HSBC Bank Canada

Annual Report and Accounts 2015

HSBC

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Headlines

- Profit before income tax expense was $617m for the year ended 31 December 2015, a decrease of 32.3% compared with 2014.
- Profit attributable to the common shareholder was $414m for the year ended 31 December 2015, a decrease of 32.5% compared with 2014.
- Return on average common equity was 9.6% for the year ended 31 December 2015 compared with 13.9% for 2014.
- The cost efficiency ratio was 58.2% for the year ended 31 December 2015 compared with 52.2% for 2014.
- Total assets were $94.0bn at 31 December 2015 compared with $88.2bn at 31 December 2014.
- Common equity tier 1 capital ratio was 10.1%, the tier 1 ratio was 12.1% and the total capital ratio was 13.5% at 31 December 2015.

Basis of preparation of financial information

HSBC Bank Canada ('the bank', 'we', 'our') is an indirectly wholly-owned subsidiary of HSBC Holdings plc ('HSBC Holdings'). Throughout Management's Discussion and Analysis ('MD&A'), the 'HSBC Group' or the 'Group' means 'HSBC Holdings and its subsidiaries'. The MD&A is dated 18 February 2016, the date that our consolidated financial statements and MD&A for the year ended 31 December 2015 were approved by our Board of Directors ('the Board').

The bank has prepared its consolidated financial statements in accordance with International Financial Reporting Standards ('IFRS') and accounting guidelines as issued by the Office of the Superintendent of Financial Institutions Canada ('OSFI'), as required under Section 308(4) of the *Bank Act*. The information in this MD&A is derived from our consolidated financial statements or from the information used to prepare them. The abbreviations '$m' and '$bn' represent millions and billions of Canadian dollars, respectively. All tabular amounts are in millions of dollars except where otherwise stated.

The references to 'notes' throughout this MD&A refer to notes on the consolidated financial statements for the year ended 31 December 2015. All disclosures in the MD&A are unaudited unless otherwise stated after 31 December 2015.

Outstanding securities data. Note 26 contains details of the number of preferred and common shares issued and outstanding at 31 December 2015. Subsequent to that date and up to the date of this MD&A, there have been no issues of any form of securities.

Table of contents

2 Message from the President and Chief Executive Officer
4 Management's Discussion and Analysis
- *4* Who we are
- *4* Our strategic priorities
- *7* Financial summary
- *8* Use of non-IFRS financial measures
- *9* Financial performance 2015
- *14* Movement in financial position
- *15* Global lines of business
- *21* Fourth quarter 2015 financial performance
- *24* Summary quarterly performance
- *25* Economic outlook for 2016
- *26* Critical accounting estimates and judgements
- *28* Changes in accounting policy during 2015
- *28* Future accounting developments
- *29* Off-balance sheet arrangements
- *30* Disclosure controls and procedures and internal control over financial reporting
- *31* Related party transactions
- *31* Risk management
- *57* Factors that may affect future results
- *58* Capital
- *60* Dividends

61 Statement of Management's Responsibility for Financial Information
62 Independent Auditor's Report
63 Financial Statements
69 Notes on the Financial Statements

Message from the President and Chief Executive Officer

HSBC celebrated its 150th anniversary in 2015. Founded in Hong Kong and Shanghai in 1865, we have endured many challenges and celebrated many successes through our storied history. This milestone anniversary also marks 150 years of resilience – of learning, adapting, changing; of helping customers to do the same and, in the process, persistently building a sound business.

It is with this deep experience that we view the current environment. Our 2015 results reflect the macroeconomic challenges that mounted globally and in Canada, particularly through the second half of the year. Despite prevailing low interest rates and other headwinds, we delivered strong results in the first half. Our results in the latter half were negatively impacted by the sharp decline in oil prices, the depreciating Canadian dollar and credit related losses in Alberta. To mitigate credit risk and minimize energy industry-related losses, we have partnered closely with our customers to help them weather this downturn. We also continued to build for long term growth, investing to meet rapidly changing customer demand, and making our business more efficient.

The fundamentals of our business remain sound. Our total assets have grown to C$94bn at the end of this year, up from C$88.2bn last year, and the bank remains well capitalized with our common equity tier 1 capital ratio at 10.1% at the end of 2015. Total reported revenues were down 3.4% in a difficult environment.

Revenues from Commercial Banking were lower, driven by margin compression and the wind-down of the mezzanine financing business. In Global Banking and Markets, revenues were lower, affected by FX trading and by a credit valuation adjustment. Retail Banking and Wealth Management continued to deliver resilient performance, though it saw increased costs as we invested in digitization to match customers' changing habits and deliver future savings, and in wealth services to drive revenue growth. Higher operating expenses across our operations were due mainly to continued investment in people, processes and technology to protect our customers and our business from financial crime, as well as efficiencies to reduce costs in the long term. The significant weakening of the Canadian dollar also adversely impacted our foreign currency denominated expenses.

Ultimately, reported profit before income tax expense was down 32.3% from 2014 as we faced headwinds largely related to the downturn in the energy sector and resulting impairment charges.

Investments and strategic choices produced gains we take into 2016. In Commercial Banking, our people drove new to bank activity up 43%, helped by streamlined processes to improve frontline productivity. Retail Banking and Wealth Management achieved balanced growth in residential mortgages and deposits, and benefited from increases in wealth balances in the first half of the year. Global Banking and Markets saw increased lending and credit activities, increased revenue in Capital Financing and our Multinational segment, and won a milestone mandate for project export finance reinforcing our focus on infrastructure. Revenues from our Global Trade and Receivables Finance product group were up in both Commercial Banking and Global Banking and Markets. We were recognized by DALBAR for customer service at HSBC InvestDirect (for the fourth consecutive year), by Euromoney as the Best Trade Finance Bank, by Corporate Knights as one of Canada's 50 best corporate citizens, and we moved up in Euromoney's foreign exchange industry ranking to third.

While the macroeconomic outlook points to some improvement in 2017, we expect moderate growth in 2016. Despite the tailwinds from the low Canadian dollar, exports had little momentum going into 2016 and there are few clear signs that underlying demand is improving. However, with our business stable, liquid and well capitalized, we are pursuing growth.

We see prospects in non-energy sectors including exports and infrastructure. As a priority market for HSBC, Canada plays a significant role in leveraging the value of HSBC's international network. NAFTA is our largest and the China-Canada corridor also ranks in the world's top 20 largest trade corridors. We are playing a lead role in Canada in the internationalization of the Chinese renminbi (RMB). In 2015, we launched several products to help our clients take advantage of the opportunities the world has to offer – RMB-denominated term deposits for both retail and business customers and three new globally focused mutual funds – and these are being well received with RMB balances up about 20% over last year.

In my first six months as CEO, I have met with hundreds of customers who generously shared their stories. And while there is economic uncertainty, there are also many successful companies doing exciting things. It is encouraging to hear about the value that our customers find in the unique expertise we bring to helping internationally minded individuals and businesses manage their finances. On behalf of all of us at HSBC Bank Canada, we are grateful for their business and their trust.

As the world continues on the path of globalization and technology continues to impact how we interact with each other, it is more important than ever that Canadians have a financial partner that understands the forces shaping the global economy. Canada has more than 50 free trade agreements so even local businesses can face foreign competition and should be alive to the opportunities the world presents. With a network that provides access to more than 90% of global GDP, trade and capital flows, we can help with that.

While it was a challenging year, this is a great business in a great market and our commitment remains steadfast. In the coming year, we will continue to invest in Canada – managing prudently, and building for the future.

Sandra Stuart
President and Chief Executive Officer
HSBC Bank Canada

Vancouver, Canada
18 February 2016

Management's Discussion and Analysis

Who we are

HSBC Bank Canada, a subsidiary of HSBC Holdings plc, is the leading international bank in the country. We help companies and individuals across Canada to do business and manage their finances internationally through our Commercial Banking, Global Banking and Markets, and Retail Banking and Wealth Management businesses. No international bank has our Canadian presence and no Canadian domestic bank has our international reach.

Canada is a priority market for the HSBC Group and a key player in HSBC's work to support customers and drive growth, leveraging its footprint across all key trade corridors including in North America alongside the United States and Mexico, and with China.

The HSBC Group is one of the world's largest banking and financial services groups with assets of US$2,410bn at 31 December 2015. Linked by advanced technology, HSBC serves customers worldwide through an unparalleled international network of around 6,000 offices in 71 countries and territories in Europe, Asia, North and Latin America, and the Middle East and North Africa.

Throughout HSBC's 150 year history we have been where the growth is, connecting customers to opportunities, enabling businesses to thrive and economies to prosper, helping people fulfil their hopes and dreams and realize their ambitions.

Shares in HSBC Holdings are listed on the London, Hong Kong, New York, Paris and Bermuda stock exchanges. The shares are traded in New York in the form of American Depositary Receipts. Certain of HSBC Bank Canada preferred shares are traded on the Toronto Stock Exchange.

Our continuous disclosure materials, including interim and annual filings, are available through a link on the bank's website and on the Canadian Securities Administrators' web site at www.sedar.com.

Complete financial, operational and investor information for HSBC Holdings and the HSBC Group, including HSBC Bank Canada, can be obtained from its website, www.hsbc.com, including copies of HSBC Holdings 2015 Annual Review and its 2015 Annual Report and Accounts.

Our strategic priorities

HSBC Connecting Customers to Opportunities

HSBC Bank Canada is an integral part of one of the most international banking and financial services organizations in the world.

The value of our international network comes from our connections to the people and companies that drive economic activity. We provide products and services to meet diverse financial needs – from purchasing a music download to financing the construction of an international airport. Our relationships reflect the geographic reach of our network and the range of customers we support.

Our network of customers provides us with significant insight into trade and capital flows across supply chains. When we bank customers on both sides of a transaction, we can help them overcome obstacles and manage risk more effectively. We are uniquely positioned to be the bridge between customers, both large and small, around the world.

HSBC's global businesses set globally consistent business strategies and operating models and manage the products and services offered to our customers.

The three HSBC global lines of business that operate in Canada are:

Commercial Banking ('CMB') which supports business customers with banking products and services to help them operate and grow. Our customers range from small enterprises, through to large companies operating globally

Global Banking and Markets ('GB&M') which provides financial services and products to corporates, governments and institutions. Our comprehensive range of products and solutions can be combined and customized to meet our customers' specific objectives – from primary equity and debt capital, global trade and receivables finance.

Retail Banking and Wealth Management ('RBWM') which helps customers manage their finances, buy their home, save and invest for the future.

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

- We are open to different ideas and cultures and value diverse perspectives.
- We are connected to our customers, communities, regulators and each other, caring about individuals and their progress.
- We are dependable, standing firm for what is right and delivering on commitments.

These values reflect the best aspects of the HSBC Group's 150-year heritage. They are critical to fulfilling our purpose to help businesses to thrive, economies to prosper and people to realize their ambitions.

Our role in society

HSBC's ambition is to be recognized as the world's leading and most respected international bank. How we do business is as important as what we do. We seek to build trusting and lasting relationships with our many stakeholders to generate value in society and deliver long-term shareholder returns.

We are part of a group that serves millions of customers around the world, ranging from individuals to the largest companies. We are committed to conduct our business in a way that delivers fair value to customers, strengthens our communities and helps ensure a properly functioning financial system.

We employ thousands of people, providing them livelihoods and opportunities for professional development and personal growth. We value diversity in all its forms as essential to who we are and our ability to fulfil our purpose. In Canada, our Board of Directors reached gender parity several years ago and our Executive Committee has done the same – a first in the Canadian industry. Our focus continues to be on achieving better diversity across all dimensions.

We also recognize the significant role that the financial system has in tackling challenges such as financial crime and climate change. We are strengthening our ability to safeguard customers and ourselves against financial crime, and believe this will be a source of long-term advantage for our business. We are also committed to helping enable a transition to a low carbon economy through our business activities and own operations.

Strategy
At an HSBC Group Investor Update in June 2015, a series of 10 actions were outlined to drive HSBC Group strategy and capture value from the global network. Of those actions, the following are applicable to Canada:

- Realize the value of the Group's international network
- Rebuild North American profitability focussing on opportunities offered by NAFTA
- Renminbi ('RMB') internationalization
- Reduce risk weighted assets ('RWA')
- Deliver cost savings
- Global Standards – safeguarding against financial crime.

Accordingly, the bank is directing its efforts and actions to implement the Group's strategy in the Canadian business particularly focussing on collaboration with HSBC's Global Businesses.

Capturing value from HSBC's international network
HSBC aims to provide an unparalleled international network to connect faster growing and developed markets – developing the wealth and retail banking businesses in markets where it can achieve profitable scale, including Canada. Our strategy is built around long-term trends and reflects our distinctive advantages.

Unrivalled global presence
Our network provides access to more than 90% of global GDP, trade and capital flows. We use it to offer products that facilitate trade and investment, and help customers participate in global growth opportunities. Our global presence helps us build deeper and more enduring relationships with businesses and individuals with international needs.

Universal banking model
The three global businesses that operate in Canada serve the full range of banking customers, from individual savers to large multinational companies. This universal banking model enables us to effectively meet customers' diverse financial needs. Our balanced mix of businesses supports a strong capital and funding base, provides competitive rewards to employees, and generates stable shareholder returns.

Management's Discussion and Analysis (continued)

Invest in wealth management and select retail businesses
HSBC aims to capture opportunities arising from social mobility and wealth creation in our priority markets, including Canada. HSBC's global network and our extensive expertise in international markets provide a competitive advantage in serving Canadian retail and wealth management customers.

Rebuild North American profitability focussing on opportunities offered by NAFTA
We continued to realize value from the network across North America as our GB&M and CMB businesses worked closely with our affiliates in the US and Mexico to assist our customers' cross border banking needs including cross border product and sales initiatives and improvements in customer on-boarding processes.

RMB internationalization
We continued to identify new opportunities where the Group's presence in China and its ability to undertake transactions in the Chinese RMB currency can add value for our customers. We rolled out a number of RMB products to both Corporate and Retail customers and were the first local custodian in Canada to serve customers from the Canadian Renminbi Qualified Foreign Institutional Investor (RQFII) market. We have received a mandate from the Province of British Columbia as joint lead for a RMB denominated bond issuance in China ('Panda' Bond). This will be the first sovereign government Panda bond program in China.

Reduce risk weighted assets
We are implementing initiatives to optimize systems and processes to improve data collection and reposition portfolios to ensure returns on risk weighted assets are commensurate with the risks in the current environment. We implemented initiatives to optimize RWA utilization from improvements in data quality and modelling as well as winding down certain portfolios.

Deliver cost savings
We continue to take actions to better manage our costs. We are growing our digital capabilities and realizing efficiency gains through automating or re-engineering processes. We are also simplifying our technology and reshaping our global functions.

Global Standards – safeguarding against financial crime
Our aim is to safeguard customers, ourselves and the financial services industry from financial crime. We have made significant investments in Global Standards and have made good progress on our implementation plans. We have enhanced customer due diligence, improved transaction monitoring and sanctions screening capabilities and introduced strategic technology to support customer selection and exit decisions. We have introduced financial crime detection and investigation capabilities within our business teams.

Financial summary

($ millions, except where otherwise stated)

	2015	2014	2013
Financial performance for the year ended 31 December			
Total operating income	**2,037**	2,110	2,161
Profit before income tax expense	**617**	912	934
Profit attributable to the common shareholder	**414**	613	616
Basic earnings per common share ($)	**0.83**	1.23	1.24
Financial position at 31 December			
Loans and advances to customers	**48,378**	41,219	40,524
Customer accounts	**55,089**	50,843	50,926
Ratio of customer advances to customer accounts (%)[1]	**87.8**	81.1	79.6
Shareholders' equity	**5,376**	4,800	4,885
Average total shareholders' equity to average total assets (%)[1]	**5.7**	5.7	6.1
Capital measures[2]			
Common equity tier 1 capital ratio (%)	**10.1**	10.6	11.0
Tier 1 ratio (%)	**12.1**	12.0	13.2
Total capital ratio (%)	**13.5**	13.5	15.0
Leverage ratio (%)[3]	**4.7**	n/a	n/a
Assets-to-capital multiple[3]	**n/a**	17.1	15.1
Risk-weighted assets ($m)[3]	**42,846**	40,269	36,862
Performance ratios (%)[1]			
Return ratios (%)			
Return on average common shareholder's equity	**9.6**	13.9	14.5
Post-tax return on average total assets	**0.45**	0.72	0.72
Pre-tax return on average risk-weighted assets[2]	**1.4**	2.3	2.6
Credit coverage ratios (%)			
Loan impairment charges to total operating income	**11.5**	5.1	8.7
Loan impairment charges to average gross customer advances and acceptances	**0.6**	0.3	0.5
Total impairment allowances to impaired loans and acceptances at year end	**83.4**	69.9	66.4
Efficiency and revenue mix ratios (%)			
Cost efficiency ratio	**58.2**	52.2	49.5
As a percentage of total operating income:			
– net interest income	**56.1**	57.4	60.7
– net fee income	**33.5**	30.6	27.9
– net trading income	**4.0**	6.9	8.2

1 *Refer to the 'Use of non-IFRS financial measures' section of this document for a discussion of non-IFRS financial measures.*

2 *The bank assesses capital adequacy against standards established in guidelines issued by OSFI in accordance with the Basel III capital adequacy framework.*

3 *Leverage ratio replaced assets-to-capital multiple effective 1 January 2015.*

Management's Discussion and Analysis (continued)

Use of non-IFRS financial measures

In measuring our performance, the financial measures that we use include those which have been derived from our reported results. However these are not presented within the Financial Statements and are not defined under IFRS. These are considered non-IFRS financial measures and are unlikely to be comparable to similar measures presented by other companies. The following non-IFRS financial measures are used throughout this document and their purposes and definitions are discussed below:

Financial position ratios

These measures are indicators of the stability of the bank's balance sheet and the degree funds are deployed to fund assets.

Ratio of customer advances to customer accounts is calculated by dividing loans and advances to customers by customer accounts using year-end balances.

Average total shareholders' equity to average total assets is calculated by dividing average total shareholders' equity for the year (determined using month-end balances) with average total assets (determined using month-end balances) for the year.

Return ratios

Return ratios are useful for management to evaluate profitability on equity, assets and risk-weighted assets.

Return on average common shareholder's equity is calculated as annual profit attributable to the common shareholder divided by average common equity (determined using month-end balances).

Post-tax return on average total assets is calculated as annual profit attributable to common shareholders divided by average assets (determined using average month-end balances).

Pre-tax return on average risk-weighted assets is calculated as the profit before income tax expense divided by the average monthly balances of risk-weighted assets for the year. Risk-weighted assets are calculated using guidelines issued by OSFI in accordance with the Basel III capital adequacy framework.

Credit coverage ratios

Credit coverage ratios are useful to management as a measure of the extent of incurred loan impairment charges relative to the bank's performance and size of its customer loan portfolio during the period.

Loan impairment charges to total operating income is calculated as loan impairment charges and other credit provisions, as a percentage of total operating income for the year.

Loan impairment charges to average gross customer advances is calculated as annualized loan impairment charges and other credit provisions for the period, as a percentage of average gross customer advances (determined using month-end balances during the year).

Total impairment allowances to impaired loans at period-end are useful to management to evaluate the coverage of impairment allowances relative to impaired loans using year-end balances.

Efficiency and revenue mix ratios

Efficiency and revenue mix ratios are measures of the bank's efficiency in managing its operating expense to generate revenue and demonstrates the contribution of each of the primary revenue streams to total income.

Cost efficiency ratio is calculated as annual total operating expenses as a percentage of annual total operating income.

Net interest income, net fee income and net trading income as a percentage of total operating income is calculated as annual net interest income, annual net fee income and annual net trading income divided by annual total operating income.

Financial performance 2015

Summary consolidated income statement

	2015 $m	2014 $m
Net interest income	**1,143**	1,212
Net fee income	**683**	645
Net trading income	**81**	146
Net income/(expense) from financial instruments designated at fair value	**3**	(5)
Gains less losses from financial investments	**63**	56
Other operating income	**64**	56
Net operating income before loan impairment charges and other credit risk provisions	**2,037**	2,110
Loan impairment charges and other credit risk provisions	**(234)**	(107)
Net operating income	**1,803**	2,003
Total operating expenses	**(1,186)**	(1,102)
Operating profit	**617**	901
Share of profit in associates	**–**	11
Profit before income tax expense	**617**	912
Income tax expense	**(170)**	(263)
Profit for the year	**447**	649

Overview

HSBC Bank Canada reported a profit before income tax expense for 2015 of $617m, a decrease of $295m, or 32.3%, compared with 2014.

The decrease from 2014 was primarily due to:

- the competitive low interest rate environment;
- adverse credit valuation adjustments ('CVA') on derivative contracts as a result of widening customer credit spreads and the weakening Canadian dollar;
- increased loan impairment charges primarily arising from our energy portfolio; and
- higher operating expenses mainly from continued investments in HSBC's Global Standards program and other risk and compliance activities, investment in efficiency initiatives as well as the impact of the weaker Canadian dollar on expenses denominated in foreign currencies.

These were partially offset by increased fee income from credit and wealth management products and capital markets fees.

Management's Discussion and Analysis (continued)

Performance by income and expense item

Net interest income

Interest income

	2015			2014		
	Average balance **$m**	***Interest income*** **$m**	***Yield*** **%**	*Average balance* $m	*Interest income* $m	*Yield* %
Short-term funds and loans and advances to banks	**982**	**3**	**0.31**	669	4	0.60
Loans and advances to customers	**42,568**	**1,385**	**3.25**	41,384	1,514	3.66
Reverse repurchase agreements – non-trading	**7,436**	**50**	**0.67**	7,917	91	1.15
Financial investments	**22,366**	**255**	**1.14**	19,847	272	1.37
Other interest-earning assets	**115**	**7**	**6.09**	323	5	1.55
Total interest-earning assets	**73,467**	**1,700**	**2.31**	70,140	1,886	2.69
Trading assets and financial assets designated at fair value	**6,713**	**–**		5,441	–	
Non-interest-earning assets	**13,289**	**–**		12,095	–	
Year ended 31 December	**93,469**	**1,700**	**1.82**	87,676	1,886	2.15

Interest expense

	2015			2014		
	Average balance **$m**	*Interest expense* **$m**	*Cost* **%**	*Average balance* $m	*Interest expense* $m	*Cost* %
Deposits by banks	**409**	**1**	**0.24**	410	1	0.24
Financial liabilities designated at fair value – own debt issued	**421**	**5**	**1.19**	428	6	1.40
Customer accounts	**46,045**	**251**	**0.55**	44,930	352	0.78
Repurchase agreements – non-trading	**3,241**	**22**	**0.68**	2,393	27	1.13
Debt securities in issue	**11,152**	**269**	**2.41**	11,300	284	2.51
Other interest-earning liabilities	**764**	**9**	**1.18**	661	4	0.61
Total interest-earning liabilities	**62,032**	**557**	**0.90**	60,122	674	1.12
Trading liabilities and financial liabilities designated at fair value (excluding own debt issued)	**2,500**	**–**		3,074	–	
Non-interest bearing current accounts	**5,430**	**–**		4,932	–	
Total equity and other non-interest bearing liabilities	**21,228**	**–**		19,547	–	
Year ended 31 December	**91,190**	**557**	**0.61**	87,675	674	0.77
Net interest income – year ended 31 December		**1,143**			1,212	

Net interest income for 2015 was $1,143m, a decrease of $69m, or 5.7%, compared with 2014. This was primarily due to the impact on the commercial loan portfolio of the competitive low interest rate environment including two Bank of Canada rate cuts in 2015. Also contributing to the decrease was the impact of the continued planned run-off of both the higher yielding consumer finance and mezzanine financing portfolios. This was partially offset by increases associated with the growth in commercial loans, residential mortgages and retail deposits.

Management's Discussion and Analysis (continued)

Net fee income

	2015 $m	2014 $m
Credit facilities	**304**	278
Funds under management	**172**	163
Account services	**72**	77
Credit cards	**59**	62
Corporate finance	**50**	37
Remittances	**31**	32
Immigrant Investor Program	**14**	17
Brokerage commissions	**14**	13
Insurance	**9**	12
Trade finance import/export	**10**	9
Trustee fees	**5**	5
Other	**18**	18
Fee income	**758**	723
Less: fee expense	**(75)**	(78)
Net fee income	**683**	645

Net fee income for 2015 was $683m, an increase of $38m, or 5.9%, over 2014. This was primarily due to higher fees from credit products such as standby lines of credit and banker's acceptances ('BAs'), as well as increased fees from higher funds under management. In addition, in 2015 there were higher fees from advisory, debt capital market and leveraged and acquisition finance activities. This was partially offset by lower fees earned from account services resulting from the introduction of low fee customer accounts, lower credit card fees due to industry wide reductions in interchange revenues and lower immigrant investor fees resulting from the cancellation of the Canadian government's Immigrant Investor Program.

Net trading income

	2015 $m	2014 $m
Trading activities	**56**	127
Net interest from trading activities	**39**	18
Hedge ineffectiveness	**(14)**	1
Net trading income	**81**	146

Net trading income for 2015 was $81m, a decrease of $65m, or 44.5%, compared with 2014. Revenues were negatively impacted by CVA on derivative contracts due to the widening of customers credit spreads and the weakening Canadian dollar and derivative fair value movements recycled to the income statement due to hedge accounting criteria not having been met. Net interest income on trading activities is higher mainly due to lower interest expense from short position securities resulting from a reduction in customer facilitation transactions.

Other items of income

	2015 $m	2014 $m
Net income/(expense) from financial instruments designated at fair value	**3**	(5)
Gains less losses from financial investments	**63**	56
Other operating income	**64**	56
Other items of income	**130**	107

Net income/(expense) from financial instruments designated at fair value for 2015 was $3m compared to a loss of $5m in 2014, mainly due to widening credit spreads in 2015.

Gains less losses from financial investments for 2015 were $63m, an increase of $7m, or 12.5%, compared with 2014 arising on sales of available-for-sale debt securities resulting from the continued re-balancing of the Balance Sheet Management portfolio.

Other operating income for 2015 was $64m, an increase of $8m, or 14.3%, compared with 2014. The increase primarily reflects income from the sale of a small impaired loan portfolio as well as amounts received on settlement of a longstanding legal dispute.

Loan impairment charges and other credit risk provisions

	2015	2014
	$m	$m
Individually assessed provisions	**129**	90
Collectively assessed provisions	**48**	2
Loan impairment charges	**177**	92
Other credit risk provisions	**57**	15
Loan impairment charges and other credit risk provisions	**234**	107

Loan impairment charges and other credit risk provisions for 2015 were $234m, an increase of $127m, or 118.7%, compared with 2014. The increase primarily arose from increases in specific provisions as well as collective and other credit risk provisions resulting from adverse economic factors impacting the bank's energy sector customers. Offsetting this there was a small reduction in the charge for collectively assessed allowances in the retail portfolio and a larger reduction for the consumer finance portfolio.

Operating expenses

	2015	2014
	$m	$m
Employee compensation and benefits	**673**	619
General and administrative expenses	**470**	434
Depreciation of property, plant and equipment	**30**	33
Amortization and impairment of intangible assets	**13**	16
Total operating expenses	**1,186**	1,102

Total operating expenses for 2015 were $1,186m, an increase of $84m, or 7.6%, compared with 2014. As planned, operating expenses have increased due to our investment in systems, people and processes to meet the highest global standards for detecting and deterring financial crime, continued investments in digitization to match customers' changing habits and deliver future savings, and in wealth services to drive revenue growth as well as increased investments in efficiency initiatives. In addition, expenses have also been adversely impacted by the effect of the lower Canadian dollar on expenses denominated in foreign currencies.

Share of profit in associates

Share of profits of associates for 2015 was $nil, compared with income of $11m in 2014. The share of profit represents changes in the value of the bank's investments in private equity funds.

Income tax expense

The effective tax rate was 27.8% for 2015, compared with 29.2% for 2014. The lower income tax expense resulted from the resolution and closure in the prior year of multiple tax issues covering a number of years with the Canadian tax authorities.

Management's Discussion and Analysis (continued)

Movement in financial position

Summary consolidated balance sheet

	2015 $m	2014 $m	2013 $m
ASSETS			
Trading assets	**3,893**	8,914	6,728
Derivatives	**4,909**	4,082	2,112
Loans and advances to banks	**1,400**	1,264	1,149
Loans and advances to customers	**48,378**	41,219	40,524
Reverse repurchase agreements – non-trading	**6,807**	6,714	6,161
Financial investments	**23,935**	20,122	21,814
Customers' liability under acceptances	**3,834**	5,023	4,757
Other assets	**868**	866	1,015
Total assets	**94,024**	88,204	84,260
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks	**2,049**	681	635
Customer accounts	**55,089**	50,843	50,926
Repurchase agreements – non-trading	**6,606**	4,054	1,487
Trading liabilities	**1,713**	4,227	4,396
Derivatives	**5,005**	3,885	1,746
Debt securities in issue	**10,896**	10,610	11,348
Acceptances	**3,834**	5,023	4,757
Other liabilities	**3,456**	3,881	3,880
Total liabilities	**88,648**	83,204	79,175
Equity			
Share capital and other reserves	**2,167**	1,692	1,959
Retained earnings	**3,209**	3,108	2,926
Non-controlling interests	**–**	200	200
Total equity	**5,376**	5,000	5,085
Total equity and liabilities	**94,024**	88,204	84,260

Assets

Total assets at 31 December 2015 were $94.0bn, an increase of $5.8bn from 31 December 2014. Loans and advances to customers increased by $7.2bn. Residential mortgages increased by almost $1.2bn although this was partially offset by the planned run-off of the consumer finance portfolio and reductions in other personal lending. Cash Management Accounts increased by $1.3bn. Commercial Loans in GB&M grew by almost $0.5bn, although this was partially offset by a decrease in Commercial Loans in CMB of $0.3bn resulting from the reduced economic demand driven by reductions in energy prices. Customer demand for loan facilities provided through BAs increased by about $0.8bn overall, but reduced market demand for BAs meant that direct lending increased by about $1.2bn and reduced customers' liability under acceptances by the same amount. Part of the increase in loans and advances resulted from a change in categorization of customers' BA loans that originated in the fourth quarter of 2015 and onwards. Previously, customer BA loans, which amounted to $3.2bn at 31 December 2014, were categorized as trading assets. Increased liquidity resulted in growth in financial investments of $3.8bn. Derivatives increased by $0.8bn due to changes in the value of the US dollar on values of forward foreign exchange contracts with customers. Trading assets decreased by $5.0bn due to a reduction of customer settlement accounts of $2.0bn and changes in categorization of customer BA Loans noted above.

Liabilities

Total liabilities at 31 December 2015 were $88.6bn, an increase of $5.4bn from 31 December 2014. Customer Accounts increased by $4.2bn arising from growth in the underlying business, including $1.3bn in Cash Management Accounts. Repurchase agreements and deposits by banks increased by $2.6bn and $1.4bn respectively as a result of balance sheet management activities. Derivatives increased by $1.1bn due to the effect of changes in the value of the US dollar on clients forward contracts. This was offset by decreases in trading liabilities of $2.5bn mainly from lower securities short positions arising from a reduction in customer facilitation trading as well as lower liabilities under customer acceptances of $1.2bn due to reduced demand as noted above.

Equity

Total equity at 31 December 2015 was $5.4bn, an increase of $0.4bn from 31 December 2014, primarily due to an issue of $0.5bn in preferred shares to the bank's parent and profits generated in the year. This was partially offset by the redemption of $0.2bn in HSBC Canada Asset Trust Securities which reduced non-controlling interests.

Global lines of business

We manage and report our operations around the following global lines of business: Commercial Banking, Global Banking and Markets, and Retail Banking and Wealth Management. The latter segment also includes the run-off 'Consumer Finance' portfolio following a previous decision to wind down this business.

Commercial Banking ('CMB')

CMB provides a broad range of banking and financial services to enable customers to manage and grow their businesses domestically and internationally. HSBC serves close to 2.5 million Commercial Banking customers globally in 55 countries and territories. We aim to be recognized as part of the leading international trade and business bank by connecting customers to markets and by enhancing collaboration within the Group, including within the NAFTA and Canada-China trade corridors. Implementing HSBC's global operating model in Canada increases transparency, enables consistency, improves efficiency and ensures the right outcomes for our customers.

Products and services

- *Credit and Lending:* we offer a broad range of domestic and cross-border financing including overdrafts, corporate cards, term loans and syndicated, leveraged, acquisition and project finance.
- *Global Trade and Receivables Finance:* we support customers' access to the world's trade flows and provide unrivalled experience in addressing today's most complex trade challenges. Our comprehensive suite of products and services – letters of credit, collections, guarantees, receivables finance, supply chain solutions, commodity and structured finance and risk distribution – can be combined into global solutions that make it easier for businesses to manage risk, process transactions and fund activities throughout the trade cycle.
- *Payments and Cash Management:* We are part of a global network strategically located where most of the world's payments and capital flows originate. We provide local, regional and global transaction banking services including payments, collections, account services, e-commerce and liquidity management via electronic platforms such as HSBCNet and HSBC Connect to address the needs of our customers. We maintain our leadership position in international RMB services and are well positioned to leverage opportunities in Canada as a new RMB Hub.
- *Collaboration:* Our CMB franchise represents a key customer base for products and services provided by GB&M and RBWM, including foreign exchange, interest rate, capital markets and advisory services, payroll and personal accounts services and wealth management and wealth transition services

Strategic direction

We support our customers with tailored relationship management and financial solutions to allow them to operate efficiently and to grow. This includes providing them with working capital, term loans, payment services, international trade facilitation, project finance and the expertise for acquisitions and access to the financial markets. We are focused on creating value from our network which covers 90% of the global GDP, trade and capital flows. We are therefore investing heavily in digital and technology aspects of our core Payments and Cash Management and Global Trade and Receivables Finance propositions. We have organized ourselves around our customers' needs and their degree of complexity by developing three distinct segments within CMB: Business Banking, Mid-Market and Large Corporates.

Management's Discussion and Analysis (continued)

- Business Banking is dedicated to assisting the growth of small enterprises both domestically and within our international reach.
- We have brought increased focus to our Mid-Market customers and have invested resources to provide enhanced relationship management.
- For our Large Corporate customers, who typically have complex and multi-country needs, we provide globally managed senior coverage teams, who are also able to coordinate with GB&M.

To ensure that our customers remain at the heart of our business, we continue to place the utmost value on customer feedback and customer engagement. We are now in the 6th year of our Client Engagement Program, designed to deepen our understanding of our customers and reinforce our relationship with them. This initiative, combined with other insight programs, helps us to identify customers' critical business issues so that we can tailor solutions and services offered to better meet their needs. Building long-term relationships with reputable customers is core to our growth strategy and organizational values.

Review of financial performance

	2015 $m	2014 $m
Net interest income	**598**	658
Net fee income	**319**	324
Net trading income	**33**	26
Gains less losses from financial investments	**–**	16
Other operating income	**25**	19
Net operating income before loan impairment charges and other credit risk provisions	**975**	1,043
Loan impairment charges and other credit risk provisions	**(218)**	(79)
Net operating income	**757**	964
Total operating expenses	**(433)**	(408)
Operating profit	**324**	556
Share of profit in associates	**–**	11
Profit before income tax expense	**324**	567

Overview

CMB continued to make progress in growing our business and streamlining processes, despite headwinds from sustained low energy and commodity prices as well as the low interest rate environment. New-to-bank activities increased 43% during 2015. We continuously re-priced for risk to reflect the dynamic credit profile of our customers, which helped to mitigate revenue challenges resulting from reduced business spending in the current market condition and subsequently lower utilization of authorized credit facilities. Initiatives to streamline credit application and customer on-boarding processes helped to improve front-line productivity and increase focus on our customers' needs.

Profit before income tax expense for 2015 was $324m, a decrease of $243m, or 43%, compared with 2014. The decrease was primarily driven by lower net interest income including the impact of Bank of Canada rate cuts, higher loan impairment charges, the continued wind-down of our mezzanine financing business and higher operating expenses primarily from increased investments in HSBC's Global Standards, risk and compliance activities.

Financial performance by income and expense item

Net interest income for 2015 was $598m, a decrease of $60m, or 9%, compared to 2014 primarily due to margin compression from two Bank of Canada rate cuts and lower asset balances driven by lower utilization and the continued wind-down of our mezzanine financing portfolio.

Net fee income for 2015 was $319m, a decrease of $5m or 2% compared with 2014 mainly arising from non-recurring gain on realization of assets in the mezzanine portfolio in 2014 and lower account service fees.

Net trading income for 2015 was $33m, an increase of $7m, or 27%, compared with 2014, primarily from higher foreign exchange revenues particularly resulting from changing the revenue sharing methodology between each of the business lines compared to 2014.

Gains less losses from financial investments for 2015 were lower than the comparative amount for 2014 which included gains of $16m recorded on the disposal of certain available-for-sale securities that was not repeated in 2015.

Other operating income for 2015 was $25m, an increase of $6m or 32%, compared with 2014 reflecting amounts received on settlement of a longstanding legal dispute.

Loan impairment charges and other credit risk provisions for 2015 were $218, an increase of $139m, or 176%, compared with 2014 as a result of higher loan impairment charges driven by the adverse economic factors impacting the bank's energy sector customers.

Total operating expenses for 2015 was $433m, an increase of $25m, or 6%, compared with 2014 primarily from increased investments in HSBC's Global Standards, risk and compliance activities.

Share of profit in associates for 2015 was $nil, compared with income of $11m in 2014 representing changes in the value of the bank's investments in certain private equity funds.

Global Banking and Markets ('GB&M')

GB&M provides tailored financial solutions to major government, corporate and institutional customers worldwide.

Products and services

GB&M takes a long-term relationship management approach to build a full understanding of customers' financial requirements and strategic goals. Customer coverage is centralized in Global Banking, under relationship managers organized by sector, region and country who work to understand customer needs and provide holistic solutions by bringing together our broad array of products and extensive global network.

Our customer coverage and product teams are supported by a unique customer relationship management platform and comprehensive customer planning process. Our teams use these platforms to better serve global customers and help connect to international growth opportunities.

GB&M provides wholesale capital markets and transaction banking services organized across six customer facing businesses.

Sales and trading services in the secondary market are provided through three businesses organized by asset class:

- *Credit and Rates* sell, trade and distribute fixed income securities to customers including corporates, financial institutions, sovereigns, agencies and public sector issuers. They assist customers in managing risk via interest rate derivatives and facilitate customer facing financing via repurchase.
- *Foreign Exchange* provides spot and derivative products to meet the investment demands of institutional investors, the hedging needs of businesses of all sizes as well as the needs of retail customers in our branches.
- *Capital Financing* offers strategic financing and advisory services focusing on a customer's capital structure. Products include debt and equity capital raising in the primary market, transformative merger and acquisition advisory and execution, and corporate lending and specialized structured financing solutions such as leveraged and acquisition finance, asset and structured finance and infrastructure and project finance.
- *Payments and Cash Management* helps customers move, control, access and invest their cash. Products include non-retail deposit taking, and international, regional and domestic payments and cash management services.
- *Global Trade and Receivables Finance* provides trade services on behalf of customers to support them throughout their trade cycle.

In addition to the above, Balance Sheet Management is responsible for the management of liquidity and funding for the bank. It also manages structural interest rate positions within the Markets limit structure.

Strategic direction

GB&M continues to pursue its well-established 'tailored financial solutions' strategy, with the goal of being a 'top tier' bank to our priority customers. This strategy has evolved to include a greater emphasis on connectivity between the global businesses, across the regions and within GB&M, leveraging the HSBC Group's extensive distribution network.

We focus on four strategic initiatives:

- leveraging our distinctive geographical network which connects developed and faster-growing regions;
- connecting customers to global growth opportunities;
- continuing to be well positioned in products that will benefit from global trends; and

Management's Discussion and Analysis (continued)

- enhancing collaboration with other global businesses to serve the needs of our international customers.

GB&M's strategy uses a disciplined application of hurdle rates to new and existing customer relationships in order to manage RWA efficiently. Implementing Global Standards, enhancing risk management controls and simplifying processes also remain top priorities for GB&M.

Review of financial performance

	2015 **$m**	2014 $m
Net interest income	**175**	179
Net fee income	**138**	98
Net trading income	**2**	68
Gains less losses from financial investments	**63**	40
Other operating income	**–**	1
Net operating income before loan impairment charges and other credit risk provisions	**378**	386
Loan impairment charges and other credit risk provisions	**(5)**	(5)
Net operating income	**373**	381
Total operating expenses	**(135)**	(117)
Profit before income tax expense	**238**	264

Overview

GB&M continued to leverage our global network on behalf of our customers and increased lending and credit activities. In addition, the Capital Financing business generated increased revenues across each product area.

Profit before income tax expense was $238m for 2015, a decrease of $26m, or 10% compared with 2014. This resulted from the adverse impact on trading income of CVA resulting from changes in counterparty risk as well as derivate fair value movements being recycled to the income statement due to hedge accounting criteria not having been met, and increased costs, partially offset by higher capital markets fees.

Financial performance by income and expense item

Net interest income for 2015 was $175m, a decrease of $4m, or 2%, compared with 2014 primarily due to funding activities for the trading book partially offset by the growth in credit and lending activities.

Net fee income for 2015 was $138m, an increase of $40m, or 41%, compared with 2014 primarily due to increased fees from debt capital markets, leveraged and acquisition and project finance activities, advisory services and higher standby fees.

Net trading income for 2015 was $2m, a decrease of $66m, or 97%, compared with 2014. The decrease in net trading income was mainly due to an increase in CVA on derivative contracts due to the widening of customer spreads and the weakening Canadian dollar. In addition, derivative fair value movements were recycled to the income statement due to hedge accounting criteria not having been met, which negatively impacted net trading income. Also a change in the revenue sharing methodology between each of the business lines resulted in a lower share of foreign exchange revenue compared to 2014.

Gains less losses from financial investments for 2015 was $63m, an increase of $23m, or 58%, compared with 2014 primarily as a result of the bank's continuous balance sheet management activities. The bank realizes gains and losses from financial investments from disposals of available-for-sale financial investments driven by balance sheet management activities.

Total operating expenses for 2015 was $135m, an increase of $18m or 15% compared with 2014, primarily due to increased investments in HSBC's Global Standards, risk and compliance activities.

Retail Banking and Wealth Management (RBWM)

RBWM provides banking and wealth management services for our personal customers to help them to manage their finances and protect and build their financial future, serving more than 800,000 personal customers in Canada.

Products and services

We take deposits and provide transactional banking services to enable customers to manage their day-to-day finances and save. We selectively offer credit facilities to assist customers in their short or longer-term borrowing requirements, and we provide wealth advisory and investment services to help them to manage their finances.

We develop products designed to meet the needs of specific customer segments, which may include a range of different services and delivery channels.

Customer offerings include:

– deposits and account services;

– secured and unsecured credit and lending; and

– wealth advisory and asset management.

Strategic direction

In delivering a full range of banking and wealth products and services through our branches and direct channels to individuals we focus on three strategic initiatives:

– building a consistent, high standard wealth management service for retail customers drawing on our wealth advisory and asset management businesses which puts the customer at the heart of what we do;

– leveraging global expertise to efficiently provide a high standard of banking solutions and service to our customers; and

– simplifying the RBWM portfolio of products and services, directing resources towards the development and delivery of products through a relationship led approach.

To support these initiatives, we are making deepening customer relationships and enhancing our distribution capabilities a priority. Implementing Global Standards, enhancing risk management control models and simplifying processes also remain top priorities for RBWM.

Review of financial performance

	2015	2014
	$m	$m
Net interest income	**393**	413
Net fee income	**225**	223
Net trading income	**22**	18
Other operating income	**13**	8
Net operating income before loan impairment charges and other credit risk provisions	**653**	662
Loan impairment charges and other credit risk provisions	**(11)**	(23)
Net operating income	**642**	639
Total operating expenses	**(567)**	(533)
Profit before income tax expense	**75**	106

Profit before income tax expense

	2015	2014
	$m	$m
Ongoing Retail Banking and Wealth Management business	**38**	76
Run-off consumer finance portfolio	**37**	30
Profit before income tax expense	**75**	106

Management's Discussion and Analysis (continued)

Overview
During 2015, RBWM continued to achieve sustainable and balanced growth in residential mortgages and deposits and benefited from increases in wealth balances during the first half of the year. The business continues to deliver a resilient performance given that spread compression in the highly competitive low interest rate environment is impacting margins.

Profit before income tax expense was $75m for 2015, a decrease of $31m, or 29%, compared with 2014. Profit before income tax expense relating to ongoing business (excluding the run-off consumer finance portfolio) was $38m for 2015, a decrease of $38m, or 50%, compared with 2014. Profit before income tax expense relating to ongoing business declined from last year primarily due to increased expenses from the implementation of HSBC's Global Standards and risk and compliance activities, increased investment in wealth services to drive revenue growth, and a change in the inter-segment allocation methodology of branch network support costs, although this was partially offset by increased revenues.

Profit before income tax expense relating to the consumer finance portfolio was $37m, compared with $30m for 2014. Results were positively impacted by a release of loan loss provisions from the continuing planned run-off of the portfolio, lower operating expenses and income on the sale of an impaired loan portfolio. This was partially offset by lower interest income on loan balances which reduced from $635m at the beginning of 2014 to $228m at the end of 2015.

Financial performance of the ongoing business by income and expense item
Net interest income of the ongoing business for 2015 was $352m, an increase of $6m, or 2%, compared with 2014 primarily due to growth and improved spread in residential mortgages and growth in deposits.

Net fee income of the ongoing business for 2015 was $225m, an increase of $6m, or 2% compared with 2014. Continued growth in wealth management product sales increased fee income. However, fee income for the year reflects a provision for certain expected payments to current and former account holders in our fund distribution business.

Net trading income relating to the ongoing business for 2015 was $22m, an increase of $4m, or 22% compared with 2014. This principally resulted from a change in revenue sharing methodology noted previously.

Loan impairment charges and other credit risk provisions relating to the ongoing business for 2015 were $15m, an increase of $3m, or 25%, compared with 2014 as a result of increased collective allowances related to the effects of lower energy prices.

Total operating expenses of the ongoing business for 2015 were $554m, an increase of $51m, or 10%, compared with 2014. This was primarily due to increased investment in HSBC's Global Standards and risk and compliance activities, hiring in our Wealth and Premier businesses to support revenue growth, an increase in the allocation of branch network support costs and the impact of weakening Canadian dollar on costs. Higher costs also resulted from supporting strategic initiatives to streamline processes and improve the customer experience.

Other

'Other' contains the results of movements in fair value of own debt, income related to information technology services provided to HSBC Group companies on an arm's length basis and other transactions which do not directly relate to our global lines of business.

Review of financial performance

	2015 **$m**	2014 $m
Net interest expense	**(23)**	(38)
Net fee income	**1**	–
Net trading income	**24**	34
Net income (expense) from financial instruments designated at fair value	**3**	(5)
Other operating income	**26**	28
Net operating income	**31**	19
Total operating expenses	**(51)**	(44)
Loss before income tax expense	**(20)**	(25)

Loss before income tax expense was $20m for the year ended 31 December 2015, compared with a loss of $25m for 2014. The reduced loss mainly arose from the impact of widening credit spreads on financial instruments designated at fair value partially offset by increased costs not specifically allocated to global business lines.

Fourth quarter 2015 financial performance

Summary consolidated income statement

	Quarter ended		
	31 December 2015 $m	31 December 2014 $m	30 September 2015 $m
Net interest income	**282**	295	285
Net fee income	**165**	169	165
Net trading (loss)/income	**(23)**	39	48
Net (expense)/income from financial instruments designated at fair value	**(1)**	(1)	2
Gains less losses from financial investments	**7**	3	2
Other operating income	**18**	14	16
Net operating income before loan impairment charges and other credit risk provisions	**448**	519	518
Loan impairment charges and other credit risk provisions	**(164)**	(37)	(31)
Net operating income	**284**	482	487
Total operating expenses	**(311)**	(278)	(298)
Operating (loss)/profit	**(27)**	204	189
Share of (loss) profit in associates	**(1)**	2	(2)
(Loss)/profit before income tax expense	**(28)**	206	187
Income tax expense	**–**	(81)	(50)
(Loss)/profit for the quarter	**(28)**	125	137

Overview

HSBC Bank Canada reported a loss before income tax expense of $28m for the fourth quarter of 2015, a decrease of $234m compared with the fourth quarter of 2014, and a decrease of $215m compared with the third quarter of 2015.

Profit before income tax expense decreased, compared with the same quarter last year and the previous quarter primarily due to lower net interest income including the impact of two Bank of Canada rate cuts, the impact of CVA and other adjustments on trading income, increased loan impairment charges mainly on the energy portfolio as well as higher costs from increased investment in systems, people and processes to meet the highest global standards for detecting and deterring financial crime and costs related to improving efficiency.

Performance by income and expense item

Net interest income

Net interest income for the fourth quarter of 2015 was $282m, a decrease of $13m, or 4.4%, compared with the fourth quarter of 2014 and a decrease of $3m, or 1.0% compared with the third quarter of 2015. Net interest income decreased compared to the same period in 2014 primarily due to the impact of two Bank of Canada rate cuts and the planned run-offs of the consumer finance and mezzanine financing portfolios. Compared to the previous quarter, net interest income decreased due to reductions in commercial and retail loan volumes.

Management's Discussion and Analysis (continued)

Net fee income

	Quarter ended		
	31 December 2015 $m	31 December 2014 $m	30 September 2015 $m
Credit facilities	**72**	72	76
Funds under management	**44**	42	45
Account services	**18**	19	17
Credit cards	**15**	16	15
Corporate finance	**8**	9	9
Remittances	**8**	8	8
Immigrant Investor Program	**3**	4	4
Brokerage commissions	**3**	4	4
Insurance	**2**	3	2
Trade finance import/export	**3**	1	2
Trustee fees	**1**	1	1
Other	**6**	8	3
Fee income	**183**	187	186
Less: fee expense	**(18)**	(18)	(21)
Net fee income	**165**	169	165

Net fee income for the fourth quarter of 2015 was $165m, a decrease of $4m, or 2.4% compared with the fourth quarter of 2014 and unchanged from the third quarter of 2015. The decreases were primarily due to small reductions in a number of fee categories.

Net trading (loss)/income

	Quarter ended		
	31 December 2015 $m	31 December 2014 $m	30 September 2015 $m
Trading activities	**(17)**	27	30
Net interest from trading activities	**12**	11	13
Hedge ineffectiveness	**(18)**	1	5
Net trading income	**(23)**	39	48

Net trading loss for the fourth quarter of 2015 was $23m, compared with income of $39m in the fourth quarter of 2014, and $48m in the third quarter of 2015. Trading revenue for the fourth quarter was negatively impacted by CVA on derivative contracts due to the widening of customer credit spreads and the weakening Canadian dollar as well as derivative fair value movements recycled to the income statement due to hedge accounting criteria not having been met.

Other items of income

	Quarter ended		
	31 December 2015 $m	31 December 2014 $m	30 September 2015 $m
Net expense from financial instruments designated at fair value	**(1)**	(1)	2
Gains less losses from financial investments	**7**	3	2
Other operating income	**18**	14	16
Other items of income	**24**	16	20

Net expense from financial instruments designated at fair value for the fourth quarter of 2015 was a loss of $1m, unchanged from the fourth quarter of 2014 and decreased from the third quarter of 2015 due to the narrowing of credit spreads.

Gains less losses from financial investments for the fourth quarter of 2015 were $7m, an increase of $4m and $5m respectively, compared with the fourth quarter of 2014 and the third quarter of 2015. Balance Sheet Management recognized lower gains on sales of available-for-sale debt securities as a result of the continued re-balancing of the portfolio for balance sheet management purposes.

Other operating income for the fourth quarter of 2015 was $18m, an increase of $4m and $2m compared with the fourth quarter of 2014 and the third quarter of 2015 respectively mainly resulting from amounts received on settlement of a longstanding legal dispute.

Loan impairment charges and other credit risk provisions

	Quarter ended		
	31 December 2015 $m	31 December 2014 $m	30 September 2015 $m
Individually assessed provisions	**65**	43	31
Collectively assessed provisions/(provision releases)	**48**	(12)	(5)
Loan impairment charges	**113**	31	26
Other credit risk provisions	**51**	6	5
Loan impairment charges and other credit risk provisions	**164**	37	31

Loan impairment charges and other credit risk provisions for the fourth quarter of 2015 were $164m, an increase of $127m and $133m respectively, compared with the fourth quarter of 2014 and the third quarter of 2015. This resulted from increases in individual provisions as well as collectively assessed and other credit risk provisions resulting primarily from the bank's energy sector exposures.

Operating expenses

	Quarter ended		
	31 December 2015 $m	31 December 2014 $m	30 September 2015 $m
Employee compensation and benefits	**170**	152	167
General and administrative expenses	**130**	114	121
Depreciation of property, plant and equipment	**8**	8	7
Amortization and impairment of intangible assets	**3**	4	3
Total operating expenses	**311**	278	298

Total operating expenses for the fourth quarter of 2015 were $311m, increases of $33m, or 11.9%, and $13m or 4.4% compared with the fourth quarter of 2014 and the third quarter of 2015 respectively. This was largely due to increased investment in systems, people and processes to meet the highest global standards for detecting and deterring financial crime, continued investment in digitization to match customers' changing habits and deliver future savings, and in wealth services to drive revenue growth as well as increased investments in efficiency initiatives. Expenses have also been adversely impacted by the foreign exchange impact of the lower Canadian dollar. The increase over the third quarter of 2015 is due to increased investments in efficiency initiatives.

Share of profit in associates

Share of profit in associates for the fourth quarter of 2015 was a loss of $1m, compared with income of $2m in the fourth quarter of 2014 and $2m loss in the third quarter of 2015. This arose from adjustments to the fair values of the underlying investments in private equity funds.

Management's Discussion and Analysis (continued)

Income tax expense
The effective tax rate in the fourth quarter of 2015 was 0% compared to a rate of 39.7% in the fourth quarter of 2014 and a rate of 26.7% in the third quarter of 2015. The tax credit that would otherwise have arisen was offset by a small number of additional amounts set aside to cover certain tax issues. In 2014, additional amounts were set aside for resolution and closure of multiple tax issues covering a number of years with Canadian tax authorities.

Summary quarterly performance

Summary consolidated income statement

	2015 Quarter ended				2014 Quarter ended			
	Dec 31 $m	**Sep 30 $m**	**Jun 30 $m**	**Mar 31 $m**	Dec 31 $m	Sep 30 $m	Jun 30 $m	Mar 31 $m
Net interest income	**282**	**285**	**289**	**287**	295	303	307	307
Net fee income	**165**	**165**	**181**	**172**	169	161	160	155
Net trading income	**(23)**	**48**	**41**	**15**	39	35	33	39
Other operating income/(expense)	**24**	**20**	**30**	**56**	16	21	39	31
Net operating income before loan impairment charges and other credit risk provisions	**448**	**518**	**541**	**530**	519	520	539	532
Loan impairment charges and other credit risk provisions	**(164)**	**(31)**	**(23)**	**(16)**	(37)	(17)	(27)	(26)
Net operating income	**284**	**487**	**518**	**514**	482	503	512	506
Operating expenses	**(311)**	**(298)**	**(291)**	**(286)**	(278)	(272)	(276)	(276)
Operating (loss)/profit	**(27)**	**189**	**227**	**228**	204	231	236	230
Share of (loss)/profit in associates	**(1)**	**(2)**	**–**	**3**	2	–	6	3
(Loss)/profit before income tax expense	**(28)**	**187**	**227**	**231**	206	231	242	233
Income tax expense	**–**	**(50)**	**(59)**	**(61)**	(81)	(61)	(60)	(61)
(Loss)/profit for the period	**(28)**	**137**	**168**	**170**	125	170	182	172
(Loss)/profit attributable to:								
common shareholder	**(38)**	**128**	**161**	**163**	118	163	172	160
preferred shareholders	**10**	**9**	**5**	**4**	5	4	8	9
non-controlling interests	**–**	**–**	**2**	**3**	2	3	2	3
Basic (loss) earnings per common share ($)	**(0.08)**	**0.26**	**0.32**	**0.33**	0.24	0.32	0.35	0.32

Comments on trends over the past eight quarters

Seasonal factors did not have a significant impact on our results although the number of days in the first and second quarters does impact net interest income.

Net interest income declined from 2014 primarily as a result of the planned run-off of the consumer finance portfolio, lower interest margins in a low interest rate environment contributed to the decrease as did the run-off of the mezzanine financing portfolio. This decline has been partially offset by growth in deposit volumes which reduced our cost of funding.

Net fee income trended upwards from 2014 due to higher funds under management fees, resulting from increased sales as well as improved markets and credit product fees.

Net trading income trended upwards through 2014 and 2015. However, the first and fourth quarters of 2015 were negatively impacted by adjustments relating to valuations of derivatives and hedge accounting.

Operating expenses from 2014 onwards have been increasing as a result of investments related to HSBC's Global Standards program and other risk and compliance activities. Investment in our businesses and for efficiency initiatives which are expected to reduce costs in the longer term also contributed to increasing costs.

Economic outlook for 2016

The economy rebounded from a technical recession in the first half of the year, growing by 2.3% quarter-on-quarter annualized in Q3. The good news on the economy, however, was largely due to developments at the end of Q2 that gave a firm hand-off to Q3. The early Q3 momentum, however, proved unsustainable. We think that the economy stalled in Q4. This implies a weak hand-off to 2016. For 2015, we expect growth of 1.2%, and for growth to slow to slightly less than 1.0% in 2016. The sluggish growth in 2016 is in large part owing to the ongoing complex adjustment to the decline in oil prices, soft domestic demand as a result of the deterioration in the terms-of-trade, and weak global growth. In 2017, we look for the economy to grow by around 2.0% as headwinds dissipate.

Exports are a key factor in our outlook for moderate growth. In our view, exports, particularly in categories expected to lead a recovery, have little underlying momentum despite a tail-wind from a weaker Canadian dollar. Lingering competitive challenges in the factory sector are hindering the export recovery. While the lower Canadian dollar has helped improve exporters' US dollar revenues, there are few clear signs that underlying demand is improving on a sustainable basis. We now look for a more moderate trajectory for growth for non-energy, currency-sensitive exports. Hence, in 2016, we look for total exports to rise by just 1.2%, down from expected growth of 2.9% in 2015.

Corporate profits highlight the complex adjustment underway. We look for corporate profits to decline by 7.4% in 2016 after a 16.3% drop in 2015. The decline in oil prices, uncertainty over the global growth outlook has weighed on corporate sentiment even beyond the energy-sensitive sectors. We are thus not yet at the point where the positive effects of the decline in oil prices and a weaker Canadian dollar are dominant trends in Corporate Canada. Hence, amid a weak profit outlook firms continue to face pressures to control costs and for business investment to remain weak in early 2016. Overall, we look for business investment to decline by 6.1% in 2016, before a modest rebound in 2017.

The consumer is not expected to ride to the economy's rescue. Firstly, with firms reluctant to invest, they are also reluctant to hire. Hence, private sector job creation has slowed. As well, full-time job creation is now more due to the "self-employed" category than to those on corporate payrolls. For example, over the 2012-to-2014 period, full-time paid employment rose by almost 160,000 per year, accounting for all of the increase in full-time jobs. However, in 2015, full-time paid employment rose by less than 50,000, and accounted for only 30% of the increase in full-time jobs. The shift that has seen self-employment account for much of the rise in full-time employment is a sign of an economy that is struggling for momentum. Second, households are already heavily indebted, and debt continues to rise more quickly than domestic income. This suggests little scope for borrowing to accelerate to offset sluggish growth elsewhere. Third, the weaker Canadian dollar is making imports, particularly consumer imports, more expensive. To us, these signs point to a more modest contribution to economic growth from consumers.

The focus in early 2016 will be on the macro-economic policy mix. We look for the Bank of Canada to provide some further stimulus, with another 25 basis point rate cut either late in Q1 or early in Q2. Much of the focus will be on possible federal fiscal stimulus, however, the size of the programme is unclear, and its details are unlikely to be released until the budget which is not expected until late March.

Management's Discussion and Analysis (continued)

Another issue that will likely be discussed intensely in 2016 is the state of the housing market, particularly as external and domestic organizations have pointed to key vulnerabilities in the sector. Encouraging developments to us would be for residential investment as a share of GDP to decline from record highs and for real home prices to show signs of stabilization, even if they remain historically high. That said, while we do not anticipate the housing market becoming disorderly, we see risks of such a development as having increased.

Critical accounting estimates and judgements

The preparation of financial information requires the use of estimates and judgments about future conditions.

In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of items discussed 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 consolidated financial statements. Management's selection of the bank's accounting policies which contain critical estimates and judgments are discussed below; it reflects the materiality of the items to which the policies are applied and the high degree of judgment and estimation uncertainty involved.

Impairment of loans and advances

The bank's accounting policy for losses arising from the impairment of customer loans and advances is described in note 1(i). 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.

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.

The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience.

For individually assessed loans, judgment 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, judgment 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 judgment 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 realizable 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 bank 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, maximize collection opportunities or avoid default or repossession. Where forbearance activities are significant, higher levels of judgment and estimation uncertainty are involved in determining their effects on loan impairment allowances. Judgments 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, and estimates are made of the incurred losses inherent within each forbearance portfolio segments.

The exercise of judgment requires the use of assumptions which are highly subjective and very sensitive to the risk factors. Many of the factors have a high degree of interdependency and there is no single factor to which our loan impairment allowances as a whole are sensitive.

Valuation of financial instruments

The bank's accounting policy for determining the fair value of financial instruments is described in note 24. 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 the 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. Judgment 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. Judgment 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; and
- judgment 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' utilizes 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 such calculations include interest rate yield curves, exchange rates, volatilities, correlations and prepayment and default rates. For interest rate derivatives with collateralized counterparties and in significant currencies, the bank 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 judgmental. 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).

Deferred tax assets

The bank's accounting policy for the recognition of deferred tax assets is described in note 6. The recognition of a deferred tax asset relies on an assessment of the probability and sufficiency of future taxable profits, future reversals of existing taxable temporary differences and ongoing tax planning strategies.

Management's Discussion and Analysis (continued)

Defined benefit obligations
The bank's accounting policy for the recognition of defined benefit obligations is described in note 4. As part of employee compensation, the bank provides certain employees with pension and other post-retirement benefits under defined benefit plans which are closed to new entrants. In consultation with its actuaries, the bank makes certain assumptions in measuring its obligations under these defined benefit plans as presented in note 4.

Changes in accounting policy during 2015

There have been no changes in accounting policy adopted during 2015.

Future accounting developments

The International Accounting and Standards Board ('IASB') have issued standards on revenue, leases and financial instrument accounting in 2015 and previous years discussed below which may represent significant changes to accounting requirements in the future.

Revenue
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 recognizing revenue for obligations as they are satisfied. The standard should be applied retrospectively, with certain practical expedients available. The bank has carried out an initial assessment of the impact of this standard and does not believe that it will have a significant effect on the bank's consolidated financial statements.

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 the entity's business model for their management and their contractual cash flow characteristics and result in financial assets being at amortized cost, fair value through other comprehensive income ('OCI'), or fair value through profit or loss. In many instances, the classification and measurement outcomes will be similar to IAS 39, although differences will arise, for example, equity securities will be measured at fair value through profit or loss or, in limited circumstances, at fair value through OCI. The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in population of financial assets measured at amortized cost or fair value compared with IAS 39.

The classification of financial liabilities is essentially unchanged, except that, 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 OCI.

Impairment
The impairment requirements apply to financial assets measured at amortized cost and fair value through OCI, lease receivables, 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').

The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the probability of default occurring over the remaining life of the financial instrument, rather than by considering an increase in ECL.

The assessment of credit risk, as well as the estimation of ECL, are required to be unbiased, 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 between it and risk management strategy and permitting the former 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. At this time no determination has been made.

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 generally to restate comparative periods. Hedge accounting is applied prospectively from that date.

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 bank plans to early adopt the presentation of fair value gains and losses relating to an entity's own credit risk on certain liabilities, at the same time as the HSBC Group, whose early adoption is subject to endorsement by the European Union. In addition, early adoption of the presentation is subject to regulatory consent. If this presentation had been applied at 31 December 2015, there would be no effect on profit before tax, other comprehensive income or net assets. Further information on change in fair value attributable to changes in credit risk, including the bank's credit risk, is disclosed in note 21.

The bank is currently assessing the impact that the rest of IFRS 9 will have on the financial statements through an HSBC Group-wide project which has been in place since 2012, but due to the complexity of the classification and measurement, impairment, and hedge accounting requirements and their inter-relationships, it is not possible at this stage to quantify the potential effect.

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 finance leases are currently accounted for under IAS 17 'Leases'. Lessees will recognize a 'right of use' asset and a corresponding financial liability on the balance sheet. The asset will be amortized over the length of the lease and the financial liability measured at amortized cost. Lessor accounting remains substantially the same as in IAS 17. The bank 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.

Off-balance sheet arrangements

As part of our banking operations, we enter into a number of off-balance sheet financial transactions that have a financial impact, but may not be recognized in our financial statements. These types of arrangements are contingent and may not necessarily, but in certain circumstances could, involve us incurring a liability in excess of amounts recorded in our consolidated statement of financial position. These arrangements include: guarantees and letters of credit.

Guarantees and letters of credit

We routinely issue financial and performance guarantees and documentary and commercial letters of credit on behalf of our customers to meet their banking needs. Guarantees are often provided on behalf of customers' contractual obligations, particularly providing credit facilities for customers' overseas trading transactions and in construction financings. Letters of credit are often used as part of the payment and documentation process in international trade arrangements.

Management's Discussion and Analysis (continued)

Although guarantees and letters of credit are financial instruments, they are considered contingent obligations and the notional amounts are not included in our financial statements, as there are no actual advances of funds. Any payments actually made under these obligations are recorded as loans and advances to our customers. In accordance with accounting standards for financial instruments, we record the fair value of guarantees made on behalf of customers.

For credit risk management purposes, we consider guarantees and letters of credit to be part of our customers' credit facilities, which are subject to appropriate risk management procedures. Guarantees and letters of credit are considered to be part of our overall credit exposure, as set out in the analysis of our loan portfolio on page 36 of the MD&A.

Disclosure controls and procedures and internal control over financial reporting

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information required to be disclosed in reports filed or submitted under Canadian securities laws is recorded, processed, summarized and reported within the time periods specified under those laws. These include controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the Chief Executive Officer ('CEO') and the Chief Financial Officer ('CFO'), to allow timely decisions regarding required disclosure.

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of the consolidated financial statements in accordance with IFRS. Management is responsible for establishing and maintaining adequate internal control over financial reporting. These controls include those policies and procedures that:

– pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the bank;
– provide reasonable assurance that transactions are recorded as necessary to permit preparation of the consolidated financial statements in accordance with IFRS;
– that receipts and expenditures of the bank are being made only in accordance with authorizations of management; and
– provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the bank's assets that could have a material effect on the consolidated financial statements.

Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis. Furthermore, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

During 2015, management has evaluated, under the supervision of and with the participation of the CEO and the CFO, the effectiveness of our disclosure controls and procedures and the design and effectiveness of the internal control over financial reporting as required by the Canadian securities regulatory authorities under National Instrument 52-109. The evaluation of internal control over financial reporting was performed using the framework and criteria established in the *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in May 2013. Based on these evaluations, management has concluded that the design and operation of these disclosure controls and procedures and internal control over financial reporting was effective as at 31 December 2015.

Changes in internal control over financial reporting

There were no changes in our internal control over financial reporting during the year ended 31 December 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Related party transactions

We enter into transactions with other HSBC affiliates such as banking and operational services as part of the normal course of business. In particular, as a member of one of the world's largest financial services organizations, we share in the expertise and economies of scale provided by the HSBC Group. We provide and receive services or enter into transactions with a number of HSBC Group companies, including sharing in the cost of development for technology platforms used around the world and benefit from worldwide contracts for advertising, marketing research, training and other operational areas. These related party transactions are on terms similar to those offered to non-related parties and are subject to formal approval procedures that have been approved by the bank's Conduct Review Committee. Further details can be found in note 31.

All our common shares are indirectly held by HSBC Holdings as a wholly-owned subsidiary.

Risk management

(Certain information in tables within this section, where indicated as audited, forms an integral part of the audited consolidated financial statements taken as a whole)

Risk Overview

All our activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risk or combinations of risks.

As a provider of banking and financial services, we actively manage risk as a core part of our day-to-day activities. We employ a risk management framework at all levels of the organization, underpinned by a strong risk management culture and reinforced by HSBC's Values and our Global Standards. It ensures that our risk profile remains conservative and aligned to our risk appetite, which describes the type and quantum of risk we are willing to accept in achieving our strategic objectives.

Concerns remained during 2015 over the sustainability of economic growth in both developed and emerging markets, while geopolitical tensions rose or remained high in many parts of the world. Expectations of divergent monetary policies increased market volatility and resulted in changes in capital flows.

We continued to maintain a conservative risk profile based on our core philosophy of maintaining balance sheet, liquidity and capital strength by reducing exposure to the most likely areas of stress:

- we regularly assessed our exposures to sovereign debt, bank counter-parties, higher risk countries and sectors and adjusted our risk appetite, limits and exposures accordingly to ensure that overall quality of the portfolio remained strong;
- we use stress testing, both internal and regulatory programs, to assess vulnerabilities and proactively adjust our portfolios, where required; and
- we mitigated risks, for example reputational and operational, when they were forecast to exceed our risk appetite.

We monitored a range of key risk metrics in 2015 as part of our risk appetite process, supported by a limit and control framework.

Risks incurred in our business activities

Our principal banking risks are credit, liquidity and funding, market, operational (including fiduciary, regulatory compliance and financial crime compliance risk), reputational, pension and sustainability risks.

How we manage risk

Managing risk effectively is fundamental to the delivery of our strategic priorities.

Our enterprise-wide risk management framework fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions. It also ensures that we have a robust and consistent approach to risk management at all levels of the organization and across all risk types.

Risk management framework

Key elements of our risk management framework are:

Risk governance framework

Robust risk governance and accountability are embedded through an established framework that ensures appropriate oversight of and accountability for the effective management of risk at all levels of the organization and across all risk types.

The Board has ultimate responsibility for approving the bank's risk appetite and the effective management of risk. The Risk Management Committee ('RMC') advises the Board on risk appetite and its alignment with strategy, risk governance and internal controls and high-level risk matters.

Management's Discussion and Analysis (continued)

Executive accountability for the ongoing monitoring, assessment and management of the risk environment and the effectiveness of our risk management policies resides with the RMC. Day-to-day risk management activities are the responsibility of senior managers of individual businesses, supported by global functions as described under 'Three lines of defence' below.

Risk appetite

The Risk Appetite Statement is the written articulation of the aggregated level and types of risk that HSBC is willing to accept in its business activities in order to achieve our business objectives. It is a key component in our management of risk and is reviewed on an ongoing basis, with a formal approval from the Audit and Risk Committee (ARC), a subcommittee of the Board, every six months.

The actual position of the risk appetite profile is reported to the RMC on a monthly basis to track the risk profile of the bank in order to guide business activity to balance risk and return, allow risks to be promptly identified and mitigated, and to inform risk-adjusted remuneration.

Risk appetite is dynamically linked with the Strategic and Financial Planning process, defining the desired forward-looking risk profile. Risk appetite is also embedded with other enterprise risk tools such as Top and Emerging Risks and Stress Testing, to drive robust risk management.

Enterprise-wide risk management tools

The following processes to identify, manage and mitigate risks are integral to risk management at HSBC, ensuring that we remain within our risk appetite.

Risk map

The risk map process provides a point-in-time view of the risk profile across a suite of risk categories. It assesses the potential of these risks to have a material impact on the bank's financial results, reputation or sustainability of HSBC's business on a current and projected basis.

The risks presented on the risk map are regularly assessed through our risk appetite profile, stress tested and, where thematic issues arise, are considered for classification as top or emerging risks.

Top and emerging risks

Identifying, managing and monitoring risks are integral to our approach to risk management. Our top and emerging risks process provides a more forward-looking view of the risks which have potential to threaten the execution of HSBC's strategy and our operations. Our top and emerging risks are generally described thematically, and may have an impact across multiple risk map categories, global businesses or regions.

Our top and emerging risk framework enables us to identify and manage current and forward-looking risks to ensure our risk appetite remains appropriate. The ongoing assessment of our top and emerging risks is informed by a comprehensive suite of risk factors and the results of our stress testing program.

Stress testing

Our stress testing and scenario analysis program examines the sensitivities of our capital plans and unplanned demand for regulatory capital under a number of scenarios and ensures that top and emerging risks are appropriately considered. These scenarios include, but are not limited to, adverse macroeconomic events, failures at country, sector and counterparty levels, geopolitical occurrences and a variety of projected major operational risk events.

Three lines of defence

We have a strong risk management approach based on the three lines of defence model. It defines who is responsible for identifying, assessing, measuring, managing, monitoring and mitigating risks, and encourages collaboration and efficient coordination of risk and control activities. For additional details on the three lines of defence model, see page 54–55.

People

All employees are required to identify, assess and manage risk within the scope of their assigned responsibilities and, as such, they are critical to the effectiveness of the three lines of defence.

Clear and consistent employee communication on risk conveys strategic messages and sets the tone from senior leadership. We deploy a suite of mandatory training on critical risk and compliance topics to embed skills and understanding and strengthen the risk culture within HSBC. It reinforces the behaviour and attitude expected of employees, as described in our risk policies. The training is updated regularly, describing technical aspects of the various risks assumed and how they should be managed effectively. A confidential disclosure line enables staff to raise concerns.

Our risk culture is reinforced by our approach to remuneration. Individual awards, including those for executives, are based on compliance with HSBC Values and the achievement of financial and non-financial objectives which are aligned to our risk appetite and global strategy.

Credit risk

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under contract. It arises principally from direct lending, trade finance and the leasing business, but also from other products such as guarantees and credit derivatives and from holding assets in the form of debt securities.

Credit risk management

The bank's principal objectives of credit risk management are:

- to maintain a strong culture of responsible lending, supported by a robust risk policy and control framework;
- to both partner with and challenge businesses in defining and 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 their mitigation.

Credit risk is managed in accordance with the bank's credit policy, which is established in consultation with HSBC Group and approved by the ARC. Risk limits and credit authorities are delegated to senior credit management staff. Credit exposures in excess of certain levels or other specific risk attributes are referred for concurrence to HSBC Group to ensure they remain within HSBC Group's global risk limits.

Credit risk rating framework

Under the Basel framework, two principal approaches are available for measuring credit risk: Advanced Internal Ratings Based ("AIRB') and Standardized. Most of the bank's credit risk exposure is measured using the AIRB approach.

Under the AIRB approach, the bank's credit risk rating framework incorporates the Probability of Default ('PD') of an obligor and loss severity expressed in terms of Exposure at Default ('EAD') and Loss Given Default ('LGD'). These measures are used to calculate expected loss and minimum capital requirements. They are also used in conjunction with other inputs to inform rating assessments and other risk management decisions such as:

- Credit approval and monitoring: Internal Ratings Based ('IRB') models are used in the assessment of customer and portfolio risk in lending decisions;
- Risk appetite: IRB measures are an important element in identifying risk exposure at customer, sector, and portfolio level;
- Pricing: IRB parameters are used in wholesale pricing tools for new transactions and reviews; and
- Economic capital and portfolio management: IRB parameters are used in the economic capital model that has been implemented across HSBC.

For wholesale customer segments (central governments and central banks, financial institutions and corporate customers, and for certain individually assessed personal customers), obligor PD is estimated using a 23-grade Customer Risk Rating ('CRR') scale, of which 21 are non-default ratings representing varying degrees of strength of financial condition, and two are default ratings. The score generated by a credit risk rating model for the obligor is mapped to a corresponding PD and master-scale CRR. The CRR is then reviewed by a credit approver who, taking into account all relevant information, such as most recent events and market data, where available, makes the final decision on the rating. The rating assigned therefore reflects the approver's overall view of the obligor's credit standing and propensity to default.

EAD is estimated to a 12-month forward time horizon and represents the current exposure plus an estimate for future increases in exposure taking into account such factors as available but undrawn facilities, and the realization of contingent exposures post-default.

LGD is based on the effects of facility and collateral structure on outcomes post-default. This includes such factors as the type of customer, the facility seniority, the type and value of collateral, past recovery experience and priority under law. It is expressed as a percentage of EAD. For all retail business, excluding credit cards and the run-off consumer finance portfolio, exposures are segmented into homogeneous pools of accounts with similar risk characteristics. PD, LGD and EAD parameters are estimated for each pool based on observed historical loss data. The segmentation of exposures into different pools is carried out every month based on the characteristics associated with the exposures at the time of monthly review while the risk measures applied to the exposures are based on the measures associated with the pools that have been derived using data over an entire economic cycle.

For credit cards and the run-off consumer finance portfolio, the simplified Standardized approach is applied within the Basel framework to calculate the risk weighting of credit exposures.

Management's Discussion and Analysis (continued)

Credit portfolio management

The bank places the highest importance on the integrity and quality of its credit portfolio and has stringent policies to avoid undue concentration of risk. Our RMC and ARC meet regularly to review portfolio credit quality, geographic, product and industry distributions, large customer concentrations, adequacy of loan impairment allowances and rating system performance. Policies relating to large customer limits and industry, product and geographic concentration are approved by the ARC, in line with HSBC Group policy.

All new and renewed major authorized facilities, derivative exposures, 'watch-list' exposures and impaired facilities are also reported quarterly to the ARC. The appetite for credit risk is expressed through portfolio level limits on specific segments, e.g. commercial real estate and energy, as well as through Commercial and Personal Lending Guidelines that conform with HSBC Group guidelines. These are disseminated throughout our business along with various credit manuals. The ARC is advised of any material changes in guidelines through the quarterly monitoring process.

We have a disciplined approach to managing credit risk through ongoing monitoring of all credit exposures at branches, with weaker quality credits being reviewed at more frequent intervals. Problem and impaired loans are identified at an early stage and are actively managed by a separate dedicated Special Credit Management unit which possesses the relevant expertise and experience.

Exposure to banks and financial institutions involves consultation with a dedicated unit within the HSBC Group that controls and manages these exposures on a global basis. Similarly, cross border risk is also controlled globally by this unit through the imposition of country limits.

A review of all credit matters undertaken by our branch and head office credit managers is completed regularly to ensure all our policies, guidelines, practices, conditions and terms are followed.

We manage real estate lending within well-defined parameters, with an emphasis on relationship and project sponsorship for all new transactions. We are actively managing the exposure level and composition of this portfolio given its concentration in our credit portfolio.

Where we are dependent upon third parties for establishing asset values, consistent and transparent valuations are ensured through maintaining a list of approved professionals that meet our standards.

Top and emerging risks

Due to the volatility and uncertainty regarding the price of oil, we have conducted several stress tests at various prices to assess the impacts to our Energy portfolio. The results showed the bank is expected to have sufficient capital to absorb any potential increase in loan impairment charges and risk weighted assets due to sustained low prices of oil.

The portfolio and our customers are being closely monitored and managed. In view of the current geopolitical and macroeconomic instability, direct and indirect exposures are continuously monitored by country. We have limited exposure to the Eurozone peripheral countries (Greece, Italy, Ireland, Portugal & Spain), Russia and China.

Maximum exposure to credit risk

The following table presents the maximum exposure to credit risk of balance sheet and off-balance sheet financial instruments, before taking into account any collateral held or other credit enhancements. For on-balance sheet financial assets, the exposure to credit risk equals their carrying amount. For financial guarantees, the maximum exposure to credit risk is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are not unconditionally cancellable, the maximum exposure to credit risk is the full amount of the committed facilities.

Maximum exposure to credit risk (Audited)

	2015	2014
	$m	$m
On-balance sheet		
Balances at central bank	**6**	3
Items in the course of collection from other banks	**73**	76
Trading assets	**3,893**	8,914
Treasury and other eligible bills	**642**	674
Debt securities	**3,025**	2,778
Customer trading assets	**226**	2,208
Banker's acceptances	**–**	3,254
Derivatives	**4,909**	4,082
Reverse Repurchase agreements – non-trading	**6,807**	6,714
Loans and advances held at amortized cost	**49,778**	42,483
Loans and advances to banks	**1,400**	1,264
Loans and advances to customers	**48,378**	41,219
Financial investments – available-for-sale	**23,921**	20,114
Treasury and other similar bills	**279**	422
Debt securities	**23,620**	19,694
Equity securities	**36**	4
Less: Securities not exposed to credit risk	**(14)**	(6)
Other assets		
Customers' liability under acceptances	**3,834**	5,023
Accrued income and other	**258**	261
Total on-balance sheet	**93,479**	87,670
Off-balance sheet		
Financial guarantees	**5,585**	5,230
Loan and other credit-related commitments	**40,508**	37,811
Total maximum exposure to credit risk	**139,572**	130,711

Loan portfolio diversity

Concentration of credit risk may arise when the ability of a number of borrowers or counterparties to meet their contractual obligations are similarly affected by external factors. Diversification of credit risk is a key concept by which we are guided.

In assessing and monitoring for credit risk concentration, we aggregate exposures by product type, industry and geographic area as presented in the tables below. Exposures are measured at EAD which reflects drawn balances as well as a factor for undrawn amounts of commitments and contingent exposures, and therefore would not agree to the financial statements.

Management's Discussion and Analysis (continued)

Loan portfolio by product type (Audited)

	EAD at 31 December 2015					
	Drawn **$m**	*Undrawn* **$m**	*Repurchase type transactions* **$m**	*Derivatives* **$m**	*Other off-balance sheet* **$m**	*Total* **$m**
Wholesale portfolio						
Sovereign	**24,807**	**195**	**–**	**406**	**70**	**25,478**
Banks	**3,549**		**75**	**1,276**	**482**	**5,382**
Corporate	**29,568**	**12,995**	**15**	**1,917**	**3,511**	**48,006**
Total Wholesale	**57,924**	**13,190**	**90**	**3,599**	**4,063**	**78,866**
Retail portfolio						
Residential mortgages	**19,239**	**4**	**–**	**–**	**–**	**19,243**
Home equity lines of credit	**1,862**	**1,040**	**–**	**–**	**–**	**2,902**
Personal unsecured revolving loan facilities	**267**	**224**	**–**	**–**	**–**	**491**
Other personal loan facilities	**1,677**	**186**	**–**	**–**	**5**	**1,868**
Other small to medium enterprises loan facilities	**228**	**262**	**–**	**–**	**18**	**508**
Run-off consumer loan portfolio	**254**	**–**	**–**	**–**	**–**	**254**
Retail Master Card	**383**	**–**	**–**	**–**	**–**	**383**
Total Retail	**23,910**	**1,716**	**–**	**–**	**23**	**25,649**
Total loan portfolio	**81,834**	**14,906**	**90**	**3,599**	**4,086**	**104,515**

	EAD at 31 December 2014					
	Drawn $m	*Undrawn* $m	*Repurchase type transactions* $m	*Derivatives* $m	*Other off-balance sheet* $m	*Total* $m
Wholesale portfolio						
Sovereign	21,186	34	–	57	70	21,347
Banks...........................	3,269	–	8	2,375	628	6,280
Corporate.....................	27,950	12,137	37	1,212	3,650	44,986
Total Wholesale...........	52,405	12,171	45	3,644	4,348	72,613
Retail portfolio						
Residential mortgages....	18,089	1	–	–	–	18,090
Home equity lines of credit	2,006	1,040	–	–	–	3,046
Personal unsecured revolving loan facilities.................	293	234	–	–	–	527
Other personal loan facilities.................	1,891	197	–	–	30	2,118
Other small to medium enterprises loan facilities.................	279	294	–	–	20	593
Run-off consumer loan portfolio.................	426	–	–	–	–	426
Retail Master Card	372	–	–	–	–	372
Total Retail..................	23,356	1,766	–	–	50	25,172
Total loan portfolio	75,761	13,937	45	3,644	4,398	97,785

Wholesale loan portfolio by geographic area (Audited)

	EAD **2015**	*EAD* 2014
Sovereign		
Canada..........	**20,215**	17,984
United States of America	**2,949**	1,240
Other	**2,314**	2,123
	25,478	21,347
Banks		
Canada..........	**2,525**	2,775
United States of America	**1,348**	1,675
Other	**1,509**	1,830
	5,382	6,280
Corporate		
Canada		
British Columbia..........	**11,856**	11,261
Ontario	**12,504**	11,264
Alberta..........	**11,869**	12,000
Quebec	**6,330**	6,025
Saskatchewan and Manitoba..........	**1,744**	1,718
Atlantic provinces	**816**	1,068
United States of America	**1,973**	1,214
Other	**914**	436
	48,006	44,986
Total wholesale loan portfolio exposure..........	**78,866**	72,613

Management's Discussion and Analysis (continued)

Wholesale loan portfolio by industry sector (Audited)

	EAD at 31 December						
	Drawn **$m**	*Undrawn* **$m**	*Repurchase type transactions* **$m**	*Derivatives* **$m**	*Other off-balance sheet* **$m**	*Total 2015* **$m**	*Total 2014* **$m**
Corporate							
Real Estate	**6,226**	**1,706**	**–**	**212**	**471**	**8,615**	8,050
Energy	**3,886**	**2,894**	**–**	**721**	**900**	**8,401**	8,648
Manufacturing	**3,898**	**1,811**	**–**	**110**	**345**	**6,164**	5,698
Finance and insurance	**1,382**	**948**	**15**	**554**	**161**	**3,060**	2,509
Wholesale trade	**2,769**	**1,301**	**–**	**35**	**170**	**4,275**	4,244
Services	**2,318**	**594**	**–**	**36**	**138**	**3,086**	2,856
Transport and storage	**1,808**	**631**	**–**	**38**	**158**	**2,635**	2,268
Business services	**1,299**	**620**	**–**	**9**	**507**	**2,435**	2,540
Mining, logging and forestry	**959**	**714**	**–**	**33**	**353**	**2,059**	1,771
Construction services	**1,025**	**622**	**–**	**17**	**195**	**1,859**	1,803
Automotive	**1,064**	**344**	**–**	**6**	**39**	**1,453**	1,271
Retail Trade	**977**	**406**	**–**	**94**	**35**	**1,512**	1,492
Hotels and accommodation	**711**	**48**	**–**	**5**	**6**	**770**	691
Agriculture	**433**	**305**	**–**	**46**	**29**	**813**	720
Sole proprietors	**403**	**51**	**–**	**1**	**4**	**459**	423
Government Services	**410**	**–**	**–**	**–**	**–**	**410**	2
Total Wholesale	**29,568**	**12,995**	**15**	**1,917**	**3,511**	**48,006**	44,986

Energy Exposures

The following table provides a breakdown of our exposure to energy industries under the AIRB approach. Of these exposures, 60% at 31 December 2015 are investment grade based on our internal risk rating (equivalent to S&P/Moody's rating of BBB-/Baa3 and higher). In light of sustained low oil prices the bank remains selective in this sector and continues to reduce its exposure to energy and related companies.

	EAD at 31 December 2015				
	Drawn **$m**	*Undrawn commitments* **$m**	*Derivatives* **$m**	*Other off-balance sheet exposures* **$m**	*Total* **$m**
Pipelines	**610**	**501**	**630**	**27**	**1,768**
Energy services	**1,322**	**750**	**1**	**85**	**2,158**
Exploration, development and production	**1,300**	**1,138**	**46**	**512**	**2,996**
Power and utilities	**380**	**278**	**6**	**230**	**894**
Transportation, refining and marketing	**275**	**227**	**37**	**46**	**585**
Total	**3,887**	**2,894**	**720**	**900**	**8,401**

	EAD at 31 December 2014				
	Drawn	*Undrawn commitments*	*Derivatives*	*Other off-balance sheet exposures*	*Total*
	$m	$m	$m	$m	$m
Pipelines	414	523	364	22	1,323
Energy services	1,758	694	2	69	2,523
Exploration, development and production	1,128	1,144	30	408	2,710
Power and utilities	340	356	24	207	927
Transportation, refining and marketing	300	179	18	668	1,165
Total	3,940	2,896	438	1,374	8,648

Large customer concentrations

We monitor and manage credit risk from large customer concentrations, which we define as borrowing groups where approved facilities exceed 10% of our regulatory capital base, or $575m at 31 December 2015 (2014: $544m). At 31 December 2015, the aggregate approved facilities from large customers was $27,361m (2014: $25,994m), an average of $1,052m (2014: $896m) per customer. The increase in total approved facilities from large customers is primarily comprises of increased facilities to Canadian provinces and to Canadian chartered banks.

Collateral and other credit enhancements

Although collateral can be an important mitigant of credit risk, it is the bank's practice to lend on the basis of the customer's ability to meet their obligations out of cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, some facilities may be unsecured. However, for other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of default, the bank may utilize the collateral as a source of repayment.

The principal collateral types are as follows:

- in the personal sector, mortgages over residential properties or charges over other personal assets being financed;
- in the commercial and industrial sector, charges over business assets such as land, buildings and equipment, inventory and receivables;
- in the commercial real estate sector, charges over the properties being financed; and
- in the financial sector, charges over financial instruments such as debt and equity securities in support of trading facilities.

Our credit risk management policies include appropriate guidelines on the acceptability of specific classes of collateral or credit risk mitigation. Valuation parameters are updated periodically depending on the nature of the collateral. Full covering corporate guarantees as well as bank and sovereign guarantees are recognized as credit mitigants for capital purposes.

The bank does not disclose the fair value of collateral held as security or other credit enhancements on loans past due but not impaired or individually assessed impaired loans, as it is not practical to do so.

Collateral held as security for financial assets other than loans is determined by the nature of the instrument. Government and other debt securities, including money market instruments, are generally unsecured, with the exception of asset-backed securities and similar instruments, which are secured by pools of financial assets.

The bank has policies in place to monitor the existence of undesirable concentration of the collateral supporting our credit exposures.

Management's Discussion and Analysis (continued)

Credit quality

The bank uses the classification as outlined in the table below to measure the quality of its loans and advances.

Credit quality classification

	Wholesale and retail lending		
Quality classification	*External credit rating*	*Internal credit rating*	*12 month probability of default %*
Strong	A– and above	CRR1 to CRR2	0–0.169
Good	BBB+ to BBB–	CRR3	0.170–0.740
Satisfactory	BB+ to B+	CRR4 to CRR5	0.741–4.914
Sub-standard	B to C	CRR6 to CRR8	4.915–99.999
Impaired	Default	CRR9 to CRR10	100

Credit quality of wholesale portfolio (Audited)

	2015			2014		
	EAD Drawn **$m**	*EAD Undrawn* **$m**	*EAD Total* **$m**	*EAD Drawn* $m	*EAD Undrawn* $m	*EAD Total* $m
Strong	**34,860**	**3,295**	**38,155**	31,806	2,757	34,563
Good	**16,054**	**5,658**	**21,712**	15,801	6,003	21,804
Satisfactory	**12,165**	**3,660**	**15,825**	11,047	3,123	14,170
Sub-standard	**2,066**	**499**	**2,565**	1,447	276	1,723
Impaired	**531**	**78**	**609**	340	13	353
	65,676	**13,190**	**78,866**	60,441	12,172	72,613

The proportion of exposures categorized as Strong or Good decreased from 77.6% at 2014 to 75.9% at 31 December 2015, while impaired loans increased from $353m to $609m. This was mainly due to deterioration in the quality of the portfolio related to energy and related exposures. This is consistent with the significant reduction in oil prices and was in accordance with our expectations.

Credit quality of retail portfolio (Audited)

	2015			2014		
	EAD Drawn **$m**	*EAD Undrawn* **$m**	*EAD Total* **$m**	*EAD Drawn* $m	*EAD Undrawn* $m	*EAD Total* $m
Strong	**10,010**	**2**	**10,012**	9,501	1	9,502
Good	**10,989**	**1,231**	**12,220**	10,717	1,262	11,979
Satisfactory	**2,211**	**434**	**2,645**	2,451	455	2,906
Sub-standard	**638**	**49**	**687**	642	48	690
Impaired	**85**	**–**	**85**	95	–	95
	23,933	**1,716**	**25,649**	23,406	1,766	25,172

Mortgages and home equity lines of credit

The bank's mortgage and home equity lines of credit portfolios are considered to be low-risk since the majority are secured by a first charge against the underlying real estate. The tables below detail how the bank mitigates risk further by diversifying the geographical markets in which it operates as well as benefiting from borrower default insurance. In addition the bank maintains strong underwriting and portfolio monitoring standards to ensure the quality of its portfolio is maintained.

Insurance and geographic distribution[1]	**31 December 2015**						
	Residential mortgages					*HELOC*[2]	
	Insured[3]		*Uninsured*[3]		*Total*	*Uninsured*	
	$m	**%**	**$m**	**%**	**$m**	**$m**	**%**
British Columbia	**972**	**8**	**10,940**	**92**	**11,912**	**898**	**100**
Western Canada[4]	**235**	**18**	**1,103**	**82**	**1,338**	**248**	**100**
Ontario	**657**	**12**	**5,010**	**88**	**5,667**	**606**	**100**
Quebec and Atlantic provinces	**166**	**15**	**950**	**85**	**1,116**	**110**	**100**
Total at 31 December 2015	**2,030**	**10**	**18,003**	**90**	**20,033**	**1,862**	**100**

Insurance and geographic distribution[1]	31 December 2014						
	Residential mortgages					*HELOC*[2]	
	Insured[3]		*Uninsured*[3]		*Total*	*Uninsured*	
	$m	%	$m	%	$m	$m	%
British Columbia	1,267	11	9,976	89	11,243	992	100
Western Canada[4]	269	19	1,152	81	1,421	280	100
Ontario	723	14	4,400	86	5,123	618	100
Quebec and Atlantic provinces	178	16	923	84	1,101	116	100
Total at 31 December 2015	2,437	13	16,451	87	18,888	2,006	100

Amortization period[5]	**31 December**				
	Residential mortgages				
	Less than 20 years	20–24 years	25–29 years	30–34 years	35 years and greater
Total at 31 December 2015	**26%**	**36%**	**37%**	**1%**	**0%**
Total at 31 December 2014	29%	38%	31%	2%	0%

1 *Geographic location is determined by the address of the originating branch.*

2 *HELOC is an abbreviation for Home Equity Lines of Credit, which are lines of credit secured by equity in real estate.*

3 *Insured mortgages are protected from potential losses caused by borrower default through the purchase of insurance coverage, either from the Canadian Housing and Mortgage Corporation or other accredited private insurers.*

4 *Western Canada excludes British Columbia.*

5 *Amortization period is based on the remaining term of residential mortgages.*

Management's Discussion and Analysis (continued)

For the three months ended:	**31 December 2015**	
Average loan-to-value ratios of new originations[2]	**Uninsured % LTV**[3]	
	Residential mortgages %	**HELOC** %
British Columbia	**60**	**52**
Western Canada[1]	**64**	**57**
Ontario	**64**	**57**
Quebec and Atlantic provinces	**62**	**56**
Total at 31 December 2015	**62**	**55**
Total at 31 December 2014	62	55

1 *Western Canada excludes British Columbia.*
2 *All new loans and home equity lines of credit were originated by the bank; there were no acquisitions during the period.*
3 *Loan-to-value ratios are simple averages, based on property values at the date of mortgage origination.*

Potential impact of an economic downturn on residential mortgage loans and home equity lines of credit
The bank performs stress testing on its Retail portfolio to assess the impact of increased levels of unemployment, rising interest rates, reduction in property values and changes in other relevant macro-economic variables. Potential increase in losses in the mortgage portfolio under downturn economic scenarios are considered manageable given the diversified composition of the portfolio, the low Loan to Value in the portfolio and risk mitigation strategies in place.

Renegotiated loans
The carrying amount of loans that would otherwise be past due or impaired whose terms have been renegotiated was $234m at 31 December 2015 (2014: $170m).

Loans past due but not impaired
Examples of exposures considered past due but not impaired include loans that have missed the most recent payment date but on which there is no evidence of impairment; loans fully secured by cash collateral; residential mortgages in arrears more than 90 days, but where the value of collateral is sufficient to repay both the principal debt and all potential interest for at least one year; and short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

The aging analysis below includes past due loans on which collective impairment allowances have been assessed, though at their early stage of arrears, there is normally no identifiable impairment.

Days past due but not impaired loans and advances (Audited)

	2015 **$m**	2014 $m
Up to 29 days	**920**	435
30–59 days	**200**	109
60–89 days	**113**	23
90–179 days	**30**	–
Over 180 days	**7**	4
	1,270	571

Impaired loans and allowance for credit losses
When impairment losses occur, we reduce the carrying amount of loans through the use of an allowance account with a charge to income. The allowance for credit losses consists of both individually assessed and collectively assessed allowances, each of which is reviewed on a regular basis. The allowance for credit losses reduces the gross value of an asset to its net carrying value.

An allowance is maintained for credit losses which, in management's opinion, is considered adequate to absorb all incurred credit-related losses in our portfolio, of both on and off-balance sheet items, including deposits with other regulated financial institutions, loans, acceptances, derivative instruments and other credit-related contingent liabilities, such as letters of credit and guarantees.

Assessing the adequacy of the allowance for credit losses is inherently subjective as it requires making estimates that may be susceptible to significant change. This includes the amount and timing of expected future cash flows and incurred losses for loans that are not individually identified as being impaired.

Individually significant accounts are treated as impaired as soon as there is objective evidence that an impairment loss has been incurred. The criteria used to determine that there is objective evidence include:

– known cash flow difficulties experienced by the borrower;
– past-due contractual payments of either principal or interest;
– breach of loan covenants or conditions;
– the probability that the borrower will enter bankruptcy or other financial realization; and
– a significant downgrading in credit rating by an external credit rating agency.

Individually assessed impairment allowances are recorded on these individual accounts on an account-by-account basis to reduce their carrying value to estimated realizable amount.

The collectively assessed impairment allowance is our best estimate of incurred losses in the portfolio for those 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. In determining an appropriate level of collectively assessed impairment, we apply the following methodologies:

– *Business and government* – For these loans, the underlying credit metrics including PD, LGD and EAD, for each customer are derived from the bank's internal rating system as a basis for the collectively assessed impairment allowance. In order to reflect the likelihood of a loss event not being identified and assessed an emergence period assumption is applied which reflects the period between a loss occurring and its identification. The emergence period is estimated by management for each identified portfolio. The factors that may influence this estimation include economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. The emergence period is assessed empirically on a periodic basis and may vary over time as these factors change. The bank also incorporates a quantitative management judgment framework which includes internal and external indicators, to establish an overall collective impairment allowance consistent with recent loss experience and uncertainties in the environment.
– *Residential mortgages* – Historic average loss rates are used to determine the collective provision for these portfolios. Management may consider other current information should they believe that these historic loss rates do not fully reflect incurred losses in these portfolios.
– *Consumer Finance and other consumer loans* – Analysis of historical delinquency movements by product type is used as the basis for the collectively assessed impairment allowance for these loan portfolios. By tracking delinquency movement among pools of homogeneous loans, an estimate of incurred losses in each pool is determined. These estimates can be amended should management believe they do not fully reflect incurred losses. This judgemental adjustment employs an established framework and references both internal and external indicators of credit quality.

In addition to the methodologies outlined above, the balance of the collectively assessed impairment allowance is also analyzed as a function of risk-weighted assets and referenced to the allowances held by our peer group.

Management's Discussion and Analysis (continued)

Impaired financial assets (Audited)

	EAD 2015 $m	EAD 2014 $m
Impaired wholesale portfolio[1]		
Real estate	**62**	76
Energy	**254**	36
Construction services	**18**	21
Manufacturing	**56**	73
Wholesale trade	**48**	8
Agriculture	**5**	8
Automotive	**12**	16
Hotels and accommodation	**7**	12
Mining, logging and forestry	**19**	6
Business services	**81**	48
Sole proprietors	**5**	11
Transportation and storage	**6**	13
Services	**21**	17
Finance and insurance	**1**	4
Retail trade	**14**	4
Total impaired wholesale portfolio	**609**	353
Impaired retail portfolio		
Residential mortgages	**45**	58
Other retail loans	**29**	18
Run off consumer finance portfolio	**44**	20
Total impaired retail portfolio	**118**	96
Total impaired financial assets	**727**	449

1 *Includes $193m (2014: $20m) of impaired acceptances, letters of credit and guarantees*

Impairment allowances (Audited)

	2015 $m	2014 $m
Gross loans and advances to customers		
Individually assessed impaired loans and advances[1] (A)	**502**	403
Collectively assessed loans and advances (B)	**48,387**	41,178
– impaired loans and advances[1]	**48**	97
– non-impaired loans and advances	**48,339**	41,081
Total gross loans and advances to customers (C)	**48,889**	41,581
Less: impairment allowances (c)	**511**	362
– individually assessed (a)	**253**	170
– collectively assessed (b)	**258**	192
Net loans and advances to customers	**48,378**	41,219
Individually assessed impaired loans and advances coverage – (a) as a percentage of (A)	**50.3%**	42.2%
Collectively assessed loans and advances coverage – (b) as a percentage of (B)	**0.5%**	0.5%
Total loans and advances coverage – (c) as a percentage of (C)	**1.0%**	0.9%

1 *Includes restructured loans with a higher credit quality than 'impaired' and for which there is insufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, or the absence of other indicators of impairment.*

Movement in impairment allowances and provision for credit losses (Audited)

	2015			
	Customers individually assessed **$m**	*Customers collectively assessed* **$m**	*Other credit risk provisions* **$m**	*Total* **$m**
Opening balance at the beginning of the year	**170**	**192**	**76**	**438**
Movement				
Loans and advances written off net of recoveries of previously written off amounts[1]	**(43)**	**(10)**	**–**	**(53)**
Charge/(release) to income statement	**129**	**48**	**57**	**234**
Interest recognized on impaired loans and advances	**(9)**	**–**	**–**	**(9)**
Other movements	**6**	**28**	**(28)**	**6**
Closing balance at the end of the year	**253**	**258**	**105**	**616**

	2014			
	Customers individually assessed $m	*Customers collectively assessed* $m	*Other credit risk provisions* $m	*Total* $m
Opening balance at the beginning of the year	157	206	61	424
Movement				
Loans and advances written off net of recoveries of previously written off amounts[1]	(69)	(15)	–	(84)
Charge/(release) to income statement	90	2	15	107
Interest recognized on impaired loans and advances	(10)	–	–	(10)
Other movements	2	(1)	–	1
Closing balance at the end of the year	170	192	76	438

1 *Recovered $27m (2014: $15m) of loans and advances written off in prior periods*

Derivative portfolio

The credit equivalent amount of derivative exposure comprises the current replacement cost of positions plus an allowance for potential future fluctuation of interest rate or foreign exchange rate derivative contracts. We enter into derivatives primarily to support our customers' requirements and to assist us in the management of assets and liabilities, particularly relating to interest and foreign exchange rate risks as noted above.

Credit equivalent amount of our derivative portfolio (Audited)

	2015 **$m**	2014 $m
Interest rate contracts	**557**	700
Foreign exchange contracts	**3,017**	2,755
Commodity contracts	**23**	51
Net credit equivalent amount	**3,597**	3,506

A more detailed analysis of our derivative portfolio is presented in note 11.

Management's Discussion and Analysis (continued)

Liquidity and funding risk

Liquidity risk is the risk that the bank does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.

Funding risk is the risk that funding considered to be sustainable (and therefore used to fund assets) proves not to be sustainable over time.

Liquidity and funding risk management

The objective of our liquidity and funding risk management framework is to ensure that all foreseeable funding commitments, including deposit withdrawals, can be met when due, and that access to the wholesale markets is coordinated and cost-effective. It is designed to allow us to withstand very severe liquidity stresses and be adaptable to changing business models, markets and regulations.

The ARC is responsible for defining the bank's liquidity risk tolerances within the HSBC Group's liquidity risk framework, which mandates that each site manages its liquidity and funding on a self-sustaining basis. The ARC also reviews and approves the bank's liquidity and funding policy and is responsible for its oversight.

The bank's Asset and Liability Committee ('ALCO') is responsible for the development of policies and practices to manage liquidity and funding risk. Its mandate is established by HSBC Group policy, the ARC, and the bank's RMC.

ALCO is responsible for the oversight of liquidity and funding risk management, establishing liquidity risk parameters, and monitoring metrics against risk appetite, funding costs, and early warning indicators of a liquidity stress. ALCO is also responsible for ensuring the operational effectiveness of the bank's contingency funding plan.

The management of liquidity and funding is carried out by our Balance Sheet Management group in accordance with practices and limits approved by ALCO, the ARC and HSBC Group. Compliance with policies is monitored by ALCO.

Our liquidity and funding risk management framework requires:

- liquidity to be managed on a stand-alone basis with no implicit reliance on the HSBC Group or central banks;
- compliance with the limit for the advances to core funding ratio; and
- maintaining cumulative positive cash flows in each time band within the specified time horizons in respect of idiosyncratic and market-wide stress scenarios, respectively.

Our liquidity and funding management processes include:

- projecting cash flows under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- monitoring the statement of financial position liquidity ratios against internal measures;
- maintaining a diverse range of funding sources;
- managing the concentration and profile of debt maturities;
- managing contingent liquidity commitment exposures within predetermined caps;
- maintaining debt financing plans;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensuring a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans.

Liquidity regulation

In accordance with OSFI's Liquidity Adequacy Requirements ('LAR') guideline, which incorporates Basel liquidity standards, effective 1 January 2015, the bank is required to maintain a liquidity coverage ratio ('LCR') above 100% as well as monitor the net cumulative cash flow ('NCCF'). The LCR estimates the adequacy of liquidity over a 30 day stress period while the NCCF calculates a horizon for net positive cash flows to capture the risk posed by funding mismatches between assets and liabilities. The bank also computes LCR under European Commission Delegated Regulation 2015/61. As at 31 December 2015, the bank was compliant with OSFI LAR requirements throughout 2015.

European Commission Delegated Regulation ("EU") 2015/61 became a minimum regulatory standard for European banks from 1 October 2015. HSBC Group is subject to EU LCR requirements and the bank calculates an LCR under this basis as well as part of the consolidated reporting requirement of the HSBC Group.

The net stable funding ratio (NSFR), which will require a stable funding profile to be maintained in relation to the composition of assets and off-balance sheet activities, was finalized by the Basel Committee on Banking Supervision in 2015 and is expected to come into force on 1 January 2018.

Developments for 2016

From 1 January 2016 the bank, in line with HSBC Group, implemented a new internal liquidity and funding risk management framework. 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 bank considers are not adequately reflected by the external regulatory framework.

The key aspects of the new internal liquidity and funding risk management framework are:

- Minimum LCR requirement (EU LCR delegated regulation basis).
- Minimum NSFR requirement (Basel NSFR basis pending finalization of the EU NSFR delegated regulation).
- Depositor concentration limit.
- Three-month and twelve-month cumulative rolling term contractual maturity limits covering deposits from banks, deposits from non-bank financials and securities issued.
- During 2016, the bank will also implement an annual individual liquidity adequacy assessment ('ILAA') process.

The ILAA process is designed to identify any risk that is not reflected in the framework and where additional limits are assessed to be required, and to validate the risk tolerances and limits.

The decision to create an internal framework based 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 bank's internal funds transfer pricing framework incentivizes the global business lines to collectively ensure compliance with both the external (regulatory) and the internal risk tolerance.

Liquidity and funding in 2015

Liquidity coverage ratio – OSFI regulation

The bank's OSFI LCR is summarized in the following table. For the quarter ended 31 December 2015, the bank's average LCR of 130% is calculated as the ratio of the stock of High-Quality Liquid Assets (HQLA) to the total net stressed cash outflows over the next 30 calendar days.

OSFI liquidity coverage ratio

	Average for the three months ended December 31, 2015 $m[1]
Total HQLA[2]	**24,691**
Total net cash outflows[2]	**19,074**
Liquidity coverage ratio (%)	**130**

1 *The data in this table has been calculated using averages of the three month-end figures in the quarter. Consequently, the LCR is an average ratio for the three months of the quarter and might not equal the LCR ratios calculated dividing total weighted HQLA by total weighted net cash outflows.*

2 *These are weighted values and are calculated after the application of the weights prescribed under the OSFI LAR Guideline for HQLA and cash inflows and outflows.*

Advances to core funding ratio

The bank emphasizes the importance of core current accounts and savings accounts as a source of stable funding to finance lending to customers, and discourages reliance on short-term professional funding. This is achieved by placing limits to restrict the bank's ability to increase loans and advances to customers without corresponding growth in current accounts and savings accounts or long-term debt funding with a residual maturity beyond one year. This measure is referred to as the 'advances to core funding' ratio.

The advances to core funding ratio describes loans and advances to customers as a percentage of the total of core customer current and savings accounts and term funding with a remaining term to maturity in excess of one year. Loans and advances to customers which are part of reverse repurchase arrangements, and where the bank receives securities which are deemed to be liquid, are excluded from the advances to core funding ratio, as are current accounts and savings accounts from customers deemed to be 'non-core'. The categorization of customer deposits into core and non-core takes into account the nature of the customer and the size and pricing of the deposit.

The distinction between core and non-core deposits generally means that the bank's measure of advances to core funding is more restrictive than that which could be inferred from the published financial statements.

The table below shows the extent to which loans and advances to customers were financed by reliable and stable sources of funding.

Advances to core funding ratio

	2015	2014
	%	%
Year-end	**94**	100
Maximum	**104**	102
Minimum	**93**	93
Average	**100**	99

Stress testing

The bank runs a range of stressed cash flow scenarios as its primary liquidity risk measures, spanning various idiosyncratic and market-wide stress scenarios. Stressed cash flow scenarios are further supplemented by regular enterprise-wide stress testing and reverse stress testing. The results of all liquidity stress tests are reviewed and monitored by ALCO.

We would meet any unexpected cash outflows primarily from our cash, by selling or entering into repurchase agreements ('repos') with the securities assessed as liquid assets, and by maturing interbank loans and reverse repos. In general, customer advances are assumed to be renewed and as a result are not assumed to generate a stressed cash inflow or represent a liquidity resource.

Contingent liquidity risk is the risk associated with the need to provide additional funds to customers. We include estimates of contingent liquidity cash outflows within all stressed cash flow scenarios.

The stressed coverage ratios tabulated below express stressed cash inflows as a percentage of stressed cash outflows over one-month and three-month time horizons. Inflows included in the numerator of the stressed coverage ratio are those that are assumed to be generated from monetization of liquid assets net of assumed haircuts, and cash inflows related to assets contractually maturing within the stressed cash flow horizon and not already reflected as a monetization of a liquid asset.

Stressed one-month coverage ratios

	2015	2014
	%	%
Year-end	**113**	130
Maximum	**115**	136
Minimum	**108**	125
Average	**111**	128

Stressed three-month coverage ratios

	2015	2014
	%	%
Year-end	**104**	113
Maximum	**105**	121
Minimum	**100**	109
Average	**102**	114

The stressed one-month and three-month ratios in 2015 decreased compared with 2014 primarily due to the inclusion of contingent margin outflows related to market valuation changes on derivative transactions not reflected in the 2014 calculations.

Liquid Assets

The table below shows the estimated liquidity value (before assumed haircuts) of assets categorized as liquid used for the purpose of calculating the one and three month stressed coverage ratios.

Any unencumbered asset held as a consequence of a reverse repo transaction with a residual contractual maturity within the relevant stress testing horizon and unsecured interbank loans maturing within three months are not included in liquid assets, as these assets are reflected as contractual cash inflows.

Estimated liquidity value

	2015 **$m**	2014 $m
Level 1[1]	**20,670**	17,342
Level 2[2]	**5,238**	4,095
	25,908	21,437

1 *Includes debt securities of central governments, central banks, supranationals and multilateral development banks.*
2 *Includes debt securities of local and regional governments, public sector entities and secured covered bonds.*

Net contractual cash flows

The following table quantifies the net contractual cash flows from interbank and intra-Group loans and deposits, and reverse repo, repo (including intergroup transactions) and short positions of the one and three-month stressed coverage ratios and should be considered alongside the level of liquid assets.

Cash inflows (outflows) within three months

	2015 **$m**	2014 $m
Interbank and intra-Group loans and deposits	**(1,594)**	2,484
Reverse repo, repo and outright short positions (including intra-Group)	**(1,571)**	(1,298)

Contingent liquidity risk arising from committed lending facilities

The bank provides commitments to various counterparts. In terms of liquidity risk, the most significant risk relates to committed lending facilities which, whilst undrawn, give rise to contingent liquidity risk, as these could be drawn during a period of liquidity stress. Commitments are given to customers and committed lending facilities are provided to conduits, established to enable customers to access a flexible market-based source of finance.

The table below shows the level of undrawn commitments outstanding to conduits and customers for the five largest single facilities and the largest market sector.

The bank's contractual undrawn exposures monitored under the contingent liquidity risk structure

	2015 **$m**	2014 $m
Commitments to conduits		
Total lines	**230**	245
Largest individual lines	**179**	194
Commitments to customers		
Five largest	**1,885**	1,928
Largest market sector	**4,687**	4,012

Management's Discussion and Analysis (continued)

Sources of funding
Current accounts and savings deposits, payable on demand or on short notice, form a significant part of our funding. We place considerable importance on maintaining the stability and growth of these deposits, which provide a diversified pool of funds.

We also access professional markets to maintain a presence in local money markets and to optimize the funding of asset maturities not naturally matched by core deposit funding. As part of our wholesale funding arrangements, we have a number of fund raising programs, so that undue reliance is not placed on any one source of funding.

No reliance is placed on unsecured money market wholesale funding as a source of core funding. Only wholesale funding with a residual term to maturity of one year or greater is counted towards the core funding base. In addition, our stress testing assumptions require an equivalent amount of liquid assets to be held against wholesale funding maturing within the relevant stress testing horizon.

Cash flows payable by the bank under financial liabilities by remaining contractual maturities (Audited)

	On demand and 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
At 31 December 2015					
Deposits by banks	**2,049**	**–**	**–**	**–**	**2,049**
Customer accounts	**46,099**	**6,799**	**2,266**	**–**	**55,164**
Repurchase agreements	**6,556**	**50**	**–**	**–**	**6,606**
Trading liabilities	**1,713**	**–**	**–**	**–**	**1,713**
Financial liabilities designated at fair value	**5**	**14**	**33**	**409**	**461**
Derivatives	**4,545**	**19**	**251**	**190**	**5,005**
Debt securities in issue	**814**	**1,212**	**7,347**	**2,295**	**11,668**
Subordinated liabilities[1]	**2**	**3**	**17**	**246**	**268**
Other financial liabilities	**4,502**	**318**	**1,465**	**–**	**6,285**
	66,285	**8,415**	**11,379**	**3,140**	**89,219**
Loan commitments	**40,105**	**52**	**18**	**–**	**40,175**
Financial guarantee contracts	**168**	**1,803**	**352**	**9**	**2,332**
	106,558	**10,270**	**11,749**	**3,149**	**131,726**

1 *Excludes interest payable exceeding 15 years.*

Certain balances in the above table will not agree directly to the balances in the consolidated statement of financial position as the table incorporates cash flows for both principal and interest, on an undiscounted basis, except for derivatives and trading liabilities.

Cash flows payable in respect of deposits are primarily contractually repayable on demand or on short notice. However, in practice, short-term deposit balances remain stable as cash inflows and outflows broadly match.

Trading derivatives and trading liabilities have been included in the 'On demand and due within 3 months' time bucket, and not by contractual maturity, because trading liabilities and trading derivatives are typically held for short periods of time. The undiscounted cash flows on hedging derivative liabilities are classified according to their contractual maturity.

Furthermore, loan commitments and financial guarantee contracts are not recognized on the statement of financial position. The undiscounted cash flows potentially payable under financial guarantee contracts are classified on the basis of the earliest date they can be drawn down.

Encumbered assets
In the normal course of business, the bank will pledge or otherwise encumber assets. The pledging of assets will occur to meet the bank's payments and settlement system obligations, as security in a repurchase transaction, to support secured debt instruments or as margining requirements. Limits are in place to control such pledging.

The bank actively monitors its pledging positions. Encumbered assets are not counted towards the bank's liquid assets used for internal stress testing scenarios. We further estimate the impact of credit rating downgrade triggers, and exclude the estimated impact from liquid assets within the bank's liquidity stress testing scenarios.

Contractual obligations

As part of our normal business operations we have contractual obligations liability payments. Amounts included in unsecured long-term funding in the table below are wholesale term deposits with an original term to maturity of more than one year, based on contractual repayment dates. Also included are obligations related to commitments not recorded in the consolidated statement of financial position, such as those relating to operating leases.

Summary of future contractual payments

	Less than 1 year	*1 to 5 years*	*After 5 years*	*Total*
	$m	$m	$m	$m
At 31 December 2015				
Subordinated debentures[1]	–	–	639	639
Operating leases	49	145	53	247
Committed purchase obligations	225	353	60	638
Unsecured funding[1]	3,084	3,248	2,336	8,668
Total contractual obligations	3,358	3,746	3,088	10,192

1 *Principal amounts only. Includes $200m in debentures which on 18 January 2016 the bank gave notice that it intends to redeem on 16 March 2016.*

Committed purchase obligations include long-term arrangements for the provision of technology and data processing services by HSBC Group companies. Not included in the table are any commitments relating to customers utilizing undrawn portions of their loan facilities. As a result of our ongoing funding and liquidity management process which we monitor regularly, we expect to be able to meet all of our funding and other commitments in the normal course of our operations.

Market risk

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

Market risk management

The objective of market risk management is to identify, measure and control market risk exposures in order to optimize return on risk within the bank's risk appetite.

We separate exposures to market risk into trading and non-trading portfolios. Trading portfolios include those positions arising from market-making, proprietary position-taking and other positions designated as held-for-trading.

Market risk is managed in accordance with policies and risk limits set out by RMC and approved by the Board as well as centrally by HSBC Group Risk Management. We set risk limits for each of our trading operations dependent upon the size, financial and capital resources of the operations, market liquidity of the instruments traded, business plan, experience and track record of management and dealers, internal audit ratings, support function resources and support systems. Risk limits are reviewed and set by RMC on an annual basis at a minimum.

We use a range of tools to monitor and limit market risk exposures. These include: present value of a basis point, Value at Risk ('VaR'), foreign exchange exposure limits, maximum loss limits, credit spread limits, and issuer limits.

Value at Risk

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

The VaR models used are predominantly based on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking account of 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.

Management's Discussion and Analysis (continued)

The historical simulation models used incorporate the following features:

- potential market movements are calculated with reference to data from the past two years;
- historical market rates and prices are calculated with reference to foreign exchange rates, credit spreads, interest rates, equity prices and the associated volatilities;
- VaR is calculated to a 99% confidence level; and
- VaR is calculated for a one-day holding period.

Statistically, we would expect to see losses in excess of VaR only one percent of the time over a one-year period. Although a valuable guide to risk, VaR should always be viewed in the context of its limitations:

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

VaR disclosed in the tables and graph below is the bank's total VaR for both trading and non-trading books and remained within the bank's limits.

For the calculation of regulatory capital for market risk purposes, the bank utilizes an Internal Models Approach (IMA), which has been approved by OSFI. The IMA follows HSBC Group practice for market risk capital calculation, mitigating the impact on capital requirements while aligning with industry best practice.

Average non-trading VaR for the year ended 31 December 2015 increased by $4m compared to the prior year and non-trading VaR volatility increased during Q4. The increase is due to the inclusion from the fourth quarter of 2015 of more granular risks into the VaR calculation. This accounted for the increase in the maximum amount of non-trading VaR during 2015 as well as the "increase" in the total VaR in the fourth quarter of 2015 as shown in the graph below. The VaR model has also been enhanced to capture LIBOR tenor basis spreads and cross currency basis spreads.

The average trading VaR was up $0.2m from the prior year. The increase was mainly due to an enhanced VaR model which includes basis risks and was driven by an increase in interest rate risks.

Non-trading VaR

	2015 **$m**	2014 $m
End of year	**17**	13
Average	**16**	12
Minimum	**8**	7
Maximum	**36**	17

VaR by risk type for trading activities[1]

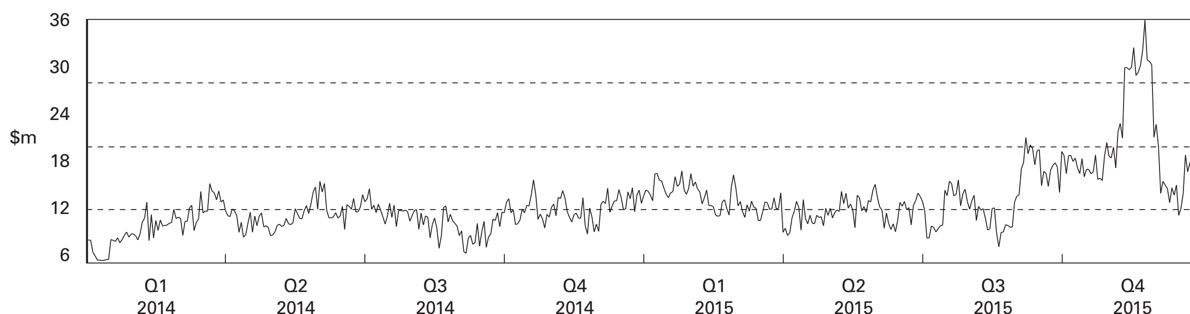
	Foreign exchange and commodity	*Interest rate*	*Equity*	*Credit Spread*	*Portfolio diversifi-cation*[2]	*Total*[3]
	$m	**$m**	**$m**	**$m**	**$m**	**$m**
January–December 2015						
At year end...............	**0.1**	**1.2**	**0.0**	**1.1**	**(0.8)**	**1.5**
Average	**0.2**	**0.6**	**0.0**	**1.1**	**(0.7)**	**1.3**
Minimum..................	**0.0**	**0.2**	**0.0**	**0.7**		**0.7**
Maximum.................	**1.1**	**1.9**	**0.4**	**2.8**		**2.8**
January–December 2014						
At year end...............	0.0	0.4	0.0	1.0	(0.4)	1.0
Average	0.2	0.4	0.0	0.9	(0.5)	1.1
Minimum..................	0.0	0.1	0.0	0.3		0.4
Maximum.................	1.1	1.3	0.4	2.4		2.4

1 *Trading portfolios comprise positions arising from the market-making and warehousing of customer derived positions.*

2 *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 and minimum occur on different days for different risk types, it is not meaningful to calculate a portfolio diversification benefit for these measures. Some small differences in figures presented are due to rounding.*

3 *The total VaR is non-additive across risk types due to diversification effects.*

Daily total VaR



Structural interest rate risk

Structural interest rate risk arises primarily out of differences in the term to maturity or repricing of our assets and liabilities, both on- and off-balance sheet.

Structural interest rate risk is managed in accordance with policies and risk limits set out by ALCO.

We use a variety of cash and derivative instruments to manage our interest rate risk within prescribed limits. We use derivatives to modify the interest rate characteristics of related balance sheet instruments and to hedge anticipated exposures when market conditions are considered beneficial.

The risk is measured based on contractual re-pricing, as well as incorporating embedded optionality of early redemption, prepayment or re-pricing (such as redeemable deposit products, mortgages with prepayment options and fixed rate mortgage commitments). Non-maturity products are laddered out over an assumed maturity profile, based on historical behaviour. These behavioural and optionality assumptions are approved by ALCO.

Management's Discussion and Analysis (continued)

We use two primary interest rate risk metrics to measure and monitor the risk:

- Economic value of equity sensitivity – the change in the notional equity value of the non-trading portfolio resulting from an immediate parallel shift in all relevant yield curves.
- Earnings at risk sensitivity – the change in projected net interest income over a 12 month horizon, resulting from a ramped +/–100 basis point change in all relevant yield curves.

Sensitivity of structural interest rate risk in the non-trading portfolio

At 31 December	**2015**		2014	
	Economic value of equity **$m**	*Earnings at risk* **$m**	*Economic value of equity* $m	*Earnings at risk* $m
Impact as a result of 100 basis point change in interest rate:				
Increase	**(267)**	**98**	(167)	35
Decrease	**310**	**(90)**	42	(54)

Reputational risk

Reputational risk encompasses negative reaction to activities which may be illegal or against regulations, or counter to societal standards, values and expectations. It can arise from a wide variety of causes including how we conduct our business and the way in which customers, to whom we provide services, conduct themselves.

Reputational risk is measured by reference to our reputation as indicated by our dealings with all relevant stakeholders, including media, regulators, customers and employees. It is managed by every member of staff and is covered by a number of policies and guidelines.

Each of the lines of business is required to have a procedure to assess and address reputational risks potentially arising from proposed business transactions and customer activity. Potential risks are directed to the RMC for review. Where necessary, the RMC reports reputational risks to the ARC quarterly.

Reputational risks are considered and assessed by the ARC, RMC and senior management during the formulation of policy and the establishment of our standards. These polices are communicated through manuals and statements of policy through internal communications and training. The policies set out our risk appetite and operational procedures in all areas of reputation risk, including money laundering deterrence, counter terrorist financing, environmental impact, anti-bribery and corruption measures and employee relations.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Operational risk is relevant to every aspect of our business, and covers a wide spectrum of issues, in particular legal, compliance, security and fraud. Losses arising from breaches of regulation and law, unauthorized activities, error, omission, inefficiency, fraud, systems failure or external events all fall within the definition of operational risk.

Responsibility for minimizing operational risk lies with the bank's management and staff, and every employee plays a role in managing operational risk at HSBC. Accountability for managing and controlling risks lies directly with the risk owners.

Operational risk management framework

The Operational Risk function and the operational risk management framework ('ORMF') direct business management in discharging their responsibilities. The ORMF is our overarching approach for managing operational risk in accordance with our business and operational risk strategies. It defines minimum standards and processes, and the governance structure for operational risk and internal control in our businesses and functions.

The Three Lines of Defence model is essential to delivering strong risk management within the bank. It defines who is responsible to do what to identify, assess, measure, manage, monitor and mitigate operational risks, encouraging collaboration and enabling efficient coordination of risk and control activities.

- *First line of defence:* Every employee is responsible for the risks that are a part of their day-to-day jobs. The first line of defence is accountable for managing and monitoring operational risk in the business.
- *Second line of defence:* Consists of Functions such as Risk, Finance and Human Resources. The second line is responsible for providing risk oversight, challenge, advice and insights to the business.
- *Third line of defence:* Internal Audit independently assures that the bank is managing operational risk effectively.

The ORMF has been codified in a high level standards manual supplemented with detailed policies, which describe our approach to identifying, assessing, monitoring and controlling operational risk and give guidance on mitigating action to be taken when weaknesses are identified.

Activity to strengthen our operational risk culture and to better embed the use of our ORMF continued in 2015. In particular, we continued to streamline our operational risk management processes, procedures and tool sets to provide more forward-looking risk insights and more effective operation of the ORMF. In addition, the Security and Fraud Risk and Financial Crime Compliance functions have built a Financial Intelligence Unit ('FIU') which provides intelligence on the potential risks of financial crime posed by customers and business prospects to enable better risk management decision-making. The FIU provides context and expertise to identify, assess and understand financial crime risks holistically in customers, sectors and markets.

Business and Functional management is responsible for maintaining an acceptable level of internal control, commensurate with the scale and nature of operations, and for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The ORMF helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational incident information. A centralized database is used to record the results of the operational risk management process.

The standard operational risk and control assessments are performed by individual business units and functions. The risk and control assessment process is designed to provide business areas and functions with a forward looking view of operational risks and an assessment of the effectiveness of controls, and a tracking mechanism for action plans so that they can proactively manage operational risks within acceptable levels. Risk and control assessments are reviewed and updated at least annually.

Articulating our risk appetite for material operational risks helps the business understand the level of risk our organization is willing to accept. Monitoring operational risk exposure against risk appetite on a regular basis and implementing our risk acceptance process drives risk awareness in a more forward-looking manner and assists management in determining whether further action is required.

An Operational Risk Management function, reporting to the Chief Risk Officer, provides end-to-end oversight, challenge and review of the ORMF. The function works closely with the bank's Operational Risk Management Group whose mission is to provide governance and strategic oversight of the bank's operational risk management framework. We actively manage operational risk to reduce exposure to events that could lead to negative impacts.

Compliance risk

Compliance risk is the risk that we fail to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice, and incur fines or penalties and suffer damage to our business as a consequence. We have committed to adopt and enforce industry leading compliance standards and have put in place a robust compliance risk management infrastructure to help us achieve this.

The two Compliance sub-functions: Financial Crime Compliance ('FCC') and Regulatory Compliance ('RC'), are appropriately supported by shared Compliance Chief Operating Officer and FCC and RC Assurance teams. The Head of Financial Crime Compliance and the Head of Regulatory Compliance both report to the Chief Executive Officer.

FCC focuses on setting policy and managing risks in the following areas:

- anti-money laundering, counter terrorist financing and proliferation finance;
- sanctions; and
- anti-bribery and corruption.

Regulatory Compliance focuses on setting policy and managing risks in the following areas:

- conduct of business;
- market conduct; and
- general regulatory compliance management.

Management's Discussion and Analysis (continued)

Security and fraud risk
Security and fraud risk includes: Fraud Risk, Information Security Risk, and Business Continuity.

The Fraud Risk function is responsible for ensuring that effective protection measures are in place against all forms of fraudulent activity, whether initiated internally or externally, and is available to support any part of the business. To achieve that and to attain the level of integration needed to face the threat, the management of all types of fraud (e.g. card fraud, non-card fraud and internal fraud, including investigations), is established within one management structure and is part of the overall Risk function. We have increased monitoring, root cause analysis and review of internal controls to enhance our defences against external attacks and reduce the level of loss in these areas. Security and Fraud Risk is working closely with the businesses to continually assess fraud threats as they evolve and adapt our controls to mitigate these risks. We have developed a holistic and effective anti-fraud strategy comprising fraud prevention policies and practices, the implementation of strong internal controls, investigations response team and liaison with law enforcement where appropriate.

Information Security Risk protects bank information assets against the risk of loss, operational discontinuity, misuse, unauthorized disclosure, inaccessibility and damage. It also protects against the ever-increasing potential for civil or legal liability that the bank could face as a result of information inaccuracy and loss, or the absence of due care in its protection. Information Security Risk covers all information processes, regardless of whether they involve people and technology or relationships with trading partners, customers and third parties. Information Security Risk addresses information protection, confidentiality, availability and integrity throughout the life cycle of information and its use within the bank. The security of our information and technology infrastructure is crucial for maintaining our banking applications and processes while protecting our customers and the HSBC brand.

The Business Continuity Management function is responsible for ensuring that our businesses and functions have the resilience to maintain continuity in the face of major disruptive events. Within this wider risk, Business Continuity Management pre-plans and considers strategies to minimize the adverse effects of major business disruption against a range of actual or emerging risks. The pre-planning concentrates on the protection of customer services, our staff, reputation, revenue generation and the integrity of data and documents. Each business and function has its own recovery plan, which is developed following the completion of a Business Impact Analysis. This determines how much time the business could sustain an outage before the level of losses becomes unacceptable, i.e. its criticality. These plans are reviewed and tested every year. The planning is undertaken against Group policy and standards and each business confirms in an annual compliance certificate that all have been met. Should there be exceptions, these are raised and their short-term resolution is overseen by Group and regional business continuity teams.

Fiduciary risk
Fiduciary risk is the risk associated with failing to offer services honestly and properly to customers where we act in a fiduciary capacity. We define a fiduciary duty as any duty where we hold, manage, oversee or have responsibilities for assets of a third party that involves a legal and/or regulatory duty to act with the highest standard of care and with utmost good faith. A fiduciary must make decisions and act in the best interests of the third parties and must place the wants and needs of the customer first, above the needs of the organization.

Fiduciary risk is managed within the designated businesses via a policy framework and monitoring of key indicators. The bank's principal fiduciary businesses (designated businesses) are:

- HSBC Trust Company (Canada), where it is exposed to fiduciary risk via trustee's responsibilities, and
- HSBC Global Asset Management (Canada) Limited and HSBC Private Wealth Services (Canada) Inc. which are exposed to fiduciary risks via investment management activities on behalf of customers.

Factors that may affect future results

The risk management section in the MD&A describes the most significant risks to which the bank is exposed and if not managed appropriately could have a material impact on our future financial results. This section outlines additional factors which may affect future financial results.

General economic and market conditions

Factors such as the general health of capital and/or credit markets, including liquidity, level of activity, volatility and stability, could have a material impact on our business. As well, interest rates, foreign exchange rates, consumer saving and spending, housing prices, consumer borrowing and repayment, business investment, government spending and the rate of inflation affect the business and economic environment in which we operate.

In addition, the financial services industry is characterized by interrelations among financial services companies. As a result, defaults by other financial services companies could adversely affect our earnings. Given the interconnectedness of global financial markets and the importance of trade flows, deterioration of the sovereign creditworthiness of over-indebted countries could affect the supply and cost of credit and constrain the pace of economic growth in Canada.

Fiscal, monetary and interest rate policies

Our earnings are affected by fiscal, monetary, interest rate and economic policies that are adopted by Canadian regulatory authorities. Such policies can have the effect of increasing or reducing competition and uncertainty in the markets. Such policies may also adversely affect our customers and counterparties, causing a greater risk of default by these customers and counterparties. As well, expectations in the bond and money markets about inflation and central bank monetary policy have an impact on the level of interest rates. Changes in market expectations and monetary policy are difficult to anticipate and predict. Fluctuations in interest rates that result from these changes can have an impact on our earnings. The current prolonged low interest rate policies have had a negative impact on results and a continuation of such policies would likely continue to pressure earnings.

Changes in laws, regulations and approach to supervision

Regulators in Canada are very active on a number of fronts, including consumer protection, capital markets activities, anti-money laundering, and the oversight and strengthening of risk management. Regulations are in place to protect our customers and the public interest. Considerable changes in laws and regulations that relate to the financial services industry have been proposed and enacted, including changes related to capital and liquidity requirements. Changes in laws and regulations, including their interpretation and application, and changes in approaches to supervision could adversely affect our earnings. For example, such changes could limit the products or services we can provide and the manner in which we provide them and, potentially, lower our ability to compete, while also increasing the costs of compliance.

As such, they could have a negative impact on earnings and return on equity. These changes could also affect the levels of capital and liquidity we choose to maintain.

In addition to the factors outlined here, our failure to comply with laws and regulations could result in sanctions and financial penalties that could adversely affect our strategic flexibility, reputation and earnings.

Level of competition

The level of competition among financial services companies is high. Furthermore, non-financial companies have increasingly been offering services traditionally provided by banks. Customer loyalty and retention can be influenced by a number of factors, including service levels, prices for products or services, our reputation and the actions of our competitors. Changes in these factors or any subsequent loss of market share could adversely affect our earnings.

Changes to our credit rating

Credit ratings are important to our ability to raise both capital and funding to support our business operations. Maintaining strong credit ratings allows us to access the capital markets at competitive pricing. Should our credit ratings experience a material downgrade, our costs of funding would likely increase significantly and our access to funding and capital through capital markets could be reduced.

Management's Discussion and Analysis (continued)

Operational and infrastructure risks
We are exposed to many operational risks including: the risk of fraud by employees or others, unauthorized transactions by employees, and operational or human error. We face the risk of loss due to cyber-attack and also face the risk that computer or telecommunications systems could fail, despite our efforts to maintain these systems in good working order. Some of our services (such as online banking) or operations may face the risk of interruption or other security risks arising from the use of the internet in these services or operations, which may impact our customers and infrastructure. Given the high volume of transactions we process on a daily basis, certain errors may be repeated or compounded before they are discovered and rectified. Shortcomings or failures of our internal processes, employees or systems, or those provided by third parties, including any of our financial, accounting or other data processing systems, could lead to financial loss and damage to our reputation. In addition, despite the contingency plans we have in place, our ability to conduct business may be adversely affected by a disruption in the infrastructure that supports both our operations and the communities in which we do business, including but not limited to disruption caused by public health emergencies or terrorist acts.

Capital

Our objective in the management of capital is to maintain appropriate levels of capital to support our business strategy and meet our regulatory requirements.

Capital management
The bank manages its capital in accordance with the principles contained within its capital management policy and its annual capital plan, which includes the results of its internal capital adequacy assessment process ('ICAAP'). The bank determines an optimal amount and composition of regulatory and working capital required to support planned business growth, taking into consideration economic capital and the costs of capital, accepted market practices and the volatility of capital and business levels in its annual operating plan.

The bank maintains a capital position commensurate with its overall risk profile and control environment as determined by the ICAAP. The ICAAP supports capital management and ensures that the bank carries sufficient capital to meet regulatory requirements and internal targets to cover current and future risks; and, survive periods of severe economic downturn (stressed scenarios). The key elements of the bank's ICAAP include: a risk appetite framework; the identification and assessment of the risks the bank is exposed to; and, an assessment of capital adequacy against regulatory requirements as well as under stressed scenarios.

Management has established appropriate governance structures and internal control to ensure the ICAAP remains effective in supporting the bank's capital management objectives.

The bank met its regulatory requirements throughout 2015.

Basel III capital and leverage rules
The bank assesses capital adequacy against standards established in guidelines issued by OSFI in accordance with the Basel III capital adequacy framework.

The Basel III capital adequacy framework significantly revised the definitions of regulatory capital and introduced the requirement that all regulatory capital must be able to absorb losses in a failed financial institution. Capital instruments issued prior to the adoption of the existing requirements in 2013 that do not meet these requirements are being phased out as regulatory capital over a ten year period from 2013 to 2022.

The framework emphasizes common equity as the predominant component of tier 1 capital by adding a minimum common equity tier 1 ('CET1') capital ratio. In addition, for the purposes of calculating CET1 capital, certain other regulatory adjustments including those relating to goodwill, intangible assets, pension assets and deferred tax assets are being phased in over a five year period from 2014 to 2018. The Basel III rules also require institutions to hold capital buffers designed to avoid breaches of minimum regulatory requirements during periods of stress.

OSFI revised the leverage requirement it imposes on banks effective January 2015 with the implementation of a leverage ratio that is consistent with the leverage requirement under the Basel III framework.

In guidance issued in December 2013, OSFI established "all-in" capital targets (including capital conservation buffer) that all institutions are expected to attain or exceed early in the transition period, as follows: CET1 capital ratio of 7% by the first quarter of 2014, and tier 1 capital ratio of 8.5% and total capital ratio of 10.5% by the first quarter of 2015.

Regulatory capital ratios

Actual regulatory capital ratios and capital requirements

	2015	2014
Actual regulatory capital ratios[1]		
Common equity tier 1 capital ratio	**10.1%**	10.6%
Tier 1 capital ratio	**12.1%**	12.0%
Total capital ratio	**13.5%**	13.5%
Leverage ratio[2]	**4.7%**	n/a
Assets-to-capital multiple[2]	**n/a**	17.1x
Required regulatory capital limits[3]		
Minimum Common equity tier 1 capital ratio	**7.0%**	7.0%
Minimum Tier 1 capital ratio	**8.5%**	8.5%
Minimum Total capital ratio	**10.5%**	10.5%

1 *Presented under a Basel III 'all-in' basis per OSFI guidelines which applies Basel III regulatory adjustments from 1 January 2014, however phases out of non-qualifying capital instruments over 10 years starting 1 January 2013.*

2 *The Leverage ratio replaced the assets-to-capital multiple effective 1 January 2015.*

3 *On an 'all-in' basis.*

Regulatory capital

Regulatory capital and risk weighted assets

Presented under a Basel III 'all-in' basis which applied Basel III regulatory adjustments from 1 January 2013, and the phase out of non-qualifying capital instruments over 10 years starting from the same date.

	2015 $m	2014 $m
Tier 1 capital	**5,178**	4,830
Common equity tier 1 capital	**4,328**	4,280
Gross common equity[1]	**4,526**	4,450
Regulatory adjustments	**(198)**	(170)
Additional tier 1 eligible capital[2]	**850**	550
Tier 2 capital[3]	**585**	611
Total capital available for regulatory purposes	**5,763**	5,441
Total risk-weighted assets	**42,846**	40,269

1 *Includes common share capital, retained earnings and other reserves.*

2 *Includes directly issued capital instruments which are subject to phase out and directly issued non-viability contingent capital instruments which fully qualify as alternative tier 1 capital.*

3 *Includes directly issued capital instruments which are subject to phase out and collective allowances.*

Management's Discussion and Analysis (continued)

Dividends

Dividends on our shares declared and paid, and distributions per unit on our HSBC HaTS™ in each of the last three years were as follows:

	2015	2014	2013
Common shares ($m)	**332**	400	360
Preferred shares ($ per share)			
Class 1, Series C	**1.275**	1.275	1.275
Class 1, Series D	**1.250**	1.250	1.250
Class 1, Series E[1]	**n/a**	0.825	1.650
Class 1, Series G[2]	**0.500**	n/a	n/a
Class 2, Series B[3]	**n/a**	n/a	0.310
HSBC HaTS™ – Series 2015[4] ($ per unit)	**25.75**	51.50	51.50

1 *Preferred shares – Class 1, Series E were redeemed on 30 June 2014.*

2 *Preferred shares – Class 1, Series G were issued on 30 June 2015.*

3 *Preferred shares – Class 2, Series B were redeemed on 27 December 2013.*

4 *HSBC HATS™ Series 2015 were redeemed on 30 June 2015*

Statement of Management's Responsibility for Financial Information

The presentation and preparation of the annual consolidated financial statements, Management's Discussion and Analysis ('MD&A') and all other information in the Annual Report is the responsibility of the management of HSBC Bank Canada ('the bank'). The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards. The consolidated financial statements and information in the MD&A include amounts based on informed judgments and estimates of the expected effects of current events and transactions with appropriate consideration to materiality.

In meeting its responsibility for the reliability of financial information, management relies on comprehensive internal accounting, operating and system controls. The bank's overall controls include: an organizational structure providing for effective segregation of responsibilities; delegation of authority and personal accountability; written communication of policies and procedures of corporate conduct throughout the bank; careful selection and training of personnel; regular updating and application of written accounting and administrative policies and procedures necessary to ensure adequate internal control over transactions, assets and records; and a continuing program of extensive internal audit covering all aspects of the bank's operations. These controls are designed to provide reasonable assurance that financial records are reliable for preparing the consolidated financial statements and maintaining accountability for assets that assets are safeguarded against unauthorized use or disposition and that the bank is in compliance with all regulatory requirements. Management has a process in place to evaluate internal control over financial reporting based on the criteria established in the Internal Control – Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

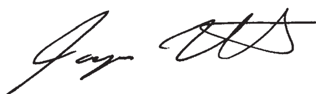
At least once a year, the Office of the Superintendent of Financial Institutions Canada ('OSFI'), makes such examination and enquiry into the affairs of the bank as deemed necessary to ensure that the provisions of the *Bank Act*, having reference to the rights and interests of the depositors and the creditors of the bank, are being complied with and that the bank is in a sound financial condition.

The bank's Board of Directors oversees management's responsibilities for financial reporting through the Audit and Risk Committee, which is composed of directors who are not officers or employees of the bank. The Audit and Risk Committee reviews the bank's interim and annual consolidated financial statements and MD&A. The committee approves the interim statements and recommends the Annual statements for approval by the Board of Directors. Other key responsibilities of the Audit and Risk Committee include monitoring the bank's system of internal control, monitoring its compliance with legal and regulatory requirements, considering the appointment of the Shareholders' auditors and reviewing the qualifications, independence and performance of Shareholders' auditors and internal auditors.

As at 31 December 2015, we, the bank's Chief Executive Officer and Chief Financial Officer, have certified the design and effectiveness of our internal control over financial reporting as defined by the Canadian Securities Administrators under National Instrument 52-109 (Certification of Disclosure in Issuer's Annual and Interim Filings).

The Shareholders' auditors, the bank's Chief Auditor and OSFI have full and free access to the Board of Directors and its committees to discuss audit, financial reporting and related matters.

Sandra Stuart
President and Chief Executive Officer
HSBC Bank Canada



Jacques Fleurant
Chief Financial Officer
HSBC Bank Canada

Vancouver, Canada
18 February 2016

Independent Auditor's Report

To the Shareholders of HSBC Bank Canada

We have audited the accompanying consolidated financial statements of HSBC Bank Canada and its subsidiaries, which comprise the consolidated balance sheet as at December 31, 2015 and the consolidated income statement and statements of comprehensive income, cash flows and changes in equity for the year then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audit is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of HSBC Bank Canada and its subsidiaries as at December 31, 2015 and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other matter

The financial statements of HSBC Bank Canada for the year ended December 31, 2014, were audited by another auditor who expressed an unmodified opinion on those statements on February 20, 2015.

PricewaterhouseCoopers LLP

Chartered Professional Accountants

Vancouver, British Columbia
22 February 2016

Consolidated Financial Statements

Consolidated Financial Statements and Notes on the Financial Statements

	Page
Financial Statements	
Consolidated income statement	64
Consolidated statement of comprehensive income	65
Consolidated balance sheet	66
Consolidated statement of cash flows	67
Consolidated statement of changes in equity	68
Notes on the Financial Statements	
1 Basis of preparation and significant accounting policies	69
2 Non-trading reverse repurchase and repurchase agreements	77
3 Net operating income	77
4 Employee compensation and benefits	78
5 Share-based payments	81
6 Tax expense	82
7 Dividends	84
8 Segment analysis	85
9 Analysis of financial assets and liabilities by measurement basis	88
10 Trading assets	90
11 Derivatives	91
12 Financial investments	98
13 Interest rate sensitivity	100
14 Transfer of financial assets not qualifying for derecognition	102
15 Property, plant and equipment	102
16 Investments in subsidiaries and other entities	103
17 Other assets	105
18 Goodwill and intangible assets	105
19 Trading liabilities	106
20 Debt securities in issue	106
21 Financial liabilities designated at fair value	107
22 Other liabilities	107
23 Subordinated liabilities	108
24 Fair values of financial instruments	108
25 Assets charged as security for liabilities and collateral accepted as security for assets	115
26 Share capital	116
27 Non-controlling interest in trust and subsidiary	116
28 Notes on the statement of cash flows	117
29 Contingent liabilities, contractual commitments and guarantees	118
30 Lease commitments	119
31 Related party transactions	120
32 Offsetting of financial assets and financial liabilities	122
33 Legal proceedings and regulatory matters	124
34 Events after the reporting period	127

Consolidated income statement

For the year ended 31 December *(in millions of dollars except per share amounts)*

	Notes	**2015 $m**	2014 $m
Interest income		**1,700**	1,886
Interest expense		**(557)**	(674)
Net interest income		**1,143**	1,212
Fee income		**758**	723
Fee expense		**(75)**	(78)
Net fee income		**683**	645
Trading income excluding net interest income		**41**	128
Net interest income on trading activities		**40**	18
Net trading income		**81**	146
Net income/(expense) from financial instruments designated at fair value		**3**	(5)
Gains less losses from financial investments		**63**	56
Other operating income		**64**	56
Total operating income		**2,037**	2,110
Loan impairment charges and other credit risk provisions		**(234)**	(107)
Net operating income	3	**1,803**	2,003
Employee compensation and benefits	4, 5	**(673)**	(619)
General and administrative expenses		**(470)**	(434)
Depreciation of property, plant and equipment		**(30)**	(33)
Amortization and impairment of intangible assets		**(13)**	(16)
Total operating expenses		**(1,186)**	(1,102)
Operating profit		**617**	901
Share of profit in associates		**–**	11
Profit before income tax expense		**617**	912
Income tax expense	6	**(170)**	(263)
Profit for the year		**447**	649
Profit attributable to the common shareholder		**414**	613
Profit attributable to preferred shareholders		**28**	26
Profit attributable to shareholders		**442**	639
Profit attributable to non-controlling interests		**5**	10
Average number of common shares outstanding (000's)		**498,668**	498,668
Basic earnings per common share		**$ 0.83**	$ 1.23

The accompanying notes and the audited sections of 'Risk Management' and 'Capital' within Management's Discussion and Analysis form an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December *(in millions of dollars)*

	Notes	**2015 $m**	2014 $m
Profit for the year		**447**	649
Other comprehensive income			
Available-for-sale investments[1]		**(89)**	21
– fair value (loss)/gain		**(57)**	84
– fair value loss transferred to income statement on disposal		**(63)**	(56)
– income taxes/(recovery)		**31**	(7)
Cash flow hedges[1]		**64**	(38)
– fair value (loss)/gain		**(123)**	39
– fair value gain/(loss) transferred to income statement		**210**	(90)
– income (recovery)/taxes		**(23)**	13
Remeasurement of defined benefit plans[2]		**14**	(31)
– before income taxes	4	**19**	(41)
– income taxes	6	**(5)**	10
Other comprehensive loss for the year, net of tax		**(11)**	(48)
Total comprehensive income for the year		**436**	601
Total comprehensive income for the year attributable to:			
– shareholders		**431**	591
– non-controlling interests		**5**	10
		436	601

1 *Other comprehensive income/(loss) items that can be reclassified into income.*

2 *Other comprehensive income/(loss) items that cannot be reclassified into income.*

The accompanying notes and the audited sections of 'Risk Management' and 'Capital' within Management's Discussion and Analysis form an integral part of these consolidated financial statements.

Consolidated balance sheet

At 31 December *(in millions of dollars)*

	Notes	**2015 $m**	2014 $m
ASSETS			
Cash and balances at central banks		**65**	73
Items in the course of collection from other banks		**73**	76
Trading assets	10	**3,893**	8,914
Derivatives	11	**4,909**	4,082
Loans and advances to banks		**1,400**	1,264
Loans and advances to customers		**48,378**	41,219
Reverse repurchase agreements – non-trading	2	**6,807**	6,714
Financial investments	12	**23,935**	20,122
Other assets	17	**365**	345
Prepayments and accrued income		**194**	186
Customers' liability under acceptances		**3,834**	5,023
Property, plant and equipment	15	**110**	124
Goodwill and intangible assets	18	**61**	62
Total assets		**94,024**	88,204
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks		**2,049**	681
Customer accounts		**55,089**	50,843
Repurchase agreements – non-trading	2	**6,606**	4,054
Items in the course of transmission to other banks		**219**	105
Trading liabilities	19	**1,713**	4,227
Financial liabilities designated at fair value	21	**414**	425
Derivatives	11	**5,005**	3,885
Debt securities in issue	20	**10,896**	10,610
Other liabilities	22	**1,822**	2,279
Acceptances		**3,834**	5,023
Accruals and deferred income		**474**	524
Retirement benefit liabilities	4	**288**	309
Subordinated liabilities	23	**239**	239
Total liabilities		**88,648**	83,204
Equity			
Common shares	26	**1,225**	1,225
Preferred shares	26	**850**	350
Other reserves		**92**	117
Retained earnings		**3,209**	3,108
Total shareholders' equity		**5,376**	4,800
Non-controlling interests	27	**–**	200
Total equity		**5,376**	5,000
Total equity and liabilities		**94,024**	88,204

The accompanying notes and the audited sections of 'Risk Management' and 'Capital' within Management's Discussion and Analysis form an integral part of these consolidated financial statements.

Approved on behalf of the Board of Directors:

Samuel Minzberg
Chair
HSBC Bank Canada

Sandra Stuart
President and Chief Executive Officer
HSBC Bank Canada

Consolidated statement of cash flows

For the year ended 31 December *(in millions of dollars)*

	Notes	**2015 $m**	2014 $m
Cash flows from operating activities			
Profit before tax		**617**	912
Adjustments for:			
– non-cash items included in profit before tax	28	**305**	189
– change in operating assets	28	**(3,826)**	(3,337)
– change in operating liabilities	28	**6,774**	1,920
– tax paid		**(220)**	(230)
Net cash from/(used in) operating activities		**3,650**	(546)
Cash flows from investing activities			
Purchase of financial investments		**(20,521)**	(11,549)
Proceeds from the sale and maturity of financial investments		**16,619**	13,255
Purchase of property, plant and equipment		**(34)**	(28)
Purchase of intangibles		**(3)**	(5)
Net cash (used in)/from investing activities		**(3,939)**	1,673
Cash flows from financing activities			
Dividends paid to shareholders		**(360)**	(426)
Distributions to non-controlling interests		**(5)**	(10)
Redemption of preferred shares		**(200)**	(250)
Issuance of preferred shares		**500**	–
Net cash used in financing activities		**(65)**	(686)
(Decrease)/Increase in cash and cash equivalents		**(354)**	441
Cash and cash equivalents at the beginning of the year		**2,337**	1,896
Cash and cash equivalents at the end of the year	28	**1,983**	2,337

The accompanying notes and the audited sections of 'Risk Management' and 'Capital' within Management's Discussion and Analysis form an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December *(in millions of dollars)*

			Other reserves					
	Share capital[1] **$m**	*Retained earnings* **$m**	*Available-for-sale fair value reserve* **$m**	*Cash flow hedging reserve* **$m**	*Total other reserves* **$m**	*Total shareholders' equity* **$m**	*Non-controlling interests* **$m**	*Total equity* **$m**
At 1 January 2015	**1,575**	**3,108**	**56**	**61**	**117**	**4,800**	**200**	**5,000**
Profit for the year	–	**442**	–	–	–	**442**	**5**	**447**
Other comprehensive income/(loss), net of tax	–	**14**	**(89)**	**64**	**(25)**	**(11)**	–	**(11)**
Available-for-sale investments	–	–	**(89)**	–	**(89)**	**(89)**	–	**(89)**
Cash flow hedges	–	–	–	**64**	**64**	**64**	–	**64**
Remeasurement of defined liability/asset	–	**14**	–	–	–	**14**	–	**14**
Total comprehensive income for the year	–	**456**	**(89)**	**64**	**(25)**	**431**	**5**	**436**
Dividends paid on common shares	–	**(332)**	–	–	–	**(332)**	–	**(332)**
Dividends paid on preferred shares	–	**(28)**	–	–	–	**(28)**	–	**(28)**
Distributions to unit holders	–	–	–	–	–	–	**(5)**	**(5)**
Issuance of preferred shares	**500**	–	–	–	–	**500**	–	**500**
Redemption of HaTS™ (note 27)	–	–	–	–	–	–	**(200)**	**(200)**
Shares issued under employee plan	–	**5**	–	–	–	**5**	–	**5**
At 31 December 2015	**2,075**	**3,209**	**(33)**	**125**	**92**	**5,376**	–	**5,376**

			Other reserves					
	Share capital[1] $m	*Retained earnings* $m	*Available-for-sale fair value reserve* $m	*Cash flow hedging reserve* $m	*Total other reserves* $m	*Total shareholders' equity* $m	*Non-controlling interests* $m	*Total equity* $m
At 1 January 2014	1,825	2,926	35	99	134	4,885	200	5,085
Profit for the year	–	639	–	–	–	639	10	649
Other comprehensive income/(loss), net of tax	–	(31)	21	(38)	(17)	(48)	–	(48)
Available-for-sale investments	–	–	21	–	21	21	–	21
Cash flow hedges	–	–	–	(38)	(38)	(38)	–	(38)
Remeasurement of defined liability/asset	–	(31)	–	–	–	(31)	–	(31)
Total comprehensive income for the year	–	608	21	(38)	(17)	591	10	601
Dividends paid on common shares	–	(400)	–	–	–	(400)	–	(400)
Dividends paid on preferred shares	–	(26)	–	–	–	(26)	–	(26)
Distributions to unit holders	–	–	–	–	–	–	(10)	(10)
Redemption of preferred shares	(250)	–	–	–	–	(250)	–	(250)
At 31 December 2014	1,575	3,108	56	61	117	4,800	200	5,000

1 *Share capital is comprised of common shares $1,225m and preferred shares $850m (2014: $350m).*

The accompanying notes and the audited sections of 'Risk Management' and 'Capital' within Management's Discussion and Analysis form an integral part of these consolidated financial statements.

Notes on the Consolidated Financial Statements

31 December 2015 and 2014 *(all tabular amounts are in millions of dollars unless stated otherwise)*

1 Basis of preparation and significant accounting policies

a *Compliance with International Financial Reporting Standards*

International Financial Reporting Standards ('IFRSs') comprise accounting standards as issued or adopted by the International Accounting Standards Board ('IASB') as well as interpretations issued or adopted by the IFRS Interpretations Committee.

HSBC Bank Canada ('the bank', 'we', 'our') is an indirectly wholly-owned subsidiary of HSBC Holdings plc ('the Parent', 'HSBC Holdings'). In these consolidated financial statements, HSBC Group means the Parent and its subsidiary companies. The consolidated financial statements of the bank have been prepared in accordance with IFRSs and accounting guidelines as issued by the Office of the Superintendent of Financial Institutions Canada ('OSFI'), as required under Section 308(4) of the *Bank Act*.

b *Future accounting developments*

In addition to the projects to complete financial instrument accounting, discussed below, the IASB has worked on a project on lease accounting which will represent significant changes to accounting requirements in the future.

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 finance leases are currently accounted for under IAS 17 'Leases'. Lessees will recognize a 'right of use' asset and a corresponding financial liability on the balance sheet. The asset will be amortized over the length of the lease and the financial liability measured at amortized cost. Lessor accounting remains substantially the same as in IAS 17. The bank 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.

In May 2014, the IASB issued IFRS 15 'Revenue from Contracts with Customers'. The standard is effective for annual periods beginning on or after 1 January 2018 with early adoption permitted. IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognizing revenue for obligations as they are satisfied. The standard should be applied retrospectively, with certain practical expedients available. The bank has assessed the impact of this standard and it is not expected to have a material impact to these financial statements.

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 the entity's business model for their management and their contractual cash flow characteristics and result in financial assets being at amortized cost, fair value through Other Comprehensive Income ('OCI') or fair value through profit or loss. In many instances, the classification and measurement outcomes will be similar to IAS 39, although differences will arise, for example, equity securities will be measured at fair value through profit or loss or, in limited circumstances, at fair value through OCI. The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in population of financial assets measured at amortized cost or fair value compared with IAS 39. The classification of financial liabilities is essentially unchanged, except that, 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 OCI.

Impairment

The impairment requirements apply to financial assets measured at amortized cost and fair value through OCI, lease receivables, 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').

The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the probability of default occurring over the remaining life of the financial instrument, rather than by considering an increase in ECL.

Notes on the Consolidated Financial Statements (continued)

1 Basis of preparation and significant accounting policies *(continued)*

b *Future accounting developments (continued)*

Impairment *(continued)*

The assessment of credit risk, as well as the estimation of ECL, are required to be unbiased, 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 between it and risk management strategy and permitting the former 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.

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. Hedge accounting is generally applied prospectively from that date.

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 bank plans to early adopt the presentation of fair value gains and losses relating to an entity's own credit risk on certain liabilities, at the same time as the HSBC Group, whose early adoption is subject to endorsement by the European Union. In addition, early adoption of the presentation is subject to regulatory consent. If this presentation was applied at 31 December 2015, there would be a minimal increase in profit before tax and minimal reduction in other comprehensive income by the same amount with no effect on net assets. Further information on change in fair value attributable to changes in credit risk, including the bank's credit risk, is disclosed in note 21.

The bank is currently assessing the impact that the rest of IFRS 9 will have on the financial statements through an HSBC Group-wide project which has been in place since 2012, but due to the complexity of the classification and measurement, impairment, and hedge accounting requirements and their inter-relationships, it is not possible at this stage to quantify the potential effect.

c *Presentation of information*

Disclosures required under IFRS 7 'Financial Instruments: Disclosures' concerning the nature and extent of risks relating to financial instruments and reconciliation of allowance accounts for credit loses have been included in the audited information within the 'Risk Management' section within Management's Discussion and Analysis.

Capital disclosures under IAS 1 'Presentation of financial statements' have been included in the audited information in the 'Capital' section within Management's Discussion and Analysis.

The bank's consolidated financial statements are presented in Canadian dollars which is also its functional currency. The abbreviation '$m' represents millions of dollars. All tabular amounts are in millions of dollars except where otherwise noted.

1 Basis of preparation and significant accounting policies *(continued)*

d *Critical accounting estimates and assumptions*

The preparation of financial information requires the use of estimates and judgments 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 bank's accounting policies which contain critical estimates and judgments is listed below and discussed in the 'Critical accounting estimates and judgments' section of Management's Discussion and Analysis. It reflects the materiality of the items to which the policies are applied, the high degree of judgment involved and estimation uncertainty:

- Impairment of loans and advances: refer to note 1(h);
- Valuation of financial instruments: refer to note 24;
- Deferred tax assets: refer to note 6;
- Defined benefit obligations: refer to note 4.

e *Consolidation and related disclosures*

The bank 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 bank 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 judgment 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 recognized 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 bank'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.

All intra-bank transactions are eliminated on consolidation.

The consolidated financial statements of the bank also include the attributable share of the results and reserves of associates.

f *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 in effect at the balance sheet date. Any resulting exchange differences are included in the income statement. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Any exchange component of a gain or loss on a non-monetary item is recognized either in other comprehensive income or in the income statement depending where the gain or loss on the underlying non-monetary item is recognized.

Notes on the Consolidated Financial Statements (continued)

1 Basis of preparation and significant accounting policies *(continued)*

g *Loans and advances to banks and customers*

These include loans and advances originated by the bank, not classified as held for trading or designated at fair value. They are recognized when cash is advanced to a borrower and are derecognized when either the borrower repays its obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortized cost using the effective interest method, less impairment allowance.

Loans and advances are reclassified to 'Assets held for sale' when they meet the criteria; however, their measurement continues to be in accordance with this policy.

The bank may commit to underwrite loans on fixed contractual terms for specified periods of time. Where 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. Where the bank intends to hold the loan, a provision on the loan commitment is only recorded where it is probable that the bank will incur a loss. On inception of the loan, the loan to be held is recorded at its fair value and subsequently measured at amortized 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 will be recovered over the life of the loan, through the recognition of interest income, unless the loan becomes impaired.

h *Impairment of loans and advances and available-for-sale assets*

Impairment of loans and advances

Losses for impaired loans are recognized 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 recognized.

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 meet the above criteria will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify collective assessment.

Loans considered as individually significant are typically to corporate and commercial customers, are for larger amounts and are managed on an individual basis. These loans are assessed individually at each balance sheet date whether objective evidence of impairment exists based on the following criteria:

- known cash flow difficulties experienced by the borrower;
- contractual payments of either principal or interest being past due;
- the probability that the borrower will enter bankruptcy or other financial realization;
- 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.

1 Basis of preparation and significant accounting policies *(continued)*

h *Impairment of loans and advances and available-for-sale assets (continued)*

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

- the bank'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 equally with the bank, and the likelihood of other creditors continuing to support the company;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realizable value of security (or other credit mitigants) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding;
- the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and
- when available, the secondary market price of the debt.

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

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at the loan's original effective interest rate, or an approximation thereof, 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. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

Collectively assessed loans and advances

Impairment is assessed 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 generally are large homogeneous loans 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 type of business involved, type of products offered, security obtained or other relevant factors. This assessment captures impairment losses that the bank has incurred as a result of events occurring before the balance sheet date, which the bank 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 impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and

Notes on the Consolidated Financial Statements (continued)

1 Basis of preparation and significant accounting policies *(continued)*

h *Impairment of loans and advances and available-for-sale assets (continued)*

- management's experienced judgment as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by local management for each identified portfolio based on economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. 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. Losses in these groups of loans are recorded individually when individual loans are removed from the group and written off. The methods that are used to calculate collective allowances are:

- When appropriate empirical information is available, the bank utilizes roll-rate methodology, which employs statistical analysis of historical data and experience of delinquency and default to reliably estimate the amount of loans that will eventually be written off as a result of the events occurring before the balance sheet date and which the bank 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. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio, and the carrying amount of the portfolio.
- When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, the bank adopts a basic formulaic approach based on historical loss rate experience, or a discounted cash flow model. Where a basic formulaic approach is undertaken, management estimates that typically it takes between six and twelve months between a loss occurring and its identification.

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

Write-off of loans and advances

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realization of security. In circumstances where the net realizable 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 recognized, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognized in the income statement.

h *Impairment of loans and advances and available-for-sale assets (continued)*

Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans as part of an orderly realization are recorded as assets held for sale and reported in 'Other assets' if those assets are classified 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. Impairment and reversals of previous impairments are recognized in the income statement in 'Other operating income' together with any realized 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. They 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, including write-off.

A loan that is renegotiated is derecognized 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 agreements arising due to a derecognition event will continue to be disclosed as renegotiated loans.

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 recognized.

If the available-for-sale financial asset is impaired, the difference between its acquisition cost (net of any principal repayments and amortization) and its current fair value, less any previous impairment loss recognized in the income statement, is recognized in the income statement.

Impairment losses are recognized 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 available-for-sale securities. The impairment methodologies for available-for-sale financial assets are set out in more detail below:

– **Available-for-sale debt securities**. In assessing objective evidence of impairment at the reporting date, the bank considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. 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 asset-backed securities ('ABS's). 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 Consolidated Financial Statements (continued)

1 Basis of preparation and significant accounting policies *(continued)*

h *Impairment of loans and advances and available-for-sale assets (continued)*

Once an impairment loss has been recognized, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the type of asset:

– for an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognized in the income statement when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognized 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 recognized 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 recognized in other comprehensive income. Impairment losses recognized 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 recognized in the income statement, to the extent that further cumulative impairment losses have been incurred.

i *Operating income*

Interest income and expense

Interest income and expense for financial instruments not carried at fair value: 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 bank and derivatives managed in conjunction with those debt securities) are recognized 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 recognized 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 bank to its customers. Fee income is accounted for as follows:

– income earned on the execution of a significant act is recognized 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 recognized as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees); and

– income which forms an integral part of the effective interest rate of a financial instrument is recognized 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 related interest income, expense and dividends.

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

– all gains and losses from changes in the fair value of financial assets and liabilities designated at fair value;

– all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets and liabilities designated at fair value; and

– interest income and expense in respect of financial assets and liabilities designated at fair value as well as derivatives managed in conjunction with the above. However, interest arising from debt securities issued by the bank, and derivatives managed in conjunction with those debt securities is recognized in 'Interest expense'.

2 Non-trading reverse repurchase and repurchase agreements

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 sell are not recognized on the balance sheet and the right to receive back the initial consideration paid is recorded in 'Non-trading reverse repurchase agreements' or 'Trading assets' as appropriate. The difference between the sale and repurchase price is treated as interest and recognized in net interest income over the life of the agreement.

The extent to which reverse repos and repos represents loans to/from customers and banks is set out below.

	2015 $m	2014 $m
Assets		
Banks	**435**	744
Customers	**6,372**	5,970
Reverse repurchase agreements – non-trading	**6,807**	6,714
Liabilities		
Banks	**1,176**	765
Customers	**5,430**	3,289
Repurchase agreements – non-trading	**6,606**	4,054

3 Net operating income

Net operating income is stated after the following items of income, expense, and loan impairment charges and other credit risk provisions:

	2015 $m	2014 $m
Income		
Interest recognized on impaired financial assets	**9**	10
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	**380**	360
Fees earned on trust and other fiduciary activities where the bank holds or invests assets on behalf of its customers	**178**	169
Expense		
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated at fair value	**(545)**	(665)
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	**(42)**	(45)
Fees payable on trust and other fiduciary activities where the bank holds or invests assets on behalf of its customers	**(13)**	(14)
Loan impairment charge and other credit risk provisions		
Net impairment charge on loans and advances	**(177)**	(92)
(Other credit risk provisions)/reversal of provisions	**(57)**	(15)

Notes on the Consolidated Financial Statements (continued)

4 Employee compensation and benefits

Accounting policy

The bank operates a number of pension and other post-employment benefit plans. These plans include both defined benefit and defined contribution plans and various other post-employment benefits such as post-employment healthcare. The pension plans are funded by contributions from the bank and its employees, while the supplemental pension arrangements are not funded.

Payments to defined contribution plans 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 recognized 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 liability recognized on the balance sheet 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 healthcare plans, are accounted for on the same basis as defined benefit pension plans.

Total employee compensation	**2015**	2014
	$m	$m
Wages and salaries	**536**	502
Post-employment benefits	**66**	62
Other	**71**	55
	673	619

Post-employment benefits

We sponsor a number of defined benefit and defined contribution plans providing pension, other retirement and post-employment benefits to eligible employees. Non-pension plans are comprised of healthcare and other post-employment benefits and are not funded.

Income statement charge	**2015**	2014
	$m	$m
Defined benefit plans		
Pension plans	**17**	19
Non-pension plans	**14**	12
Defined contribution pension plans	**35**	31
Post-employment benefits	**66**	62

Post-employment defined benefit plans

Principal actuarial assumptions

The principal actuarial financial assumptions used to calculate the bank's obligations under its defined plans are presented in the table below. The 2015 and 2014 assumptions will also form and have formed the basis for measuring periodic costs under the plans in 2016 and 2015 respectively.

	Pension plans		Non-pension plans	
	2015	2014	**2015**	2014
	%	%	**%**	%
Discount rate	**4.00**	3.75–4.00	**4.00**	3.75–4.00
Rate of pay increase	**2.75**	3.00	**2.75**	3.00
Healthcare cost trend rates – Initial rate	**n/a**	n/a	**7.50**	8.00
Healthcare cost trend rates – Ultimate rate[1]	**n/a**	n/a	**5.00**	5.00

1 *The non-pension 'Healthcare cost trend rates – Ultimate rate' is applied from 2020.*

The bank determines the discount rates to be applied to its obligations in consultation with the plans' actuaries, on the basis of the current average yield of high quality Canadian corporate bonds, with maturities consistent with those of the defined benefit obligations. At 31 December 2015, the weighted average duration of the defined benefit obligation was 16.8 years.

Mortality assumption

Assumptions regarding future mortality have been based on published mortality tables. The life expectancies underlying the defined benefit obligation at the reporting dates are as follows:

	Average years from age 65	
	2015	2014
For a male currently aged 65	**22**	22
For a male currently aged 45	**23**	23
For a female currently aged 65	**24**	24
For a female currently aged 45	**25**	25

Actuarial assumption sensitivities

The following table shows the effect of a ¼ percentage point change ('25bps') in key assumptions on the present value of defined benefit obligation as at 31 December:

Pension plans

	2015	2014
	$m	$m
Discount rate		
Change in defined benefit obligation at year end from a 25 bps increase	**(26)**	(26)
Change in defined benefit obligation at year end from a 25 bps decrease	**27**	27
Rate of pay increase		
Change in defined benefit obligation at year end from a 25 bps increase	**5**	6
Change in defined benefit obligation at year end from a 25 bps decrease	**(5)**	(6)

Non-pension plans

Change in defined benefit obligation at year end from a 25 bps increase in the discount rate	**(8)**	(8)
Increase in defined benefit obligation from each additional year of longevity assumed	**9**	9

Notes on the Consolidated Financial Statements (continued)

4 Employee compensation and benefits *(continued)*

Plan Assets

	2015 **$m**	2014 $m
Fair value of plan assets		
Equities	**159**	175
Bonds	**404**	368
Other – principally bank balances and short-term investments	**6**	1
	569	544

Substantially all the equities and bonds are Level 1 (note 24). Bank balances and short-term investments are considered Level 2.

Fair value of plan assets and present value of defined benefit obligations

	Pension plans		Non-pension plans	
	2015 **$m**	2014 $m	**2015** **$m**	2014 $m
Fair value of plan assets				
At 1 January	**544**	486	**–**	–
Interest on plan assets	**21**	23	**–**	–
Contributions by the bank	**30**	30	**4**	4
Contributions by employees	**1**	1	**–**	–
Experience gains	**3**	34	**–**	–
Benefits paid	**(29)**	(26)	**(4)**	(4)
Non-investment expenses	**(1)**	(1)	**–**	–
Distributed on settlements	**–**	(3)	**–**	–
At 31 December	**569**	544	**–**	–
Present value of defined benefit obligations				
At 1 January	**(653)**	(579)	**(189)**	(157)
Current service cost	**(11)**	(12)	**(6)**	(5)
Interest cost	**(25)**	(27)	**(8)**	(7)
Contributions by employees	**(1)**	(1)	**–**	–
Actuarial gains/(losses) arising from changes in:				
– Demographic assumptions	**–**	(4)	**–**	(1)
– Financial assumptions	**10**	(67)	**4**	(24)
– Experience adjustments	**(7)**	10	**17**	–
Benefits paid	**29**	26	**4**	5
Past service cost	**–**	(1)	**–**	–
Liabilities extinguished on curtailments and settlements	**–**	2	**–**	–
At 31 December	**(658)**	(653)	**(178)**	(189)
Funded	**(595)**	(592)	**–**	–
Unfunded	**(63)**	(61)	**(178)**	(189)
Other – effect of limit on plan surpluses	**(20)**	(11)	**–**	–
Net liability	**(109)**	(120)	**(178)**	(189)

The actual return on plan assets for the year ended 31 December 2015 was $24m (2014: $57m).

Actuarial valuations for the majority of the bank's pension plans are prepared annually and for non-pension arrangements triennially. The most recent actuarial valuations of the defined benefit pension plans for funding purposes were conducted as at 31 December 2014 and the most recent actuarial valuation of the non-pension arrangements was as at 31 December 2014. Based on the most recent valuations of the plans, the bank expects to make $20m of contributions to defined benefit pension plans during 2016.

4 Employee compensation and benefits *(continued)*

The defined benefit pension plans expose the bank to risks, including: interest rate risk to the extent that the assets are not invested in bonds that match the plans' obligations, general market risk in respect of its equity investments, and longevity risk in respect of pensioners and beneficiaries living longer than assumed. These risks would be realized through higher pension costs and a higher defined benefit liability.

The bank takes steps to manage these risks through an asset liability management program, which includes reducing interest rate and market risk over time by increasing its asset allocation to bonds that more closely match the plan's obligations.

Summary of remeasurement, net on defined benefit obligations

	Pension plans		Non-pension plans	
	2015	2014	**2015**	2014
	$m	$m	**$m**	$m
Experience gain on plan assets	**3**	34	**–**	–
Demographic assumptions	**–**	(4)	**–**	–
Financial assumptions	**10**	(67)	**4**	(24)
Experience adjustments	**(6)**	10	**17**	(1)
Effect of increase in limit on plan surpluses	**(9)**	11	**–**	–
	(2)	(16)	**21**	(25)

5 Share-based payments

Accounting policy

HSBC Holdings is the grantor of its equity instruments awarded to employees of the bank. The bank is required to partially fund share-based payment arrangements awarded to its 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 recognized as an expense on a straight-line basis over the vesting period.

Fair value is determined by using appropriate valuation models, taking into account the terms and conditions of the award. Vesting conditions include service conditions and performance conditions; any other features of 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 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 recognized immediately for the amount that would otherwise have been recognized for services over the vesting period.

Share-based payments income statement charge

	2015	2014
	$m	$m
Restricted share awards	**11**	11
Savings-related share option plans	**–**	1
	11	12

Notes on the Consolidated Financial Statements (continued)

5 Share-based payments *(continued)*

During 2015, $11m was charged to the income statement in respect of share-based payment transactions (2014: $12m) mostly relating to restricted share awards. These awards are generally granted to employees early in the year following the year to which the award relates. The charge for these awards is recognized from the start of the period to which the service relates to the end of the vesting period. The vesting period is the period over which the employee satisfies certain service conditions in order to become entitled to the award. Due to the staggered vesting profile of certain deferred share awards, the employee becomes entitled to a portion of the award at the end of each year during the vesting period. The income statement charge reflects this vesting profile.

The purpose of restricted share awards is to support retention of key employees, and to reward employee performance and potential. Vesting of restricted share awards is generally subject to continued employment with a vesting period of three years and may be subject to performance conditions.

The weighted average fair value of shares awarded by the HSBC Group for restricted share awards in 2015 was $10.72 per share (2014: $11.40 per share). Fair value is measured at the prevailing market price at the date of the share award.

The bank carries a liability in respect of restricted share awards of $9m as at 31 December 2015 (2014: $19m) to its parent, HSBC Holdings, for the funding of awards that will vest in the future.

6 Tax expense

Accounting policy

Income tax comprises current tax and deferred tax. Income tax is recognized in the income statement except to the extent that it relates to items recognized in other comprehensive income or directly in equity, in which case it is recognized 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. The bank provides for potential current tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities. Current tax assets and liabilities are offset when the bank intends to settle on a net basis and the legal right to offset exists.

Deferred tax is recognized 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 recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilized.

Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realized 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 the bank has a legal right to offset.

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

	2015	2014
	$m	$m
Current taxation		
Federal	**99**	141
Provincial	**75**	105
	174	246
Deferred taxation		
Origination and reversal of temporary differences	**(4)**	17
Tax expense	**170**	263

6 Tax expense *(continued)*

The provision for income taxes shown in the consolidated income statement is at a rate that is different than the combined federal and provincial statutory income tax rate for the following reasons:

Analysis of tax expense	**2015**	2014
	%	%
Combined federal and provincial income tax rate	**26.3**	26.2
Adjustments resulting from:		
Adjustments related to prior years	**–**	3.5
Substantively enacted tax rate changes	**–**	–
Other, net	**1.5**	(0.5)
Effective tax rate	**27.8**	29.2

In addition to the amount charged to the income statement, the aggregate amount of current and deferred taxation relating to items that are taken directly to equity was a $3m increase in equity (2014: $17m increase in equity).

Deferred taxation

Movement in deferred taxation during the year:

	2015	2014
	$m	$m
At 1 January	**112**	120
Income statement charge	**5**	(17)
Other movements	**(2)**	(1)
Other comprehensive income:		
Share-base payment	**(2)**	–
Actuarial gains and losses	**(4)**	10
At 31 December	**109**	112

The amount of deferred taxation accounted for in the balance sheet comprised the following deferred tax assets and liabilities:

	2015	2014
	$m	$m
Deferred tax assets		
Retirement benefits	**76**	81
Loan impairment allowances	**93**	37
Property, plant and equipment	**1**	–
Assets leased to customers	**(102)**	(88)
Share-based payments	**4**	5
Relief for tax losses carried forward	**3**	38
Other temporary differences	**34**	39
	109	112
Deferred tax liabilities		
Cash flow hedges	**–**	(1)
Net deferred tax asset	**109**	111

The amount of temporary differences for which no deferred tax asset is recognized in the balance sheet is $4.2m (2014: $4.2m). This amount is in respect of capital losses where the recoverability of potential benefits is not considered likely. The entire amount has no expiry date.

Deferred tax is not recognized in respect of the bank's investments in subsidiaries where remittance of retained earning is not contemplated, and for those associates where it has been determined that no additional tax will arise. The aggregate amount of temporary differences associated with investments where no deferred tax liability is recognized is $544m (2014: $290m).

On the evidence available, including management's updated analysis and projection of income, there will be sufficient taxable income generated by the bank to support the recognition of its net deferred tax asset.

Notes on the Consolidated Financial Statements (continued)

7 Dividends

Dividends on our shares declared and paid, and distributions per unit on our HSBC HaTS™ in each of the last two years were as follows:

	2015		2014	
	$per share/unit	**$m**	$per share/unit	$m
Common Shares		**332**		400
Preferred Shares Class 1				
Series C	**1.275**	**9**	1.275	9
Series D	**1.250**	**9**	1.250	9
Series E[1]	**–**	**–**	0.825	8
Series G[2]	**0.500**	**10**	–	–
HSBC HaTS™				
Series 2015[3]	**25.75**	**5**	51.50	10

1 *Preferred shares – Class 1, Series E were redeemed on 30 June 2014*
2 *Preferred shares – Class 2, Series G were issued on 30 June 2015*
3 *HSBC HaTS™ Series 2015 were redeemed on 30 June 2015*

8 Segment analysis

Accounting policy

The bank's operations are managed according to the following global lines of business: Commercial Banking, Global Banking and Markets, as well as Retail Banking and Wealth Management. Measurement of segmental assets, liabilities, income and expenses is in accordance with the bank's accounting policies. Segmental income and expenses include transfers between segments and these transfers are conducted at arm's length. Shared costs are included in segments on the basis of the actual recharges made.

We manage and report our operations according to the following global lines of business: Commercial Banking, Global Banking and Markets, as well as Retail Banking and Wealth Management. Various estimate and allocation methodologies are used in the preparation of the global lines of business financial information. We allocate expenses directly related to earning revenues to the global lines of business that earned the related revenue. Expenses not directly related to earning revenue, such as overhead expenses, are allocated to global lines of business using appropriate allocation formulas. Global lines of business net interest income reflects internal funding charges and credits on the global lines of business assets, liabilities and capital, at market rates, taking into account relevant terms. The offset of the net impact of these charges and credits is reflected in Global Banking and Markets.

A description of each customer group is as follows:

Commercial Banking

Commercial Banking consist of Corporate, to serve both large and mid-market companies with more sophisticated financial needs, and Business Banking, to serve small and medium-sized enterprises ('SME's), enabling differentiated coverage of our target customers. Client offering includes Credit and Lending; International trade and receivables finance; Payments and Cash Management; and Global Banking and Markets.

Global Banking and Markets

Global Banking and Markets provides tailored financial solutions to major government, corporate and institutional clients worldwide. Managed as a global business, Global Banking and Markets operates a long-term relationship management approach to build a full understanding of clients' financial requirements. Sector-focused client service teams comprising of relationship managers and product specialists develop financial solutions to meet individual client needs. Global Banking and Markets is managed as three principal business lines: Markets, Capital Financing and Banking.

8 Segment analysis *(continued)*

Retail Banking and Wealth Management

Retail Banking and Wealth Management provides banking and wealth management services for our personal customers to help them to manage their finances and protect and build their financial future. Customer offerings include: liability-driven services (deposits and account services), asset-driven services (credit and lending), and fee-driven and other services (financial advisory and asset management).

Other

'Other' contains the results of movements in fair value of own debt, income related to information technology services provided to HSBC Group companies on an arm's length basis with associated recoveries and other transactions which do not directly relate to our global lines of business.

	2015	2014
	$m	$m
Commercial Banking		
Net interest income	**598**	658
Net fee income	**319**	324
Net trading income	**33**	26
Gains less losses from financial investments	**–**	16
Other operating income	**25**	19
Total operating income	**975**	1,043
Loan impairment charges and other credit risk provisions	**(218)**	(79)
Net operating income	**757**	964
Total operating expenses	**(433)**	(408)
Operating profit	**324**	556
Share of profit in associates	**–**	11
Profit before income tax expense	**324**	567
Global Banking and Markets		
Net interest income	**175**	179
Net fee income	**138**	98
Net trading income	**2**	68
Gains less losses from financial investments	**63**	40
Other operating income	**–**	1
Net operating income	**378**	386
Loan impairment charges and other credit risk provisions	**(5)**	(5)
Net operating income	**373**	381
Total operating expenses	**(135)**	(117)
Profit before income tax expense	**238**	264
Retail Banking and Wealth Management		
Net interest income	**393**	413
Net fee income	**225**	223
Net trading income	**22**	18
Gains less losses from financial investments	**–**	–
Other operating income	**13**	8
Total operating income	**653**	662
Loan impairment charges and other credit risk provisions	**(11)**	(23)
Net operating income	**642**	639
Total operating expenses	**(567)**	(533)
Profit before income tax expense	**75**	106

Notes on the Consolidated Financial Statements (continued)

8 Segment analysis *(continued)*

	2015 $m	2014 $m
Other		
Net interest expense	**(23)**	(38)
Net fee income	**1**	–
Net trading income	**24**	34
Net income/(expense) from financial instruments designated at fair value	**3**	(5)
Other operating income	**26**	28
Total operating income	**31**	19
Total operating expenses	**(51)**	(44)
Loss before income tax expense	**(20)**	(25)

Other information about the profit/(loss) for the year

	Commercial Banking $m	*Global Banking and Markets* $m	*Retail Banking and Wealth Management* $m	*Other* $m	*Total* $m
Year ended 31 December 2015					
Net operating income	**757**	**373**	**642**	**31**	**1,803**
External	**722**	**330**	**720**	**31**	**1,803**
Inter-segment	**35**	**43**	**(78)**	**–**	**–**
Year ended 31 December 2014					
Net operating income	964	381	639	19	2,003
External	915	332	737	19	2,003
Inter-segment	49	49	(98)	–	–

8 Segment analysis *(continued)*

Balance sheet information

	Commercial Banking **$m**	*Global Banking and Markets* **$m**	*Retail Banking and Wealth Management* **$m**	*Other* **$m**	*Intersegment* **$m**	*Total* **$m**
At 31 December 2015						
Loans and advances to customers (net)	**21,728**	**2,523**	**24,127**	**–**	**–**	**48,378**
Customers' liability under acceptances....	**2,794**	**1,040**	**–**	**–**	**–**	**3,834**
Total assets	**28,801**	**50,161**	**28,669**	**411**	**(14,018)**	**94,024**
Customer accounts	**22,684**	**6,774**	**25,631**	**–**	**–**	**55,089**
Acceptances	**2,794**	**1,040**	**–**	**–**	**–**	**3,834**
Total liabilities.....	**25,828**	**48,537**	**27,890**	**411**	**(14,018)**	**88,648**
At 31 December 2014						
Loans and advances to customers (net)	16,093	1,642	23,484	–	–	41,219
Customers' liability under acceptances....	4,168	855	–	–	–	5,023
Total assets	29,210	44,194	27,585	421	(13,206)	88,204
Customer accounts	21,645	4,939	24,259	–	–	50,843
Acceptances	4,168	855	–	–	–	5,023
Total liabilities.....	26,312	42,853	26,824	421	(13,206)	83,204

Notes on the Consolidated Financial Statements (continued)

9 Analysis of financial assets and liabilities by measurement basis

Financial assets and financial liabilities are measured on an ongoing basis at either fair value or amortized cost. The following tables analyze the carrying amount of financial assets and liabilities by category as defined in IAS 39 and by balance sheet heading:

	2015						
	Held for trading $m	*Designated at fair value* $m	*Available-for-sale securities* $m	*Financial assets and liabilities at amortized cost* $m	*Derivatives designated as fair value hedging instruments* $m	*Derivatives designated as cash flow hedging instruments* $m	*Total* $m
Financial assets							
Cash and balances at central bank	–	–	–	65	–	–	65
Items in the course of collection from other banks	–	–	–	73	–	–	73
Trading assets	3,893	–	–	–	–	–	3,893
Derivatives	4,623	–	–	–	104	182	4,909
Loans and advances to banks	–	–	–	1,400	–	–	1,400
Loans and advances to customers	–	–	–	48,378	–	–	48,378
Reverse repurchase agreements	–	–	–	6,807	–	–	6,807
Financial investments	–	–	23,935	–	–	–	23,935
Other assets	–	–	–	365	–	–	365
Prepayments and accrued income	–	–	–	194	–	–	194
Customers' liability under acceptances	–	–	–	3,834	–	–	3,834
Property, plant and equipment	–	–	–	110	–	–	110
Goodwill and intangible assets	–	–	–	61	–	–	61
Total financial assets	8,516	–	23,935	61,287	104	182	94,024
Financial liabilities							
Deposits by banks	–	–	–	2,049	–	–	2,049
Customer accounts	–	–	–	55,089	–	–	55,089
Repurchase agreements	–	–	–	6,606	–	–	6,606
Items in the course of transmission to other banks	–	–	–	219	–	–	219
Trading liabilities	1,713	–	–	–	–	–	1,713
Financial liabilities designated at fair value	–	414	–	–	–	–	414
Derivatives	4,539	–	–	–	258	208	5,005
Debt securities in issue	–	–	–	10,896	–	–	10,896
Other liabilities	–	–	–	1,775	–	–	1,775
Acceptances	–	–	–	3,834	–	–	3,834
Accruals	–	–	–	474	–	–	474
Subordinated liabilities	–	–	–	239	–	–	239
Total financial liabilities	6,252	414	–	81,181	258	208	88,313

	2014						
	Held for trading $m	*Designated at fair value* $m	*Available-for-sale securities* $m	*Financial assets and liabilities at amortized cost* $m	*Derivatives designated as fair value hedging instruments* $m	*Derivatives designated as cash flow hedging instruments* $m	*Total* $m
Financial assets							
Cash and balances at central bank	–	–	–	73	–	–	73
Items in the course of collection from other banks	–	–	–	76	–	–	76
Trading assets	8,914	–	–	–	–	–	8,914
Derivatives	3,591	–	–	–	33	458	4,082
Loans and advances to banks	–	–	–	1,264	–	–	1,264
Loans and advances to customers	–	–	–	41,219	–	–	41,219
Reverse repurchase agreements	–	–	–	6,714	–	–	6,714
Financial investments	–	–	20,122	–	–	–	20,122
Other assets	–	–	–	102	–	–	102
Accrued income	–	–	–	159	–	–	159
Customers' liability under acceptances	–	–	–	5,023	–	–	5,023
Total financial assets	12,505	–	20,122	54,630	33	458	87,748
Financial liabilities							
Deposits by banks	–	–	–	681	–	–	681
Customer accounts	–	–	–	50,843	–	–	50,843
Repurchase agreements	–	–	–	4,054	–	–	4,054
Items in the course of transmission to other banks	–	–	–	105	–	–	105
Trading liabilities	4,227	–	–	–	–	–	4,227
Financial liabilities designated at fair value	–	425	–	–	–	–	425
Derivatives	3,478	–	–	–	163	244	3,885
Debt securities in issue	–	–	–	10,610	–	–	10,610
Other liabilities	–	–	–	2,219	–	–	2,219
Acceptances	–	–	–	5,023	–	–	5,023
Accruals	–	–	–	524	–	–	524
Subordinated liabilities	–	–	–	239	–	–	239
Total financial liabilities	7,705	425	–	74,298	163	244	82,835

Notes on the Consolidated Financial Statements (continued)

10 Trading assets

Accounting policy

Financial assets are classified as held for trading if they have been acquired principally for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. They are recognized on trade date, when the bank enters into contractual arrangements with counterparties, and are normally derecognized when sold. They are initially measured at fair value, with transaction costs taken to the income statement. Subsequent changes in their fair values and interest earned are recognized in the income statement in 'Net trading income'.

	2015 **$m**	2014 $m
Trading assets:		
not subject to repledge or resale by counterparties	**2,651**	7,938
which may be repledged or resold by counterparties	**1,242**	976
	3,893	8,914
Canadian and Provincial Government bonds[1]	**2,247**	1,963
Debt securities	**778**	815
Total debt securities	**3,025**	2,778
Banker's acceptances	**–**	3,254
Customer trading assets	**226**	2,208
Treasury and other eligible bills	**642**	674
	3,893	8,914

1 *Including government guaranteed bonds*

Term to maturity of debt securities	**2015**	2014
Less than 1 year	**778**	695
1–5 years	**1,638**	1,333
5–10 years	**447**	514
Over 10 years	**162**	236
	3,025	2,778

Banker's acceptances originated in the fourth quarter of 2015 and onwards, were categorized as loans and advances on the balance sheet.

11 Derivatives

Accounting policy

Derivatives

Derivatives are initially recognized, and are subsequently re-measured, at fair value. Fair values of derivatives are obtained either from quoted market prices or by using valuation techniques. Derivatives are only offset for accounting purposes if the offsetting criteria are met.

Embedded derivatives are treated as separate derivatives ('bifurcated') 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 recognized 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 if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

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

When derivatives are designated as hedges, the bank classifies them as either: (i) hedges of the change in fair value of recognized assets or liabilities or firm commitments ('fair value hedges'); or (ii) hedges of the variability in highly probable future cash flows attributable to a recognized asset or liability, or a forecast transaction ('cash flow hedges').

Hedge accounting

At the inception of a hedging relationship, the bank documents the relationship between the hedging instruments and the hedged items, its risk management objective and its strategy for undertaking the hedge. The bank requires a 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 thereof in relation to the risk being hedged. 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 amortized to the income statement on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognized.

Cash flow hedge:

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in other comprehensive income; the residual change in fair value is recognized immediately in the income statement.

The accumulated gains and losses recognized 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 forecasted transactions that result in recognition of a non-financial asset or liability, previous gains and losses recognized in other comprehensive income are included in the initial measurement of the asset or liability.

When a hedging relationship is discontinued, any previous cumulative gain or loss recognized in other comprehensive income remains in equity until the forecast transaction is recognized in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss previously recognized in other comprehensive income is immediately reclassified to the income statement.

Hedge effectiveness testing

To qualify for hedge accounting, the bank 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 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 0.8 to 1.25. Hedge ineffectiveness is recognized in the income statement in 'Net trading income'.

Notes on the Consolidated Financial Statements (continued)

11 Derivatives *(continued)*

Derivatives that do not qualify for hedge accounting

Non-qualifying hedges are economic hedges entered into as part of documented interest rate management strategies for which hedge accounting was not applied. Changes in fair value of non-qualifying hedges do not alter the cash flows expected as part of the documented management strategies for both the non-qualifying hedge instruments and the related assets and liabilities.

Fair values of derivatives by product contract type held

	2015					
	Assets			**Liabilities**		
	Trading **$m**	*Hedging* **$m**	*Total* **$m**	*Trading* **$m**	*Hedging* **$m**	*Total* **$m**
Foreign exchange	**3,729**	**–**	**3,729**	**3,637**	**190**	**3,827**
Interest rate	**827**	**286**	**1,113**	**841**	**276**	**1,117**
Commodity	**61**	**–**	**61**	**61**	**–**	**61**
Equity	**6**	**–**	**6**	**–**	**–**	**–**
Gross total fair values	**4,623**	**286**	**4,909**	**4,539**	**466**	**5,005**

	2014					
	Assets			Liabilities		
	Trading $m	*Hedging* $m	*Total* $m	*Trading* $m	*Hedging* $m	*Total* $m
Foreign exchange	2,861	328	3,189	2,789	177	2,966
Interest rate	603	163	766	573	230	803
Commodity	116	–	116	116	–	116
Equity	11	–	11	–	–	–
Gross total fair values	3,591	491	4,082	3,478	407	3,885

11 Derivatives *(continued)*

The following tables summarize the notional amounts by remaining term to maturity of the derivative portfolio.

	2015								
	Trading				**Hedging**				**Total**
	Less than 1 year **$m**	*1 to 5 years* **$m**	*More than 5 years* **$m**	*Total trading* **$m**	*Less than 1 year* **$m**	*Between 1–5 years* **$m**	*Over 5 years* **$m**	*Total hedging* **$m**	**$m**
Interest rate contracts									
Exchange traded futures	**2,524**	**2,013**	**–**	**4,537**	**–**	**–**	**–**	**–**	**4,537**
Swaps	**8,440**	**24,502**	**13,711**	**46,653**	**2,797**	**16,060**	**6,655**	**25,512**	**72,165**
Caps	**546**	**1,195**	**–**	**1,741**	**–**	**–**	**–**	**–**	**1,741**
Other interest rate contracts	**425**	**–**	**–**	**425**	**–**	**–**	**–**	**–**	**425**
	11,935	**27,710**	**13,711**	**53,356**	**2,797**	**16,060**	**6,655**	**25,512**	**78,868**
Foreign exchange contracts									
Spot contracts	**2,554**	**–**	**–**	**2,554**	**–**	**–**	**–**	**–**	**2,554**
Forward contracts	**91,624**	**3,903**	**73**	**95,600**	**–**	**–**	**–**	**–**	**95,600**
Currency swaps and options	**23,676**	**11,767**	**3,408**	**38,851**	**290**	**1,766**	**–**	**2,056**	**40,907**
	117,854	**15,670**	**3,481**	**137,005**	**290**	**1,766**	**–**	**2,056**	**139,061**
Other derivative contracts									
Commodity contracts	**90**	**1**	**–**	**91**	**–**	**–**	**–**	**–**	**91**
Equity	**49**	**18**	**–**	**67**	**–**	**–**	**–**	**–**	**67**
	139	**19**	**–**	**158**	**–**	**–**	**–**	**–**	**158**
	129,928	**43,399**	**17,192**	**190,519**	**3,087**	**17,826**	**6,655**	**27,568**	**218,087**

	2014								
	Trading				Hedging				Total
	Less than 1 year $m	*1 to 5 years* $m	*More than 5 years* $m	*Total trading* $m	*Less than 1 year* $m	*Between 1–5 years* $m	*Over 5 years* $m	*Total hedging* $m	$m
Interest rate contracts									
Exchange traded futures	1,501	1,585	86	3,172	–	–	–	–	3,172
Swaps	7,643	22,542	9,584	39,769	6,112	17,449	6,206	29,767	69,536
Caps	–	627	–	627	–	–	–	–	627
Other interest rate contracts	3,759	66	–	3,825	–	–	–	–	3,825
	12,903	24,820	9,670	47,393	6,112	17,449	6,206	29,767	77,160
Foreign exchange contracts									
Spot contracts	2,966	–	–	2,966	–	–	–	–	2,966
Forward contracts	73,791	3,979	66	77,836	–	–	–	–	77,836
Currency swaps and options	40,469	7,836	2,950	51,255	57	3,403	–	3,460	54,715
	117,226	11,815	3,016	132,057	57	3,403	–	3,460	135,517
Other derivative contracts									
Commodity contracts	155	12	–	167	–	–	–	–	167
	130,284	36,647	12,686	179,617	6,169	20,852	6,206	33,227	212,844

11 Derivatives *(continued)*

Use of derivatives

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

The bank'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 in accordance with the bank's approved risk management policies, with matching deals being used to achieve this where necessary. When entering into derivative transactions, the bank employs the same credit risk management procedures that are used for traditional lending to assess and approve potential credit exposures.

Trading derivatives

Most of the bank's derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities in derivatives are entered into principally for the purpose of generating profits from short-term fluctuations in price or margin. Positions may be traded actively or be held over a period of time to benefit from expected changes in currency rates, interest rates, equity prices or other market parameters. Trading includes market-making, positioning and arbitrage activities. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume; positioning means managing market risk positions in the expectation of benefiting from favourable movements in prices, rates or indices; arbitrage involves identifying and profiting from price differentials between markets and products.

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

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

11 Derivatives *(continued)*

An analysis of the derivative portfolio and related credit exposure

	2015			2014		
	Notional amount[1] **$m**	*Credit equivalent amount*[2] **$m**	*Risk-weighted balance*[3] **$m**	*Notional amount*[1] $m	*Credit equivalent amount*[2] $m	*Risk-weighted balance*[3] $m
Interest rate contracts						
Future	**4,537**	**–**	**–**	3,172	–	–
Swaps	**72,165**	**553**	**287**	69,536	691	267
Caps	**1,741**	**5**	**2**	627	2	1
Other interest rate contracts	**425**	**–**	**–**	3,825	7	1
	78,868	**558**	**289**	77,160	700	269
Foreign exchange contracts						
Spot contracts	**2,554**	**–**	**–**	2,966	–	–
Forward contracts	**95,600**	**1,655**	**444**	77,836	967	252
Currency swaps and options	**40,907**	**1,363**	**580**	54,715	1,788	476
	139,061	**3,018**	**1,024**	135,517	2,755	728
Other derivative contracts						
Commodity contracts	**91**	**23**	**7**	167	51	7
Equities	**67**	**–**	**–**	–	–	–
	158	**23**	**7**	167	51	7
	218,087	**3,599**	**1,320**	212,844	3,506	1,004

1 *Notional amounts are the contract amounts used to calculate the cash flows to be exchanged. They are a common measure of the volume of outstanding transactions, but do not represent credit or market risk exposure.*

2 *Credit equivalent amount is the current replacement cost plus an amount for future credit exposure associated with the potential for future changes in currency and interest rates. The future credit exposure is calculated using a formula prescribed by OSFI in its capital adequacy guidelines.*

3 *Risk-weighted balance represents a measure of the amount of regulatory capital required to support the derivative activities. It is estimated by risk weighting the credit equivalent amounts according to the credit worthiness of the counterparties using factors prescribed by OSFI in its capital adequacy guidelines.*

Interest rate and currency futures are exchange-traded. All other contracts are over-the-counter. The notional or contractual amounts of these instruments indicate the nominal value of transactions outstanding at the reporting date; they do not represent amounts at risk.

Hedging instruments

The bank 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 bank to optimize the overall cost to the bank 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.

Fair value hedges

The bank'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. For qualifying fair value hedges, all changes in the fair value of the derivative and in the fair value of the item in relation to the risk being hedged are recognized in the income statement. If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortized to the income statement as a yield adjustment over the remainder of the hedging period.

11 Derivatives *(continued)*

Fair value of derivatives designated as fair value hedges

	2015		2014	
	Assets **$m**	***Liabilities*** **$m**	*Assets* $m	*Liabilities* $m
Interest rate	**104**	**258**	32	163

Gains or losses arising from the change in fair value of fair value hedges

	2015 **$m**	2014 $m
Gains/(losses)		
– on hedging instruments	**(121)**	(146)
– on hedged items attributable to the hedged risk	**121**	144

The gains and losses on ineffective portions of fair value hedges are recognized immediately in 'Net trading income'.

Cash flow hedges

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

Fair value of derivatives designated as cash flow hedges

	2015		2014	
	Assets **$m**	***Liabilities*** **$m**	*Assets* $m	*Liabilities* $m
Foreign exchange	**–**	**190**	327	176
Interest rate	**182**	**18**	130	67

The schedule of forecast principal balances on which the expected interest cash flows arise as at 31 December is as follows:

	2015			
	3 months or less **$m**	*More than 3 months but less than 1 year* **$m**	*More than 1 year but less than 5 years* **$m**	*5 years or more* **$m**
Assets	**11,840**	**11,029**	**8,874**	**1,037**
Liabilities	**(243)**	**(243)**	**(243)**	**(243)**
Net cash inflow/(outflow) exposure	**11,597**	**10,786**	**8,631**	**794**

	2014			
	3 months or less $m	*More than 3 months but less than 1 year* $m	*More than 1 year but less than 5 years* $m	*5 years or more* $m
Assets	14,033	12,249	10,028	574
Liabilities	(6,756)	(6,615)	(6,340)	(785)
Net cash inflow/(outflow) exposure	7,277	5,634	3,688	(211)

The gains and losses on ineffective portions of such derivatives are recognized immediately in 'Net trading income'. During 2015, a gain of $2m (2014: gain of $7m) was recognized due to hedge ineffectiveness.

The following tables summarize the fair values of the bank's derivative portfolio at 31 December segregated between derivatives that are in a favourable or receivable position and those in an unfavourable or payable position. Fair values of derivative instruments are determined using observable inputs (note 24).

	2015						
	Trading			**Hedging**			
	Favourable position **$m**	*Unfavourable position* **$m**	*Net position* **$m**	*Favourable position* **$m**	*Unfavourable position* **$m**	*Net position* **$m**	*Total net position* **$m**
Interest rate contracts							
Swaps	**821**	**(833)**	**(12)**	**286**	**(276)**	**10**	**(2)**
Caps	**5**	**(5)**	**–**	**–**	**–**	**–**	**–**
Other interest rate contracts	**1**	**(3)**	**(2)**	**–**	**–**	**–**	**(2)**
	827	**(841)**	**(14)**	**286**	**(276)**	**10**	**(4)**
Foreign exchange contracts							
Spot contracts	**2**	**(4)**	**(2)**	**–**	**–**	**–**	**(2)**
Forward contracts	**1,953**	**(1,914)**	**39**	**–**	**–**	**–**	**39**
Currency swaps and options	**1,774**	**(1,719)**	**55**	**–**	**(190)**	**(190)**	**(135)**
	3,729	**(3,637)**	**92**	**–**	**(190)**	**(190)**	**(98)**
Other derivative contracts							
Commodity contracts	**61**	**(61)**	**–**	**–**	**–**	**–**	**–**
Equities	**6**	**–**	**6**	**–**	**–**	**–**	**6**
	67	**(61)**	**6**	**–**	**–**	**–**	**6**
	4,623	**(4,539)**	**84**	**286**	**(466)**	**(180)**	**(96)**

Notes on the Consolidated Financial Statements (continued)

11 Derivatives *(continued)*

	2014						
	Trading			Hedging			
	Favourable position $m	*Unfavourable position* $m	*Net position* $m	*Favourable position* $m	*Unfavourable position* $m	*Net position* $m	*Total net position* $m
Interest rate contracts							
Swaps	600	(571)	29	163	(230)	(67)	(38)
Caps	3	(3)	–	–	–	–	–
Other interest rate contracts	–	–	–	–	–	–	–
	603	(574)	29	163	(230)	(67)	(38)
Foreign exchange contracts							
Spot contracts	3	(6)	(3)	–	–	–	(3)
Forward contracts	1,239	(1,180)	59	–	–	–	59
Currency swaps and options	1,619	(1,602)	17	328	(177)	151	168
	2,861	(2,788)	73	328	(177)	151	224
Other derivative contracts							
Commodity contracts	116	(116)	–	–	–	–	–
	3,580	(3,478)	102	491	(407)	84	186

12 Financial investments

Accounting policy

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. They are recognized on trade date when the bank enters into contractual arrangements to purchase those instruments, and are normally derecognized when either the securities are sold or redeemed.

Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. They are subsequently re-measured at fair value, and changes therein are recognized 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 recognized in other comprehensive income are recognized in the income statement as 'Gains less losses from financial investments'.

Interest income is recognized over the debt asset's expected life. Premiums and/or discounts arising on the purchase of dated debt securities are included in the interest recognized. Dividends from equity assets are recognized in the income statement when the right to receive payment is established.

The accounting policy related to impairment of available-for-sale securities is presented in note 1(h).

12 Financial investments *(continued)*

Financial investments comprise the following:

	2015 $m	2014 $m
Financial investments		
Not subject to repledge or resale by counterparties	**20,325**	17,648
Which may be repledged or resold by counterparties	**3,610**	2,474
	23,935	20,122
Available-for-sale		
Canadian and Provincial Government bonds[1]	**16,752**	14,846
International Government bonds[1]	**4,729**	2,947
Other debt securities issued by banks and other financial institutions	**2,139**	1,901
Treasury and other eligible bills	**279**	422
Other debt securities	**36**	6
	23,935	20,122

1 *Includes government guaranteed bonds.*

The term to maturity of financial investments are as follows:

	2015 $m	2014 $m
Term to maturity		
Less than 1 year	**1,615**	4,088
1–5 years	**17,729**	11,417
5–10 years	**4,555**	4,617
No specific maturity	**36**	–
	23,935	20,122

Notes on the Consolidated Financial Statements (continued)

13 Interest rate sensitivity

The following table provides an analysis of the interest rate sensitivity position based on contractual repricing dates of assets and liabilities.

	2015									
	Floating rate $m	*Within 3 months* $m	*3–12 months* $m	*Average interest rate* %	*1–5 years* $m	*Average interest rate* %	*Greater than 5 years* $m	*Average interest rate* %	*Non-interest sensitive* $m	*Total* $m
Cash and balances at central bank	–	–	–		–		–		65	65
Items in the course of collection from other banks	–	–	–		–		–		73	73
Trading assets	3,893	–	–	0.6	–		–			3,893
Derivatives	–	–	–		–		–		4,909	4,909
Loans and advances to banks	–	899	–	0.5	–		–		501	1,400
Loans and advances to customers	27,204	12,106	2,752	2.5	6,096	3.4	181	3.8	39	48,378
Reverse repurchase agreements	–	6,807	–	0.5	–		–			6,807
Financial investments	–	3,297	970	0.9	14,000	1.3	5,631	2.3	37	23,935
Acceptances	–	–	–		–		–		3,834	3,834
Other assets	–	–	–		–		–		730	730
Total assets	31,097	23,109	3,722		20,096		5,812		10,188	94,024
Deposits by banks	–	743	640	0.9	–		–		666	2,049
Customer accounts	32,486	3,036	6,795	0.7	2,224	2.1	–	0.9	10,548	55,089
Repurchase agreements	–	6,606	–	0.5	–		–			6,606
Items in the course of transmission to other banks	–	–	–		–		–		219	219
Trading liabilities	1,713	–	–	0.5	–		–			1,713
Financial liabilities designated at fair value	–	–	–		414	4.8	–			414
Derivatives	–	–	–		–		–		5,005	5,005
Debt securities in issue	–	1,777	433	1.6	6,605	2.6	2,081	2.8		10,896
Acceptances	–	–	–		–		–		3,834	3,834
Subordinated liabilities	–	239	–	4.4	–		–			239
Other liabilities	–	–	–		–		–		2,584	2,584
Shareholders' equity	–	–	–		850	4.4	–		4,526	5,376
Non controlling interest	–	–	–		–		–		–	–
Total liabilities and shareholders' equity	34,199	12,401	7,868		10,093		2,081		27,382	94,024
On-balance sheet gap	(3,102)	10,708	(4,146)		10,003		3,731		(17,194)	
Off-balance sheet positions	–	(1,520)	1,779		3,988		(4,427)		–	–
Total interest rate gap	(3,102)	9,188	(2,367)		13,991		(516)		(17,194)	–

13 Interest rate sensitivity *(continued)*

	2014									
	Floating rate $m	*Within 3 months* $m	*3–12 months* $m	*Average interest rate* %	*1–5 years* $m	*Average interest rate* %	*Greater than 5 years* $m	*Average interest rate* %	*Non-interest sensitive* $m	*Total* $m
Cash and balances at central bank	–	–	–		–		–		73	73
Items in the course of collection from other banks	–	–	–		–		–		76	76
Trading assets	5,661	3,239	15	1.1	–		–		–	8,914
Derivatives	–	–	–		–		–		4,082	4,082
Loans and advances to banks	–	918	–	1.0	–		–		346	1,264
Loans and advances to customers	23,721	6,577	3,230	3.2	7,407	3.6	146	4.3	138	41,219
Reverse repurchase agreements	–	6,714	–	1.0	–		–		–	6,714
Financial investments	–	3,329	3,256	1.6	9,015	1.4	4,515	2.7	7	20,122
Acceptances	–	–	–		–		–		5,023	5,023
Other assets	–	–	–		–		–		717	717
Total assets	29,381	20,777	6,501		16,422		4,661		10,462	88,204
Deposits by banks	–	116	–	0.2	–		–		565	681
Customer accounts	27,715	3,817	8,007	1.0	1,889	2.4	–		9,415	50,843
Repurchase agreements	–	4,054	–	1.0	–		–		–	4,054
Items in the course of transmission to other banks	–	–	–		–		–		105	105
Trading liabilities	4,227	–	–	1.0	–		–		–	4,227
Financial liabilities designated at fair value	–	–	–		425	4.8	–		–	425
Derivatives	–	–	–		–		–		3,885	3,885
Debt securities in issue	–	3,054	1,824	2.1	3,397	2.9	2,335	3.0	–	10,610
Acceptances	–	–	–		–		–		5,023	5,023
Subordinated liabilities	–	39	–	1.6	200	5.0	–		–	239
Other liabilities	–	–	–		–		–		3,112	3,112
Shareholders' equity	–	–	–		350	5.1	–		4,450	4,800
Non controlling interest	–	–	200	5.2	–		–		–	200
Total liabilities and shareholders' equity	31,942	11,081	10,031		6,260		2,335		26,555	88,204
On-balance sheet gap	(2,561)	9,696	(3,530)		10,162		2,326		(16,093)	–
Off-balance sheet positions	–	(800)	218		4,263		(3,681)		–	–
Total interest rate gap	(2,561)	8,896	(3,312)		14,425		(1,355)		(16,093)	–

Notes on the Consolidated Financial Statements (continued)

14 Transfers of financial assets not qualifying for derecognition

Accounting policy

Derecognition of financial assets

Financial assets are derecognized when the contractual right to receive cash flows from the assets has expired; or when the bank 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 bank has neither retained nor transferred substantially all the risks and rewards, but has not retained control.

The following table analyzes the carrying amount of financial assets as at 31 December that did not qualify for derecognition during the year and their associated financial liabilities:

Financial assets and associated liabilities transferred not qualifying for derecognition are as follows:

	2015				2014	
	Fair value of assets **$m**	*Fair value of associated liabilities* **$m**	*Carrying amount of assets* **$m**	*Carrying amount of associated liabilities* **$m**	*Carrying amount of assets* $m	*Carrying amount of associated liabilities* $m
Nature of transaction						
Assets securitized..	**1,098**	**1,106**	**1,100**	**1,094**	1,858	1,915
Mortgages sold with recourse...	**1,638**	**1,638**	**1,634**	**1,634**	1,757	1,757
Repurchase agreements	**6,807**	**6,606**	**6,807**	**6,606**	6,714	4,054
	9,543	**9,350**	**9,541**	**9,334**	10,329	7,726

In addition to assets securitized as noted above which did not result in derecognition of the transferred financial instruments, the bank has also created $535m (2014: $878m) of securitized assets which are collateralized by certain Bank's mortgage receivables which remain on the bank's balance sheet. A liability has not been recognized as the securitized assets have not been transferred to third parties.

15 Property, plant and equipment

Accounting policy

Land and buildings are stated at historical cost, or fair value at the Parent's 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 over their estimated useful lives, which are generally between 20 and 40 years; and
- leasehold improvements are depreciated over the shorter of their unexpired lease terms of the leases or their remaining useful lives.

Equipment, fixtures and fittings (including equipment on operating leases where the bank is the lessor) are stated at cost less impairment losses and depreciation over their useful lives, which are generally between 3 and 5 years.

Property, plant and equipment is subject to an impairment review if their carrying amount may not be recoverable.

15 Property, plant and equipment *(continued)*

	Freehold land and buildings **$m**	*Leasehold improvements* **$m**	*Equipment, fixtures and fittings* **$m**	*Total* **$m**
Cost				
At 1 January 2015	**3**	**163**	**87**	**253**
Additions at cost	**–**	**8**	**7**	**15**
Disposals and write-offs	**–**	**(4)**	**(16)**	**(20)**
At 31 December 2015	**3**	**167**	**78**	**248**
Accumulated depreciation and impairment				
At 1 January 2015	**(2)**	**(76)**	**(51)**	**(129)**
Depreciation charge for the year	**–**	**(15)**	**(14)**	**(29)**
Disposals and write-offs	**–**	**4**	**16**	**20**
At 31 December 2015	**(2)**	**(87)**	**(49)**	**(138)**
Net carrying amount at 31 December 2015	**1**	**80**	**29**	**110**

	Freehold land and buildings $m	*Leasehold improvements* $m	*Equipment, fixtures and fittings* $m	*Total* $m
Cost				
At 1 January 2014	3	163	97	263
Additions at cost	–	11	9	20
Disposals and write-offs	–	(11)	(19)	(30)
At 31 December 2014	3	163	87	253
Accumulated depreciation and impairment				
At 1 January 2014	(2)	(71)	(53)	(126)
Depreciation charge for the year	–	(16)	(17)	(33)
Disposals and write-offs	–	11	19	30
At 31 December 2014	(2)	(76)	(51)	(129)
Net carrying amount at 31 December 2014	1	87	36	124

16 Investments in subsidiaries and other entities

Accounting policy

Subsidiaries

The bank classifies investments in entities which it controls as subsidiaries. The bank's consolidation policy is described in note 1(e).

Structured entities

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 as set out in note 1(e).

The bank 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. The bank is not considered to be a sponsor if the only involvement with the entity is to provide services at arm's length and it ceases to be a sponsor once it has no ongoing involvement with the structured entity.

16 Investments in subsidiaries and other entities *(continued)*

At 31 December 2015, HSBC Bank Canada wholly-owned the following principal subsidiaries:

Subsidiary	*Place of incorporation*	*Issued equity capital*
HSBC South Point Investments (Barbados) LLP[1]	St. Michael, Barbados	989
HSBC Finance Mortgages Inc.	Toronto, Ontario, Canada	410
HSBC Securities (Canada) Inc.	Toronto, Ontario, Canada	187
HSBC Trust Company (Canada)	Vancouver, British Columbia, Canada	201
HSBC Mortgage Corporation (Canada)	Vancouver, British Columbia, Canada	50
HSBC Global Asset Management (Canada) Limited	Vancouver, British Columbia, Canada	19
HSBC Private Wealth Services (Canada) Inc.	Toronto, Ontario, Canada	14
HSBC Capital (Canada) Inc.	Vancouver, British Columbia, Canada	8

1 *On 4 January 2016, substantially all the capital of HSBC South Point Investments (Barbados) LLP was redeemed.*

The bank sponsored and organized Performance Trust ('PT'), a multi-seller asset-backed commercial paper conduit, designed to provide collateralized asset-backed financing primarily to its corporate and institutional clients in Canada. The asset-backed commercial paper structure involves PT purchasing financial instruments issued by client-sponsored special purpose entities for cash or PT providing asset-backed financing directly to its clients. PT funds the eligible assets through a Funding Agreement between PT and Regency Trust Inc. ('Regency'), a multi-seller asset-backed commercial paper conduit sponsored by and consolidated into another HSBC group entity.

The bank is the financial services agent for PT for a market-based fee. As the agent, we are responsible for arranging transactions between clients and PT. As at 31 December, 2015, PT had no outstanding activity or balances. The bank provided liquidity facilities to Regency to backstop the liquidity risk of the commercial paper issued by Regency to fund their clients.

The bank periodically creates National Housing Act Mortgage Backed Securities with certain of the bank's mortgages identified as collateral for such securities and issues these legally created securities to Canada Housing Trust, a structured entity, which issues Canada Mortgage Bonds. The bank does not have any decision-making power over Canada Housing Trust. The bank's only exposure to the Trust is derived from the contractual arrangements arising from the legal transfer of the mortgage backed securities and related collateral. Additional information can be found on Note 14 in respect to assets securitized.

HSBC Investment funds

The bank establishes and manages investment funds such as mutual funds and pooled funds. We act as an investment manager and earn market-based management fees. We do not consolidate those mutual and pooled funds in which our interests indicated that we are exercising our decision making power as an agent of the other unit holder. Seed capital is provided from time to time to HSBC managed investment funds for initial launch. We consolidate those investment funds in which we have power to direct the relevant activities of the funds and in which our seed capital, or our units held, are significant relative to the total variability of returns of the funds such that we are deemed to be a principal rather than an agent.

HSBC Mortgage Fund

The bank periodically transfers mortgages to the HSBC Mortgage Fund (the "fund") in accordance with the investment parameters of the Fund and recognizes a liability for mortgages sold with recourse for the initial proceeds received. The bank provides an undertaking to repurchase mortgages which are in arrears for a period that is greater than 90 days and repurchases mortgages in certain circumstances when an individual mortgage is prepaid in full. In addition to these obligations the bank provides a liquidity arrangement to the HSBC Mortgage Fund whereby if the level of redemption requests by unitholders cannot be met by the fund the bank will either repurchase such funds as are deemed necessary by the HSBC Mortgage Fund to satisfy the liquidity requirements arising from unitholder requests or facilitate the purchase of such mortgages by a third party at the bank's discretion. The bank has not received any such liquidity requests from the Fund in respect of unitholder redemptions.

17 Other assets

Accounting policy

Interests in associates

The bank classifies investments in entities over which it has significant influence, and that are not subsidiaries (note 16), as associates.

Investments in associates are recognized 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 bank's share of net assets.

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

	2015	2014
	$m	$m
Deferred tax	**109**	111
Accounts receivable and other	**78**	92
Investments in associates	**60**	93
Current tax	**76**	29
Due from clients, dealers and clearing corporations	**32**	12
Other non-financial assets	**10**	8
	365	345

18 Goodwill and intangible assets

Accounting policy

Intangible assets

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

Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable. Computer software is stated at cost less amortization and accumulated impairment losses and is amortized over the estimated useful life of between 3 and 5 years.

	2015	2014
	$m	$m
Goodwill	**23**	23
Computer software	**38**	39
	61	62

No goodwill impairment was recognized in 2015 or 2014.

Notes on the Consolidated Financial Statements (continued)

19 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 recognized on trade date, when the bank enters into contractual arrangements with counterparties and are normally derecognized when extinguished. They are initially measured at fair value, with subsequent changes in fair value and interest paid recognized in the income statement in 'Net trading income'.

	2015	2014
	$m	$m
Other liabilities – net short positions	**1,571**	3,910
Customer trading liabilities	**134**	282
Trading liabilities due to other banks	**–**	18
Other debt securities in issue	**8**	17
	1,713	4,227

20 Debt securities in issue

Accounting policy

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

	2015	2014
	$m	$m
Bonds and medium-term notes	**10,616**	10,029
Money market instruments	**280**	581
	10,896	10,610

Debt securities are recorded at cost

Term to maturity		
Less than 1 year	**1,877**	3,712
1–5 years	**6,773**	5,553
Over 5 years	**2,211**	1,302
Over 10 years	**35**	43
	10,896	10,610

21 Financial liabilities designated at fair value

Accounting policy

Financial instruments, other than those held for trading, are classified in this category if they meet the necessary criteria set out below, and are so designated irrevocably at inception. The bank 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 recognizing gains and losses on different bases from related positions. Under this criterion, the main classes of financial liabilities designated by the bank are issued debt securities and subordinated debt. The interest payable on certain fixed rate long-term debt instruments issued has been matched with certain interest rate swaps as part of a documented interest rate risk management strategy. An accounting mismatch would arise if the debt instruments issued were accounted for at amortized cost, and this mismatch is eliminated through the fair value designation;
- 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;
- relates to financial instruments containing one or more non-closely related embedded derivatives.

The fair value designation, once made, is irrevocable. Designated financial liabilities are recognized when the bank enters into the contracts with counterparties, which is generally on trade date, and are normally derecognized when extinguished.

	2015	2014
	$m	$m
Subordinated debentures (note 23)	**414**	425

The carrying amount at 31 December 2015 of financial liabilities designated at fair value was $14m higher (2014: $25m higher) than the contractual amount at maturity. At 31 December 2015, the cumulative amount of change in fair value attributable to changes in credit risk was nil (2014: $2m gain).

22 Other liabilities

Accounting policy

Provisions

Provisions are recognized 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.

	2015	2014
	$m	$m
Mortgages sold with recourse	**1,634**	1,756
Accounts payable	**47**	346
Provisions and other non-financial liabilities	**125**	143
Share-based payment liability	**9**	19
Current tax	**7**	15
	1,822	2,279

Notes on the Consolidated Financial Statements (continued)

23 Subordinated liabilities

Subordinated debentures, which are unsecured and subordinated in right of payment to the claims of depositors and certain other creditors, comprise:

Interest rate (%)	*Year of maturity*	Carrying amount **2015** **$m**	2014 $m
Issued to third parties			
4.94[1]	2021	**200**	200
4.80[2]	2022	**414**	425
30 day bankers' acceptance rate plus 0.50	2083	**39**	39
Total debentures		**653**	664
Less: designated at fair value (note 21)		**(414)**	(425)
Debentures at amortized cost		**239**	239

1 *The interest rate is fixed at 4.94% until March 2016 and thereafter the rate reprices at the 90 day average bankers' acceptance rate plus 1%. On 18 January 2016, the bank announced its intention to redeem all $200m of its 4.94% subordinated debentures. In accordance with the terms, it will be redeemed at 100% of their principal amount plus accrued interest to the redemption date. The redemption will occur on 16 March 2016 and will be financed out of the general corporate funds of HSBC Bank Canada.*

2 *Interest rate is fixed at 4.8% until April 2017 and thereafter interest is payable at an annual rate equal to the 90 day bankers' acceptance rate plus 1%. These debentures are designated as held for trading under the fair value option.*

24 Fair values of financial instruments

Accounting policy

Valuation of financial instruments

All financial instruments are recognized 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 the 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.

The fair value of financial instruments is generally measured on an individual basis. However, in cases where the bank manages a group of financial assets and liabilities according to its net market or credit risk exposure, the bank measures the fair value of the group of financial instruments on a net basis but presents the underlying financial assets and liabilities separately in the financial statements, unless they satisfy the IFRS offsetting criteria as described in note 32.

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. To this end, ultimate responsibility for the determination of fair values lies with the bank's finance department, ('Finance'). Finance establishes the accounting policies and procedures governing valuation, and is responsible for ensuring that they comply with all relevant accounting standards.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilized. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the bank 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 reporting date; and

– the manner in which the data was sourced.

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

Determination of 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 in the principal, or in its absence, the most advantageous market to which the bank has access to at that date. The fair value of a liability reflects its non-performance risk.

Fair values are determined according to the following hierarchy:

Level 1 – quoted market price: financial instruments with quoted prices for identical instruments in active markets.

Level 2 – valuation technique using observable inputs: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

Level 3 – valuation technique with significant unobservable inputs: financial instruments valued using models where one or more significant inputs are unobservable.

The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. In inactive markets, obtaining assurance that the transaction price provides evidence of fair value or determining the adjustments to transaction prices that are necessary to measure the fair value of the instrument requires additional work during the valuation process.

Valuation techniques incorporate assumptions about factors that other market participants would use in their valuations. A range of valuation techniques is employed, dependent upon the instrument type and available market data. Most valuation techniques are based upon discounted cash flow analysis, in which expected future cash flows are calculated and discounted to present value using a discounting curve. Prior to consideration of 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 utilizes 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 are dependent upon more than one market factor, and in these cases it will typically be necessary to consider how movements in one market factor may impact the other market factors. The model inputs necessary to perform such calculations include interest rate yield curves, exchange rates, volatilities, correlations, prepayment and default rates. For interest rate derivatives with collateralized counterparties and in significant currencies, HSBC uses a discounting curve that reflects the overnight interest rate.

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

Notes on the Consolidated Financial Statements (continued)

24 Fair values of financial instruments *(continued)*

In certain circumstances, primarily where debt is hedged with interest rate derivatives or structured notes issued, the bank uses fair value to measure the carrying value of its own debt in issue. The bank records its own debt in issue at fair value, based on quoted prices in an active market for the specific instrument concerned, if available. When quoted market prices are unavailable, the own debt in issue is valued using valuation techniques, the inputs for which are either based upon quoted prices in an inactive market for the instrument, or are estimated by comparison with quoted prices in an active market for similar instruments. In both cases, the fair value includes the effect of applying the credit spread which is appropriate to the bank's liabilities. For all issued debt securities, discounted cash flow modelling is used to separate the change in fair value that may be attributed to the bank's credit spread movements from movements in other market factors such as benchmark interest rates or foreign exchange rates. Specifically, the change in fair value of issued debt securities attributable to the bank'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 risk-free discount curve. The difference in the valuations is attributable to the bank'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 bank would issue structured notes.

Gains and losses arising from changes in the credit spread of liabilities issued by the bank reverse over the contractual life of the debt, provided that the debt is not repaid early. All net positions in non-derivative financial instruments, and all derivative portfolios, are valued at bid or offer prices as appropriate. Long positions are marked at bid prices; short positions are marked at offer prices.

The fair value of a portfolio of financial instruments quoted in an active market is calculated as the product of the number of units and its quoted price and no block discounts are made.

Transaction costs are not included in the fair value calculation, nor are the future costs of administering the over the counter derivative portfolio. These, along with trade origination costs such as brokerage fees and post-trade costs, are included either in 'Fee expense' or in 'Total operating expenses'.

A detailed description of the valuation techniques applied to instruments of particular interest follows:

– *Private equity*

  The bank's private equity portfolios are classified as investments in associates, held at fair value, 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. The exercise of judgment is required because of uncertainties inherent in estimating fair value for private equity investments.

– *Debt securities, treasury and other eligible bills, and equities*

  The fair value of these instruments is based on quoted market prices from an exchange, dealer, broker, industry group or pricing service, when available. When unavailable, the fair value is determined by reference to quoted market prices for similar instruments, adjusted as appropriate for the specific circumstances of the instruments.

  In the absence of quoted market prices, fair value is determined using valuation techniques based on the calculation of the present value of expected future cash flows of the assets. The inputs to these valuation techniques are derived from observable market data and, where relevant, assumptions in respect of unobservable inputs.

– *Derivatives*

Over-the-counter (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 modeling 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. Finally, some inputs are not observable, but can generally be estimated from historical data or other sources. Examples of inputs that are generally observable include foreign exchange spot and forward rates, benchmark interest rate curves and volatility surfaces for commonly traded option products. Examples of inputs that may be unobservable include volatility spreads, 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.

HSBC views the Overnight Indexed Swap ("OIS") curve as the base discounting curve for all derivatives, both collateralized and uncollateralized, and has adopted a 'funding fair value adjustment' to reflect the funding of uncollateralized derivative exposure at rates other than OIS. The bank continues to monitor industry evolution and refine the calculation methodology as necessary.

Derivative products valued using valuation techniques with significant unobservable inputs comprise certain long-dated foreign exchange options.

– *Structured notes*

The fair value of structured notes is derived from the fair value of the underlying debt security as described above, and the fair value of the embedded derivative is determined as described in the paragraph above on derivatives.

Trading liabilities valued using a valuation technique with significant unobservable inputs comprised equity-linked structured notes, which are issued by HSBC and provide the counterparty with a return that is linked to the performance of certain equity securities. The notes are classified as Level 3 due to the unobservability of parameters such as long-dated equity volatilities, correlations between equity prices and interest rates and between interest rates and foreign exchange rates.

Notes on the Consolidated Financial Statements (continued)

24 Fair values of financial instruments *(continued)*

Bases of valuing financial assets and liabilities measured at fair value

The table below provides an analysis of the various bases described above which have been deployed for valuing financial assets and financial liabilities measured at fair value in the consolidated financial statements.

	Valuation techniques			
	Level 1 Quoted market price **$m**	*Level 2 using observable inputs* **$m**	*Level 3 with significant unobservable inputs* **$m**	*Total* **$m**
At 31 December 2015				
Assets				
Trading assets	**2,770**	**1,123**	**–**	**3,893**
Derivatives	**–**	**4,909**	**–**	**4,909**
Financial investments: available-for-sale	**21,204**	**2,731**	**–**	**23,935**
Liabilities				
Trading liabilities	**1,235**	**472**	**6**	**1,713**
Financial liabilities at fair value	**–**	**414**		**414**
Derivatives	**–**	**5,005**	**–**	**5,005**
At 31 December 2014				
Assets				
Trading assets	2,680	6,234	–	8,914
Derivatives	–	4,042	40	4,082
Financial investments: available-for-sale	17,078	3,044	–	20,122
Liabilities				
Trading liabilities	3,753	468	6	4,227
Financial liabilities at fair value	–	425	–	425
Derivatives	–	3,845	40	3,885

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

	Assets		Liabilities	
	Available-for-sale **$m**	*Derivatives* **$m**	*Held for trading* **$m**	*Derivatives* **$m**
At 1 January 2015	**–**	**40**	**6**	**40**
Total gains or losses recognized in profit or loss	**–**	**2**	**–**	**2**
Settlements	**–**		**–**	
Transfer out	**–**	**(98)**	**–**	**(98)**
Transfer in	**–**	**56**	**–**	**56**
At 31 December 2015	**–**	**–**	**6**	**–**
Total gains or losses recognized in profit or loss relating to those assets and liabilities held at the end of the reporting period	**–**	**–**	**–**	**–**

24 Fair values of financial instruments *(continued)*

Bases of valuing financial assets and liabilities measured at fair value (continued)

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy (continued)

	Assets		Liabilities	
	Available-for-sale $m	*Derivatives* $m	*Held for trading* $m	*Derivatives* $m
At 1 January 2014	–	34	9	34
Total gains or losses recognized in profit or loss	–	5	–	5
Settlements	–	–	(1)	–
Transfer out	–	(14)	(3)	(14)
Transfer in	–	15	1	15
At 31 December 2014	–	40	6	40
Total gains or losses recognized in profit or loss relating to those assets and liabilities held at the end of the reporting period	–	5	–	5

During 2015 and 2014, there were no significant transfers between Level 1 and 2.

For assets and liabilities classified as held for trading, realized and unrealized gains and losses are presented in the income statement under 'Trading income excluding net interest income'. The income statement line item 'Net income from financial instruments designated at fair value' captures fair value movements on all other financial instruments designated at fair value and related derivatives.

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

Fair values of financial instruments not carried at fair value

Fair values at the balance sheet date of the assets and liabilities set out below are estimated for the purpose of disclosure at follows:

i) Loans and advances to banks and customers

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

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

ii) Deposits by banks and customer accounts

For the purposes of estimating fair value, deposits by banks and customer accounts are grouped by residual maturity. Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand approximates its book value.

iii) Debt securities in issue and subordinated liabilities

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

24 Fair values of financial instruments *(continued)*

Fair values of financial instruments not carried at fair value (continued)

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

For all classes of financial instruments, fair value represents the product of the value of a single instrument, multiplied by the number of instruments held.

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

Assets

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

Liabilities

Items in the course of transmission to other banks
Acceptances
Short-term payables within 'Other liabilities'
Accruals

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

	2015					2014	
	Carrying amount **$m**	*Fair value* **$m**	*Level 1 Quoted market price* **$m**	*Level 2 using observable inputs* **$m**	*Level 3 with significant unobservable inputs* **$m**	*Carrying amount* $m	*Fair value* $m
Assets							
Loans and advances to banks	**1,400**	**1,400**	**–**	**1,400**	**–**	1,264	1,264
Loans and advances to customers	**48,378**	**48,444**	**–**	**124**	**48,320**	41,219	41,311
Reverse repurchase agreements	**6,807**	**6,807**	**–**	**6,807**	**–**	6,714	6,714
Liabilities							
Deposits by banks	**2,049**	**2,049**	**–**	**2,049**	**–**	681	681
Customer accounts	**55,089**	**55,121**	**–**	**43,426**	**11,695**	50,843	5,882
Repurchase agreements	**6,606**	**6,606**	**–**	**6,606**	**–**	4,054	4,054
Debt securities in issue	**10,896**	**10,960**	**–**	**10,960**	**–**	10,610	10,765
Subordinated liabilities	**239**	**217**	**–**	**217**	**–**	239	247

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

Assets charged as security for liabilities and contingent obligations

In the ordinary course of business, we pledge assets recorded on our consolidated balance sheet in relation to securitization activity, mortgages sold with recourse, securities lending and securities sold under repurchase agreements. These transactions are conducted under terms that are usual and customary to standard securitization, mortgages sold with recourse, securities lending and repurchase agreements. In addition, we also pledge assets to secure our obligations within payment and depository clearing systems.

Financial assets pledged to secure recognized liabilities on the balance sheet and obligations within payment and depository clearing systems:

	2015	2014
	$m	$m
Cash	**1,007**	628
Residential mortgages	**2,734**	3,122
Debt securities	**6,868**	4,783
	10,609	8,533

The bank is required to pledge assets to secure its obligations in the Large Value Transfer System ('LVTS'), which processes electronically in real-time large value and time-critical payments in Canada. In the normal course of business, pledged assets are released upon settlement of the bank's obligations at the end of each business day. Only in very rare circumstances are we required to borrow from the Bank of Canada to cover any settlement obligations. Under those circumstances, the pledged assets would be used to secure the borrowing. No amounts were outstanding under this arrangement at 31 December 2015 or 2014. Consequently, the assets pledged with respect to the bank's LVTS obligations have not been included in the table above.

Collateral accepted as security for assets

The fair value of financial assets accepted as collateral that the bank is permitted to sell or repledge in the absence of default is $7,228m (2014: $7,457m). The fair value of financial assets accepted as collateral that have been sold or repledged is $3,469m (2014: $4,702m). The bank is obliged to return equivalent assets.

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

26 Share capital

Accounting policy

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

Authorized:

Preferred – Unlimited number of Class 1 preferred shares in one or more series and unlimited number of Class 2 preferred shares in one or more series. We may, from time to time, divide any unissued Class 1 preferred shares into separate series and fix the number of shares in each series along with the associated rights, privileges, restrictions and conditions.

Common – 993,677,000 shares.

Issued and fully paid:

	2015		2014	
	Number of shares	*Share capital* **$m**	*Number of shares*	*Share capital* $m
Preferred shares Class 1				
Series C[1]	**7,000,000**	**175**	7,000,000	175
Series D[2]	**7,000,000**	**175**	7,000,000	175
Series G[3]	**20,000,000**	**500**	–	–
	34,000,000	**850**	14,000,000	350
Common Shares	**498,668,000**	**1,225**	498,668,000	1,225

1 *The shares are non-voting, non-cumulative and redeemable. Each share yields 5.1%, payable quarterly, as and when declared. During 2015 and 2014, $9m in dividends were declared and paid. Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash at a declining premium up to 30 June 2014, and at par thereafter. In each case, declared and unpaid dividends will also be paid thereon to the date fixed for redemption.*

We may also, at any time but only with the prior consent of the regulator, give shareholders notice that they have the right, at their option, to convert their shares into a new series of Class 1 Preferred Shares on a share-for-share basis.

2 *The shares are non-voting, non-cumulative and redeemable. Each share yields 5%, payable quarterly, as and when declared. During 2015 and 2014, $9m in dividends were declared and paid.*

Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash at a declining premium up to 31 December 2015, and at par thereafter. In each case, declared and unpaid dividends will also be paid thereon to the date fixed for redemption.

We may also, at any time but only with the prior consent of the regulator, give shareholders notice that they have the right, at their option, to convert their shares into a new series of Class 1 Preferred Shares on a share-for-share basis.

3 *The shares are non-voting, non-cumulative and redeemable. Each share yields 4%, payable quarterly, as and when declared. Subject to regulatory approval, HBCA may on June 30, 2020 and every 5 years thereafter, redeem a portion or all of the Series G shares at par value in cash. The shares include non-viability contingency capital (NVCC) provisions, necessary for the shares to qualify as Tier 1 regulatory capital under Basel III. In the event that OSFI determines that a regulatory defined non-viability trigger event has occurred, NVCC provisions require the write off and cancellation of the Series G shares against equity.*

Dividend restrictions:

We have covenanted that if the Trust fails to pay the indicated yield in full on the HSBC HaTS™, we will not declare dividends on any of our shares unless the Trust first pays the indicated yield (note 27).

27 Non-controlling interest in trust and subsidiary

HSBC Canada Asset Trust (‘the Trust’) was a closed-end trust. The Trust was established by HSBC Trust Company (Canada), our wholly-owned subsidiary, as trustee. The Trust’s objective was to hold qualifying assets which would generate net income for distribution to holders of securities issued by the Trust (‘HSBC HaTS™’). The Trust assets were primarily undivided co-ownership interests in pools of Canada Mortgage and Housing Corporation and Genworth Financial Mortgage Insurance Company Canada insured first mortgages originated by the bank, and Trust deposits with the bank. Originally 200,000 units of Series 2015 were issued to third party investors at $1,000 per unit to providing a yield of 5.149% to 30 June 2015. The Trust, having obtained regulatory approval, redeemed all of the Series 2015 securities at par for cash on 30 June 2015.

28 Notes on the statement of cash flows

Non-cash items included in profit before tax	**2015 $m**	2014 $m
Depreciation and amortization	**43**	50
Share-based payment expense	**11**	12
Loan impairment charges and other credit risk provisions	**234**	107
Charge for defined benefit pension plans	**17**	20
	305	189

Change in operating assets		
Change in prepayment and accrued income	**(8)**	20
Change in net trading securities and net derivatives	**2,808**	(2,134)
Change in loans and advances to customers	**(7,393)**	(802)
Change in reverse repurchase agreements – non-trading	**(402)**	(142)
Change in other assets	**1,169**	(279)
	(3,826)	(3,337)

Change in operating liabilities		
Change in accruals and deferred income	**(50)**	(27)
Change in deposits by banks	**1,368**	46
Change in customer accounts	**4,246**	(83)
Change in repurchase agreements – non-trading	**2,552**	2,567
Change in debt securities in issue	**286**	(738)
Change in financial liabilities designated at fair value	**(11)**	(3)
Change in other liabilities	**(1,617)**	158
	6,774	1,920

Interest		
Interest paid	**(634)**	(715)
Interest received	**1,700**	1,910

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, and include cash and balances at the central bank, debt securities, loans and advances to banks, items in the course of collection from or in transmission to other banks and certificates of deposit.

	2015 $m	2014 $m
Cash and balances at central bank	**65**	73
Items in the course of collection from other banks, net	**(146)**	(29)
Loans and advances to banks of one month or less	**1,400**	1,264
Reverse repurchase agreements with banks of one month or less	**435**	744
T-Bills and certificates of deposits – three months or less	**229**	285
	1,983	2,337

Notes on the Consolidated Financial Statements (continued)

29 Contingent liabilities, contractual commitments and guarantees

Accounting policy

Contingent liabilities

Contingent liabilities are possible obligations that arise from past events whose existence will be confirmed by uncertain future events not wholly within the control of the bank; or are present obligations that have arisen from past events where it is not probable that settlement will require the outflow of economic benefits or because the amount of settlement cannot be reliably measured. Contingent liabilities are not recognized in the balance sheet but are disclosed unless the probability of settlement is remote.

Financial guarantee contracts

Financial guarantee contacts are contracts that require the bank to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due. Liabilities under financial guarantee contracts are recorded initially at their fair value, which is generally the fee received or receivable. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortization, and the best estimate of the expenditure required to settle the obligations.

	2015 $m	2014 $m
Guarantees and other contingent liabilities		
Guarantees and irrevocable letters of credit pledged as collateral security	**5,585**	5,230
Commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend[1]	**39,951**	37,239
Documentary credits and short-term trade-related transactions	**557**	572
	40,508	37,811

1 *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.

Guarantees

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

Guarantees in favour of third parties	**2015 $m**	2014 $m
Guarantee type		
Financial guarantee contracts[1]	**2,505**	2,489
Performance bonds[2]	**3,080**	2,741
	5,585	5,230

1 *Financial guarantees contracts 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 *Performance bonds, bid bonds, standby letters of credit and other transaction-related guarantees are undertakings by which the obligation on the bank and/or the bank to make payment depends on the outcome of a future event.*

The amounts disclosed in the above table reflect the bank'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 bank's overall credit risk management policies and procedures. Guarantees with terms of more than one year are subject to the bank's annual credit review process.

29 Contingent liabilities, contractual commitments and guarantees *(continued)*

Credit enhancements

The bank provides partial program-wide credit enhancements to the multi-seller conduit program administered by it to protect commercial paper investors in the event that the collections on the underlying assets and any draws on the transaction specific credit enhancement and liquidity backstop facilities are insufficient to repay the maturing asset-backed commercial paper issued by such multi-seller conduit program. Each of the asset pools funded by this multi-seller conduit program is structured to achieve a high investment grade credit profile through the provision of transaction specific credit enhancement provided by the seller of each asset pool to this multi-seller conduit program. The term of this program-wide credit enhancement is 12 months.

30 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 bank presents the amounts due under the leases, after deduction of unearned charges, in 'Loans and advances to banks' or 'Loans and advances to customers'.

All other leases are classified as operating leases. As lessor, the bank presents assets subject to operating leases in 'Property, plant and equipment'. Impairment losses are recognized to the extent that carrying values are not fully recoverable. As lessee, leased assets are not recognized on the balance sheet.

Finance income or charges on the finance lease are recognized in 'Net interest income' over the lease periods so as to give a constant rate of return. Rentals payable and receivable under operating leases are spread on a straight-line basis over the lease periods and are recognized in 'General and administrative expenses' or in 'Other operating income'.

Operating lease commitments

At 31 December 2015, the bank was obligated under a number of non-cancellable operating leases for land and buildings for which the future minimum lease payments extend over a number of years, with an option to renew after that period. Base rents are increased as according to the terms stated in the lease.

	Land and buildings	
	2015	2014
	$m	$m
Future minimum lease payments under non-cancellable operating leases expiring		
No later than one year	**50**	49
Later than one year and no later than five years	**144**	145
Later than five years	**27**	53
	221	247

In 2015, $55m (2014: $50m) was charged to 'General and administrative expenses' in respect of lease and sublease agreements, all of which related to minimum lease payments.

Notes on the Consolidated Financial Statements (continued)

30 Lease commitments *(continued)*

Finance lease receivables

The bank 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 payment **$m**	*Unearned finance income* **$m**	*Present value* **$m**	*Total future minimum payment* $m	*Unearned finance income* $m	*Present value* $m
Less receivables:						
No later than one year.........	**732**	**(50)**	**682**	700	(57)	643
Later than one year and no later than five years.......	**1,274**	**(80)**	**1,194**	1,326	(89)	1,237
Later than five years.......	**83**	**(4)**	**79**	80	(3)	77
	2,089	**(134)**	**1,955**	2,106	(149)	1,957

At 31 December 2015, unguaranteed residual values of $13m (2014: $11m) had been accrued, and the accumulated allowance for uncollectible minimum lease payments is included in loan loss allowances.

During the year, no contingent rents were received (2014: $nil) and recognized in the income statement.

31 Related party transactions

The ultimate parent company of the bank is HSBC Holdings, which is incorporated in England. The bank's related parties include the parent, fellow subsidiaries, and Key Management Personnel.

a *Transactions with Key Management Personnel*

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the bank and includes members of the Board of HSBC Bank Canada.

Compensation of Key Management Personnel

The following represents the compensation paid to the Key Management Personnel of the bank in exchange for services rendered to the bank.

	2015 **$m**	2014 $m
Short-term employee benefits..	**13**	10
Post-employment benefits..	**1**	1
Share-based payments...	**3**	2
	17	13

31 Related party transactions *(continued)*

a *Transactions with Key Management Personnel (continued)*

Other transactions, arrangements and agreements involving Key Management Personnel

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 transactions below 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.

	2015		2014	
	Highest balance during the year	*Balance at 31 December*	*Highest balance during the year*	*Balance at 31 December*
	$m	**$m**	$m	$m
Key Management Personnel[1]				
Loans	**5.3**	**4.8**	5.5	2.7
Credit cards	**0.1**	**0.1**	0.1	0.1

1 *Includes Key Management Personnel, close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced, or for which significant voting power is held, by Key Management Personnel or their close family member.*

b *Transactions between the bank and HSBC Holdings including fellow subsidiaries of HSBC Holdings*

Transactions detailed below include amounts due to/from the bank and HSBC Holdings including fellow subsidiaries of HSBC Holdings. 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 transactions below were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

	2015		2014	
	Highest balance during the year	*Balance at 31 December*	*Highest balance during the year*	*Balance at 31 December*
	$m	**$m**	$m	$m
Assets				
Trading assets	**1,027**	**10**	1,729	1,729
Derivatives	**3,182**	**2,081**	2,128	2,128
Loans and advances to banks	**455**	**134**	613	209
Loans and advances to customers	**782**	**130**	155	155
Other assets	**38**	**37**	43	26
Liabilities				
Deposits by banks	**1,736**	**1,587**	1,620	420
Customer accounts	**4,553**	**3,305**	1,464	1,464
Derivatives	**2,460**	**1,720**	1,346	1,346
Trading liabilities	**1,456**	**4**	2,080	67
Other liabilities	**120**	**39**	184	21
Subordinated liabilities	**–**	**–**	–	–

Notes on the Consolidated Financial Statements (continued)

31 Related party transactions *(continued)*

b *Transactions between the bank and HSBC Holdings including fellow subsidiaries of HSBC Holdings (continued)*

	2015 **$m**	2014 $m
Income Statement		
Interest income	**30**	44
Interest expense	**(12)**	(9)
Fee income	**27**	12
Fee expense	**(4)**	(9)
Other operating income	**41**	43
General and administrative expenses	**(140)**	(102)

The bank has issued Class 1 Preferred Shares Series G that are non-voting non-cumulative and redeemable to HSBC Canada Holdings (UK) Limited on 30 June 2015. See note 26 for more information.

32 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 recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements are as follows:

				Amounts not set off in the balance sheet		
	Gross amounts of recognized financial assets **$m**	*Gross amounts set off in the balance sheet* **$m**	*Amounts presented in the balance sheet* **$m**	*Financial instruments*[1] **$m**	*Cash collateral received* **$m**	*Net amount* **$m**
At 31 December 2015						
Derivatives[2] (note 11)	**4,909**	**–**	**4,909**	**1,487**	**51**	**3,371**
Reverse repurchase, securities borrowing and similar agreements:						
– Loan and advances to banks at amortized cost	**661**	**(226)**	**435**	**435**	**–**	**–**
– Loan and advances to customers at amortized cost	**6,555**	**(183)**	**6,372**	**6,372**	**–**	**–**
Loans and advances excluding reverse repos						
– to customers at amortized cost	**1,722**	**–**	**1,722**	**–**	**–**	**1,722**
	13,847	**(409)**	**13,438**	**8,294**	**51**	**5,093**

1 *Including non-cash collateral.*

2 *Includes amounts that are both subject to and not subject to enforceable master netting agreements and similar agreements.*

32 Offsetting of financial assets and financial liabilities *(continued)*

	Gross amounts of recognized financial assets	*Gross amounts set off in the balance sheet*	*Amounts presented in the balance sheet*	Amounts not set off in the balance sheet		*Net amount*
				Financial instruments[1]	*Cash collateral received*	
	$m	$m	$m	$m	$m	$m
At 31 December 2014						
Derivatives[2] (note 11).....	4,082	–	4,082	3,375	6	701
Reverse repurchase, securities borrowing and similar agreements:						
– Loan and advances to banks at amortized cost.......	1,316	(572)	744	744	–	–
– Loan and advances to customers at amortized cost.......	6,118	(148)	5,970	5,970	–	–
Loans and advances excluding reverse repos						
– to customers at amortized cost.......	1,720	(1,174)	546	–	–	546
	13,236	(1,894)	11,342	10,089	6	1,247

1 *Including non-cash collateral.*

2 *Includes amounts that are both subject to and not subject to enforceable master netting agreements and similar agreements.*

Notes on the Consolidated Financial Statements (continued)

32 Offsetting of financial assets and financial liabilities *(continued)*

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements are as follows:

	Gross amounts of recognized financial liabilities $m	Gross amounts set off in the balance sheet $m	Amounts presented in the balance sheet $m	Amounts not set off in the balance sheet: Financial instruments[1] $m	Amounts not set off in the balance sheet: Cash collateral pledged $m	Net amount $m
At 31 December 2015						
Derivatives[2] (note 11)	**5,005**	**–**	**5,005**	**1,197**	**1,035**	**2,773**
Repurchase, securities lending and similar agreements						
– Deposits by banks at amortized cost	**1,402**	**(226)**	**1,176**	**1,176**	**–**	**–**
– Customer accounts at amortized cost	**5,613**	**(183)**	**5,430**	**5,430**	**–**	**–**
Customer accounts excluding repos at amortized cost	**2,428**	**–**	**2,428**	**–**	**–**	**2,428**
	14,448	**(409)**	**14,039**	**7,803**	**1,035**	**5,201**
At 31 December 2014						
Derivatives[2] (note 11)	3,885	–	3,885	2,791	659	435
Repurchase, securities lending and similar agreements						
– Deposits by banks at amortized cost	1,337	(572)	765	765	–	–
– Customer accounts at amortized cost	3,437	(148)	3,289	3,289	–	–
Customer accounts excluding repos at amortized cost	2,245	(1,174)	1,071	–	–	1,071
	10,904	(1,894)	9,010	6,845	659	1,506

1 *Including non-cash collateral.*

2 *Includes amounts that are both subject to and not subject to enforceable master netting agreements and similar agreements.*

33 Legal proceedings and regulatory matters

The bank is subject to a number of legal proceedings arising in the normal course of our business. The bank does not expect the outcome of any of these proceedings, in aggregate, to have a material effect on its consolidated balance sheet or its consolidated income statement.

33 Legal proceedings and regulatory matters *(continued)*

HSBC global disclosures

HSBC Holdings plc and its subsidiaries are collectively referred to below as 'HSBC'.

Anti-money laundering and sanctions-related matters

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

In December 2012, HSBC Holdings, HNAH and HSBC Bank USA entered into agreements with US and UK government agencies regarding past inadequate compliance with the BSA, AML and sanctions laws. Among those agreements, HSBC Holdings and HSBC Bank USA entered into a five-year deferred prosecution agreement with the 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 ('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 $1.9bn 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 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.

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 May 2014, a shareholder derivative action was filed by a shareholder of HSBC Holdings purportedly on behalf of HSBC Holdings, HSBC Bank USA, HNAH and HSBC USA Inc. (the 'Nominal Corporate Defendants') in New York state court against certain current and former directors and officers of those HSBC companies (the 'Individual Defendants'). The complaint alleges that the Individual Defendants breached their fiduciary duties to the Nominal Corporate Defendants and caused a waste of corporate assets by allegedly permitting and/or causing the conduct underlying the US DPA. In March 2015, the Nominal Corporate Defendants moved to dismiss the action, and the Individual Defendants who had been served also responded to the complaint. In November 2015, the New York state court granted the motion to dismiss. Plaintiff has appealed that decision.

Notes on the Consolidated Financial Statements (continued)

33 Legal proceedings and regulatory matters *(continued)*

Anti-money laundering and sanctions-related matters (continued)

In July 2014, a claim was filed in the Ontario Superior Court of Justice against HSBC Holdings and a former employee purportedly on behalf of a class of persons who purchased HSBC common shares and American Depositary Shares between July 2006 and July 2012. The complaint, which seeks monetary damages of up to CA$20bn, alleges that the defendants made statutory and common law misrepresentations in documents released by HSBC Holdings and the bank, relating to HSBC's compliance with BSA, AML, sanctions and other laws.

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 ('US ATA') 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.

In November 2015, a complaint was filed in the US District Court for the Northern District of Illinois on behalf of representatives of four US persons alleged to have been killed or injured in terrorist attacks on three hotels in Amman, Jordan in 2005. The complaint was filed against HSBC Holdings, HSBC Bank USA, HNAH, HSI, HSBC Finance, HSBC USA Inc. and HSBC Bank Middle East, as well as a non-HSBC bank. The plaintiffs allege that the HSBC defendants violated the US ATA by failing to enforce due diligence methods to prevent its financial services from being used to support the terrorist attacks.

In February 2016, a complaint was filed in the US District Court for the Southern District of Texas by representatives of US persons alleged to have been killed or injured in Mexico by Mexican drug cartels. The complaint was filed against HSBC Holdings, HSBC Bank USA, HSBC México SA, and Grupo Financiero HSBC. The plaintiffs allege that defendants violated the US ATA by providing financial services to individuals and entities associated with the Mexican drug cartels. Defendants have not yet been served with process.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these lawsuits, including the timing or any possible impact on HSBC, which 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 $2.5bn. 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 WM/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.

33 Legal proceedings and regulatory matters *(continued)*

Foreign exchange rate investigations and litigation (continued)

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 the bank, and numerous other financial institutions.

As at 31 December 2015, HSBC has recognized a provision in the amount of $1.2bn. 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.

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 Commodity Exchange Act ('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 the bank, 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.

34 Events after the reporting period

Except as noted above, there have been no other material events after the reporting period which would require disclosure or adjustment to the 31 December 2015 consolidated financial statements.

These accounts were approved by the Board of Directors on 18 February 2016 and authorized for issue.

HSBC Group International Network*

Services are provided by over 6,000 offices in 71 countries and territories:

Europe	Offices
Armenia	9
Austria	1
Belgium	1
Channel Islands	25
Czech Republic	2
France	361
Germany	18
Greece	17
Ireland	3
Isle of Man	2
Italy	3
Luxembourg	5
Malta	39
Monaco	2
Netherlands	1
Poland	5
Russia	2
Spain	3
Sweden	2
Switzerland	8
Turkey	286
United Kingdom	985

Asia-Pacific	Offices
Australia	38
Bangladesh	13
Brunei Darussalam	11
China	263
Cook Islands	1
Hong Kong Special Administrative Region	272
India	68
Indonesia	144
Japan	4
Korea, Republic of	3
Macau Special Administrative Region	6
Malaysia	75
Maldives	1
New Zealand	5
Philippines	16
Singapore	17
Sri Lanka	12
Taiwan	44
Thailand	1
Vietnam	16

Americas	Offices
Argentina	144
Bahamas	1
Bermuda	10
Brazil	1,376
British Virgin Islands	2
Canada	155
Cayman Islands	4
Chile	1
Colombia	1
Mexico	987
Peru	1
United States of America	245
Uruguay	11

Middle East and Africa	Offices
Algeria	3
Bahrain	5
Egypt	64
Israel	1
Kuwait	1
Lebanon	4
Libya	1
Mauritius	12
Morocco	1
Nigeria	1
Oman	74
Palestinian Territories	1
Qatar	3
Saudi Arabia	102
South Africa	4
United Arab Emirates	17

Associated companies are included in the network of offices.

HSBC Bank Canada Subsidiaries*

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1 (888) 390-3333
www.hsbc.ca

HSBC Investment Funds (Canada) Inc.
1 (800) 830-8888
www.hsbc.ca/funds

HSBC Private Wealth Services (Canada) Inc.
1 (844) 756-7783
www.hsbc.ca

HSBC Securities (Canada) Inc.
1 (800) 760-1180
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For more information, or to find the HSBC Bank Canada branch nearest you, call 1 (888) 310-4722 or visit our website at www.hsbc.ca

* *As of March 2016*

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* *As of March 2016*

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HSBC BANK CANADA SECURITIES ARE LISTED ON THE TORONTO STOCK EXCHANGE:

HSBC Bank Canada
Class 1 Preferred Shares – Series C
(HSB.PR.C)
Class 1 Preferred Shares – Series D
(HSB.PR.D)

SHAREHOLDER CONTACT:

For change of address, shareholders are requested to contact their brokers.

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DIVIDEND DATES:

Dividend record and payable dates for the bank's preferred shares, subject to approval by the Board, are:

Record Date	*Payable Date*
15 March	31 March
15 June	30 June
15 September	30 September
15 December	31 December

Designation of eligible dividends:
For the purposes of the *Income Tax Act* (Canada), and any similar provincial legislation, HSBC Bank Canada advises that all of its dividends paid to Canadian residents in 2006 and subsequent years are eligible dividends unless indicated otherwise.

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Form number 1040146 (03/16). Published by Communications, HSBC Bank Canada, Vancouver

Cover designed by Black Sun Plc, London; text pages designed by Communications (Asia), The Hongkong and Shanghai Banking Corporation Limited, Hong Kong

Printed by RRD / Moore Canada, Toronto, Ontario, Canada, on 80# Rolland Opaque Cover – 30% Post-Consumer, Acid Free, Elemental Chlorine Free and FSC Certified, 60# Rolland Opaque Text – 30% Post-Consumer, Acid Free, Elemental Chlorine Free and FSC Certified.

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