HSBC

27 February 2017

News Release

GRUPO FINANCIERO HSBC, S.A. DE C.V.
2016 FINANCIAL RESULTS –HIGHLIGHTS

- For the 12 months to 31 December 2016, Grupo Financiero HSBC reported a profit before taxes of MXN4,901m an increase of MXN4,510m resulting from a turnaround on business strategy, compared with MXN391m for the same period of 2015.

- Excluding non-recurrent items, profit before taxes for the 12 months to 31 December 2016 was MXN4,054m an increase of MXN2,283m or 128.9% compared with the same period of 2015.

- Non-recurrent items included in the profit before tax for the 12 months to 31 December 2015 were MXN1,380m of net loan impairment charges creation relating to the homebuilders portfolio. The profit before tax for the 12 months to 31 December 2016 include a MXN994m transition adjustment income related to Solvency II (new regulatory framework for insurance companies effective since 1 January 2016) and MXN147m of net loan impairment charges creation relating to the homebuilders portfolio.

- Excluding non-recurrent items, net income for the 12 months to 31 December 2016 was MXN2,707m, an increase of MXN1,232m or 83.5%. On a reported basis net income after minority interest for the 12 months to 31 December 2016 was MXN3,300m, an increase of MXN2,790m or 547% compared with MXN510m for the same period of 2015.

- Total operating income, excluding loan impairment charges, for the 12 months to 31 December 2016 was MXN37,065m, an increase of MXN5,414m or 17.1% compared with MXN31,651m for the same period of 2015.

- On a reported basis loan impairment charges for the 12 months to 31 December 2016 were MXN8,220m, a decrease of MXN620m or 7% compared with MXN8,840m for the same period of 2015.

- On a reported basis administrative and personnel expenses for the 12 months to 31 December 2016 were MXN24,008m, an increase of MXN1,536m or 6.8% compared with MXN22,472m for the 12 months to 31 December 2015 driven by investment in technology costs.

- The cost efficiency ratio was 64.8% for the 12 months to 31 December 2016, compared with 71% for the same period of 2015.

- Net loans and advances to customers were MXN265.7bn at 31 December 2016, an increase in both retail and wholesale portfolios of MXN33.5bn or 14.5% compared with MXN232.1bn at 31 December 2015. Total impaired loans as a percentage of gross loans and advances at 31 December 2016 decreased to 3% compared with 5.2% at 31 December 2015 driven by whole sale loan portfolio write offs and sales.

This news release is issued by
HSBC Holdings plc

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Incorporated in England with limited liability. Registered number 617987

- At 31 December 2016, total deposits were MXN302.9bn, an increase of MXN22.9bn or 8.2% compared with MXN280bn at 31 December 2015.

- Return on equity was 5.8% for the 12 months to December 2016 compared with 0.9% for the same period of 2015.

- At 31 December 2016, the bank's preliminary total capital adequacy ratio was 13.2% and the preliminary tier 1 capital ratio was 11% compared with 12.3% and 9.9% respectively at 31 December 2015. HSBC's global strategy is to work with optimal levels of capital with a reasonable buffer above regulatory limits.

- For the fourth quarter of 2016, Grupo Financiero HSBC's profit before tax decreased compared to the one presented on third quarter of 2016, from MXN1,452m to MXN950m driven by investment in technology costs and impairment of intangibles. Excluding these two items profit before taxes for the fourth quarter would have been of MXN1,401m.

- On an IFRS basis, for the 12 months to 31 December 2016, profit before taxes was MXN4,595m, an increase of MXN4,146m or 924.3% compared with MXN449m for the same period of 2015. The main differences between the Mexican GAAP and IFRS results for the period January-December 2016 relate to differences in accounting for loan impairment charges and insurance liabilities.

- Grupo Financiero HSBC received on 11 October 2016 a capital injection of MXN5.5bn from its holding company, HSBC Holdings plc. This capital injection demonstrates the commitment and confidence in the organic growth of the Mexican subsidiary.

HSBC Mexico S.A. (the bank) is a subsidiary of Grupo Financiero HSBC, S.A. de C.V. (Grupo Financiero HSBC) and is subject to supervision by the Mexican Banking and Securities Commission. The bank is required to file financial information on a quarterly basis (in this case for the quarter ended 31 December 2016) and this information is publicly available. Given that this information is available in the public domain, Grupo Financiero HSBC has elected to file this release. HSBC Seguros, S.A. de C.V. Grupo Financiero HSBC (HSBC Seguros) is Grupo Financiero HSBC's insurance group.

Results are prepared in accordance with Mexican GAAP (Generally Accepted Accounting Principles).

The results for the 12 months to 31 December 2016 include MXN994m transition adjustment income related to Solvency II (new regulatory framework for insurance companies which took effect on 1 January 2016), with no reclassification for the previous year.

Since the second quarter of 2016, the positive excess of loan impairment charges, determined monthly, to be classified in Other Operating Income, is measured on a portfolio basis rather than on an individual basis. Fourth quarter 2015 figures have been restated to reflect this change, which implies certain reclassifications between Loan Impairment Charges and Other Operating Income for a total of MXN4,827m. This restatement follows a clarification of the rule as per a formal consultation to the local regulator.

Finally, certain impairments of fixed/intangibles assets which were previously classified in Administrative and Personnel Expenses have been classified in Other Operating Income. The results for the 12 months to 31 December 2015 have been restated to reflect this change for a total of MXN64m.

ROE calculation includes for 2016 a benefit due to Solvency II of MXN696 net of taxes and the retrospective recognition of deferred profit sharing net of taxes which had a positive impact on equity of MXN1.7bn.

Overview

The Mexican economy grew at a modest pace of 2.3% in 2016, according to preliminary data. However, the performance among sectors was uneven, as services maintained a healthy growth throughout the year, while industrial production remained stagnant. The main external threat for economic activity came from a reduction of external demand, particularly from the US. However, there were other domestic factors at play such as the sluggishness of construction due to lower dynamism from public projects, as well as a depressed oil output that prolonged the weak performance of industrial production.

Inflation rose considerably throughout the year and stood above the central bank's mid-point target of 3% in October for the first time since April 2015. The upwards trend in both core and non-core components prevailed in November and December, and inflation stood at 3.4% at the end of 2016. The gradual acceleration was driven by the expansion of the core component, given the pressure on merchandise prices from the FX pass-through effect.

Given this backdrop, Banxico delivered a total of 250bp monetary policy rate hikes in 2016, equally spread out in five different meetings in order to tame inflation expectations. Banxico surprised markets with two hikes in February and June, reflecting high concerns on the FX evolution. In the second half of the year, the two hikes of December and November were driven by MXN weakness stemming from the US election. The key policy rate ended the year at 5.7%.

For the 12 months to 31 December 2016, Grupo Financiero HSBC reported a profit before taxes of MXN4,901m an increase of MXN4,510m resulting from a turnaround on business strategy, compared with MXN391m for the same period of 2015.

Excluding non-recurrent items, profit before taxes for the 12 months to 31 December 2016 was MXN4,054m an increase of MXN2,283m or 128.9% compared with the same period of 2015.

Non-recurrent items included in the profit before tax for the 12 months to 31 December 2015 were MXN1,380m of net loan impairment charges creation for the homebuilders portfolio. The profit before tax for the 12 months to 31 December 2016 include a MXN994m transition adjustment income related to Solvency II (new regulatory framework for insurance companies effective since 1 January 2016) and MXN147m of net loan impairment charges creation for the homebuilders portfolio.

Net interest income for the 12 months to 31 December 2016 was MXN27,720m, an increase of MXN4,962m or 21.8% compared with the same period of 2015. The increase is driven by higher loan volumes, particularly in consumer and commercial loan portfolios and higher average deposit spreads in the retail and corporate segments. In addition, the higher net interest income is due to the insurance-related business (premiums, claims and technical reserves) which accounted for an increase of MXN1,177m compared with the 12 months to 31 December 2015, explained by growth in term life portfolio due to higher sales coupled with the MXN955m Solvency II initial adjustment income.

Excluding non-recurrent items, loan impairment charges for the 12 months to 31 December 2016 were MXN8,073m, an increase of MXN613m or 8.2%. This increase is driven by portfolio growth coupled with credit performance in consumer unsecured portfolios. On a reported basis loan impairment charges for the 12 months to 31 December 2016 were MXN8,220m, a decrease of MXN620m or 7% compared with MXN8,840m for the same period of 2015 December.

Net fee income was MXN6,568m, an increase of MXN206m or 3.2% compared with the 12 months to December 2015. This increase is due to higher credit card and structuring loan portfolio fees.

Trading income was MXN941m, an increase of MXN141m or 17.6% compared with the 12 months to 31 December 2015. This increase is driven by mark-to-market results of derivatives, gains on sale of available of sale debt securities and results in FX transactions.

Other operating income was MXN1,836m, an increase of MXN105m or 6% compared with the 12 months to December 2015, driven by releases of impairment losses on commercial loan portfolio and lower impairments on intangible assets for the year.

On a reported basis administrative and personnel expenses for the 12 months to 31 December 2016 were MXN24,008m, an increase of MXN1,536m or 6.8% compared with MXN22,472m for the 12 months to 31 December 2015 driven by investment in technology costs.

The cost efficiency ratio was 64.8% for the 12 months to 31 December 2016, compared with 71% for the same period of 2015.

The effective tax rate was 32.7% for the 12 months to December 2016 is higher compared with -30.2% for the same period of 2015. The increase is driven by a higher profit before tax during 2016 but similar inflationary and non-taxable income when comparing the two periods, having a major specific weight in the 2015 effective tax rate.

Grupo Financiero HSBC's insurance subsidiary, HSBC Seguros, reported profit before tax of MXN2,313m for the 12 months of 2016. This amount includes a benefit due to Solvency II of MXN994m for the transition adjustment recognised through P&L as recommended by the Comisión Nacional de Seguros y Fianzas. Excluding non-recurrent items, net income before tax increased 8.6% compared with the same period of 2015 driven by higher life product sales.

Net loans and advances to customers were MXN265.7bn at 31 December 2016, an increase in both retail and wholesale portfolios of MXN33.5bn or 14.4% compared with MXN232.1bn at 31 December 2015. The performing consumer and mortgage loan portfolios increased by 20% and 16.4% respectively, while the performing commercial loan portfolio increased by 13.1%, compared with the same period of 2015.

Total impaired loans as a percentage of gross loans and advances at 31 December 2016 decreased to 3% compared with 5.2% at 31 December 2015.

Total loan loss allowances at 31 December 2016 were MXN12.4bn, a decrease of MXN3.2bn or 20.5% compared with 31 December 2015. The total coverage ratio (allowance for loan losses divided by impaired loans) was 150.8% at 31 December 2016 compared with 121% at 31 December 2015. The higher coverage ratio is in line with the decrease of impaired loans balance driven by the partial sale of the homebuilders' portfolio, improvement in credit profile of non performing customers, and an active management in the retail portfolio.

At 31 December 2016, total deposits were MXN302.9bn, an increase of MXN22.9bn or 8.2% compared with MXN280bn at 31 December 2015. Demand deposits increased by 12.6% due to higher deposit balances across all segments. Time deposits had no material variation (0.3%).

At 31 December 2016, the bank's preliminary total capital adequacy ratio was 13.2% and the preliminary tier 1 capital ratio was 11% compared with 12.3% and 9.9% respectively at 31 December 2015. HSBC's global strategy is to work with optimal levels of capital with a reasonable buffer above regulatory limits.

Relevant events

Grupo Financiero HSBC received on 11 October 2016 a capital injection of MXN5.5bn from its holding company, HSBC Holdings plc. This capital injection demonstrates the commitment and confidence in the organic growth of the Mexican subsidiary.

Business highlights *(Amounts described include the impact of internal cost and value of funds applied to different lines of business)*

Retail Banking and Wealth Management (RBWM)

RBWM revenues for full year 2016 presented a significant growth compared to the same period of 2015. Results were driven by a robust growth in lending balances in payroll and personal loans, higher deposits balances and spreads and a solid performance in insurance. The performing RBWM consumer, credit card and mortgage loan portfolio as at 31 December 2016 increased 5% and 16.4% compared with the same period of 2015 respectively. Average number of credit cards issued per month increased 9% compared with the same period of 2015. Personal loans and payroll loans portfolio balance at 31 December 2016 increased 57% and 27% respectively compared with balances as at 31 December 2015. In both portfolios HSBC continues to outgrow the market with personal loans reaching 11.3% (+2.9 pp) of the share that the top six banks country has and payroll loans reaching 8.9% (+1.0 pp). Mortgage balances increased by 16.4% compared with the same period of 2015.

The insurance business continues to be focused on offering fair value for our customers. This strategy has generated a positive impact, improving the persistency for temporary life insurance portfolio. By better targeting and segmentation, annualised premiums of life product sales for 2016 have increased 19% compared with the same period of 2015, leading to a portfolio growth of 10.5% compared with the same period of 2015.

Aligned to our strategy, these are the six pillars to deliver our RBWM plan and core challenges:

- Accelerate customer base growth with focus on payroll acquisition with enhanced collaboration with CMB and GBM and for non-payroll customer’s acquisition focus on reviewing and enhancing value propositions and products offerings.
- Continuously improve our lending portfolio by capturing pricing opportunities in fees and rates and reviewing essential capabilities such as credit risk appetite and analytics to deliver data solutions that cover customer and product information to deploy triggers and campaigns focused on customer needs.
- Turnaround retail business banking as a priority by strengthening the proposition, commercial model, product portfolio, processes and enablers.
- Increase channel productivity and leverage third-party sales agents to better serve customers.
- Implement contact centre and digital enhancements leveraging group solutions.
- Leverage RBWM Transformation Programme, to deliver sustainable improvements in sales and service processes, multichannel, sales processes and sales funnel to improve customer experience.

Commercial Banking (CMB)

CMB 2016 year-end results increased compared to prior year, enhanced by growth in assets and liabilities, coupled by higher fee income from a shared revenue strategy with RBWM regarding payroll.

Balance sheet displays a positive trend with a 16% growth in assets across all segments except for public sector, where external factors *(elections and changes in administration*) represented a challenge for growth. Asset growth was supported by different business strategies related to identification and service proposition to cover financial needs of our customers.

On the liabilities side, we also observe a positive trend in balances, growth by 13% vs prior year, following a strategy to attract operational deposits that was successfully implemented.

In addition, during December 2016, HSBC Mexico acted as Sole Green Structuring Advisor & Delivery Agent for a MXN1bn (US$53m) Green Bond with Mexico City; this is the first Green Bond for a Latin American city.

Aligned to our global strategy of becoming the leading international trade and business bank, CMB continues to increase connectivity with global customers and is focusing on these key elements:

- Improve profitability through a more focused analysis of our clients and their supply / value chain. Commercial Banking continues to strengthen the International Subsidiary Banking proposition (ISB), leveraging from our international connectivity.
- Targeted approach to our customers creating new business opportunities.
- Better credit quality in our portfolio, non-performing loans have reduced and LICs were maintained under control.
- Continue to develop product proposition and IT investment to capture market share on NAFTA, focus on leverage from trade corridor connectivity. For Global Liquidity and Cash Management (GLCM), enhancements made on the manual collection process and reinforcement of product campaigns.

Global Banking and Markets (GBM)

GBM results for 2016 were positive reflecting higher revenues by 38% compared with 2015, driven by better results in trading income as well as higher NII due to better spreads and higher credit and deposit volumes (11% and 22% respectively).

Global Banking demonstrated a strong increase in credit balances with both Mexican clients and multinationals as a result of following effective business strategies. In addition, there was an important growth of balances on active GLCM clients (9.5%) and in GTRF (14%). Revenues grew 44% and 16% in both business respectively.

Global Banking total revenue is 23% higher compared to prior year and for LICs there was an outstanding improvement given 2015 credit impairments totalised MXN0.75bn and for 2016 the cumulative amount is a release for MXN0.08bn; Expenses remained under control therefore profit before taxes improved from a loss of MXN0.31bn to a gain of MXN1bn.

In terms of collaboration, payroll holders increased 7.5% in 2016 vs prior year that benefited payroll revenues that grew more than 50% due to a strong cross-selling execution plan by RBWM.

Business synergies increased in 2016, particularly in Asset and Structured Finance, following a joint effort with CMB clients. Additionally, during 2016 the Debt Capital Markets business closed relevant local and off-shore DCM & ECM transactions with local clients.

FX sales business continued its steady growth during 2016. The bank continues to diversify the customers base and customers product portfolio through the use of FX forwards and FX options, with the support of the Risk Advisory Team.

Trading income was MXN941m, which means an increase of MXN141m or 17.6% compared with 2015; driven by higher results in FX transactions partially offset by negative results in derivatives and bonds transactions.

HSBC Mexico acted as Global Coordinator, Sole Green Structuring Advisor and Billing & Delivery agent in regards to a Green Bond deal with the new Mexico City Airport; this operation includes two US$1bn tranches (due October 2026 & October 2046); this is the largest Green Bond from a Latin American issuer to date that is also the first one associated with the construction and operation of an airport and the first one from an emerging market to receive a Moody’s Green Bond Assessment grade (GB1).

Corporate centre

Starting December 2016 HSBC Mexico treasury (balance sheet management) constitutes an independent business segment, responsible for the administration of interest rate risk, funding and liquidity management of the assets and liabilities in compliance with local regulation. This segment also includes costs and revenues arising from technology solution services provided to other entities of the group.

Grupo Financiero HSBC's fourth quarter of 2016 financial results as reported to HSBC Holdings plc, our ultimate parent company, are prepared in accordance with International Financial Reporting Standards (IFRS).

For the 12 months to 31 December 2016, on an IFRS basis, Grupo Financiero HSBC reported a net income before taxes of MXN4,595m, an increase of MXN4,146m or 924.3% compared with MXN449m for the 12 months to 31 December 2015. The higher net income before tax reported under Mexican GAAP compared with IFRS for the fourth quarter of 2016 is due to differences in accounting for loan impairment charges and insurance liabilities. A reconciliation and explanation between the Mexican GAAP and IFRS results is included with the financial statements of this document.

Awards

HSBC continues to be independently recognised and received the following awards during 2016

- Recognition from *Forbes* magazine as the company with the highest environmental commitment within the financial sector in Mexico.
- *Expansión* magazine recognised HSBC Mexico as one of the companies with the highest social responsibility, ranked 3rd among the financial institutions of the country.
- The HSBC Water Programme won the Global Corporate Volunteering Award presented by the International Association for Volunteer Efforts (IAVE). The Corporate Sustainability team in Mexico received the award on behalf of Group Sustainability during the 24th IAVE World Volunteering Conference in Mexico City.
- For the fifth consecutive year, *Euromoney* awarded HSBC Mexico with the 'Best Cash Management Bank' in recognition to the quality of its products and services and the value added offered to its clients. *Euromoney* magazine gives these awards on an annual basis to the participants of the local, regional and global financial industry, using a methodology based on surveys to the top management in charge of managing finance or Treasury of their companies in more than 55 countries.

About HSBC

Grupo Financiero HSBC is one of the leading financial groups in Mexico with 974 branches, 5,570 ATMs and more than 16,000 employees. For more information, visit www.hsbc.com.mx.

Grupo Financiero HSBC is a 99.99% directly owned subsidiary of HSBC Latin America Holdings (UK) Limited, which is a wholly owned subsidiary of HSBC Holdings plc, and a member of the HSBC Group. With around 4,000 offices in 70 countries and territories in Europe, Asia, North and Latin America, and the Middle East and North Africa, the HSBC Group is one of the world's largest banking and financial services organisations.

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Consolidated Income Statement – GROUP 2016
Figures in MXN millions

	Reported	Solvency II	Homebuilders loan impairment charges	Excluding non-recurrent items
Interest income	**39,940**	(955)	-	**38,985**
Interest expense	**(12,220)**	-	-	**(12,220)**
Net interest income	**27,720**	(955)	-	**26,765**
Loan impairment charges	**(8,220)**	-	147	**(8,073)**
Risk-adjusted net interest income	**19,500**	(955)	147	**18,692**
Fees and commissions receivable	**8,742**	-	-	**8,742**
Fees payable	**(2,174)**	-	-	**(2,174)**
Trading income	**941**	-	-	**941**
Other operating income	**1,836**	-	-	**1,836**
Total operating income	**28,845**	(955)	147	**28,037**
Administrative and personnel expenses	**(24,008)**	(39)	-	**(24,047)**
Net operating income	**4,837**	(994)	147	**3,990**
Share of profits in equity interest	**64**	-	-	**64**
Profit/loss before taxes	**4,901**	(994)	147	**4,054**
Income tax	**(782)**	-	-	**(782)**
Deferred income tax	**(819)**	298	(44)	**(565)**
Net income before discontinued operations	**3,300**	(696)	103	**2,707**
Discontinued operations	**-**	-	-	**-**
Minority interest	**-**	-	-	**-**
Profit/loss	**3,300**	(696)	103	**2,707**

Consolidated Income Statement – GROUP 2015

Figures in MXN millions

	Reported	Homebuilders loan impairment charges and CTA	Excluding non-recurrent items
Interest income	32,466	-	32,466
Interest expense	(9,708)	-	(9,708)
Net interest income	22,758	-	22,758
Loan impairment charges	(8,840)	1,380	(7,460)
Risk-adjusted net interest income	13,918	1,380	15,298
Fees and commissions receivable	8,240	-	8,240
Fees payable	(1,878)	-	(1,878)
Trading income	800	-	800
Other operating income	1,731	-	1,731
Total operating income	22,811	1,380	**24,191**
Administrative and personnel expenses	(22,472)	-	(22,472)
Net operating income	339	1,380	**1,719**
Share of profits in equity interest	52	-	**52**
Profit/loss before taxes	391	1,380	**1,771**
Income tax	(570)	-	**(570)**
Deferred income tax	688	(414)	**274**
Net income before discontinued operations	509	966	**1,475**
Discontinued operations	-	-	**-**
Minority interest	1	-	**1**
Profit/loss	510	966	**1,476**

Consolidated Income Statement – BANK 2016

Figures in MXN millions

	Reported	Homebuilders loan impairment charges & other expenses	Excluding non-recurrent items
Interest income	**34,606**	-	**34,606**
Interest expense	**(9,918)**	-	**(9,918)**
Net interest income	**24,688**	-	**24,688**
Loan impairment charges	**(8,220)**	147	**(8,073)**
Risk-adjusted net interest income	**16,468**	147	**16,615**
Fees and commissions receivable	**8,283**	-	**8,283**
Fees payable	**(2,096)**	-	**(2,096)**
Trading income	**1,053**	-	**1,053**
Other operating income	**2,224**	(123)	**2,101**
Total operating income	**25,932**	24	**25,956**
Administrative and personnel expenses	**(23,697)**	-	**(23,697)**
Net operating income	**2,235**	24	**2,259**
Share of profits in equity interest	**60**	-	**60**
Profit/loss before taxes	**2,295**	24	**2,319**
Income tax	**(52)**	37	**(15)**
Deferred income tax	**(735)**	(44)	**(779)**
Net income before discontinued operations	**1,508**	17	**1,525**
Discontinued operations	**-**	-	**-**
Minority interest	**-**	-	**-**
Profit/loss	**1,508**	17	**1,525**

Consolidated Income Statement – BANK 2015

Figures in MXN millions

	Reported	Homebuilders loan impairment charges and CTA	Excluding non-recurrent items
Interest income	28,617	-	28,617
Interest expense	(7,536)	-	(7,536)
Net interest income	21,081	-	21,081
Loan impairment charges	(8,840)	1,380	(7,460)
Risk-adjusted net interest income	12,241	1,380	13,621
Fees and commissions receivable	7,754	-	**7,754**
Fees payable	(1,892)	-	**(1,892)**
Trading income	937	-	**937**
Other operating income	1,881	-	**1,881**
Total operating income	20,921	1,380	**22,301**
Administrative and personnel expenses	(22,299)	-	**(22,299)**
Net operating income	(1,378)	1,380	**2**
Share of profits in equity interest	50	-	**50**
Profit/loss before taxes	(1,328)	1,380	**52**
Income tax	(36)	-	**(36)**
Deferred income tax	665	(414)	**251**
Net income before discontinued operations	(699)	966	**267**
Discontinued operations	-	-	**-**
Minority interest	1	-	**1**
Profit/loss	(698)	966	**268**

Consolidated Balance Sheet

Figures in MXN millions	GROUP 31 Dec 2016	GROUP 31 Dec 2015	BANK 31 Dec 2016	BANK 31 Dec 2015
Assets				
Cash and deposits in banks	**51,908**	46,266	**51,817**	46,266
Margin accounts	**1,488**	23	**1,488**	23
Investment in securities	**149,007**	139,719	**132,611**	123,352
Trading securities	**25,859**	28,810	**23,250**	25,158
Available-for-sale securities	**95,569**	80,689	**90,313**	78,669
Held to maturity securities	**27,579**	30,220	**19,048**	19,525
Repurchase agreements	**10,088**	21,606	**10,088**	21,606
Derivative transactions	**113,009**	79,833	**113,009**	79,833
Performing loans				
Commercial loans	**134,697**	115,405	**134,697**	115,405
Loans to financial intermediaries	**11,980**	10,579	**11,980**	10,579
Consumer loans	**56,124**	46,749	**56,124**	46,749
Mortgage loans	**34,030**	29,248	**34,030**	29,248
Loans to government entities	**33,062**	32,875	**33,062**	32,875
Total performing loans	**269,893**	234,856	**269,893**	234,856
Impaired loans				
Commercial loans	**5,530**	10,804	**5,530**	10,804
Loans to financial intermediaries	**-**	-	**-**	-
Consumer loans	**2,203**	1,483	**2,203**	1,483
Mortgage loans	**476**	582	**476**	582
Loans to government entities	**-**	-	**-**	-
Total impaired loans	**8,209**	12,869	**8,209**	12,869
Gross loans and advances to customers	**278,102**	247,725	**278,102**	247,725
Allowance for loan losses	**(12,383)**	(15,579)	**(12,383)**	(15,579)
Net loans and advances to customers	**265,719**	232,146	**265,719**	232,146
Accounts receivable from insurers and bonding companies	**51**	94	**-**	-
Premium receivables	**1,598**	30	**-**	-
Accounts receivable from reinsurers and rebonding companies	**45**	56	**-**	-
Benefits to be received from trading operations	**106**	121	**106**	121
Other accounts receivable	**57,706**	37,808	**57,449**	37,735
Foreclosed assets	**364**	124	**364**	124
Property, furniture and equipment, net	**5,118**	5,409	**5,118**	5,409
Long-term investments in equity securities	**258**	268	**205**	181
Long-term assets available for sale	**6**	-	**6**	-
Deferred taxes and deferred profit sharing	**11,878**	12,039	**11,849**	11,924
Goodwill	**1,081**	1,048	**-**	-
Other assets, deferred charges and intangibles	**3,959**	3,245	**3,961**	3,142
Total assets	**673,389**	579,835	**653,790**	561,862

Consolidated Balance Sheet *(continued)*

Figures in MXN millions	GROUP **31 Dec 2016**	GROUP 31 Dec 2015	BANK **31 Dec 2016**	BANK 31 Dec 2015
Liabilities				
Deposits	**302,930**	280,043	**303,520**	280,581
Demand deposits	**210,319**	186,721	**210,608**	186,969
Time deposits	**87,584**	87,285	**87,210**	86,883
Bank bonds outstanding	**5,027**	6,037	**5,027**	6,037
Global deposit account without Movements	**-**	-	**675**	692
Bank deposits and other liabilities	**35,780**	37,483	**35,781**	37,483
On demand	**6,152**	6,031	**6,152**	6,031
Short-term	**23,580**	26,314	**23,581**	26,314
Long-term	**6,048**	5,138	**6,048**	5,138
Repurchase agreements	**48,881**	32,453	**48,881**	32,453
Settlement accounts	**-**	76	**-**	76
Collateral sold	**8,587**	20,649	**8,586**	20,649
Derivative transactions	**118,810**	85,349	**118,810**	85,349
Technical reserves	**12,392**	12,361	**-**	-
Accounts payable from reinsurers and rebonding companies	**10**	5	**-**	-
Other accounts payable	**72,220**	45,771	**71,212**	45,373
Income tax and employee profit sharing payable	**151**	36	**166**	2
Sundry creditors	**72,069**	45,735	**71,046**	45,371
Subordinated debentures outstanding	**12,566**	11,175	**12,566**	11,175
Deferred taxes and deferred profit sharing	**1,352**	858	**1,235**	850
Total liabilities	**613,528**	526,223	**600,591**	513,989
Equity				
Paid in capital	**43,373**	37,823	**38,318**	32,768
Capital stock	**6,218**	5,637	**6,132**	5,680
Additional paid in capital	**37,155**	32,186	**32,186**	27,088
Other reserves	**16,483**	15,785	**14,879**	15,103
Capital reserves	**2,644**	2,644	**11,273**	11,273
Retained earnings	**13,248**	13,323	**4,245**	5,216
Result from the mark to market valuation of available-for-sale securities	**(2,097)**	(599)	**(1,969)**	(595)
Result from cash flow hedging transactions	**(612)**	(93)	**(612)**	(93)
Adjustment in the employee pension Scheme	**-**	-	**434**	-
Net income	**3,300**	510	**1,508**	(698)
Minority interest in capital	**5**	4	**2**	2
Total equity	**59,861**	53,612	**53,199**	47,873
Total liabilities and equity	**673,389**	579,835	**653,790**	561,862

Consolidated Balance Sheet *(continued)*

	GROUP		BANK	
	31 Dec	31 Dec	**31 Dec**	31 Dec
Figures in MXN millions	**2016**	2015	**2016**	2015
Memorandum Accounts	**5,594,901**	5,800,630	**5,582,041**	5,789,362
Third party accounts	**40,504**	42,642	-	-
Clients current accounts	**321**	-	-	-
Custody operations	**822**	1,533	-	-
Transactions on behalf of clients	-	-	-	-
Third party investment banking operations, net	**39,361**	41,109	**39,361**	41,108
Proprietary position	**5,554,397**	5,757,988	**5,542,680**	5,789,362
Guarantees granted	-	-	-	-
Irrevocable lines of credit granted	**280,898**	264,127	**280,898**	264,127
Goods in trust or mandate	**437,118**	458,161	**437,117**	458,161
Goods in custody or under administration	**952,994**	991,699	**947,358**	986,062
Collateral received by the institution	**31,815**	43,538	**31,815**	43,538
Collateral received and sold or delivered as guarantee	**29,416**	36,872	**29,416**	36,872
Deposit of assets	-	-	-	
Suspended interest on impaired loans	**183**	234	**183**	234
Recovery guarantees for issued bonds	-	-	-	-
Paid claims	-	-	-	-
Cancelled claims	-	-	-	-
Responsibilities from bonds in force	-	-	-	-
Other control accounts	**3,821,973**	3,963,357	**3,815,893**	3,959,260

Consolidated Income Statement

Figures in MXN millions	GROUP 31 Dec 2016	GROUP 31 Dec 2015	BANK 31 Dec 2016	BANK 31 Dec 2015
Interest income	**35,800**	29,638	**34,606**	28,617
Interest expense	**(9,897)**	(7,520)	**(9,918)**	(7,536)
Earned premiums	**4,140**	2,828	**-**	-
Technical reserves	**(237)**	(18)	**-**	-
Claims	**(2,086)**	(2,170)	**-**	-
Net interest income	**27,720**	22,758	**24,688**	21,081
Loan impairment charges	**(8,220)**	(8,840)	**(8,220)**	(8,840)
Risk-adjusted net interest income	**19,500**	13,918	**16,468**	12,241
Fees and commissions receivable	**8,742**	8,240	**8,283**	7,754
Fees payable	**(2,174)**	(1,878)	**(2,096)**	(1,892)
Trading income	**941**	800	**1,053**	937
Other operating income	**1,836**	1,731	**2,224**	1,881
Total operating income	**28,845**	22,811	**25,932**	20,921
Administrative and personnel expenses	**(24,008)**	(22,472)	**(23,697)**	(22,299)
Net operating income	**4,837**	339	**2,235**	(1,378)
Share of profits in equity interest	**64**	52	**60**	50
Profit/loss before taxes	**4,901**	391	**2,295**	(1,328)
Income tax	**(782)**	(570)	**(52)**	(36)
Deferred income tax	**(819)**	688	**(735)**	665
Net income before discontinued operations	**3,300**	509	**1,508**	(699)
Discontinued operations	**-**	-	**-**	-
Minority interest	**-**	1	**-**	1
Profit/loss	**3,300**	510	**1,508**	(698)

Audited financial statements will be re- expressed to reflect initial Solvency impact of 533 net of taxes as of December 2015. For the purpose of this press release this re-expression has not been included.

Consolidated Statement of Changes in Shareholders' Equity

GROUP

Figures in MXN millions

	Capital contributed	Capital reserves	Retained earnings	Result from valuation of available-for-sale securities	Result from cash flow hedging transactions	Net income	Minority interest	**Total Equity**
Balances at 01 January 2016	**37,823**	**2,644**	**13,323**	**(599)**	**(93)**	**510**	**4**	**53,612**
Movements inherent to the shareholders' decision								
Subscription of shares	5,550	-	-	-	-	-	-	**5,550**
Shares issue	-	-	-	-	-	-	-	**-**
Transfer of result of prior years	-	-	510	-	-	(510)	-	**-**
Constitution of reserves		-	-	-	-	-	-	**-**
Cash dividends	-	-	(880)	-	-	-	-	**(880)**
Total	**5,550**	**-**	**(370)**	**-**	**-**	**(510)**	**-**	**4,670**
Movements for the recognition of the comprehensive income								
Net income	-	-	-	-	-	3,300	-	**3,300**
Result from valuation of available-for-sale securities	-	-	-	(1,498)	-	-	-	**(1,498)**
Result from cash flow hedging transactions	-	-	-	-	(519)	-	-	**(519)**
Others	-	-	295	-	-	-	1	**296**
Total	**-**	**-**	**295**	**(1,498)**	**(519)**	**3,300**	1	**1,579**
Balances at 31 December 2016	**43,373**	**2,644**	**13,248**	**(2,097)**	**(612)**	**3,300**	**5**	**59,861**

Consolidated Statement of Changes in Shareholders' Equity *(continued)*

BANK

Figures in MXN millions	Capital contributed	Capital reserves	Retained earnings	Result from valuation of available-for-sale securities	Result from cash flow hedging transactions	Adjustment in defined benefit pension plans	Net income	Minority interest	Total equity
Balances at 1 January 2016	**32,768**	**11,273**	**5,216**	**(595)**	**(93)**	**-**	**(698)**	**2**	**47,873**
Movements inherent to the shareholders' decision									
Subscription of Shares	5,550								**5,550**
Share issue	-	-	-	-	-	-	-	-	-
Transfer of result of prior years	-	-	(698)	-	-	-	698	-	-
Constitution of reserves	-	-	-	-	-	-	-	-	-
Cash dividends	-	-	-	-	-	-	-	-	-
Others	-	-	-	-	-	-	-	-	-
Total	**5,550**	**-**	**(698)**	**-**	**-**	**-**	**698**	**-**	**5,550**
Movements for the recognition of the comprehensive income									
Net income	-	-	-	-	-	-	1,508		**1,508**
Result from valuation of available-for-sale securities	-	-	-	(1,374)			-	-	**1,374**
Result from cash flow hedging transactions	-	-	-	-	(519)	-	-	-	**(519)**
Adjustment in defined benefit pension plans	-	-	-	-	-	434	-	-	**434**
Others	-	-	(273)	-	-	-		-	**(273)**
Total	**-**	**-**	**(273)**	**(1,374)**	**(519)**	**434**	**1,508**	**2**	**(111)**
Balances at 31 December 2016	**38,318**	**11,273**	**4,245**	**(1,969)**	**(612)**	**434**	**1,508**	**2**	**53,199**

Consolidated Statement of Cash Flows

GROUP

Figures in MXN millions	**31-Dec-16**
Net income	**3,300**
Adjustments for items not involving cash flow:	**12,527**
Allowances for loan losses	8129
Depreciation	896
Amortisation	283
Provisions	237
Income tax and deferred taxes	1306
Technical reserves	1601
Discontinued operations	0
Share of profit in equity interest	(64)
Others	139
Changes in items related to operating activities:	
Margin accounts	(1,465)
Investment securities	(12,666)
Repurchase agreements	11,518
Derivative (assets)	(32732)
Loan portfolio	(42,094)
Benefits to be received from trading operations	15
Foreclosed assets	(240)
Operating assets	(19,839)
Deposits	22,887
Bank deposits and other liabilities	(1,701)
Creditors repo transactions	16,428
Collateral sold or delivered as guarantee	(12,063)
Derivative (liabilities)	33461
Subordinated debentures outstanding	1,391
Accounts receivables from reinsurers and coinsurers	54
Accounts receivables from premiums	(1,568)
Reinsurers and bonding	5
Other operating liabilities	26,035
Income tax paid	(1,195)
Funds provided by operating activities	**(13,769)**
Investing activities:	
Proceeds on disposal of property, furniture and equipment	64
Acquisition of property, furniture and equipment	(668)
Intangible asset acquisitions and prepaid expenses	(684)
Cash dividends	27
Other investment activities	175
Funds used in investing activities	**(1,086)**
Financing activities:	
Shares issue	5,550
Cash dividends	(880)
Others	-
Funds used in financing activities	**4,670**
Financing activities:	
Increase/Decrease in cash and equivalents	5,642
Cash and equivalents at beginning of period	46,266
Cash and equivalents at end of period	**51,908**

Consolidated Statement of Cash Flows *(continued)*

BANK

Figures in MXN millions	**31-Dec-16**
Net income	**1,508**
Adjustments for items not involving cash flow:	**11,171**
Allowances for loan losses	8,129
Depreciation	896
Amortisation	283
Provisions	997
Income tax and deferred taxes	787
Share of profits in equity interest	(60)
Others	139
Changes in items related to operating activities:	
Margin accounts	(1,465)
Investment securities	(12,512)
Repurchase agreements	11,518
Derivative (assets)	(32,732)
Loan portfolio	(42,094)
Benefits to be received from trading operations	15
Foreclosed assets	(240)
Operating assets	(19,719)
Deposits	22,939
Bank deposits and other liabilities	(1,703)
Creditors repo transactions	16,428
Collateral sold or delivered as guarantee	(12,063)
Derivative (liabilities)	33,461
Subordinated debentures outstanding	1,391
Other operating liabilities	25,805
Income tax paid	(588)
Funds provided by operating activities	**(11,559)**
Investing activities:	
Acquisition of property, furniture and equipment	(668)
Intangible asset acquisitions and prepaid expenses	(684)
Proceeds on disposal of property, furniture and equipment	64
Cash dividends	27
Others	142
Funds used in investing activities	**(1,119)**
Financing activities:	
Shares Issue	5,550
Funds used in financing activities	**5,550**
Financing activities:	
Increase / Decrease in cash and equivalents	**5,551**
Cash and equivalents at beginning of period	**46,266**
Cash and equivalents at end of period	**51,817**

Changes in accounting rules

- Mexican GAAP new accounting rules for defined benefit pension plans are in force starting January 2016 (NIF D-3). Those are mostly aligned with IFRS.
  CNBV issued a transitory rule to recognize accounting changes on defined benefit pension plans on an annual and progressive basis during a period of 5 years (20% each year). Grupo Financiero HSBC adhered to this option.

  Main impacts are as follows:

  a) Plan changes modifications: unrecognized balances on transition were recognized in Retained earnings, this effect was MXN19m, net of deferred taxes.
  b) Actuarial gains and losses: unrecognized cumulative balance is recognized in 'Adjustment in the employee defined benefit pension plans' which is presented separately in shareholders' equity in the bank's consolidated financial statements, this effect was MXN411m, net of deferred taxes, at December 31st 2016. The recycling through P&L is done over the average working life of the employees.

- On February 2016, Secretaría de Hacienda y Crédito Público 'SHCP' (Mexican Government Authority) recommended that Mexican domestic market is considered as a deep market managing high credit quality bonds for NIF D-3 purposes. This result in a change in discount rates used to calculate liabilities at present value, using corporate bonds rates instead of governmental bonds rates. The Bank considered a change in discount rate using corporate bonds rate for the figures reported as of 31 December 2016.

- During 2014, a new Insurance Law was issued which follows the European Solvency II principles proposing a new framework for operations, risk profile and prudential supervision of Insurance Companies in Mexico. Changes are in force starting January 2016. Main impacts are as follows:

  a) From an Insurance Liabilities perspective a Best Estimate Liabilities + Risk Margin approach is now considered;
  b) Insurance Premiums and Technical Reserves for short term insurance contracts are recognized on an annualized basis;
  c) From the Assets perspective, a Mark to Market assessment is considered for all financial assets; and
  d) Capital requirements are based on risks.

The initial application of Solvency II related to the insurance premiums now recognized on an annualized basis of MXN253m, net of deferred taxes, (MXN361m before taxes) was recognized through P&L as being defined by CNSF recommendation.

Additionally, there was an initial application benefit of MXN142m, net of deferred taxes, also related to Solvency II, due to the difference of market vs contractual rates on technical reserves, which was recognized in retained earnings; further movements were recognized in retained earnings for this concept for MXN-35m as at December 31st 2016.

On December 2015, the CNBV issued a new loan loss allowance methodology for credit cards and other revolving loans. The new methodology is in force starting 1st April 2016. Main changes are related to the incorporation of new variables such as those obtained from credit bureau and to the period in which the client has maintained a relationship with the bank. Initial application of MXN248m, net of deferred taxes, was recognized in retained earnings.

Differences between Mexican GAAP and International Financial Reporting Standards (IFRS)
Grupo Financiero HSBC
HSBC Holdings plc, the ultimate parent of Grupo Financiero HSBC, reports its results under International Financial Reporting Standards (IFRS). Set out below is a reconciliation of the results of Grupo Financiero HSBC from Mexican GAAP to IFRS for the fourth quarter of 2016 and an explanation of the key reconciling items.

Figures in MXN millions	**Dec 31st 2016**
Grupo Financiero HSBC – Net Income Under Mexican GAAP	**3,300**
Differences arising from:	
Valuation of defined benefit pensions and post-retirement healthcare benefits, including post-employment benefits ⌖	307
Deferral of fees received and paid on the origination of loans and other effective interest rate adjustments⌖	143
Loan impairment charges and other differences in presentation under IFRS⌖	(595)
Recognition of the present value in-force of long-term insurance contracts ⌖	214
Fair value adjustments on financial instruments ⌖	204
Deferred profit sharing⌖	293
Insurance liabilities and Insurance premiums recognised on an annualised basis ⌖	(1,177)
Other differences in accounting principles⌖	(89)
Net income under IFRS	**2,600**
US dollar equivalent (millions)	**140**
Add back tax expense	1,995
Net income before taxes under IFRS	**4,595**
US dollar equivalent (millions)	**247**
Exchange rate used for conversion	***18.60324***

⌖*Net of taxes*

Summary of key differences between Grupo Financiero HSBC's results as reported under Mexican GAAP and IFRS

Valuation of defined benefit pensions and post-retirement healthcare benefits, including post-employment benefits

Mexican GAAP

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 current service cost, plus the unwinding of the discount rate on plan liabilities, less the expected return on plan assets. Past service costs are charged immediately to the income statement to the extent that the benefits have vested, and are otherwise recognized on a straight-line basis over the average period until the benefits vest. Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred), as well as the effects of changes in actuarial assumptions. Actuarial gains and losses are recognized separately in 'shareholders' equity in the bank's consolidated financial statements' but then are recycled through P&L over the average working life of the employees. See also the Changes in accounting rules section.

IFRS

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 current service cost, plus the unwinding of the discount rate on plan liabilities, less the expected return on plan assets, and is presented in operating expenses. Past service costs are charged immediately to the income statement to the extent that the benefits have vested, and are otherwise recognized on a straight-line basis over the average period until the benefits vest. Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred), as well as the effects of changes in actuarial assumptions. Actuarial gains and losses are recognized in other comprehensive income in the period in which they arise. Indemnity payments are not considered as a liability for termination benefits.

Deferral of fees paid and received on the origination of loans and other effective interest rate adjustments

Mexican GAAP

From 1 January 2007, loan origination fees are required to be deferred and amortized over the life of the loan on a straight line basis. Prior to 2007, loan origination fees were recognized up-front.

IFRS

After initial recognition, an entity shall measure the loan at its amortized cost using the effective interest rate method.

The amortized cost of the financial instrument includes any premium discounts of fees paid and or received as result of the recognitions of the financial asset.

The effective interest rate method consist in allocating the interest income over the relevant period of the financial asset

The effective interest rate is the rate that exactly discounts estimated future cash payments of the financial asset through its expected life.

Loan impairment charges and other differences in presentation under IFRS

Mexican GAAP

Loan impairment charges are calculated following the rules issued by the Mexican Ministry of Finance and the National Banking and Securities Commission. Such rules establish methodologies for determining the amount of provision for each type of loan.

Cash recoveries of written off loans and the positive excess of loan impairment charges determined monthly, are presented in Other Operating Income.

IFRS

Impairment losses on collectively assessed loans are calculated as follows:

- When appropriate empirical information is available, the Bank utilizes roll rate methodology. This methodology employs statistical analysis of historical data and experience of delinquency and default to estimate the amount of loans that will eventually be written off as a result of 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.
- In other cases, loans are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss.

Impairment losses on individually assessed loans are calculated by discounting the expected future cash flows of a loan at its original effective interest rate, and comparing the resultant present value with the loans current carrying value.

Cash recoveries of written off loans and the positive excess of loan impairment charges recognized during the year are presented in Loan Impairment Charges.

Present value of in-force long-term life insurance contracts

Mexican GAAP

The present value of future earnings is not recognized. Premiums are accounted for on a received basis and reserves are calculated in accordance with guidance as set out by the Insurance Regulator (Comisión Nacional de Seguros y Fianzas).

IFRS

The value placed on insurance contracts that are classified as long-term insurance business or long-term investment contracts with discretionary participating features (‘DPF’) and are in force at the balance sheet date is recognized as an asset. The asset represents the present value of the equity holders’ interest in the issuing insurance companies’ profits expected to emerge from these contracts written at the balance sheet date.

The present value of in-force long-term insurance business and long-term investment contracts with DPF, referred to as ‘PVIF’, is determined by discounting the equity holders’ interest in future profits expected to emerge from business currently in force using appropriate assumptions in assessing factors such as future mortality, lapse rates and levels of expenses, and a risk discount rate that reflects the risk premium attributable to the respective contracts. The PVIF incorporates allowances for both non-market risk and the value of financial options and guarantees. The PVIF asset is presented gross of attributable tax in the balance sheet and movements in the PVIF asset are included in 'Other operating income' on a gross of tax basis.

Reduction of Present value of in-force long-term life insurance contracts for the nine months to 30 September 2014 is related to the reduction of sales.

Fair value adjustments on financial instruments

Mexican GAAP
Mexican GAAP requires that for those Derivatives and Investment in Securities required to be fair valued, valuations shall be obtained from prices or application of internal valuation models, applied uniformly and consistently among the operations with same nature.

Inputs for Internal valuation models such as interest rates, exchange rates and volatilities as well as prices used to valuate positions shall be obtained from authorized price vendors.

IFRS
Fair Value Adjustments ('FVAs') are applied to reflect factors not captured within the core valuation model that would nevertheless be considered by market participants in determining a trade price.
In 2014, in line with evolving market practice, HSBC revised its estimation methodology for valuing the uncollateralized derivative portfolios by introducing a funding fair value adjustment.

Deferred profit sharing
Mexican GAAP
Mexican GAAP requires that a deferred profit sharing is determined by applying a similar model to deferred income taxes; it is derived from temporary differences between the accounting result and income for profit sharing. An asset is recognized only when it can be reasonably assumed that it will generate a benefit, and there is no indication that circumstances will change in such a way that the benefits will not be realized.

IFRS
Deferred profit sharing asset is not permitted under IFRS.

Insurance liabilities and Insurance premiums recognized on an annualized basis
Mexican GAAP
As explained in the Changes in accounting rules section, new Insurance accounting principles are in place from 2016.We only present differences in insurance liabilities and insurance premiums recognized on an annualized basis / P&L.

Insurance liabilities are calculated as the sum of a best estimate and a risk margin. The best estimate is based on up-to-date credible information and realistic assumptions and aims to represent a total liability valuation aligned to its expected pricing transfer to the customer. The risk margin is calculated as the cost of providing an amount of capital equal to the Solvency Capital Requirement necessary to support the insurance obligations over their lifetime.

Insurance premiums are recognized in the tenor of the insurance contract.

IFRS
IFRS reserving process is based on a liability adequacy test to ensure that the carrying amount of liabilities is sufficient in the light of estimated future cash flows defined by a prudent, non-market consistent set of rules for such estimated cash flows (instead of using realistic assumptions) and not using risk margins components.

Insurance premiums are recognized as incurred.