumptions at that date across all of the group's insurance manufacturing companies, with comparatives for 2014.

Mortality and morbidity risk is typically associated with life insurance contracts. The effect on profit of an increase in mortality or morbidity depends on the type of business being written.

Sensitivity to lapse rates is dependent on the type of contracts being written. For insurance contracts, the cost of claims is funded by premiums received and income earned on the investment portfolio supporting the liabilities. For a portfolio of term assurance, an increase in lapse rates typically has a negative effect on profit due to the loss of future premium income on the lapsed policies.

Expense rate risk is the exposure to a change in expense rates. To the extent that increased expenses cannot be passed on to policyholders, an increase in expense rates will have a negative impact on profits.

## Notes on the Financial Statements (continued)

### Sensitivity to changes in non-economic assumptions

	PVIF	
	2015 £m	2014 £m
10% increase in mortality and/or morbidity rates	(17)	(17)
10% decrease in mortality and/or morbidity rates	17	18
10% increase in lapse rates	(25)	(29)
10% decrease in lapse rates	27	31
10% increase in expense rates	(27)	(31)
10% decrease in expense rates	26	31

### Other intangible assets

The analysis of the movement of other intangible assets was as follows:

#### The group

	Internally generated software £m	Purchased Software £m	Customer/ merchant relationships £m	Other £m	Total £m
<b>Cost</b>					
At 1 January 2015	1,540	203	220	16	1,979
Additions <sup>1</sup>	199	18	–	–	217
Disposals	(1)	(8)	(1)	–	(10)
Amounts written off	(146)	–	–	–	(146)
Exchange differences	(4)	(16)	–	(2)	(22)
<b>At 31 December 2015</b>	<b>1,588</b>	<b>197</b>	<b>219</b>	<b>14</b>	<b>2,018</b>
<b>Accumulated amortisation and impairment</b>					
At 1 January 2015	(935)	(171)	(163)	(12)	(1,281)
Amortisation charge for the year <sup>2</sup>	(183)	(17)	(11)	–	(211)
Impairment charge for the year <sup>2</sup>	(48)	–	–	–	(48)
Disposals	–	7	1	–	8
Amounts written off	146	–	–	–	146
Exchange differences	2	13	–	–	15
<b>At 31 December 2015</b>	<b>(1,018)</b>	<b>(168)</b>	<b>(173)</b>	<b>(12)</b>	<b>(1,371)</b>
<b>Net carrying amount at 31 December 2015</b>	<b>570</b>	<b>29</b>	<b>46</b>	<b>2</b>	<b>647</b>
<b>2014</b>					
	Internally generated software £m	Purchased Software £m	Customer/ merchant relationships £m	Other £m	Total £m
<b>Cost</b>					
At 1 January 2014	1,367	170	220	15	1,772
Additions <sup>1</sup>	184	47	–	1	232
Disposals	(1)	(7)	–	–	(8)
Amounts written off	(1)	–	–	–	(1)
Exchange differences	(5)	(13)	–	–	(18)
Other changes	(4)	6	–	–	2
<b>At 31 December 2014</b>	<b>1,540</b>	<b>203</b>	<b>220</b>	<b>16</b>	<b>1,979</b>
<b>Accumulated amortisation and impairment</b>					
At 1 January 2014	(765)	(137)	(151)	(11)	(1,064)
Amortisation charge for the year <sup>2</sup>	(178)	(18)	(12)	(1)	(209)
Impairment charge for the year <sup>2</sup>	–	–	–	(2)	(2)
Disposals	–	6	–	–	6
Amounts written off	1	–	–	–	1
Exchange differences	3	11	–	–	14
Other changes	4	(33)	–	2	(27)
<b>At 31 December 2014</b>	<b>(935)</b>	<b>(171)</b>	<b>(163)</b>	<b>(12)</b>	<b>(1,281)</b>
<b>Net carrying amount at 31 December 2014</b>	<b>605</b>	<b>32</b>	<b>57</b>	<b>4</b>	<b>698</b>

1 At 31 December 2015, the group did not have any contractual commitments to acquire intangible assets (2014: nil).

2 The amortisation and impairment charges are recognised within the income statement under 'Amortisation and impairment of intangible assets'.

## Notes on the Financial Statements (continued)

### The bank

	Internally generated software £m	Other £m	Total £m
<b>Cost</b>			
At 1 January 2015	1,446	37	1,483
Additions <sup>1</sup>	192	6	198
Amounts written off	(146)	–	(146)
Exchange differences	(1)	(1)	(2)
<b>At 31 December 2015</b>	<b>1,491</b>	<b>42</b>	<b>1,533</b>
<b>Accumulated amortisation and impairment</b>			
At 1 January 2014	(864)	(13)	(877)
Amortisation charge for the year <sup>2</sup>	(173)	(5)	(178)
Impairment charge for the year <sup>2</sup>	(48)	–	(48)
Amounts written off	146	–	146
Exchange differences	(1)	–	(1)
<b>At 31 December 2015</b>	<b>(940)</b>	<b>(18)</b>	<b>(958)</b>
<b>Net carrying amount at 31 December 2015</b>	<b>551</b>	<b>24</b>	<b>575</b>
<b>Cost</b>			
At 1 January 2014	1,269	30	1,299
Additions <sup>1</sup>	177	5	182
Other changes	–	2	2
<b>At 31 December 2014</b>	<b>1,446</b>	<b>37</b>	<b>1,483</b>
<b>Accumulated amortisation and impairment</b>			
At 1 January 2014	(700)	(6)	(706)
Amortisation charge for the year <sup>2</sup>	(165)	(5)	(170)
Other changes	1	(2)	(1)
<b>At 31 December 2014</b>	<b>(864)</b>	<b>(13)</b>	<b>(877)</b>
<b>Net carrying amount at 31 December 2014</b>	<b>582</b>	<b>24</b>	<b>606</b>

1 At 31 December 2015, the bank did not have any contractual commitments to acquire intangible assets (2014: nil).

2 The amortisation and impairment charges are recognised within the income statement under 'Amortisation and impairment of intangible assets'.

## Notes on the Financial Statements (continued)

### 22 Investments in subsidiaries

#### Accounting policy

The group classifies investments in entities which it controls as subsidiaries. The group consolidation policy is described in Note 1(g). Subsidiaries which are structured entities are covered in Note 36.

The bank's investments in subsidiaries are stated at cost less impairment losses. Impairment losses recognised in prior periods are reversed through the income statement if there has been a change in the estimates used to determine the investment's recoverable amount since the last impairment loss was recognised.

#### Principal subsidiary undertakings of HSBC Bank plc

	Country of incorporation or registration	HSBC Bank plc's interest in equity capital %	Share class
HSBC France	France	99.99	Ordinary €5
HSBC Asset Finance (UK) Limited	England	100.00	Ordinary £1
HSBC Bank A.S.	Turkey	100.00	A-Common TRL1 B-Common TRL1
HSBC Bank International Limited	Jersey	100.00	Ordinary £1
HSBC Bank Malta p.l.c.	Malta	70.03	Ordinary €0.30
HSBC Invoice Finance (UK) Limited	England	100.00	Ordinary £1
HSBC Life (UK) Limited	England	100.00	Ordinary £1
HSBC Private Bank (UK) Limited	England	100.00	Ordinary £10
HSBC Private Bank (C.I.) Limited	Guernsey	100.00	Ordinary US\$1
HSBC Trinkaus & Burkhardt AG	Germany	80.65	Shares of no par value
HSBC Trust Company (UK) Limited	England	100.00	Ordinary £5
Marks and Spencer Retail Financial Services Holdings Limited	England	100.00	Ordinary £1

Structured entities consolidated where the group owns less than 50 per cent of the voting rights:

	Carrying value of total consolidated assets £bn	Nature of structured entity
Barion Funding Limited	0.8	Securities investment conduit
Malachite Funding Limited	0.3	Securities investment conduit
Mazarin Funding Limited	1.3	Securities investment conduit
Regency Assets Limited	10.2	Conduit
Solitaire Funding Limited	4.2	Securities investment conduit
Turquoise Receivables Trustee Limited	0.6	Securitisation vehicle

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

Details of all group subsidiaries, as required under Section 409 of the Companies Act 2006, are set out on pages 183 to 186. The principal countries of operation are the same as the countries of incorporation.

### 23 Trading liabilities

#### Accounting policy

Trading liabilities are classified as held for trading if they have been acquired or incurred principally for the purpose of selling or repurchasing in the near term, or form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. They are recognised on trade date, when the group enters into contractual arrangements with counterparties, and are normally derecognised when extinguished. They are initially measured at fair value, with subsequent changes in fair value and interest paid recognised in the income statement in 'Net trading income'.

The sale of borrowed securities is classified as trading liabilities.

#### Trading liabilities

	The group		The bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Deposits by banks <sup>1</sup>	27,106	29,444	24,113	24,518
Customer accounts <sup>1</sup>	13,281	14,127	11,406	10,335
Other debt securities in issue <sup>2</sup>	13,033	14,390	9,176	10,801
Other liabilities – net short positions	20,069	24,639	12,741	13,385
<b>At 31 December</b>	<b>73,489</b>	<b>82,600</b>	<b>57,436</b>	<b>59,039</b>

<sup>1</sup> Deposits by banks and customer accounts include repos, settlement accounts, stock lending and other amounts.

<sup>2</sup> 'Other debt securities in issue' comprises structured notes issued by HSBC for which market risks are actively managed as part of trading portfolios.

## Notes on the Financial Statements (continued)

### 24 Financial liabilities designated at fair value

#### Accounting policy

The criteria for designating instruments at fair value and their measurement are described in Note 14. The fair value designation, once made, is irrevocable. Designated financial liabilities are recognised when the group enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when extinguished. This section provides examples of such designations:

- Long-term debt issues. The interest payable on certain fixed rate long-term debt securities issued has been matched with the interest on certain interest rate swaps as part of a documented interest rate risk management strategy. An accounting mismatch would arise if the debt securities issued were accounted for at amortised cost, and this mismatch is eliminated through the fair value designation.
- Financial liabilities under unit-linked and non-linked investment contracts.

The group issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which the group accepts insignificant insurance risk from another party is not classified as an insurance contract, but is accounted for as a financial liability. See Note 26 for contracts where the group accepts significant insurance risk.

Customer liabilities under linked and certain non-linked investment contracts issued by insurance subsidiaries and the corresponding financial assets are designated at fair value. Liabilities are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices. Premiums receivable and amounts withdrawn are accounted for as increases or decreases in the liability recorded in respect of investment contracts. The incremental costs directly related to the acquisition of new investment contracts or renewing existing investment contracts are deferred and amortised over the period during which the investment management services are provided.

#### Financial liabilities designated at fair value

	The group		The bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Deposits by banks and customer accounts	131	86	–	–
Liabilities to customers under investment contracts	928	1,017	–	–
Debt securities in issue	16,019	18,593	9,889	13,271
Subordinated liabilities (note 28)	1,594	2,526	1,924	2,856
Preference shares (note 28)	329	330	–	–
<b>At 31 December</b>	<b>19,001</b>	<b>22,552</b>	<b>11,813</b>	<b>16,127</b>

#### The group

The carrying amount at 31 December 2015 of financial liabilities designated at fair value was £1,108 million higher (2014: £1,496 million higher) than the contractual amount at maturity. At 31 December 2015, the accumulated amount of change in fair value attributable to changes in credit risk was a loss of £93 million (2014: £247 million loss).

#### The bank

The carrying amount at 31 December 2015 of financial liabilities designated at fair value was £811 million higher (2014: £1,082 million higher) than the contractual amount at maturity. At 31 December 2015, the accumulated amount of change in fair value attributable to changes in credit risk was a loss of £28 million (2014: £151 million loss).

### 25 Accruals, deferred income and other liabilities

	The group		The bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Liabilities of disposal groups held for sale <sup>1</sup>	–	4,356	–	–
Accruals and deferred income	2,470	2,531	1,592	1,518
Amounts due to investors in funds consolidated by the group	292	455	–	–
Endorsements and acceptances	572	582	478	364
Share-based payment liability to HSBC Holdings	154	191	134	148
Employee benefit liabilities	300	333	120	133
Other liabilities <sup>2</sup>	1,987	3,969	1,242	3,126
<b>At 31 December</b>	<b>5,775</b>	<b>12,417</b>	<b>3,566</b>	<b>5,289</b>

<sup>1</sup> The sale of the UK pension insurance business was completed in 2015.

<sup>2</sup> Variation margin balances meeting the offset criteria have been reported as a deduction from derivative balances (Note 30).

## Notes on the Financial Statements (continued)

### 26 Liabilities under insurance contracts

#### Accounting policy

The group issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which the group accepts significant insurance risk from another party by agreeing to compensate that party on the occurrence of a specified uncertain future event, is classified as an insurance contract. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant.

#### Liabilities under insurance contracts

Liabilities under non-linked life insurance contracts are calculated by each life insurance operation based on local actuarial principles.

Liabilities under unit-linked life insurance contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

A liability adequacy test is carried out on insurance liabilities to ensure that the carrying amount of the liabilities is sufficient in the light of current estimates of future cash flows. When performing the liability adequacy test, all contractual cash flows are discounted and compared with the carrying value of the liability. When a shortfall is identified it is charged immediately to the income statement.

#### Future profit participation on insurance contracts with discretionary participation features

Where contracts provide discretionary profit participation benefits to policyholders, liabilities for these contracts include provisions for the future discretionary benefits to policyholders. These provisions reflect actual performance of the investment portfolio to date and management expectation on the future performance in connection with the assets backing the contracts, as well as other experience factors such as mortality, lapses and operational efficiency, where appropriate. This benefit may arise from the contractual terms, regulation, or past distribution policy.

#### Investment contracts with discretionary participation features

While investment contracts with discretionary participation features are financial instruments, they continue to be treated as insurance contracts as permitted by IFRS 4. The group therefore recognises the premiums for those contracts as revenue and recognises as an expense the resulting increase in the carrying amount of the liability.

In the case of net unrealised investment gains on these contracts, whose discretionary benefits principally reflect the actual performance of the investment portfolio, the corresponding increase in the liabilities is recognised in either the income statement or other comprehensive income, following the treatment of the unrealised gains on the relevant assets. In the case of net unrealised losses, a deferred participating asset is recognised only to the extent that its recoverability is highly probable. Movements in the liabilities arising from realised gains and losses on relevant assets are recognised in the income statement.

#### Liabilities under insurance contracts

	2015		
	Gross £m	Reinsurers' Share £m	Net £m
<b>Non-linked insurance contracts</b>			
At 1 January	532	(142)	390
Claims and benefits paid	(129)	72	(57)
Movement in liabilities to policyholders	185	(104)	81
Exchange differences and other movements	(82)	48	(34)
At 31 December	506	(126)	380
<b>Investment contracts with discretionary participation features</b>			
At 1 January	16,083	–	16,083
Claims and benefits paid	(1,375)	–	(1,375)
Movement in liabilities to policyholders	1,794	–	1,794
Exchange differences and other movements <sup>1</sup>	(1,248)	–	(1,248)
At 31 December	15,254	–	15,254
<b>Linked life insurance contracts</b>			
At 1 January	907	(47)	860
Claims and benefits paid	(294)	4	(290)
Movement in liabilities to policyholders	186	(13)	173
Exchange differences and other movements	105	–	105
At 31 December	904	(56)	848
<b>Total liabilities to policyholders</b>	<b>16,664</b>	<b>(182)</b>	<b>16,482</b>

1. Includes movement in liabilities relating to discretionary profit participation benefits due to policyholders arising from net unrealised investment gains recognised in other comprehensive income.

## Notes on the Financial Statements (continued)

	2014		
	Gross £m	Reinsurers' share £m	Net £m
<b>Non-linked insurance contracts</b>			
At 1 January	836	(448)	388
Claims and benefits paid	(140)	80	(60)
Movement in liabilities to policyholders	223	(117)	106
Transfer to liabilities of disposal groups held for sale	(338)	328	(10)
Exchange differences and other movements	(49)	15	(34)
At 31 December	532	(142)	390
<b>Investment contracts with discretionary participation features</b>			
At 1 January	15,987	–	15,987
Claims and benefits paid	(1,407)	–	(1,407)
Movement in liabilities to policyholders	1,933	–	1,933
Transfer to liabilities of disposal groups held for sale	–	–	–
Exchange differences and other movements <sup>1</sup>	(430)	–	(430)
At 31 December	16,083	–	16,083
<b>Linked life insurance contracts</b>			
At 1 January	2,405	(43)	2,362
Claims and benefits paid	(247)	3	(244)
Movement in liabilities to policyholders	284	(7)	277
Transfer to liabilities of disposal groups held for sale	(1,521)	–	(1,521)
Exchange differences and other movements	(14)	–	(14)
At 31 December	907	(47)	860
Total liabilities to policyholders	17,522	(189)	17,333

2. Includes movement in liabilities relating to discretionary profit participation benefits due to policyholders arising from net unrealised investment gains recognised in other comprehensive income.

The increase in liabilities to policyholders represents the aggregate of all events giving rise to additional liabilities to policyholders in the year. The key factors contributing to the movement in liabilities to policyholders include death claims, surrenders, lapses, liabilities to policyholders created at the initial inception of the policies, the declaration of bonuses and other amounts attributable to policyholders.

## 27 Provisions

### Accounting policy

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

### Critical accounting estimates and judgements

#### Provisions

Judgement is involved in determining whether a present obligation exists and in estimating the probability, timing and amount of any outflows. Professional expert advice is taken on the assessment of litigation, property (including onerous contracts) and similar obligations. Provisions for legal proceedings and regulatory matters typically require a higher degree of judgement than other types of provisions. When matters are at an early stage, accounting judgements can be difficult because of the high degree of uncertainty associated with determining whether a present obligation exists, and estimating the probability and amount of any outflows that may arise. As matters progress, management and legal advisers evaluate on an ongoing basis whether provisions should be recognised, revising previous judgements and estimates as appropriate. At more advanced stages, it is typically easier to make judgements and estimates around a better defined set of possible outcomes. However, the amount provisioned can remain very sensitive to the assumptions used. There could be a wide range of possible outcomes for any pending legal proceedings, investigations or inquiries. As a result, it is often not practicable to quantify a range of possible outcomes for individual matters. It is also not practicable to meaningfully quantify ranges of potential outcomes in aggregate for these types of provisions because of the diverse nature and circumstances of such matters and the wide range of uncertainties involved. Provisions for customer remediation also require significant levels of estimation and judgement. The amounts of provisions recognised depend on a number of different assumptions, for example, the volume of inbound complaints, the projected period of inbound complaint volumes, the decay rate of complaint volumes, the population identified as systemically mis-sold and the number of policies per customer complaint.

## Notes on the Financial Statements (continued)

## Provisions

## The group

	2015				2014
	Customer remediation	Legal proceedings and regulatory matters	Other	Total	Total
	£m	£m	£m	£m	£m
At 1 January	1,041	456	210	1,707	1,707
Additional provisions/increase in provisions <sup>1</sup>	456	611	208	1,275	1,631
Provisions utilised	(548)	(190)	(48)	(786)	(1,523)
Amounts reversed	(80)	(16)	(48)	(144)	(102)
Acquisition/disposal of subsidiaries/businesses	–	–	–	–	2
Exchange and other movements	(1)	23	(17)	5	(8)
<b>At 31 December</b>	<b>868</b>	<b>884</b>	<b>305</b>	<b>2,057</b>	<b>1,707</b>

	2015				2014
	Customer remediation	Legal proceedings and regulatory matters	Other	Total	Total
	£m	£m	£m	£m	£m
At 1 January	890	368	87	1,345	1,271
Additional provisions/increase in provisions <sup>1</sup>	371	604	147	1,122	1,457
Provisions utilised	(491)	(183)	(13)	(687)	(1,347)
Amounts reversed	(76)	(11)	(15)	(102)	(37)
Exchange and other movements	–	36	(12)	24	1
<b>At 31 December</b>	<b>694</b>	<b>814</b>	<b>194</b>	<b>1,702</b>	<b>1,345</b>

<sup>1</sup> Other includes unwinding of discounts of £4 million (2014: £4 million) in relation to vacant space provisions.

Provisions include £868 million (2014: £1,041 million) in respect of customer redress programmes. The most significant of these provisions are as follows and relate to both the group and bank, except where stated.

- (i) £701 million (2014: £704 million) relating to the group's estimated liability for redress in respect of the possible mis-selling of Payment Protection Insurance ('PPI') policies in previous years. An increase in provisions of £359 million was recognised during the year primarily reflecting an increase in inbound complaints by Claims Management Companies compared to previous forecasts and management's current best estimate of the impact on provisions of the FCA consultation on the introduction of a time bar and Plevin, (a 2014 decision of the UK Supreme Court which held that, judged on its own facts, non-disclosure of the amounts of commissions payable in connection with the sale of PPI to a customer created an unfair relationship under the provisions of the UK Consumer Credit Act).

Cumulative provisions made since the Judicial Review ruling in the first half of 2011 amount to £2,937 million of which £2,298 million has been paid as at 31 December 2015.

The estimated liability for redress is calculated on the basis of total premiums paid by the customer plus simple interest of 8% per annum (or the rate inherent in the related loan product where higher). The basis for calculating the redress liability is the same for single premium and regular premium policies. Future estimated redress levels are based on historically observed redress per policy.

A total of approximately 5.4 million PPI policies have been sold by the group since 2000, generating estimated revenues of £2.6 billion at 2015. The gross written premiums on these policies was approximately £3.4 billion. At 31 December 2015, the estimated total complaints expected to be received was 1.9 million, representing 35% of total policies sold. It is estimated that contact will be made with regard to 2.3 million policies, representing 42% of total policies sold. This estimate includes inbound complaints as well as the group's proactive contact exercise on certain policies ('outbound contact').

The following table details the cumulative number of policies at 31 December 2015 and the number of claims expected in the future:

	Cumulative to 31 December 2015	Future expected
Inbound complaints <sup>1</sup> (000s of policies)	1,215	336
Outbound contact (000s of policies)	624	101
Response rate to outbound contact	44%	52%
Average uphold rate per claim <sup>2</sup>	74%	81%
Average redress per claim	£2,001	£1,861
Complaints to the Financial Ombudsman Service ('FOS') (000s of policies)	121	51
Average uphold rate per FOS complaint	36%	53%

<sup>1</sup> Excludes invalid claims where complainant has not held a PPI policy and FOS complaints.

<sup>2</sup> Claims include inbound and responses to outbound contact, but exclude FOS complaints

A 100,000 increase/decrease in the total inbound complaints would increase/decrease the redress provision by approximately £149 million. Each 1% increase/decrease in the response rate to our outbound contact exercise would increase/decrease redress provision by approximately £10 million.



## Notes on the Financial Statements (continued)

- (ii) At 31 December 2015, a provision of £59 million (2014: £200 million) was held relating to the estimated liability for redress in respect of the possible mis-selling of interest rate derivatives in the UK. The provision relates to the estimated redress payable to customers in respect of historical payments under derivative contracts. A release from the provision of £25 million (2014: £175 million increase) was recorded during the year.
- (iii) Provisions of £49 million (2014: £80 million) for the estimated cost of redress in relation to the provision for possible mis-selling of wealth management products. £31 million was utilised during the year.

Further details of legal proceedings and regulatory matters are set out in Note 37. Legal proceedings include civil court, arbitration or tribunal proceedings brought against HSBC companies (whether by way of claim or counterclaim) or civil disputes that may, if not settled, result in court, arbitration or tribunal proceedings. Regulatory matters refer to investigations, reviews and other actions carried out by, or in response to the actions of, regulators or law enforcement agencies in connection with alleged wrongdoing.

Also included within 'other' in the above table, for the group and bank, are provisions for onerous property contracts of £62 million (2014: £71 million) and £57 million (2014: £67 million) respectively, relating to the discounted future costs associated with leasehold properties that have become vacant. The provisions cover rent voids while finding new tenants, shortfalls in expected rent receivable compared with rent payable, and the cost of refurbishing the buildings to attract tenants. Uncertainties arise from movements in market rents, delays in finding new tenants and the timing of rental reviews.

The Group has undertaken a review of compliance with the fixed-sum unsecured loan agreement requirements of the UK Consumer Credit Act (CCA). £113 million has been recognised as at 31 December 2015 (2014: £243 million) within 'Other liabilities' for the repayment of interest to customers primarily where annual statements did not remind them of their right to partially prepay the loan, notwithstanding that the customer loan documentation did include this right. The cumulative liability to date is £384 million, of which payments of £271 million have been made to customers. There is uncertainty as to whether other technical requirements of the CCA have been met.

### 28 Subordinated liabilities

	The group		The bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Subordinated liabilities:				
– At amortised cost	8,527	8,858	7,497	7,854
Subordinated liabilities	7,827	6,677	7,497	7,854
Preference shares	700	2,181	–	–
– Designated at fair value (note 24)	1,923	2,856	1,924	2,856
Subordinated liabilities	1,594	2,526	1,924	2,856
Preference shares	329	330	–	–
	<b>10,450</b>	<b>11,714</b>	<b>9,421</b>	<b>10,710</b>

## Notes on the Financial Statements (continued)

## Subordinated borrowings of the group

		Carrying amount	
		2015	2014
		£m	£m
US\$1,450m	Floating Rate Subordinated Loan 2021	978	930
US\$450m	Subordinated Floating Rate Notes 2021	304	289
US\$275m	Floating Rate Subordinated Loan 2021	186	176
£350m	5% Callable Subordinated Notes 2023 <sup>1</sup>	379	388
£300m	6.5% Subordinated Notes 2023	299	299
€650m	Floating Rate Subordinated Loan 2023	477	507
US\$300m	7.65% Subordinated Notes 2025	260	256
US\$1,400m	Floating Rate Subordinated Loan 2025 <sup>5</sup>	945	–
€260m	Floating Rate Subordinated Loan 2029	191	203
£350m	5.375% Callable Subordinated Step-up Notes 2030 <sup>2</sup>	384	398
£500m	5.375% Subordinated Notes 2033	571	581
£225m	6.25% Subordinated Notes 2041	224	224
£600m	4.75% Subordinated Notes 2046	593	593
£700m	5.844% Non-cumulative Step-up Perpetual Preferred Securities <sup>3</sup>	700	700
£300m	5.862% Non-cumulative Step-up Perpetual Preferred Securities <sup>4</sup>	329	330
US\$750m	Undated Floating Rate Primary Capital Notes	506	481
US\$500m	Undated Floating Rate Primary Capital Notes	337	321
US\$300m	Undated Floating Rate Primary Capital Notes (Series 3)	202	192
US\$2,862m	Floating Rate Perpetual Subordinated Debt	1,931	1,836
£500m	4.75% Callable Subordinated Notes 2020 <sup>5</sup>	–	514
€500m	Callable Subordinated Floating Rate Notes 2020 <sup>5</sup>	–	377
€1,000m	Floating Rate Subordinated Loan 2017 <sup>6</sup>	–	779
€900m	7.75% Non-cumulative Subordinated Notes 2040 <sup>6</sup>	–	701
	Other subordinated liabilities less than £100m	654	639
		<b>10,450</b>	<b>11,714</b>

1 In March 2018 the interest rate changes to become the rate per annum which is the sum of the gross redemption yield of the then prevailing five year UK gilt plus 1.80%.

2 In November 2025 the interest rate changes to three month sterling LIBOR plus 1.50%.

3 In November 2031 the distribution rate changes to six month sterling LIBOR plus 1.76%.

4 In April 2020 the distribution rate changes to six month sterling LIBOR plus 1.85%.

5 In September 2015 the bank called and redeemed the 4.75% Callable Subordinated Notes 2020 and the Callable Subordinated Floating Rate Notes 2020 at par.

6 In December 2015 the bank called and redeemed the Floating Rate Subordinated Loan 2017 and the 7.75% Non-cumulative Subordinated Notes 2040 at par.

Footnotes 1 to 4 all relate to instruments that are redeemable at the option of the issuer on the date of the change in the interest or distribution rate, and on subsequent rate reset and payment dates in some cases, subject to prior notification to the Prudential Regulation Authority.

Subordinated liabilities rank behind senior obligations and generally count towards the capital base of the group. Where applicable, capital securities may be called and redeemed by the group subject to prior notification to the PRA and, where relevant, the consent of the local banking regulator. If not redeemed at the first call date, coupons payable may step-up or become floating rate based on interbank rates.

Interest rates on the floating rate capital securities are generally related to interbank offered rates. On the remaining capital securities, interest is payable at fixed rates of up to 7.65%.

## Notes on the Financial Statements (continued)

### 29 Maturity analysis of financial assets and financial liabilities

The following table provides an analysis of consolidated total assets, liabilities and off-balance sheet commitments by residual contractual maturity at the balance sheet date. Asset and liability balances are included in the maturity analysis as follows:

- except for reverse repos, repos and debt securities in issue, trading assets and liabilities (including trading derivatives) are included in the 'On demand' time bucket, and not by contractual maturity because trading balances are typically held for short periods of time;
- financial assets and liabilities with no contractual maturity (such as equity securities) are included in the 'Due over 5 years' time bucket. Undated or perpetual instruments are classified based on the contractual notice period which the counterparty of the instrument is entitled to give. Where there is no contractual notice period, undated or perpetual contracts are included in the 'Due over 5 years' time bucket;
- financial instruments included within assets and liabilities of disposal groups held for sale are classified on the basis of the contractual maturity of the underlying instruments and not on the basis of the disposal transaction.

Loan and other credit-related commitments are classified on the basis of the earliest date they can be drawn down.

#### Cash flows payable under financial liabilities by remaining contractual maturities

##### The group

	On demand £m	Due within 3 months £m	Due between 3 and 12 months £m	Due between 1 and 5 years £m	Due after 5 years £m	Total £m
<b>31 December 2015</b>						
Deposits by banks	18,204	3,047	455	2,503	63	24,272
Customer accounts	289,864	31,039	9,879	2,131	127	333,040
Repurchase agreements	6,086	10,060	861	–	–	17,007
Trading liabilities	73,489	–	–	–	–	73,489
Financial liabilities designated at fair value	190	187	3,343	10,199	6,135	20,054
Derivatives	161,191	118	413	787	371	162,880
Debt securities in issue	10	11,972	9,491	3,918	868	26,259
Subordinated liabilities	–	45	107	1,006	8,337	9,495
Other financial liabilities	2,991	1,202	777	115	417	5,502
	552,025	57,670	25,326	20,659	16,318	671,998
Loan commitments	130,114	609	744	164	2	131,633
Financial guarantee contracts	3,135	1,625	4,085	2,724	2,166	13,735
<b>31 December 2015</b>	<b>685,274</b>	<b>59,904</b>	<b>30,155</b>	<b>23,547</b>	<b>18,486</b>	<b>817,366</b>
<b>31 December 2014</b>						
Deposits by banks	18,890	6,217	1,062	1,352	109	27,630
Customer accounts	301,426	33,179	9,262	2,710	98	346,675
Repurchase agreements	110	19,492	3,781	–	–	23,383
Trading liabilities	82,600	–	–	–	–	82,600
Financial liabilities designated at fair value	218	1,257	3,419	10,204	8,651	23,749
Derivatives	186,160	183	683	2,248	268	189,542
Debt securities in issue	3	13,753	9,542	5,203	852	29,353
Subordinated liabilities	203	45	32	1,040	8,530	9,850
Other financial liabilities	4,454	1,782	875	200	482	7,793
	594,064	75,908	28,656	22,957	18,990	740,575
Loan commitments	134,306	707	380	124	5	135,522
Financial guarantee contracts	3,392	1,827	3,754	2,176	2,303	13,452
<b>At 31 December 2014</b>	<b>731,762</b>	<b>78,442</b>	<b>32,790</b>	<b>25,257</b>	<b>21,298</b>	<b>889,549</b>

## Notes on the Financial Statements (continued)

## The bank

	On demand £m	Due within 3 months £m	Due between 3 and 12 months £m	Due between 1 and 5 years £m	Due after 5 years £m	Total £m
<b>31 December 2015</b>						
Deposits by banks	19,584	3,510	2,618	3,047	316	29,075
Customer accounts	241,531	22,331	6,634	1,185	563	272,244
Repurchase Agreements	4,971	5,439	872	-	-	11,282
Trading liabilities	57,436	-	-	-	-	57,436
Financial liabilities designated at fair value	-	107	3,254	5,839	3,537	12,737
Derivatives	147,183	114	342	562	198	148,399
Debt securities in issue	-	4,059	6,632	1,287	504	12,482
Subordinated liabilities	-	44	26	1,086	7,591	8,747
Other financial liabilities	2,046	784	342	5	4	3,181
	472,751	36,388	20,720	13,011	12,713	555,583
Loan commitments	92,614	147	145	81	2	92,989
Financial guarantee contracts	513	2,027	3,525	2,385	2,243	10,693
<b>At 31 December 2015</b>	<b>565,878</b>	<b>38,562</b>	<b>24,390</b>	<b>15,477</b>	<b>14,958</b>	<b>659,265</b>
<b>At 31 December 2014</b>						
Deposits by banks	20,529	7,661	897	386	3,155	32,628
Customer accounts	254,978	18,258	7,850	2,353	1	283,440
Repurchase agreements	-	15,667	2,657	-	-	18,324
Trading liabilities	59,039	-	-	-	-	59,039
Financial liabilities designated at fair value	-	1,242	3,178	7,660	5,092	17,172
Derivatives	160,185	183	683	1,602	268	162,921
Debt securities in issue	-	4,195	7,461	2,768	842	15,266
Subordinated liabilities	-	44	25	1,562	7,149	8,780
Other financial liabilities	3,970	576	313	6	4	4,869
	498,701	47,826	23,064	16,337	16,511	602,439
Loan commitments	96,504	112	118	46	5	96,785
Financial guarantee contracts	473	2,575	3,531	2,130	2,259	10,968
<b>31 December 2014</b>	<b>595,678</b>	<b>50,513</b>	<b>26,713</b>	<b>18,513</b>	<b>18,775</b>	<b>710,192</b>

## Maturity analysis of financial assets and financial liabilities

## The group

	At 31 December 2015		Total £m
	Due within one year £m	Due after more than one year £m	
<b>Assets</b>			
Financial assets designated at fair value	246	6,583	6,829
Loans and advances to banks	19,044	4,178	23,222
Loans and advances to customers	90,956	167,550	258,506
Reverse repurchase agreements- non trading	29,829	708	30,537
Financial investments	9,993	61,359	71,352
Other financial assets	1,800	172	1,972
<b>At 31 December 2015</b>	<b>151,868</b>	<b>240,550</b>	<b>392,418</b>
<b>Liabilities</b>			
Deposits by banks	21,760	2,442	24,202
Customer accounts	330,310	2,520	332,830
Repurchase agreements – non trading	17,000	-	17,000
Financial liabilities designated at fair value	3,294	15,707	19,001
Debt securities in issue	21,451	4,618	26,069
Other financial liabilities	2,374	337	2,711
Subordinated liabilities	105	8,422	8,527
<b>At 31 December 2015</b>	<b>396,294</b>	<b>34,046</b>	<b>430,340</b>

## Notes on the Financial Statements (continued)

	At 31 December 2014		
	Due within one year £m	Due after more than one year £m	Total £m
<b>Assets</b>			
Financial assets designated at fair value	202	6,697	6,899
Loans and advances to banks	21,359	3,903	25,262
Loans and advances to customers	98,613	158,639	257,252
Reverse repurchase agreements – non trading	41,669	276	41,945
Financial investments	9,181	67,013	76,194
Other financial assets	5,772	72	5,844
<b>At 31 December 2014</b>	<b>176,796</b>	<b>236,600</b>	<b>413,396</b>
<b>Liabilities</b>			
Deposits by banks	26,191	1,399	27,590
Customer accounts	343,724	2,783	346,507
Repurchase agreements – non trading	23,353	–	23,353
Financial liabilities designated at fair value	3,449	19,103	22,552
Debt securities in issue	22,106	5,815	27,921
Other financial liabilities	8,836	370	9,206
Subordinated liabilities	4	8,854	8,858
<b>31 December 2014</b>	<b>427,663</b>	<b>38,324</b>	<b>465,987</b>

*The bank*

	At 31 December 2015		
	Due within one year £m	Due after more than one year £m	Total £m
<b>Assets</b>			
Financial assets designated at fair value	–	–	–
Loans and advances to banks	13,790	2,871	16,661
Loans and advances to customers	75,899	129,499	205,398
Reverse repurchase agreements – non trading	24,439	454	24,893
Financial investments	5,889	34,010	39,899
Other financial assets	1,663	6	1,669
<b>At 31 December 2015</b>	<b>121,680</b>	<b>166,840</b>	<b>288,520</b>
<b>Liabilities</b>			
Deposits by banks	25,710	3,363	29,073
Customer accounts	270,464	1,062	271,526
Repurchase agreements – non trading	11,275	–	11,275
Financial liabilities designated at fair value	3,126	8,687	11,813
Debt securities in issue	10,673	1,683	12,356
Other financial liabilities	1,714	4	1,718
Subordinated liabilities	–	7,497	7,497
<b>At 31 December 2015</b>	<b>322,962</b>	<b>22,296</b>	<b>345,258</b>

	At 31 December 2014		
	Due within one year £m	Due after more than one year £m	Total £m
<b>Assets</b>			
Financial assets designated at fair value	9	–	9
Loans and advances to banks	16,464	2,312	18,776
Loans and advances to customers	77,945	123,726	201,671
Reverse repurchase agreements – non trading	36,391	–	36,391
Financial investments	14,239	34,199	48,438
Other financial assets	5,093	12	5,105
<b>At 31 December 2014</b>	<b>150,141</b>	<b>160,249</b>	<b>310,390</b>
<b>Liabilities</b>			
Deposits by banks	27,843	3,540	31,383
Customer accounts	280,361	2,326	282,687
Repurchase agreements – non trading	18,293	–	18,293
Financial liabilities designated at fair value	3,195	12,932	16,127
Debt securities in issue	11,578	3,372	14,950
Other financial liabilities	3,479	11	3,490
Subordinated liabilities	–	7,854	7,854
<b>At 31 December 2014</b>	<b>344,749</b>	<b>30,035</b>	<b>374,784</b>

## Notes on the Financial Statements (continued)

## 30 Offsetting of financial assets and financial liabilities

## Accounting policy

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

The table below sets out amounts of enforceable netting meeting the offset criteria and the amount of enforceable netting that does not meet the offset criteria:

Financial assets and liabilities subject to enforceable netting	Gross amounts <sup>1</sup> £m	Amounts offset £m	Amounts after offset £m	Related amounts not offset <sup>2</sup>			Net amount after all enforceable offset £m
				Financial instruments £m	Non-cash collateral £m	Cash collateral £m	
<b>Financial assets</b>							
Derivatives	223,854	(58,151)	165,703	(125,841)	(5,094)	(20,452)	14,316
Reverse repurchase, securities borrowing and similar agreements	62,657	(29,479)	33,178	(366)	(32,634)	(178)	-
Classified as:							
- trading assets	5,092	-	5,092	-	(5,092)	-	-
- non-trading assets	57,565	(29,479)	28,086	(366)	(27,542)	(178)	-
Loans and advances to customers at amortised cost	50,174	(20,041)	30,133	(26,874)	-	-	3,259
<b>At 31 December 2015</b>	<b>336,685</b>	<b>(107,671)</b>	<b>229,014</b>	<b>(153,081)</b>	<b>(37,728)</b>	<b>(20,630)</b>	<b>17,575</b>
<b>Financial liabilities</b>							
Derivatives	218,496	(58,151)	160,345	(125,846)	(7,634)	(19,318)	7,547
Repurchase, securities lending and similar agreements	59,520	(29,479)	30,041	(91)	(29,932)	(18)	-
Classified as:							
- trading liabilities	13,345	-	13,345	-	(13,345)	-	-
- non-trading liabilities	46,175	(29,479)	16,696	(91)	(16,587)	(18)	-
Customer accounts at amortised cost	53,567	(20,041)	33,526	(26,874)	-	-	6,652
<b>At 31 December 2015</b>	<b>331,583</b>	<b>(107,671)</b>	<b>223,912</b>	<b>(152,811)</b>	<b>(37,566)</b>	<b>(19,336)</b>	<b>14,199</b>
<b>Financial assets</b>							
Derivatives	332,252	(146,170)	186,082	(146,995)	(3,126)	(23,344)	12,617
Reverse repurchase, securities borrowing and similar agreements	85,548	(40,812)	44,736	(3,284)	(41,294)	(158)	-
Classified as:							
- trading assets	5,635	(250)	5,385	-	(5,385)	-	-
- non-trading assets	79,913	(40,562)	39,351	(3,284)	(35,909)	(158)	-
Loans and advances to customers at amortised cost	61,718	(22,182)	39,536	(35,920)	-	-	3,616
<b>At 31 December 2014<sup>1</sup></b>	<b>479,518</b>	<b>(209,164)</b>	<b>270,354</b>	<b>(186,199)</b>	<b>(44,420)</b>	<b>(23,502)</b>	<b>16,233</b>
<b>Financial liabilities</b>							
Derivatives	332,215	(146,170)	186,045	(147,004)	(4,019)	(23,119)	11,903
Repurchase, securities lending and similar agreements	72,904	(40,812)	32,092	(3,285)	(28,742)	(65)	-
Classified as:							
- trading liabilities	9,307	(250)	9,057	-	(9,057)	-	-
- non-trading liabilities	63,597	(40,562)	23,035	(3,285)	(19,685)	(65)	-
Customer accounts at amortised cost	65,910	(22,182)	43,728	(35,920)	-	-	7,808
<b>At 31 December 2014<sup>1</sup></b>	<b>471,029</b>	<b>(209,164)</b>	<b>261,865</b>	<b>(186,209)</b>	<b>(32,761)</b>	<b>(23,184)</b>	<b>19,711</b>

1 Excludes amounts for which there are no enforceable netting agreements. At 31 December 2015, the amount of cash variation margin received that has been offset against the gross derivatives assets was £1,699 million. The amount of cash margin paid that has been offset against the gross derivative liabilities was £2,700 million.

2 Related amounts not offset

For derivative assets and liabilities, the 'financial instruments' column identifies amounts that are subject to set off only in the event of default, insolvency or bankruptcy.

For repurchase and reverse repurchase and other similar secured lending and borrowing, the non-cash collateral column typically comprises highly liquid securities which are legally transferred and can be liquidated in the event of counterparty default.

3 The 2014 comparatives have been restated to exclude amounts not subject to enforceable master netting agreements and similar agreements

## Notes on the Financial Statements (continued)

### 31 Foreign exchange exposures

The group's structural foreign currency exposure is represented by the net asset value of its foreign currency equity and subordinated debt investments in subsidiary undertakings, branches, joint ventures and associates.

The group's management of structural foreign currency exposures is discussed in the risk section in the Report of Directors.

#### Net structural foreign currency exposures

##### Currency of structural exposure

	2015 £m	2014 £m
Euro	11,313	10,036
US dollars	800	792
Turkish lira	679	876
South African rand	180	190
Russian rouble	123	104
Others, each less than £100 million	289	248
<b>Total</b>	<b>13,384</b>	<b>12,246</b>

### 32 Called up share capital and other equity instruments

#### Accounting policy

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

#### Issued and fully paid capital

##### HSBC Bank plc £1.00 ordinary shares

	Number	£m
1 January 2015	796,969,110	797
Shares issued	-	-
<b>31 December 2015</b>	<b>796,969,110</b>	<b>797</b>
1 January 2014	796,969,108	797
Share issued	2	-
<b>31 December 2014</b>	<b>796,969,110</b>	<b>797</b>

##### HSBC Bank plc £1.00 preferred ordinary shares

	Number	£'000
1 January and 31 December 2015	1	-
1 January and 31 December 2014	1	-

The preferred ordinary share ranks pari passu in all respects with the ordinary shares and with all other shares expressed to rank pari passu therewith. It carries the same rights and is subject to the same limitations as the ordinary shares but in addition the preferred ordinary share confers:

(i) on each and any distribution of profits by the bank on any class of share (other than the ordinary shares), the right to receive, in priority to any other share, the first £100 of any amount so distributed; and

(ii) on any distribution on a winding-up of the bank (but not on any redemption, reduction or purchase of any share capital), the right to receive out of the assets of the bank available for distribution, in priority to any other share, a sum equal to the nominal amount of the preferred ordinary share and any premium paid on the issue thereof.

##### HSBC Bank plc US\$0.01 non-cumulative third dollar preference shares

	Number	£'000
At 1 January and 31 December 2015	35,000,000	172
At 1 January and 31 December 2014	35,000,000	172

The bank has no obligation to redeem the preference shares but may redeem them in part or in whole at any time, subject to the prior consent of the Prudential Regulation Authority. Dividends on the preference shares in issue are paid annually at the sole and absolute discretion of the Board of Directors. The Board of Directors will not declare a dividend on the preference shares in issue if payment of the dividend would cause the bank not to meet the capital adequacy requirements of the Prudential Regulation Authority or the profit of the bank, available for distribution as dividends, is not sufficient to enable the bank to pay in full both dividends on the preference shares in issue and dividends on any other shares that are scheduled to be paid on the same date and have an equal right to dividends or if payment of the dividend is prohibited by the rights attached to any class of shares in the capital of the bank, excluding ordinary shares. The preference shares in issue carry no rights to conversion into ordinary shares of the bank. Holders of the preference shares in issue will be able to attend any general

## Notes on the Financial Statements (continued)

meetings of shareholders of the bank and to vote on any resolution proposed to vary or abrogate any of the rights attaching to the preference shares or any resolution proposed to reduce the paid up capital of the preference shares. If the dividend payable on the preference shares in issue has not been paid in full for the most recent dividend period or any resolution is proposed for the winding-up of the bank or the sale of its entire business then, in such circumstances, holders of preference shares will be entitled to vote on all matters put to general meetings. In the case of unpaid dividends the holders of preference shares in issue will be entitled to attend and vote at any general meetings until such time as dividends on the preference shares have been paid in full, or a sum set aside for such payment in full, in respect of one dividend period.

All shares in issue are fully paid.

### Other equity instruments

#### HSBC Bank plc additional tier 1 instruments

		2015 £m	2014 £m
£1,096m	Undated Subordinated Additional Tier 1 Instrument issued 2014 (Callable December 2019 onwards)	1,096	1,096
£1,100m	Undated Subordinated Additional Tier 1 Instrument issued 2014 (Callable December 2024 onwards)	1,100	1,100
€1,900m	Undated Subordinated Resettable Additional Tier 1 Instruments issued 2015 (Callable December 2020 onwards)	1,388	–
<b>At 31 December</b>		<b>3,584</b>	<b>2,196</b>

The bank has issued capital instruments that are included in the group's capital base as fully CRD IV compliant additional tier 1 capital.

Interest on these instruments will be due and payable only at the sole discretion of the bank, and the bank has sole and absolute discretion at all times and for any reason to cancel (in whole or in part) any interest payment that would otherwise be payable on any date. There are limitations on the payment of principal, interest or other amounts if such payments are prohibited under UK banking regulations, or other requirements, if the bank has insufficient distributable items or if the bank fails to satisfy the solvency condition as defined in the instruments' terms.

The instruments are undated and are repayable, at the option of the bank, in whole at the initial call date, or on any Interest Payment Date after the initial call date. In addition, the instruments are repayable at the option of the bank in whole for certain regulatory or tax reasons. Any repayments require the prior consent of the Prudential Regulation Authority. These instruments rank pari passu with the bank's most senior class or classes of issued preference shares and therefore ahead of ordinary shares. These instruments will be written down in whole, together with any accrued but unpaid interest if either the group's solo or consolidated Common Equity Tier 1 Capital Ratio falls below 7.00%.

### 33 Notes on the cash flow statement

#### Non-cash items included in profit before tax

	The group		The bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Depreciation, amortisation and impairment	523	532	415	412
Share-based payment expense	212	162	180	128
Credit-related impairment losses	747	833	462	498
Provisions raised	1,131	1,529	1,020	1,420
Impairment of investments	(19)	(203)	(1)	(2)
Charge/(credit) for defined benefit plans	29	123	2	79
Accretion of discounts and amortisation of premiums	(108)	(58)	(45)	(8)
	<b>2,515</b>	<b>2,918</b>	<b>2,033</b>	<b>2,527</b>

#### Change in operating assets

	The group		The bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Change in prepayments and accrued income	275	214	57	1
Change in net trading securities and net derivatives	4,532	(5,335)	804	(960)
Change in loans and advances to banks	746	(5,249)	1,235	(4,636)
Change in loans and advances to customers	(1,901)	15,543	1,330	15,381
Change in reverse repurchase agreements – non-trading	6,354	11,180	8,512	8,159
Change in financial assets designated at fair value	70	9,762	9	3,974
Change in other assets	7,082	(7,084)	7,082	(3,715)
	<b>17,158</b>	<b>19,031</b>	<b>19,029</b>	<b>18,204</b>



## Notes on the Financial Statements (continued)

### Change in operating liabilities

	The group		The bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Change in accruals and deferred income	(60)	(459)	73	(206)
Change in deposits by banks	(3,388)	(1,156)	(2,310)	(1,072)
Change in customer accounts	(13,677)	756	(11,161)	1,642
Change in repurchase agreements – non-trading	(6,353)	(42,220)	(7,018)	(32,905)
Change in debt securities in issue	(1,852)	(4,974)	(2,594)	(4,626)
Change in financial liabilities designated at fair value	(2,672)	(11,484)	(3,424)	(5,879)
Change in other liabilities	(5,085)	577	(3,963)	(515)
	<b>(33,087)</b>	<b>(58,960)</b>	<b>(30,397)</b>	<b>(43,561)</b>

### Cash and cash equivalents

#### Accounting policy

Cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition.

	The group		The bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Cash and balances at central banks	39,749	42,853	38,725	41,424
Items in the course of collection from other banks	1,328	973	993	630
Loans and advances to banks of one month or less	14,258	15,558	11,200	12,089
Reverse repurchase agreements with banks of one month or less	7,245	12,299	4,830	7,816
Treasury bills, other bills and certificates of deposit less than three months	998	484	578	319
Less: items in the course of transmission to other banks	(583)	(667)	(236)	(336)
<b>Total cash and cash equivalents<sup>1</sup></b>	<b>62,995</b>	<b>71,500</b>	<b>56,090</b>	<b>61,942</b>

<sup>1</sup> Total cash and cash equivalents include the following amounts that are not available for use by the group: Nil held by foreign subsidiaries and subject to foreign exchange control restrictions (2014: nil); and £3,753 million subject to other restrictions (2014: £4,065 million).

Total interest paid by the group during the year was £2,685 million (2014: £2,638 million). Total interest received by the group during the year was £9,594 million (2014: £9,604 million). Total dividends received by the group during the year were £383 million (2014: £451 million).

## Notes on the Financial Statements (continued)

### 34 Contingent liabilities, contractual commitments and guarantees

#### Accounting policy

##### Contingent liabilities

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security as well as contingent liabilities related to legal proceedings or regulatory matters (see Note 37), are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the group; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

##### Financial guarantee contracts

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

The group has issued financial guarantees and similar contracts to other group entities. The group elects to account for certain guarantees as insurance contracts, in which case they are measured and recognised as insurance liabilities. This election is made on a contract by contract basis, and is irrevocable.

	The group		The bank	
	2015 £m	2014 £m	2015 £m	2014 £m
<b>Guarantees and other contingent liabilities</b>				
Guarantees	18,196	17,012	14,429	13,459
Other contingent liabilities	210	71	209	70
	<b>18,406</b>	<b>17,083</b>	<b>14,638</b>	<b>13,529</b>
<b>Commitments<sup>1</sup></b>				
Documentary credits and short-term trade-related transactions	2,898	3,073	1,717	1,814
Forward asset purchases and forward deposits placed	216	335	–	–
Undrawn formal standby facilities, credit lines and other commitments to lend <sup>2</sup>	128,519	132,114	91,272	94,971
	<b>131,633</b>	<b>135,522</b>	<b>92,989</b>	<b>96,785</b>

<sup>1</sup> Excluding capital commitments, which are separately disclosed below.

<sup>2</sup> Based on original contractual maturity.

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

Contingent liabilities arising from litigation against the group are disclosed in Note 37.

#### Financial Services Compensation Scheme

The Financial Services Compensation Scheme ('FSCS') has provided compensation to consumers following the collapse of a number of deposit takers. The compensation paid out to consumers is currently funded through loans from HM Treasury which at 31 December 2015 stood at approximately £16 billion.

The bank could be liable to pay a proportion of the outstanding borrowings that the FSCS has borrowed from HM Treasury. The ultimate FSCS levy to the industry as a result of the collapses cannot currently be estimated reliably as it is dependent on various uncertain factors including the potential recoveries of assets by the FSCS and changes in the level of protected deposits and the population of FSCS members at the time.

#### Guarantees

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

## Notes on the Financial Statements (continued)

### The group

	At 31 December 2015		At 31 December 2014	
	Guarantees in favour of third parties £m	Guarantees by the group in favour of other Group entities £m	Guarantees in favour of third parties £m	Guarantees by the group in favour of other Group entities £m
<b>Guarantee type</b>				
Financial guarantee contracts <sup>1</sup>	8,745	1,225	8,853	1,048
Credit-related substitutes <sup>2</sup>	3,656	109	3,467	84
Other guarantees	4,278	393	3,249	382
<b>Total</b>	<b>16,679</b>	<b>1,727</b>	<b>15,569</b>	<b>1,514</b>

### The bank

	At 31 December 2015		At 31 December 2014	
	Guarantees in favour of third parties £m	Guarantees by the group in favour of other Group entities £m	Guarantees in favour of third parties £m	Guarantees by the group in favour of other Group entities £m
<b>Guarantee type</b>				
Financial guarantee contracts <sup>1</sup>	6,906	2,107	6,925	2,056
Credit-related substitutes <sup>2</sup>	1,583	97	1,911	76
Other guarantees	2,965	980	2,053	508
<b>Total</b>	<b>11,454</b>	<b>3,184</b>	<b>10,889</b>	<b>2,640</b>

1 *Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. The amounts in the above table are nominal principal amounts.*

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

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

### Other commitments

In addition to the commitments disclosed above, at 31 December 2015 the group had capital commitments to purchase, within one year, land and buildings and other fixed assets from a number of suppliers for a value of £17 million (2014: £8 million) and £26 million (2014: £42 million) of capital commitments authorised but not contracted for.

The group had no contingent liabilities or commitments in relation to joint ventures or associates, incurred jointly or otherwise.

## Notes on the Financial Statements (continued)

### 35 Lease commitments

#### Accounting policy

Agreements which transfer substantially all the risks and rewards incidental to the ownership of assets are classified as finance leases. As a lessor under finance leases, the group presents the amounts due under the leases, after deduction of unearned charges, in 'Loans and advances to banks' or 'Loans and advances to customers'. As a lessee under finance leases, the group presents the leased assets in 'Property, plant and equipment' and the corresponding liability to the lessor is included in 'Other liabilities'. A finance lease and its corresponding liability are recognised initially at the fair value of the asset or, if lower, the present value of the minimum lease payments. All other leases are classified as operating leases. As a lessor, the group presents assets subject to operating leases in 'Property, plant and equipment'. Impairment losses are recognised to the extent that the carrying values are not fully recoverable. As a lessee, leased assets are not recognised on the balance sheet. The finance income or charges on finance leases are recognised in 'Net interest income' over the lease periods so as to give a constant rate of return. Rentals payable or receivable under operating leases are spread on a straight-line basis over the lease periods and are recognised in 'General and administrative expenses' or in 'Other operating income'.

#### Operating lease commitments

At 31 December 2015, the group was obligated under a number of non-cancellable operating leases for properties, plant and equipment for which the future minimum lease payments extend over a number of years.

	Land and buildings	
	2015	2014
	£m	£m
<b>Future minimum lease payments under non-cancellable operating leases expiring</b>		
No later than one year	264	211
Later than one year and no later than five years	582	598
Later than five years	657	786
<b>Total</b>	<b>1,503</b>	<b>1,595</b>

In 2015, £174 million (2014: £174 million) was charged to 'General and administrative expenses' in respect of lease and sublease agreements.

#### Finance lease receivables

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

	2015			2014		
	Total future Minimum payments £m	Unearned finance income £m	Present value £m	Total future Minimum payments £m	Unearned finance income £m	Present value £m
Lease receivables						
No later than one year	1,448	(139)	1,309	1,312	(138)	1,174
Later than one year and no later than five years	3,338	(361)	2,977	3,350	(395)	2,955
Later than five years	1,424	(210)	1,214	1,583	(265)	1,318
<b>Total</b>	<b>6,210</b>	<b>(710)</b>	<b>5,500</b>	<b>6,245</b>	<b>(798)</b>	<b>5,447</b>

At 31 December 2015, unguaranteed residual values of £91 million (2014: £102 million) had been accrued, and the accumulated allowance for uncollectible minimum lease payments receivable amounted to £4 million (2014: £4 million).

In 2015, £23 million (2014: £27 million) was received as contingent rents and recognised in the income statement.

#### Operating lease receivables

The group leases a variety of different assets to third parties under operating lease arrangements, including property, aircraft and general plant and machinery.

	Equipment	
	2015	2014
	£m	£m
<b>Future minimum lease payments under non-cancellable operating leases expiring</b>		
No later than one year	12	11
Later than one year and no later than five years	24	17
Later than five years	1	–
<b>Total</b>	<b>37</b>	<b>28</b>

## Notes on the Financial Statements (continued)

### 36 Structured entities

#### Accounting policy

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only, and key activities are directed by contractual arrangements. Structured entities often have restricted activities and a narrow and well defined objective.

Structured entities are assessed for consolidation in accordance with the accounting policy set out in Note 1(f).

The group is involved with structured entities, mainly through securitisation of financial assets, conduits and investment funds.

The group's arrangements that involve structured entities are authorised centrally when they are established to ensure appropriate purpose and governance. The activities of structured entities administered by the group are closely monitored by senior management. The group has involvement with both consolidated and unconsolidated structured entities, which may be established by the group or by a third party, as detailed below.

#### Consolidated structured entities

*Total assets of the group's consolidated structured entities, split by entity type*

	Conduits £m	Securitisations £m	Other £m	Total £m
At 31 December 2015	17,807	1,174	2,250	21,231
At 31 December 2014	17,474	1,099	2,392	20,965

#### Conduits

The group has established and manages two types of conduits: securities investment conduits ('SIC's) and multi-seller conduits. These entities have been designed so that voting or similar rights are not the dominant factor in deciding who has control; in such cases, the relevant activities are directed by means of contractual arrangement. The conduits are consolidated where the group is exposed or has the right to variable returns from its involvement with the entity and has the ability to affect its returns through its power over the entity.

#### *Securities investment conduits*

*Solitaire*, the group's principal SIC, purchases highly rated ABSs to facilitate tailored investment opportunities. At 31 December 2015, *Solitaire* held £4.2 billion of ABSs (2014: £5.1 billion). These are included within the disclosures of ABS 'held through consolidated structured entities' on page 47. The group's other SICs, *Mazarin*, *Barion* and *Malachite*, evolved from the restructuring of group's established structured investment vehicles ('SIV's) in 2008.

- *Solitaire* – *Solitaire* is currently funded entirely by Commercial Paper ('CP') issued to the group. Although the group continues to provide a liquidity facility, *Solitaire* has no need to draw on it so long as the group purchases the CP issued, which it intends to do for the foreseeable future. At 31 December 2015 HSBC held £5.4 billion of CP (2014: £6.1 billion).

- *Mazarin* – the group is exposed to the par value of *Mazarin's* assets through the provision of a liquidity facility equal to the lesser of the amortised cost of issued senior debt and the amortised cost of non-defaulted assets. At 31 December 2015, this amounted to £1.2 billion (2014: £2.5 billion). First loss protection is provided through the capital notes issued by *Mazarin*, which are substantially all held by third parties.

At 31 December 2015, the group held 2.7% of *Mazarin's* capital notes (2014: 1.2%) which have a par value of £8.8 million (2014: £6 million) and a carrying amount of £2.7 million (2014: £0.9 million).

- *Barion and Malachite* – the group's primary exposure to these SICs is represented by the amortised cost of the debt required to support the non-cash assets of the vehicles. At 31 December 2015 this amounted to £0.9 billion (2014: £1.9 billion). First loss protection is provided through the capital notes issued by these vehicles, which are substantially all held by third parties.

At 31 December 2015, the group held 13.7% of the capital notes (2014: 9.9%) issued by these vehicles which have a par value of £28.5 million (2014: £35 million) and a carrying amount of £13.7 million (2014: £6 million).

#### *Multi-seller conduits*

These vehicles were established for the purpose of providing access to flexible market-based sources of finance for the group's clients.

The group bears risk equal to the transaction-specific liquidity facilities offered to the multi-seller conduits. First loss protection is provided by the originator of the assets, and not by the group, through transaction-specific credit enhancements. A layer of secondary loss protection is provided by the group in the form of programme-wide enhancement facilities.

#### Securitisations

The group uses structured entities to securitise customer loans and advances that it has originated in order to diversify its sources of funding for asset origination and for capital efficiency purposes. The loans and advances are transferred by the group to the structured entities for cash or synthetically through credit default swaps, and the structured entities issue debt securities to investors.

## Notes on the Financial Statements (continued)

### Group managed funds

The group has established a number of money market, and non-money market funds. Where the group is deemed to be acting as principal rather than agent in its role as investment manager, the group will control and hence consolidate these funds.

### Other

The group also enters into a number of transactions in the normal course of business, including asset and structured finance transactions where it has control of the structured entity.

### Unconsolidated structured entities

The term 'unconsolidated structured entities' refers to all structured entities that are not controlled by the group. The group enters into transactions with unconsolidated structured entities in the normal course of business to facilitate customer transactions and for specific investment opportunities.

The table below shows the total assets of unconsolidated structured entities in which the group has an interest at the reporting date, and the group's maximum exposure to loss in relation to those interests.

The maximum exposure to loss from the group's interests in unconsolidated structured entities represents the maximum loss that the group could incur as a result of its involvement with unconsolidated structured entities regardless of the probability of the loss being incurred.

- For commitments and guarantees, and written credit default swaps, the maximum exposure to loss is the notional amount of potential future losses.
- For retained and purchased investments in and loans to unconsolidated structured entities, the maximum exposure to loss is the carrying value of these interests at the balance sheet reporting date.

The maximum exposure to loss is stated gross of the effects of hedging and collateral arrangements entered into to mitigate the group's exposure to loss.

#### *Nature and risks associated with the group's interests in unconsolidated structured entities*

	Group managed funds £m	Non-group managed funds £m	Other £m	Total £m
<b>At 31 December 2015</b>				
Total assets	6,759	944,481	36,791	988,031
Group interest – assets				
Cash	–	–	–	–
Trading assets	23	215	1,753	1,991
Financial assets designated at fair value	903	2,203	–	3,106
Derivatives	–	–	572	572
Loans and advances to banks	–	220	35	255
Loans and advances to customers	69	–	1,429	1,498
Financial investments	24	409	107	540
Other assets	1	–	–	1
Total assets in relation to the group's interests in the unconsolidated structured entities	<b>1,020</b>	<b>3,047</b>	<b>3,896</b>	<b>7,963</b>
Group interest – liabilities				
Customer accounts	21	–	–	21
Total liabilities in relation to the group's interests in the unconsolidated structured entities	<b>21</b>	<b>–</b>	<b>–</b>	<b>21</b>
The group's maximum exposure	<b>1,020</b>	<b>3,047</b>	<b>3,896</b>	<b>7,963</b>

**Notes on the Financial Statements** (continued)

	Group managed funds £m	Non-group managed funds £m	Other £m	Total £m
At 31 December 2014				
Total assets	10,582	1,132,196	13,156	1,155,934
Group interest – assets				
Cash	–	–	–	–
Trading assets	27	85	1,057	1,169
Financial assets designated at fair value	878	3,453	–	4,331
Derivatives	–	–	797	797
Loans and advances to banks	–	84	35	119
Loans and advances to customers	55	–	171	226
Financial investments	40	416	94	550
Other assets	1	–	–	1
Total assets in relation to the group's interests in the unconsolidated structured entities	1,001	4,038	2,154	7,193
Group interest – liabilities				
Customer accounts	26	–	–	26
Total liabilities in relation to the group's interests in the unconsolidated structured entities	26	–	–	26
The group's maximum exposure	1,001	4,038	2,154	7,193

**Group managed funds**

The group has established and manages money market funds and non-money market investment funds to provide customers with investment opportunities. The group, as fund manager, may be entitled to receive a management and performance fee based on the assets under management.

**Non-group managed funds**

The group purchases and holds units of third party managed funds in order to facilitate both business and customer needs.

**Other**

The group has established structured entities in the normal course of business for example, structured credit transactions for customers, to provide finance to public and private sector infrastructure projects, and for asset and structured finance transactions.

**Group sponsored structured entities****Accounting policy**

The group is considered to sponsor another entity if, in addition to ongoing involvement with the entity, it had a key role in establishing that entity or in bringing together the relevant counterparties to a structured transaction, so that the transaction, which is the purpose of the entity, could occur. The group is generally not considered a sponsor if the only involvement with the entity is merely administrative in nature.

The amount of assets transferred to and income received from such sponsored entities during 2015 and 2014 was not significant.

**37 Legal proceedings 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 group considers that none of these matters are material. The recognition of provisions is determined in accordance with the accounting policies set out in Note 27. 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 31 December 2015. Where an individual provision is material, the fact that a provision has been made is stated and quantified, except to the extent doing so would be seriously prejudicial. 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.

## Notes on the Financial Statements (continued)

### Bernard L. Madoff Investment Securities LLC

Bernard L. Madoff ('Madoff') was arrested in December 2008, and later pleaded guilty to running a Ponzi scheme. He has acknowledged, in essence, that while purporting to invest his customers' money in securities, he in fact never invested in securities and used other customers' money to fulfil requests to return investments. His firm, Bernard L. Madoff Investment Securities LLC ('Madoff Securities'), is being liquidated in the US by a trustee (the 'Trustee').

Various non-US HSBC companies provided custodial, administration and similar services to a number of funds incorporated outside the US whose assets were invested with Madoff Securities. Based on information provided by Madoff Securities, as at 30 November 2008, the purported aggregate value of these funds was US\$8.4 billion, an amount that includes fictitious profits reported by Madoff. Based on information available to HSBC, we have estimated that the funds' actual transfers to Madoff Securities minus their actual withdrawals from Madoff Securities during the time that HSBC serviced the funds totalled approximately US\$4 billion. Various HSBC companies have been named as defendants in lawsuits arising out of Madoff Securities' fraud.

*US/UK litigation:* The Trustee has brought lawsuits against various HSBC companies in the US Bankruptcy Court and in the English High Court. The Trustee's ongoing US claims seek recovery of prepetition transfers pursuant to US bankruptcy law. The amount of these claims has not been pleaded or determined as against HSBC. The Trustee's English action seeks recovery of unspecified transfers from Madoff Securities to or through HSBC. HSBC has not yet been served with the Trustee's English action. The Trustee's deadline for serving the claim has been extended through the third quarter of 2016.

Alpha Prime Fund Ltd ('Alpha Prime') and Senator Fund SPC ('Senator'), co-defendants in the Trustee's US actions, have each brought cross-claims against HSBC. These funds have also sued HSBC in Luxembourg (discussed below). In June 2015, the US Bankruptcy Court heard HSBC's motion to dismiss Alpha Prime and Senator's cross-claims and a decision on that motion is pending.

Fairfield Sentry Limited, Fairfield Sigma Limited, and Fairfield Lambda Limited (together 'Fairfield'), funds whose assets were invested with Madoff Securities, commenced multiple lawsuits in the US and the British Virgin Islands ('BVI') against fund shareholders, including various HSBC companies that acted as nominees for HSBC clients, seeking restitution of payments made in connection with share redemptions. Fairfield's US actions are stayed pending the outcome of the cases in the BVI (discussed below).

In September 2013, the US Court of Appeals for the Second Circuit affirmed the dismissal of purported class action claims against HSBC and others brought by investors in three Madoff-invested funds on grounds of *forum non conveniens*. In May 2015, plaintiffs filed a motion asking the Court of Appeals to restore their class action claims on the basis of an alleged change of law. Plaintiffs' motion was denied by the Court of Appeals in June 2015.

In December 2014, three additional actions were filed in the US. The first is a purported class action brought in the United States District Court for the Southern District of New York (the 'New York District Court') by direct investors in Madoff Securities who were holding their investments as of December 2008, asserting various common law claims and seeking to recover damages lost to Madoff Securities' fraud on account of HSBC's purported knowledge and alleged furtherance of the fraud. HSBC moved to dismiss this action in November 2015 and a decision on that motion is pending. The other two actions were both filed by SPV Optimal SUS Ltd ('SPV OSUS'), the purported assignee of the Madoff invested company, Optimal Strategic US Equity Ltd. One of these actions was filed in New York state court and the other in New York District Court. In January 2015, SPV OSUS dismissed its federal lawsuit against HSBC. The state court action against HSBC remains pending.

In May 2015, an action was filed in New York District Court by two investors in the Madoff invested fund Hermes International Fund Limited ('Hermes') asserting various common law claims against HSBC and seeking to recover damages lost to Madoff Securities' fraud. HSBC's motion to dismiss the action was filed in January 2016 and a decision on that motion is pending.

*BVI litigation:* Beginning in October 2009, Fairfield commenced multiple lawsuits in the BVI against numerous fund shareholders, including various HSBC companies that acted as nominees for clients of HSBC's private banking business and other clients who invested in Fairfield. Fairfield is seeking restitution of redemption payments made by the funds to defendants on the grounds that they were mistakenly based on inflated net asset values. In April 2014, the UK Privy Council issued a ruling in favour of other defendants in the BVI actions, and issued its order in October 2014. The Privy Council ruling found in effect that Fairfield should not be entitled to recover share redemptions that were calculated on a net asset value per share based on fictitious profits, and were paid to shareholders prior to the collapse of Madoff Securities. Separately, a motion was brought by defendants before the BVI court challenging the authorisation of the Fairfield liquidator (appointed in July 2009) to pursue its claims in the US. That motion was heard in March 2015 and a decision is pending.

*Bermuda litigation:* Thema Fund Limited ('Thema') and Hermes, funds whose assets were invested with Madoff Securities, each also brought three actions in Bermuda in 2009. The first set of actions was brought against HSBC Institutional Trust Services (Bermuda) Limited and seeks recovery of funds in frozen accounts held at HSBC. The second set of actions asserts liability against HSBC Institutional Trust Services (Bermuda) Limited in relation to claims for mistake, recovery of fees, and damages for breach of contract. The third set of actions seeks return of fees from HSBC Bank Bermuda Limited and HSBC Securities Services (Bermuda). There has been little progress in these actions for several years, although in January 2015, Thema and Hermes served notice of intent to proceed in respect of the second set of actions referred to above.

*Cayman Islands litigation:* In February 2013, Primeo Fund (in official liquidation since April 2009), a Cayman Islands-based fund whose assets were invested with Madoff Securities, brought an action against the fund administrator, Bank of Bermuda (Cayman), and the fund custodian, HSBC Securities Services (Luxembourg) ('HSSL'), alleging breach of contract by the



## Notes on the Financial Statements (continued)

defendants and breach of fiduciary duty by HSSL. Primeo Fund claims damages from defendants (and equitable compensation from HSSL) to compensate it for alleged losses, including loss of profit. Trial is scheduled to begin in November 2016

*Luxembourg litigation:* In April 2009, Herald Fund SPC ('Herald') (in official liquidation since July 2013) commenced action against HSSL before the Luxembourg District Court seeking restitution of all cash and securities Herald purportedly lost because of Madoff Securities' fraud, or in the alternative, money damages in the same amount. In March 2013, the Luxembourg District Court dismissed Herald's restitution claim for the return of the securities, although Herald's restitution claim for return of the cash and its claim for money damages were reserved. Herald appealed this judgement in May 2013. Written submissions on the merits are due to be filed by the parties in March 2016.

In October 2009, Alpha Prime commenced an action against HSSL before the Luxembourg District Court, alleging breach of contract and negligence in the appointment of Madoff Securities as a sub-custodian of Alpha Prime's assets. Alpha Prime requested a stay of these proceedings pending its negotiations with the Trustee in the US proceedings. The matter has been temporarily suspended at Alpha Prime's request.

In March 2010, Herald (Lux) SICAV ('Herald (Lux)') (in official liquidation since April 2009) commenced an action against HSSL before the Luxembourg District Court seeking restitution of securities, or the cash equivalent, or money damages in the alternative. Herald (Lux) has also requested the restitution of fees paid to HSSL as custodian and service agent of the fund. Written submissions on the merits are due to be filed by Herald (Lux) in March 2016.

In December 2014, Senator commenced a separate action against HSSL before the Luxembourg District Court, seeking the restitution of securities held as of the latest net asset value statement from November 2008, or, in the alternative, money damages. The matter has been temporarily suspended at Senator's request.

In April 2015, Senator commenced a separate action against the Luxembourg branch of HSBC Bank plc before the Luxembourg District Court asserting identical claims to those asserted in Senator's action against HSSL. This action remains ongoing.

HSSL has been sued in various actions by shareholders in the Primeo Select Fund, Herald, Herald (Lux), and Hermes. These actions are in different stages, most of which have been dismissed suspended or postponed.

*Ireland litigation:* In November 2013, Defender Limited, a fund whose assets were invested with Madoff Securities, commenced an action against HSBC Institutional Trust Services (Ireland) Limited ('HTIE') and others, alleging breach of the custodian agreement and claiming damages and indemnification for fund losses. A trial date has not yet been scheduled.

In May 2013 and November 2013, settlements were reached in respect of claims filed against HTIE in the Irish High Court by Thema International Fund plc ('Thema International') and Alternative Advantage Plc ('AA'), respectively. Only two actions by individual Thema International shareholders against HTIE and Thema International remain active. An application to dismiss the two remaining shareholder claims was heard in December 2015 and a decision is pending.

In December 2014, a new proceeding against HTIE and HSBC Securities Services (Ireland) Limited was brought by SPV OSUS alleging breach of the custodian agreement and claiming damages and indemnification for fund losses. In July 2015, HTIE brought a preliminary application to challenge the standing of SPV OSUS to bring proceedings against its service providers. Judgement was rendered in favour of HTIE in October 2015, resulting in the dismissal of the action. SPV OSUS filed an appeal, which is scheduled for hearing in January 2017.

There are many factors that may affect the range of possible outcomes, and the resulting financial impact, of the various Madoff-related proceedings described above, including but not limited to the multiple jurisdictions in which the proceedings have been brought and the number of different plaintiffs and defendants in such proceedings. Based upon the information currently available, management's estimate of possible aggregate damages that might arise as a result of all claims in the various Madoff-related proceedings is up to or exceeding US\$800 million. Due to uncertainties and limitations of this estimate, the ultimate damages could differ significantly from this amount.

### Anti-money laundering and sanctions related matters

In October 2010, HSBC Bank USA N.A. ('HSBC Bank USA') entered into a consent cease-and-desist order with the Office of the Comptroller of the Currency ('OCC'), and HSBC North America Holdings ('HNAH') entered into a consent cease-and-desist order with the Federal Reserve Bureau ('FRB') (the 'Orders'). These Orders required improvements to establish an effective compliance risk management programme across HSBC's US businesses, including risk management related to US Bank Secrecy Act (the '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 ('HSBC Holdings'), HNAH and HSBC Bank USA entered into agreements with US and UK government agencies regarding past inadequate compliance with the BSA, AML and sanctions laws. Among those agreements, HSBC Holdings and HSBC Bank USA entered into a five-year deferred prosecution agreement with the 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'); and HSBC Holdings consented to a cease and desist order and HSBC Holdings and HNAH consented to a civil money penalty order with the FRB. HSBC Holdings also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions, as well as an undertaking with the UK Financial Conduct Authority (the 'FCA'), to comply with certain forward-looking AML and sanctions-related obligations. In addition, HSBC Bank USA entered into a civil money penalty order with the Financial Crimes Enforcement Network ('FinCEN') of the US Treasury Department and a separate civil money penalty order with the OCC.

Under these agreements, HSBC Holdings and HSBC Bank USA made payments totalling US\$1.9 billion to US authorities. In July 2013, the US District Court for the Eastern District of New York approved the US DPA and retained authority to oversee

## Notes on the Financial Statements (continued)

implementation of that agreement. An independent compliance monitor (the 'Monitor') was appointed in 2013 under the agreements entered into with the DoJ and the FCA to produce annual assessments of the effectiveness of HSBC's AML and sanctions compliance programme. Additionally, the Monitor is serving as HSBC's independent consultant under the consent order of the FRB. In January 2016, the Monitor delivered his second annual follow-up review report as required by the US DPA. The Monitor's report is discussed on page 20.

Under the terms of the US DPA, upon notice and an opportunity to be heard, the DoJ has sole discretion to determine whether HSBC has breached the US DPA. Potential consequences of breaching the US DPA could include the imposition of additional terms and conditions on HSBC, an extension of the agreement, including its monitorship or the criminal prosecution of HSBC, which could in turn entail further financial penalties and collateral consequences.

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 and sanctions laws or other regulatory or law enforcement actions for BSA, AML, sanctions or other matters not covered by the various agreements.

In November 2014, a complaint was filed in the US District Court for the Eastern District of New York on behalf of representatives of US persons alleged to have been killed or injured in Iraq between April 2004 and November 2011. The complaint was filed against HSBC Holdings, HSBC Bank plc, HSBC Bank USA and HSBC Bank Middle East, as well as other non-HSBC banks and the Islamic Republic of Iran. The plaintiffs allege that defendants violated the US Anti-Terrorism Act, by altering or falsifying payment messages involving Iran, Iranian parties and Iranian banks for transactions processed through the US. Defendants filed a motion to dismiss in May 2015 and a decision on that motion is pending.

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

### London interbank offered rates, European interbank offered rates and other benchmark interest rate investigations and litigation

Various regulators and competition and law enforcement authorities around the world including in the UK, the US, the EU, Switzerland, South Korea and elsewhere, are conducting investigations and reviews related to certain past submissions made by panel banks and the processes for making submissions in connection with the setting of London interbank offered rates ('Libor'), European interbank offered rates ('Euribor') and other benchmark interest rates. As certain HSBC companies are members of such panels, HSBC has been the subject of regulatory demands for information and is cooperating with those investigations and reviews.

In May 2014, HSBC received a Statement of Objections from the European Commission (the 'Commission') alleging anti-competitive practices in connection with the pricing of euro interest rate derivatives. The Statement of Objections sets out the Commission's preliminary views and does not prejudge the final outcome of its investigation. HSBC responded to the Commission's Statement of Objections in March 2015 and a hearing before the Commission took place in June 2015. A decision by the Commission is pending.

In addition, HSBC and other US dollar Libor panel banks have been named as defendants in a number of private lawsuits filed in the US with respect to the setting of US dollar Libor. The complaints assert claims under various US laws, including US antitrust and racketeering laws, the US Commodity Exchange Act ('CEA'), and state law. The lawsuits include individual and putative class actions, most of which have been transferred and/or consolidated for pre-trial purposes before the New York District Court.

In March 2013, the New York District Court overseeing the consolidated proceedings related to US dollar Libor issued a decision in the six oldest actions, dismissing the plaintiffs' federal and state antitrust claims, racketeering claims and unjust enrichment claims in their entirety, but allowing certain of their CEA claims that were not barred by the applicable statute of limitations to proceed. Some of those plaintiffs appealed the New York District Court's decision to the US Court of Appeals for the Second Circuit, which later dismissed those appeals as premature. In January 2015, the US Supreme Court reversed the Court of Appeals' decision and remanded the case to the Court of Appeals for consideration on the merits of the plaintiffs' appeal. Oral argument in the Court of Appeals was held in November 2015 and the parties are awaiting a decision.

Other plaintiffs sought to file amended complaints in the New York District Court to assert additional allegations. In June 2014, the New York District Court issued a decision that, amongst other things, denied the plaintiffs' request for leave to amend their complaints to assert additional theories of Libor manipulation against HSBC and certain non-HSBC banks, but granted leave to assert such manipulation claims against two other banks; and granted defendants' motion to dismiss certain additional claims under the CEA as barred by the applicable statute of limitations. Proceedings with respect to all other actions in the consolidated proceedings were stayed pending this decision. The stay was lifted in September 2014, and amended complaints were filed in certain other individual and class actions thereafter. The defendants filed motions to dismiss and in August 2015 and November 2015, the court issued decisions granting the motions in part, although it has not yet entered an order specifying which particular claims are dismissed against which defendants.

Separately, HSBC and other panel banks have also been named as defendants in two putative class actions filed in the New York District Court on behalf of persons who transacted in financial instruments allegedly related to the euroyen Tokyo

## Notes on the Financial Statements (continued)

interbank offered rate ('Tibor') and/or Japanese yen Libor. The complaints allege, amongst other things, misconduct related to euroyen Tibor, although HSBC is not a member of the Japanese Bankers Association's euroyen Tibor panel, as well as Japanese yen Libor, in violation of US antitrust laws, the CEA, and state law.

The first of the two actions was filed in April 2012, and HSBC responded by filing a motion to dismiss. In March 2014, the New York District Court dismissed the plaintiffs' claims under US antitrust law and state law, but sustained their claims under the CEA. In June 2014, the plaintiffs then moved for leave to file an amended complaint adding new claims and parties. That motion was denied in March 2015, except insofar as it granted leave to add certain defendants not affiliated with HSBC and reserving on the question of whether the California State Teachers Retirement System ('CALSTRS') may intervene and be added as a plaintiff. In October 2015, the New York District Court denied the motion of CALSTRS to intervene. In November 2015, CALSTRS filed an appeal of that ruling to the United States Court of Appeals for the Second Circuit, which remains pending.

The second action was filed in July 2015. In February 2016, HSBC and the other banks named in the complaint filed a motion to dismiss the action and a decision on that motion is pending.

In November 2013, HSBC and other panel banks were also named as defendants in a putative class action filed in the New York District Court on behalf of persons who transacted in euro futures contracts and other financial instruments allegedly related to Euribor. The complaint alleges, amongst other things, misconduct related to Euribor in violation of US antitrust laws, the CEA and state law. The court previously stayed proceedings until May 2015. After the stay expired, the plaintiffs filed an amended complaint. In October 2015, HSBC filed a motion to dismiss the action, which remains pending.

In September and October 2014, HSBC Bank plc and other panel banks were named as defendants in a number of putative class actions that were filed and consolidated in the New York District Court on behalf of persons who transacted in interest rate derivatives or purchased or sold financial instruments that were either tied to US dollar International Swaps and Derivatives Association fix ('ISDAfix') rates or were executed shortly before, during, or after the time of the daily ISDAfix setting window. The complaint alleges, amongst other things, misconduct related to these activities in violation of US antitrust laws, the CEA, and state law. In February 2015, plaintiffs filed a second consolidated amended complaint, replacing HSBC Bank plc with HSBC Bank USA. A motion to dismiss that complaint was filed in April 2015 and a decision is pending.

There are many factors that may affect the range of possible outcomes, and the resulting financial impact, of these lawsuits. Based upon the information currently available, it is possible that any liabilities that might arise as a result of the claims in these actions could be significant.

### Foreign exchange rate investigations and litigation

Various regulators and competition and law enforcement authorities around the world including in the US, the EU, Brazil, South Korea and elsewhere, are conducting investigations and reviews into trading by HSBC and others on the foreign exchange markets.

HSBC has been cooperating with these ongoing investigations and reviews.

In May 2015, the DoJ resolved its investigations with respect to five non-HSBC financial institutions, four of whom agreed to plead guilty to criminal charges of conspiring to manipulate prices in the foreign exchange spot market, and resulting in the imposition of criminal fines in the aggregate of more than US\$2.5 billion. Additional penalties were imposed at the same time by the FRB and other banking regulators. HSBC was not a party to these resolutions, and investigations into HSBC by the DoJ, FRB and others around the world continue.

In addition, in late 2013 and early 2014, HSBC Holdings, HSBC Bank plc, HNAH and HSBC Bank USA were named as defendants, amongst other banks, in various putative class actions filed in the New York District Court. In March 2014, the plaintiffs filed a consolidated amended complaint alleging, amongst other things, that defendants conspired to manipulate the WMT/Reuters foreign exchange benchmark rates ('the Consolidated Action'). Separate putative class actions were also brought on behalf of non-US plaintiffs (the 'Foreign Actions'). Defendants moved to dismiss all actions. In January 2015, the court denied defendants' motion to dismiss the Consolidated Action, but granted defendants' motion to dismiss the Foreign Actions. Five additional putative class actions were subsequently filed in the New York District Court making similar allegations on behalf of persons who engaged in foreign exchange futures transactions on a US exchange, and those additional actions were subsequently consolidated with the Consolidated Action. In July 2015, the plaintiffs in the Consolidated Action filed a further amended complaint that, amongst other things, added new claims and parties, including HSBC Securities (USA), Inc. In September 2015, HSBC reached an agreement with plaintiffs to resolve the Consolidated Action, subject to court approval. In December 2015, the court granted preliminary approval of the settlement and HSBC made payment of the agreed settlement amount into an escrow account. The court has not yet set a date for the final approval hearing.

In addition to the above actions, a putative class action was filed in the New York District Court in June 2015 making similar allegations on behalf of Employee Retirement Income Security Act of 1974 ('ERISA') plan participants, and another complaint was filed in the US District Court for the Northern District of California in May 2015. HSBC filed a motion to transfer the California action to New York, which was granted in November 2015.

In September 2015, two additional putative class actions making similar allegations under Canadian law were issued in Canada against various HSBC entities, including HSBC Bank Canada, and numerous other financial institutions.

As at 31 December 2015, HSBC has recognised a provision in the amount of £811 million. There are many factors that may affect the range of outcomes, and the resulting financial impact, of these matters. Due to uncertainties and limitations of these estimates, the ultimate penalties could differ significantly from the amount provided.

## Notes on the Financial Statements (continued)

### Precious metals fix-related litigation and investigations

Beginning in March 2014, numerous putative class actions were filed in the US District Courts for the Southern District of New York, the District of New Jersey and the Northern District of California naming HSBC and other members of The London Gold Market Fixing Limited as defendants. The complaints allege that, from January 2004 to the present, defendants conspired to manipulate the price of gold and gold derivatives during the afternoon London gold fix for their collective benefit in violation of US antitrust laws, the CEA and New York state law. The actions were subsequently consolidated in the New York District Court. An amended complaint was filed in March 2015, which defendants moved to dismiss. A hearing has been scheduled for March 2016.

Beginning in July 2014, numerous putative class actions were filed in the US District Courts for the Southern and Eastern Districts of New York naming HSBC and other members of The London Silver Market Fixing Ltd as defendants. The complaints allege that, from January 1999 to the present, defendants conspired to manipulate the price of silver and silver derivatives for their collective benefit in violation of US antitrust laws the CEA and New York state law. The actions were subsequently consolidated in the New York District Court. An amended complaint was filed in April 2015, which defendants moved to dismiss. A hearing has been scheduled for March 2016.

Between late 2014 and early 2015, numerous putative class actions were filed in the US District Court for the Southern District of New York naming HSBC and other members of The London Platinum and Palladium Fixing Company Limited as defendants. The complaints allege that, from January 2008 to the present, defendants conspired to manipulate the price of platinum group metals ('PGM') and PGM-based financial products for their collective benefit in violation of US antitrust laws and the CEA. An amended complaint was filed in August 2015, which defendants moved to dismiss.

Additionally, in December 2015, a putative class action under Canadian law was filed in the Ontario Superior Court of Justice against various HSBC entities, including HSBC Bank Canada, and other financial institutions. Plaintiffs allege that, from January 2004 to March 2014, defendants conspired to manipulate the price of gold and gold-related investment instruments in violation of the Canadian Competition Act and common law.

Various regulators and competition and law enforcement authorities, including in the US and the EU are conducting investigations and reviews relating to HSBC's precious metals operations. HSBC has been cooperating with these ongoing investigations. In November 2014, the Antitrust Division and Criminal Fraud Section of the DoJ issued a document request to HSBC Holdings seeking the voluntary production of certain documents in connection with a criminal investigation that the DoJ is conducting of alleged anti-competitive and manipulative conduct in precious metals trading. In January 2016, the Antitrust Division of the DoJ informed HSBC that it was closing its investigation; however, the Criminal Fraud Section's investigation remains ongoing.

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

### Credit default swap regulatory investigation and litigation

In July 2013, HSBC received a Statement of Objections from the Commission relating to its ongoing investigation of alleged anti-competitive activity by a number of banks and other market participants in the credit derivatives market between 2006 and 2009. The Statement of Objections sets out the Commission's preliminary views and does not prejudge the final outcome of its investigation. HSBC submitted a response and attended a hearing in May 2014. Following the hearing, the Commission decided in December 2015 to close the case against all 13 banks, including all of the HSBC entities; however, the Commission's investigation relating to Markit and ISDA is on-going.

In addition, HSBC Holdings, HSBC Bank plc and HSBC Bank USA, were named as defendants, amongst others, in numerous putative class actions filed in the New York District Court and the United States District Court for the Northern District of Illinois. These class actions allege that the defendants, which include ISDA, Markit and several other financial institutions, conspired to restrain trade in violation of US antitrust laws by, amongst other things, restricting access to credit default swap pricing exchanges and blocking new entrants into the exchange market. The plaintiffs in these suits purport to represent a class of all persons who purchased credit default swaps from or sold credit default swaps to defendants primarily in the US.

In October 2013 these cases were consolidated in the New York District Court (the 'Consolidated Action'). In September 2015, the HSBC defendants reached an agreement with plaintiffs to resolve the Consolidated Action, subject to court approval. In October 2015, the court granted preliminary approval of the settlement. The final settlement approval hearing is scheduled for April 2016.

### Fédération Internationale de Football Association ('FIFA') related investigations

HSBC has received inquiries from the DoJ regarding its banking relationships with certain individuals and entities that are or may be associated with FIFA. The DoJ is investigating whether multiple financial institutions, including HSBC, permitted the processing of suspicious or otherwise improper transactions, or failed to observe applicable AML laws and regulations. HSBC is cooperating with the DoJ's investigation.

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

## Notes on the Financial Statements (continued)

### 38 Related party transactions

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

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

HSBC Holdings plc  
8 Canada Square  
London  
E14 5HQ

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

#### (a) Transactions with Directors and other Key Management Personnel

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of HSBC Bank plc and the group and includes the Directors of HSBC Bank plc and HSBC Holdings plc and Group Managing Directors of HSBC Holdings plc.

#### Compensation of Key Management Personnel

The following represents the compensation for Directors and other Key Management Personnel of the bank in exchange for services rendered to the bank for the period they served during the year. The increase in share-based payments is mainly due to the immediate recognition of amounts in respect of directors who retired or resigned in 2015.

	2015 £000	2014 £000
Short-term employee benefits	4,384	3,937
Post-employment benefits	42	49
Other long-term benefits	1,203	808
Share-based payments	5,163	4,223
	<b>10,792</b>	<b>9,017</b>

#### Shareholdings, options and of securities of Directors and other Key Management Personnel<sup>1</sup>

	Balance at 31 December 2015 (000s)	Balance at 31 December 2014 (000s)
Number of options over HSBC Holdings plc ordinary shares under employee share plans <sup>1</sup>	29	28
Number of HSBC Holdings plc shares held	19,290	17,817
Par value of HSBC Bank 2.875% Notes 2015	-	£530

<sup>1</sup> Includes the holdings of Key Management Personnel of both the bank and its parent company, HSBC Holdings plc and their close family members

<sup>2</sup> The 2014 balance for HSBC Bank 2.875% Notes 2015 has been restated from £nil to £530,000.

#### Transactions, arrangements and agreements including Directors and other Key Management Personnel

The table below sets out transactions which fall to be disclosed under IAS 24 'Related Party Disclosures' between the group and Key Management Personnel.

	2015		2014	
	Highest balance during the year <sup>1</sup> £m	Balance at 31 December <sup>1</sup> £m	Restated highest balance during the year <sup>1</sup> £m	Restated balance at 31 December <sup>1</sup> £m
<b>Key Management Personnel<sup>2</sup></b>				
Advances and credits	272	149	225	212
Guarantees	60	49	50	50

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

<sup>2</sup> Includes the Key Management Personnel of both the bank and its parent company, HSBC Holdings plc, close family members of Key Management Personnel, and entities which are controlled or jointly controlled by Key Management Personnel or their close family members.

<sup>3</sup> The 2014 balances for advances and credits have been restated from £151 million to £225 million and for guarantees from £nil to £49,774,000.

<sup>4</sup> The 2014 balances for advances and credits have been restated from £138 million to £212 million and for guarantees from £nil million to £50 million.

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

#### Transactions with Directors: Advances, Credits and Guarantees (Companies Act 2006)

In addition to the requirements of IAS 24, particulars of advances (loans and quasi-loans), credits and guarantees entered into by HSBC Bank plc and its subsidiaries with Directors of HSBC Bank plc are required to be disclosed pursuant to section 413 of the Companies Act 2006. Under the Companies Act there is no requirement to disclose transactions with the Key Management Personnel of the bank's parent company, HSBC Holdings plc.

The table below sets out transactions which fall to be disclosed under section 413 of Companies Act 2006.

## Notes on the Financial Statements (continued)

### The group

	Balance at 31 December 2015 £000	Balance at 31 December 2014 £000
Directors		
Loans	10,291	13,036
Guarantees	325	–

### (b) Transactions with other related parties

#### Associates and joint ventures

##### The group and the bank

	2015		2014	
	Highest balance during the year <sup>1</sup>	Balance at 31 December <sup>1</sup>	Restated highest balance during the year <sup>1</sup>	Restated balance at 31 December <sup>1</sup>
	£m	£m	£m	£m
Amounts due from joint ventures – unsubordinated	132	102	132	132
Guarantees provided to joint ventures	610	610	610	610

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

<sup>2</sup> The 2014 balances for guarantees from £0 million to £610 million.

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

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

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

	2015		2014	
	Highest balance during the year <sup>1</sup>	Balance at 31 December <sup>1</sup>	Highest balance during the year <sup>1</sup>	Balance at 31 December <sup>1</sup>
	£m	£m	£m	£m
<b>Assets</b>				
Trading assets	1,319	810	1,824	1,319
Financial assets designated at fair value	24	5	23	23
Loans and advances to customers	871	871	3,966	513
Financial investments	94	67	99	94
<b>Liabilities</b>				
Trading liabilities	534	534	–	–
Customer accounts	10,599	9,266	10,993	8,689
Subordinated amounts due	5,105	5,105	6,025	4,035
Guarantees provided	–	–	–	–

	2015 £m	2014 £m
<b>Income Statement</b>		
Interest income	2	47
Interest expense	136	189
Fee income	1	1
Dividend income	1	1
Fee expense	2	–
Trading income	1	1
Other operating income	87	66
General and administrative expenses	(43)	37

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

## Notes on the Financial Statements (continued)

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

	2015		2014	
	Highest balance during the year <sup>1</sup>	Balance at 31 December <sup>1</sup>	Highest balance during the year <sup>1</sup>	Balance at 31 December <sup>1</sup>
	£m	£m	£m	£m
<b>Assets</b>				
Trading assets	5,761	2,162	8,093	1,489
Derivatives	25,086	21,819	19,767	19,767
Financial assets designated at fair value	21	8	25	21
Loans and advances to banks	12,106	11,052	12,106	12,106
Loans and advances to customers	4,643	1,147	5,624	4,643
Financial investments	176	23	246	77
<b>Liabilities</b>				
Trading liabilities	13,238	11,766	12,954	7,269
Financial liabilities designated at fair value	–	–	–	–
Deposits by banks	11,190	7,668	11,124	9,040
Customer accounts	3,653	670	8,574	1,453
Derivatives	25,003	20,014	19,289	19,289
Subordinated amount due	1,694	264	1,818	1,694
Guarantees provided	1,225	1,225	1,791	1,102

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

	2015	2014
	£m	£m
<b>Income Statement</b>		
Interest income	32	31
Interest expense	95	114
Fee income	85	95
Fee expense	249	220
Trading income	42	38
Other operating income	105	123
General and administrative expenses	468	317

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

Transactions between HSBC Bank plc and its subsidiaries and HSBC Holdings plc and the other fellow subsidiaries of HSBC Holdings plc

Transactions detailed below include amounts due to/from HSBC Bank plc and its subsidiaries.

	2015		2014	
	Highest balance during the year <sup>1</sup>	Balance at 31 December <sup>1</sup>	Highest balance during the year <sup>1</sup>	Balance at 31 December <sup>1</sup>
	£m	£m	£m	£m
<b>Assets</b>				
Trading assets	8,623	4,124	10,462	3,659
Derivatives	17,996	8,911	15,114	14,836
Financial assets designated at fair value	–	–	–	–
Loans and advances to banks	8,583	2,610	11,223	8,568
Loans and advances to customers	17,350	16,068	11,610	10,830
Financial investments	7,866	1,188	8,878	7,866
<b>Liabilities</b>				
Trading liabilities	5,094	552	6,179	1,458
Deposits by banks	11,512	10,551	15,320	11,359
Customer accounts	3,241	3,005	3,524	3,224
Derivatives	17,899	11,639	14,907	14,907
Subordinated amounts due	2,181	700	2,276	2,181
Guarantees provided	1,206	1,133	1,177	1,177

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

## Notes on the Financial Statements (continued)

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

	2015		2014	
	Highest balance during the year <sup>1</sup> £m	Balance at 31 December <sup>1</sup> £m	Highest balance during the year <sup>1</sup> £m	Balance at 31 December <sup>1</sup> £m
<b>Assets</b>				
Trading assets	954	536	1,691	954
Loans and advances to customers	863	863	3,965	511
<b>Liabilities</b>				
Trading liabilities	534	534	–	–
Customer accounts	10,555	9,220	10,961	8,669
Subordinated amounts due	4,635	4,635	5,756	3,562
Guarantees provided	–	–	–	–

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

In December 2010, the bank received two guarantees from HSBC Holdings plc in respect of monies owing to the bank by its structured investment conduits ('SICs'). The first guarantee covers due but unpaid monies owed by the bank's principal SIC, Solitaire, up to a maximum amount of US\$16 billion, to the extent that unpaid liabilities exceed US\$1 billion. A second guarantee covers due but unpaid monies owed by the bank's other SICs, Mazarin, Barion and Malachite, up to a maximum amount of US\$22 billion, to the extent that unpaid liabilities exceed US\$200 million. In December 2012, the bank received a third guarantee from HSBC Holdings plc that covers due but unpaid monies owed to the bank by its multi-seller conduit, Regency, up to a maximum amount of US\$17 billion, to the extent that unpaid liabilities exceed US\$2 billion. The bank pays no fee to its parent company for the provision of these guarantees.

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

	2015		2014	
	Highest balance during the year <sup>1</sup> £m	Balance at 31 December <sup>1</sup> £m	Highest balance during the year <sup>1</sup> £m	Balance at 31 December <sup>1</sup> £m
<b>Assets</b>				
Trading assets	5,693	2,159	7,940	1,390
Derivatives	41,730	29,806	33,412	33,412
Loans and advances to banks	8,126	7,178	8,229	8,126
Loans and advances to customers	4,203	1,133	4,941	4,203
<b>Liabilities</b>				
Trading liabilities	12,909	11,614	12,848	7,129
Deposits by banks	8,118	7,132	8,808	8,118
Customer accounts	3,511	583	8,355	1,339
Derivatives	44,657	33,644	35,806	35,806
Subordinated amount due	–	–	–	–
Guarantees provided	1,025	1,025	1,683	988

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

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

### Pension funds

At 31 December 2015, fees of £3 million (2014: £5 million) were earned by group companies for management services related to the group's pension funds held under management. The group's pension funds had placed deposits of £488 million (2014: £121 million) with its banking subsidiaries.

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

The HSBC Bank (UK) Pension Scheme (the 'Scheme') entered into swap transactions with the bank to manage the inflation and interest rate sensitivity of the liabilities. At 31 December 2015, the gross notional value of the swaps was £8,906 million (2014: £15,177 million), the swaps had a negative fair value of £335 million to the bank (2014: negative fair value of £597 million) and the bank had delivered collateral of £732 million (2014: £1,268 million) to the Scheme in respect of these swaps. All swaps were executed at prevailing market rates and within standard market bid/offer spreads.

## 39 Events after the balance sheet date

A second interim dividend for 2015 of £272 million to shareholders of the parent company was declared by the Directors after 31 December 2015.



## Notes on the Financial Statements (continued)

## 40 HSBC Bank plc's subsidiaries, associates and joint ventures.

In accordance with Section 409 of the Companies Act 2006, HSBC Bank plc's subsidiaries, associates and joint ventures, country of incorporation and percentage owned are listed below:

Subsidiaries <sup>1</sup>	Country <sup>2</sup>	Security <sup>3</sup>	Direct %	Total %
Albouys Nominees Limited	England and Wales	£1 Ordinary	100%	100.00%
Allblack Investments Limited	Jersey	£0.0037 Ordinary, Preference	100%	100.00%
AMP Client HSBC Custody Nominee (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
Assetfinance December (A) Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance December (E) Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance December (F) Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance December (H) Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance December (M) Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance December (P) Limited	England and Wales	£1 Ordinary	100%	100.00%
Assetfinance December (R) Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance December (W) Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance June (A) Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance June (D) Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance June (E) Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance March (B) Limited	Northern Ireland	£1 Ordinary		100.00%
Assetfinance March (D) Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance March (F) Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance September (F) Limited	England and Wales	£1 Ordinary		100.00%
Assetfinance September (G) Limited	England and Wales	£1 Ordinary		100.00%
B&Q Financial Services Limited	England and Wales	£1 Ordinary	100%	100.00%
Banco Nominees (Guernsey) Limited	Guernsey	£1 Ordinary		99.98%
Banco Nominees 2 (Guernsey) Limited	Guernsey	£1 Ordinary		100.00%
Beau Soleil Limited Partnership	1 Queen's Road Central, Hong Kong SAR			84.99%
Bermuda Trust (St Helier) Limited	Jersey	US\$1 Ordinary		100.00%
Bermuda Trust Executors (Jersey) Limited	Jersey	£1 Shares		100.00%
Billingsgate City Securities Public Limited Company	England and Wales	£0.01 Ordinary	100%	100.00%
Billingsgate Nominees Limited	England and Wales	£1 Issued	100%	100.00%
Canada Crescent Nominees (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
Canada Square Nominees (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
Canada Square Property Participations Limited	England and Wales	£1 Ordinary	100%	100.00%
Canada Water Nominees (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
CCF & Partners Asset Management Limited	England and Wales	£1 Ordinary		99.99%
CCF Charterhouse GmbH	Germany	€1 Actions		99.99%
CCF Charterhouse GmbH & Co Asset Leasing KG	Unsoeldstrasse 2, 80538, MUNICH, Germany			99.99%
Charterhouse Administrators (D.T.) Limited	England and Wales	£1 Ordinary		99.99%
Charterhouse Management Services Limited	England and Wales	£1 Ordinary		99.99%
Charterhouse Pensions Limited	England and Wales	£1 Ordinary	100%	100.00%
Crewfleet Limited	England and Wales	£1 Ordinary	100%	100.00%
Dem 25	France	€1 Actions		99.99%
Dem 5	France	€16 Actions		99.99%
Dem 9	France	€8.50 Actions		99.99%
Dempar 1	France	Actions no par value		99.99%
Dempar 4	France	Actions no par value		99.99%
Elysées GmbH	Germany	€1 Common		99.99%
Elysées Immo Invest	France	€16 Actions		99.99%
EMTT Limited	England and Wales	£1 Ordinary	100%	100.00%
Equator Holdings Limited	England and Wales	US\$1 Ordinary	100%	100.00%
Eton Corporate Services Limited	Guernsey	US\$1 Ordinary		100.00%
Eton Management Ltd	Virgin Islands, British	US\$1 Ordinary		100.00%
Fdm 5 SAS	France	€10 Actions		99.99%
Fdm 6 SAS	France	€10 Actions		99.99%
Finanpar 2	France	Actions no par value		99.99%
Finanpar 7	France	Actions no par value		99.99%
First Direct Investments (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
Flandres Contentieux S.A.	France	€0.16 Actions		99.99%
Foncière Elysées	France	€77 Actions		99.99%
Forward Trust Rail Services Limited	England and Wales	£0.1 Ordinary		100.00%
G.M. Gilt-Edged Nominees Limited	England and Wales	£1 Ordinary	100%	100.00%
Gesellschaft für Industrielle Beteiligungen und Finanzierung mbH	Germany	€1 Common		80.65%
Griffin International Limited	England and Wales	£1 Ordinary		100.00%
Grundstuecksgesellschaft Trinkausstrasse Kommanditgesellschaft	Germany	€1 Common		80.65%
Hilaga Investments Limited	England and Wales	£1 Issued	100%	100.00%
HITG Administration GmbH	Germany	€25,000 Ordinary		100.00%
Hongkong International Trade Finance (Holdings) Limited	England and Wales	£1 Ordinary 'A', 'B'	100%	100.00%
Hongkong International Trade Finance (U.S.A.) Inc.	United States	US\$1 Common		100.00%
HPUT A Limited	England and Wales	£1 Ordinary	100%	100.00%
HPUT B Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC (BGF) Investments Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Alpha Funding (UK) Holdings	Cayman Islands	US\$0.001 Limited Liability	99%	99.00%
HSBC Asset Finance (UK) Limited	England and Wales	£1 Ordinary		100.00%
HSBC Asset Finance Holdings Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Asset Finance M.O.G. Holdings (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Assurances Vie (France)	France	€287.50 Actions		99.99%
HSBC Bank (General Partner) Limited	Jersey	£1 Ordinary	100%	100.00%

## Notes on the Financial Statements (continued)

Subsidiaries <sup>1</sup>	Country <sup>2</sup>	Security <sup>3</sup>	Direct %	Total %
HSBC Bank (General Partner) Limited	Jersey	£1 Ordinary	100%	100.00%
HSBC Bank (RR) (Limited Liability Company)				
HSBC Bank A.S.	Turkey	TRL1 A, B – Common	100%	100.00%
HSBC Bank Armenia cjsc	Armenia	AMD30,250 Ordinary		70.00%
HSBC Bank Capital Funding (Sterling 1) LP	HSBC House, Esplanade, St. Helier, JE4 8UB, Jersey			100.00%
HSBC Bank Capital Funding (Sterling 2) LP	HSBC House, Esplanade, St. Helier, JE4 8UB, Jersey			100.00%
HSBC Bank International Limited	Jersey	£1 Ordinary		100.00%
HSBC Bank Malta p.l.c.	Malta	€0.30 Ordinary		70.03%
HSBC Bank Nominee (Jersey) Limited	Jersey	£1 Ordinary		100.00%
HSBC Bank Pension Trust (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Bank Polska S.A.	Poland	PLN1 Ordinary	100%	100.00%
HSBC Branch Nominee (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Client Holdings Nominee (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Client Share Offer Nominee (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Corporate Trustee Company (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Custody Services (Guernsey) Limited	Guernsey	£1 Ordinary		100.00%
HSBC Development Properties (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Enterprise Investment Company (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Epargne Entreprise (France)	France	€16 Actions		99.99%
HSBC Equator (UK) Limited	England and Wales	£1 Non-voting deferred		100.00%
HSBC Equipment Finance (UK) Limited	England and Wales	£1 Ordinary		100.00%
HSBC Equity (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Europe B.V.	Netherlands	€50 Ordinary		100.00%
HSBC European Clients Depository Receipts Nominee (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Executor & Trustee Company (UK) Limited	England and Wales	£1 Ordinary (£0.40 paid)		100.00%
HSBC Factoring (France)	France	€16 Actions		99.99%
HSBC Finance Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC France	France	€5 Actions	99.99%	99.99%
HSBC Fund Administration (Jersey) Limited	Jersey	£1 Ordinary		100.00%
HSBC Funds Nominee (Jersey) Limited	Jersey	£1 Ordinary		100.00%
HSBC Germany Holdings GmbH	Germany	€1 Common	100%	100.00%
HSBC Global Asset Management (Deutschland) GmbH	Germany	€1 Common		80.65%
HSBC Global Asset Management (France)	France	€16 Actions		99.99%
HSBC Global Asset Management (International) Limited	Jersey	£1 Ordinary		100.00%
HSBC Global Asset Management (Malta) Limited	Malta	€2.32937 Ordinary		70.03%
HSBC Global Asset Management (Oesterreich) GmbH	Austria	€1 GmbH Anteil		80.65%
HSBC GLOBAL ASSET MANAGEMENT (Switzerland) AG	Switzerland	CHF10 Actions		90.33%
HSBC Global Custody Nominee (UK) LimitedCFAC Payment	England and Wales	£1 Ordinary	100%	100.00%
HSBC GLOBAL CUSTODY PROPRIETARY NOMINEE (UK) LIMITED	England and Wales	£1 Ordinary	100%	100.00%
HSBC Global Shared Services (India) Private Limited	India	INR10 Ordinary		100.00%
HSBC INKA Investment-AG TGV	Germany	€1 Stückaktien		80.65%
HSBC Institutional Trust Services (Ireland) Limited	Ireland	US\$1 Ordinary		100.00%
HSBC Insurance Management Services (Europe) Limited	Malta	€1 Ordinary-B		70.03%
HSBC Insurance Management Services Limited	England and Wales	£1 Ordinary		100.00%
HSBC Insurance Services Holdings Limited	England and Wales	£0.10 Ordinary	100%	100.00%
HSBC Intermediate Leasing (UK) Limited	England and Wales	£1,000 Issued	100%	100.00%
HSBC International Financial Advisers (UK) Limited	England and Wales	£1 Ordinary		100.00%
HSBC International Financial Services (UK) Limited	England and Wales	£1 'A', £1 'B', £1 'C' and, £1 non-voting redeemable	100%	100.00%
HSBC International Holdings (Jersey) Limited	Jersey	£1 Ordinary		100.00%
HSBC International Trade Finance Limited	England and Wales	£1 Ordinary		100.00%
HSBC Internet ve Telekomunikasyon Hizmetleri Anonim Sirketi	Turkey	TRL1 Nominal		96.00%
HSBC Invoice Finance (UK) Limited	England and Wales	£1 Ordinary		100.00%
HSBC Issuer Services Common Depository Nominee (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Issuer Services Depository Nominee (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Leasing (France)	France	€9.57 Actions		99.99%
HSBC Life (Europe) Limited	Ireland	£1 Ordinary		66.15%
HSBC Life (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Life Assurance (Malta) Limited	Malta	€1.16469 Ordinary		70.03%
HSBC LU Nominees Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Marking Name Nominee (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC MIDDLE EAST LEASING PARTNERSHIP	Level 4, Building 4, The Gate, Dubai International Financial,			84.99%
HSBC Odeme Sistemleri Bilgisayar Teknolojileri Basın Yayın Ve Musteri Hizmetleri	Turkey	TRL1 Ordinary		99.99%
HSBC Overseas Nominee (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC PB Corporate Services 1 Limited	Jersey	£1 Ordinary		100.00%
HSBC PB Corporate Services 2 Limited	Jersey	£1 Ordinary		100.00%
HSBC Pension Trust (Ireland) Limited	Ireland	€1.26974 Ordinary	100%	100.00%
HSBC PH Investments (UK) Limited	England and Wales	£1 Ordinary		100.00%
HSBC Portfoy Yonetimi A.S.	Turkey	TRL1 A Common		100.00%
The A Common shares comprise 99.9995% of the issued capital and 99.5% of the voting rights		TRL1 B Common		0.00%
HSBC Preferential LP (UK)	England and Wales	£1 Ordinary	100%	100.00%
HSBC Private Bank (C.I.) Limited	Guernsey	US\$1 Ordinary		100.00%
HSBC Private Bank (UK) Limited	England and Wales	£10 Issued	100%	100.00%
HSBC Private Banking Nominee 1 (Jersey) Limited	Jersey	£1 Ordinary		100.00%
HSBC Private Banking Nominee 2 (Jersey) Limited	Jersey	£1 Ordinary		100.00%
HSBC Private Banking Nominee 3 (Jersey) Limited	Jersey	£1 Ordinary		100.00%
HSBC Private Equity Investments (UK) Limited	England and Wales	£1 Issued		100.00%
HSBC Rail (UK) Limited	England and Wales	£1 Ordinary		100.00%
HSBC Real Estate Leasing (France)	France	€15.24 Actions		99.99%
HSBC REIM (France)	France	€92 Actions		99.99%

## Notes on the Financial Statements (continued)

Subsidiaries <sup>1</sup>	Country <sup>2</sup>	Security <sup>3</sup>	Direct %	Total %
HSBC Representative Office (Nigeria) Limited	Nigeria	Ordinary no par value	99%	100.00%
HSBC Securities (South Africa) (Pty) Limited	South Africa	ZAR1 Ordinary	100%	100.00%
HSBC Securities Services (Guernsey) Limited	Guernsey	£1 Ordinary		100.00%
HSBC Securities Services (Ireland) Limited	Ireland	US\$1 and €1.25 Ordinary		100.00%
HSBC Services (France)	France	€18.50 Actions		99.99%
HSBC SFH (France)	France	€15 Actions		99.99%
HSBC Stockbroker Services (Client Assets) Nominees Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Stockbrokers (Malta) Limited	Malta	€2.32937 Ordinary		70.03%
HSBC Stockbrokers Nominee (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC TKM Limited	England and Wales	£0.01 Ordinary		100.00%
HSBC Transaction Services GmbH	Germany	€1 GmbH Anteil		80.65%
HSBC Trinkaus & Burkhardt (International) S.A.	Luxembourg	€1 Common		80.65%
HSBC Trinkaus & Burkhardt AG	Germany	Stückaktien no par value		80.65%
HSBC Trinkaus & Burkhardt Gesellschaft für Bankbeteiligungen mbH	Germany	€1 Common		80.65%
HSBC Trinkaus Consult GmbH	Germany	€1 Common		80.65%
HSBC Trinkaus Europa Immobilien-Fonds Nr. 5 GmbH	Germany	Ordinary no par value		80.65%
HSBC Trinkaus Family Office GmbH	Germany	€1 GmbH Anteil		80.65%
HSBC Trinkaus Immobilien Beteiligungs KG	Germany	€1 Ordinary		80.65%
HSBC Trinkaus Real Estate GmbH	Germany	€1 Common		80.65%
HSBC Trust Company (UK) Limited	England and Wales	£5 Ordinary	100%	100.00%
HSBC Trustee (C.I.) Limited	Jersey	£1 Ordinary		100.00%
HSBC Trustee (Guernsey) Limited	Guernsey	US\$1 Ordinary		100.00%
HSBC Tulip Funding (UK)	England and Wales	£1 Ordinary	100%	100.00%
HSBC Wealth Client Nominee Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Workplace Retirement Services Fund Platform Nominee Company Limited	England and Wales	£1 Ordinary	100%	100.00%
HSBC Yatirim Menkul Degerler A.S.	Turkey	TRL1 Ordinary-A		100.00%
INKA Internationale Kapitalanlagegesellschaft mbH	Germany	€1 Common		80.65%
James Capel & Co. Limited	England and Wales	£1 Issued	100%	100.00%
James Capel (Channel Islands) Nominees Limited	Jersey	£1 Ordinary		100.00%
James Capel (Custodian) Nominees Limited	England and Wales	£1 Issued	100%	100.00%
James Capel (Nominees) Limited	England and Wales	£1 Ordinary	100%	100.00%
James Capel (Second Nominees) Limited	England and Wales	£1 Issued	100%	100.00%
James Capel (Taiwan) Nominees Limited	England and Wales	£1 Issued	100%	100.00%
James Capel (Third Nominees) Limited	England and Wales	£1 Issued	100%	100.00%
John Lewis Financial Services Limited	England and Wales	£1 Ordinary	100%	100.00%
Keyser Ullmann Limited	England and Wales	£1 Ordinary		99.99%
Kings Meadow Nominees Limited	England and Wales	£1 Ordinary		100.00%
Lemasco Nominees Limited	Jersey	£1 Ordinary		100.00%
MAGIM Client HSBC GIS Nominee (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
Marks and Spencer Financial Services plc	England and Wales	£1 Ordinary		100.00%
Marks and Spencer Retail Financial Services Holdings Limited	England and Wales	£1 Ordinary	100%	100.00%
Marks and Spencer Savings and Investments Limited	England and Wales	£1 Ordinary		100.00%
Marks and Spencer Unit Trust Management Limited	England and Wales	£1 Ordinary		100.00%
Midcorp Limited	England and Wales	£1 Ordinary	100%	100.00%
The £1 Non-Cumulative Redeemable Preference shares have no voting rights		£1 Non-Cumulative Redeemable Preference shares		0.00%
Midland Bank (Branch Nominees) Limited	England and Wales	£1 Ordinary	100%	100.00%
Midland Nominees Limited	England and Wales	£1 Ordinary		100.00%
MIL (Jersey) Limited	Jersey	£1 Ordinary		100.00%
Neuilly Valeurs	France	€15.24 Parts		99.99%
Prudential Client HSBC GIS Nominee (UK) Limited	England and Wales	£1 Ordinary	100%	100.00%
Republic Nominees Limited	Guernsey	£1 Ordinary		100.00%
S.A.P.C. - Ufipro Recouvrement	France	€46 Parts		99.98%
Saf Baiyun	France	€10 Actions		99.99%
Saf Chang Jiang	France	€10 Actions		99.99%
Saf Chang Jiang Ba	France	€10 Actions		99.99%
Saf Chang Jiang Er	France	€10 Actions		99.99%
Saf Chang Jiang Jiu	France	€10 Actions		99.99%
Saf Chang Jiang Liu	France	€10 Actions		99.99%
Saf Chang Jiang Qi	France	€10 Actions		99.99%
Saf Chang Jiang San	France	€10 Actions		99.99%
Saf Chang Jiang Shi	France	€10 Actions		99.99%
Saf Chang Jiang Shi Liu	France	€1 Actions		99.99%
Saf Chang Jiang Shi Wu	France	€1 Actions		99.99%
Saf Chang Jiang Shi'Er	France	€10 Actions		99.99%
Saf Chang Jiang Shiyi	France	€10 Actions		99.99%
Saf Chang Jiang Wu	France	€10 Actions		99.99%
Saf Chang Jiang Yi	France	€10 Actions		99.99%
Saf Guangzhou	France	€10 Actions		99.99%
Saf Palissandre	France	€10.10 Actions		99.99%
Saf Zhu Jiang	France	€10 Actions		99.99%
Saf Zhu Jiang Ba	France	€10 Actions		99.99%
Saf Zhu Jiang Er	France	€10 Actions		99.99%
Saf Zhu Jiang Jiu	France	€10 Actions		99.99%
Saf Zhu Jiang Liu	France	€10 Actions		99.99%
Saf Zhu Jiang Qi	France	€10 Actions		99.99%
Saf Zhu Jiang San	France	€10 Actions		99.99%
Saf Zhu Jiang Shi	France	€10 Actions		99.99%
Saf Zhu Jiang Shi Ba	France	€1 Actions		99.99%

## Notes on the Financial Statements (continued)

Subsidiaries <sup>1</sup>	Country <sup>2</sup>	Security <sup>3</sup>	Direct %	Total %
Saf Zhu Jiang Shi Er	France	€1 Actions		99.99%
Saf Zhu Jiang Shi Jiu	France	€1 Actions		99.99%
Saf Zhu Jiang Shi Liu	France	€1 Actions		99.99%
Saf Zhu Jiang Shi Qi	France	€1 Actions		99.99%
Saf Zhu Jiang Shi Wu	France	€1 Actions		99.99%
Saf Zhu Jiang Shiyi	France	€10 Actions		99.99%
Saf Zhu Jiang Wu	France	€10 Actions		99.99%
Saf Zhu Jiang Yi	France	€10 Actions		99.99%
Samada Limited	Jersey	£1 Ordinary		100.00%
Samuel Montagu & Co. Limited	England and Wales	£1 Ordinary	100%	100.00%
SAS Bosquet -Audrain	New Caledonia	Franc Pacific 10,000 Actions		94.90%
SAS Cyatheas Pasteur	France	€10 Actions		94.93%
SAS Orona	New Caledonia	Franc Pacific 10,000 Actions		94.92%
SCI Herve Mathurins	France	€15.24 Parts		99.99%
SCI HSBC Assurances Immo	France	€152.44 Parts		99.99%
SFSS Nominees (Pty) Limited	South Africa	ZAR1 Ordinary		100.00%
Shuttle Developments Limited	England and Wales	£1 Ordinary	100%	100.00%
SNC Dorique	Reunion	€1 PARTS		99.99%
SNC Kerouan	France	€1 Parts		99.99%
SNC Les Mercuriales	France	€1 Parts		99.99%
SNC Les Oliviers D'Antibes	France	€15 Parts		59.99%
SNC Makala	France	€1 Parts		99.99%
SNC Nuku-Hiva Bail	France	€0.01 Parts		99.99%
SNCB/M6 - 2008 A	France	€1 Actions		99.99%
SNCB/M6-2007 A	France	€10 Actions		99.99%
SNCB/M6-2007 B	France	€10 Actions		99.99%
Société Financière et Mobilière	France	€16 Actions		99.99%
Société Française et Suisse	France	€1 Actions		99.99%
Société Immobilière Malesherbes-Anjou	France	€70 Actions		99.99%
Solandra 3	France	€100 Actions		98.37%
Somers (U.K.) Limited	England and Wales	£1 Ordinary	100%	100.00%
Somers Dublin Limited	Ireland	€1.25 Ordinary		100.00%
Sopingest	France	Ordinary no par value		99.99%
South Yorkshire Light Rail Limited	England and Wales	£0.10 Ordinary		100.00%
St Cross Trustees Limited	England and Wales	£1 Ordinary		100.00%
Swan National Leasing (Commercials) Limited	England and Wales	£1 Ordinary		100.00%
Swan National Limited	England and Wales	£1 Ordinary		100.00%
Thasosfin	France	€15 Actions		99.99%
The Venture Catalysts Limited	England and Wales	£1 Ordinary	100%	100.00%
TKM International Limited	England and Wales	£1 Ordinary		100.00%
Trinkaus Australien Immobilien Fonds Nr. 1 Brisbane GmbH & Co. KG	Germany	€1 Ordinary		80.65%
Trinkaus Australien Immobilien-Fonds Nr. 1 Treuhand-GmbH	Germany	€1 GmbH-Anteil		80.65%
Trinkaus Canada Immobilien-Fonds Nr. 1 Verwaltungs-GmbH	Germany	€1 Ordinary		80.65%
Trinkaus Europa Immobilien-Fonds Nr.3 Objekt Utrecht Verwaltungs-GmbH	Germany	€1 Ordinary		80.65%
Trinkaus Immobilien-Fonds Geschaefstuehrungs-GmbH	Germany	€1 GmbH Anteil		80.65%
Trinkaus Immobilien-Fonds Verwaltungs-GmbH	Germany	€1 GmbH-Anteil		80.65%
Trinkaus Private Equity Management GmbH	Germany	€1 Ordinary		80.65%
Trinkaus Private Equity Verwaltungs GmbH	Germany	€1 GmbH Anteil		80.65%
Turnsonic (Nominees) Limited	England and Wales	£1 Ordinary		100.00%
Valeurs Mobilières Elysées	France	€16 Actions		99.99%
<b>Associates</b>				
Business Growth Fund plc	England and Wales	£1 Ordinary	23.37%	23.98%
CFAC Payment Scheme Limited	England and Wales	£1 Ordinary	0%	0.00%
The bank's holding of preference shares comprises 33.33% of the issued capital and 33.33% of the voting rights of the company		£1 Preference	50%	50.00%
GIE EDITH BAIL 3	9, quai du Président Paul Doumer, 92400, COURBEVOIE, France			20.00%
GIE EDITH BAIL 3	9, quai du Président Paul Doumer, 92400, COURBEVOIE, France			20.00%
GIE GNIFI	37 avenue Henri Lafleur, Nouméa, BP K3 98849, New Caledonia			24.99%
Rosimian Limited	England and Wales	£0.01 B shares		25.00%
SCI Karuvefai	Guadeloupe	€0.01 Parts		33.32%
sino AG	Germany	€1 Common		20.11%
Spire Topco Hotels Limited	England and Wales	£0.01 A and £0.01 B shares		46.79%
VocaLink Holdings Limited (significant influence per right to appoint a director)	England and Wales	£1 Ordinary	15.91%	15.91%
<b>Joint Ventures</b>				
Vaultex UK Limited	England and Wales	£1 Ordinary	50%	50.00%
HCM Holdings Limited (joint control per shareholders agreement)	England and Wales	£0.01 Ordinary	51%	51.00%

1 All subsidiaries are consolidated.

2 Country of incorporation or address of principal place of business, if unincorporated

3 Where more than one class of shares have been issued, the group holds 100% of each class and 100% of the voting rights, unless indicated otherwise

**HSBC Bank plc**

*Incorporated in England with limited liability. Registered in England: number 14259*

**REGISTERED OFFICE**

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