

Interim Financial Statements 2016

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Presentation of Information

This document comprises the Interim Financial Statements 2016 for HSBC Bank Middle East Limited ('the bank') and its subsidiary undertakings (together 'the group'). It contains Condensed Financial Statements, together with the Auditor's review report. References to 'HSBC' or 'the HSBC Group' within this document mean HSBC Holdings plc together with its subsidiaries.

In accordance with IAS 34 the Interim Report is intended to provide an update on the *Annual Report and Accounts 2015* and therefore focusses on events during the first six months of 2016 rather than duplicating information previously reported.

Condensed Financial Statements (unaudited)

Consolidated income statement for the half-year to 30 June 2016

	Half-year to	
	30 June 2016 US\$000	30 June 2015 US\$000
Interest income	533,544	611,641
Interest expense	(68,392)	(80,780)
Net interest income	465,152	530,861
Fee income	275,755	310,104
Fee expense	(29,774)	(27,895)
Net fee income	245,981	282,209
Trading income excluding net interest income	162,831	153,240
Net interest expense on trading activities	(8,411)	(8,922)
Net trading income	154,420	144,318
Net income from financial instruments designated at fair value	7,733	2,088
Gains less losses from financial investments	12,689	3,775
Dividend income	1,482	2,189
Other operating income	33,952	32,640
Net operating income before loan impairment charges and other credit risk provisions	921,409	998,080
Loan impairment charges and other credit risk provisions	4 (33,199)	(30,471)
Net operating income	888,210	967,609
Employee compensation and benefits	(262,494)	(316,681)
General and administrative expenses	(156,007)	(209,394)
Depreciation and impairment of property, plant and equipment	(6,626)	(9,048)
Amortisation and impairment of intangible assets	(3,005)	(5,816)
Total operating expenses	(428,132)	(540,939)
Operating profit	460,078	426,670
Share of profit in associates	1,007	3,457
Profit before tax	461,085	430,127
Tax expense	(86,070)	(65,980)
Profit for the period	375,015	364,147
Profit attributable to shareholders of the parent company	374,673	355,541
Profit attributable to non-controlling interests	342	8,606

The accompanying notes on pages 8 to 19 form an integral part of these condensed financial statements.

Condensed Financial Statements (unaudited) (continued)**Consolidated statement of comprehensive income for the half-year to 30 June 2016**

	Half-year to	
	30 June 2016 US\$000	30 June 2015 US\$000
Profit for the period	375,015	364,147
Other comprehensive income		
Items that will be reclassified subsequently to profit or loss when specific conditions are met		
Available for sale investments:	(18,261)	(12,017)
– fair value losses	(9,860)	(11,731)
– fair value gains transferred to income statement on disposal	(9,381)	(6,136)
– amounts transferred to the income statement in respect of impairment losses	1,097	5,733
– income taxes	(117)	117
Cash flow hedges:	13,308	8,017
– fair value gains	14,786	28,711
– fair value gains transferred to income statement	–	(19,882)
– income taxes	(1,478)	(812)
Exchange differences	(4,364)	(30,941)
Items that will not be reclassified subsequently to profit or loss		
Remeasurement of defined benefit asset/liability:	–	(2,942)
– before income taxes	–	(2,942)
– income taxes	–	–
Other comprehensive expense for the period, net of tax	(9,317)	(37,883)
Total comprehensive income for the period	365,698	326,264
Total comprehensive income for the period attributable to:		
– shareholders of the parent company	365,356	318,294
– non-controlling interests	342	7,970
	365,698	326,264

The accompanying notes on pages 8 to 19 form an integral part of these condensed financial statements.

Condensed Financial Statements (unaudited) (continued)**Consolidated statement of financial position at 30 June 2016**

	Notes	30 June 2016 US\$000	31 December 2015 US\$000
ASSETS			
Cash and balances at central banks		832,635	612,413
Items in the course of collection from other banks		46,838	90,173
Trading assets	9	220,902	129,619
Derivatives	9	1,282,710	992,515
Loans and advances to banks		7,178,291	6,731,114
Loans and advances to customers	3,4	22,885,013	23,613,992
Reverse repurchase agreements – non-trading		515,141	806,928
Financial investments	9	6,715,131	7,158,981
Prepayments, accrued income and other assets		928,394	1,011,966
Current tax assets		2,795	-
Interests in associates		78,021	82,173
Intangible assets		14,828	17,025
Deferred tax assets		233,577	227,920
Total assets		40,934,276	41,474,819
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks		2,928,053	2,868,248
Customer accounts		24,643,816	25,252,079
Items in the course of transmission to other banks		248,704	391,431
Trading liabilities	9	1,688,748	1,483,677
Financial liabilities designated at fair value	6,9	404,424	848,237
Derivatives	9	1,388,551	1,073,970
Debt securities in issue	7	2,821,673	2,807,977
Accruals and deferred income and other liabilities		2,442,972	1,813,297
Current tax liabilities		156,854	165,389
Provisions		19,668	23,696
Deferred tax liabilities		523	523
Total liabilities		36,743,986	36,728,524
Equity			
Called up share capital		931,055	931,055
Other reserves		(96,902)	(87,650)
Retained earnings		3,352,559	3,899,654
Total equity attributable to shareholders of the parent company		4,186,712	4,743,059
Non-controlling interests		3,578	3,236
Total equity		4,190,290	4,746,295
Total equity and liabilities		40,934,276	41,474,819

The accompanying notes on pages 8 to 19 form an integral part of these condensed financial statements.

A M Sharaf, Director

Condensed Financial Statements (unaudited) (continued)**Consolidated statement of cash flows for the half-year to 30 June 2016**

	Half-year to	
	30 June 2016 US\$000	30 June 2015 US\$000
Cash flows from operating activities		
Profit before tax	461,085	430,127
Adjustments for:		
– non-cash items included in profit before tax	31,116	21,558
– change in operating assets	196,274	(1,673,757)
– change in operating liabilities	(857,122)	349,254
– elimination of exchange differences ¹	(14,082)	127,160
– net gain from investing activities	(13,581)	(9,873)
– net gain on disposal of businesses	-	(1,732)
– net gain on disposal of associate	(13,052)	-
– share of profit in associates	(1,007)	(3,457)
– dividends received from associates	1,312	3,363
– contributions paid to defined benefit pension plans	(536)	-
– tax paid	(130,722)	(121,982)
Net cash used in operating activities	<u>(340,315)</u>	<u>(879,339)</u>
Cash flows from investing activities		
Purchase of financial investments	(3,509,890)	(5,658,468)
Proceeds from the sale and maturity of financial investments	1,687,309	7,091,261
Purchase of property, plant and equipment	(7,715)	(14,336)
Proceeds from the sale of property, plant and equipment	-	9,991
Purchase of intangible assets	(828)	(1,360)
Net cash outflow from disposal of businesses	-	(6,993)
Net cash inflow from disposal of associate	16,900	-
Net cash (used in)/generated from investing activities	<u>(1,814,224)</u>	<u>1,420,095</u>
Cash flows from financing activities		
Dividends paid to ordinary shareholders	(420,000)	(295,000)
Dividends paid to non-controlling interests	-	(14,031)
Net cash used in financing activities	<u>(420,000)</u>	<u>(309,031)</u>
Net (decrease)/increase in cash and cash equivalents	(2,574,539)	231,725
Cash and cash equivalents at 1 January	8,996,879	9,444,465
Exchange differences in respect of cash and cash equivalents	11,603	(86,779)
Cash and cash equivalents at 30 June	<u>6,433,943</u>	<u>9,589,411</u>

1 Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on a line-by-line basis, as details cannot be determined without unreasonable expense.

The accompanying notes on pages 8 to 19 form an integral part of these condensed financial statements.

Consolidated statement of changes in equity for the half-year to 30 June 2016

	Half-year to 30 June 2016									
	Other reserves									
	Called up share capital US\$000	Retained earnings US\$000	Available- for-sale fair value reserve US\$000	Cash flow hedging reserve US\$000	Foreign exchange reserve US\$000	Other reserve US\$000	Merger reserve US\$000	Total share- holders' equity US\$000	Non- controlling interests US\$000	Total equity US\$000
At 1 January 2016	931,055	3,899,654	35,019	(8,384)	(98,964)	31	(15,352)	4,743,059	3,236	4,746,295
Profit for the period	-	374,673	-	-	-	-	-	374,673	342	375,015
Other comprehensive income (net of tax)	-	(30)	(18,255)	13,308	(4,340)	-	-	(9,317)	-	(9,317)
Available-for-sale investments	-	-	(18,261)	-	-	-	-	(18,261)	-	(18,261)
Cash flow hedges	-	-	-	13,308	-	-	-	13,308	-	13,308
Remeasurement of defined benefit asset/liability	-	-	-	-	-	-	-	-	-	-
Exchange differences and other	-	(30)	6	-	(4,340)	-	-	(4,364)	-	(4,364)
Total comprehensive income for the period	-	374,643	(18,255)	13,308	(4,340)	-	-	365,356	342	365,698
Dividends to shareholders	-	(920,000)	-	-	-	-	-	(920,000)	-	(920,000)
Other movements	-	(1,738)	35	-	-	-	-	(1,703)	-	(1,703)
At 30 June 2016	931,055	3,352,559	16,799	4,924	(103,304)	31	(15,352)	4,186,712	3,578	4,190,290

The accompanying notes on pages 8 to 19 form an integral part of these condensed financial statements.

	Half-year to 30 June 2015									
	Other reserves									
	Called up share capital US\$000	Retained earnings US\$000	Available- for-sale fair value reserve US\$000	Cash flow hedging reserve US\$000	Foreign exchange reserve US\$000	Other reserve US\$000	Merger reserve US\$000	Total share- holders' equity US\$000	Non- controlling interests US\$000	Total equity US\$000
At 1 January 2015	931,055	4,393,142	62,333	(6,512)	(52,509)	2,930	(15,352)	5,315,087	408,410	5,723,497
Profit for the period	-	355,541	-	-	-	-	-	355,541	8,606	364,147
Other comprehensive income (net of tax)	-	(3,105)	(11,533)	8,017	(30,630)	4	-	(37,247)	(636)	(37,883)
Available-for-sale investments	-	-	(11,518)	-	-	-	-	(11,518)	(499)	(12,017)
Cash flow hedges	-	-	-	8,017	-	-	-	8,017	-	8,017
Remeasurement of defined benefit asset/liability	-	(2,942)	-	-	-	-	-	(2,942)	-	(2,942)
Exchange differences and other	-	(163)	(15)	-	(30,630)	4	-	(30,804)	(137)	(30,941)
Total comprehensive income for the period	-	352,436	(11,533)	8,017	(30,630)	4	-	318,294	7,970	326,264
Dividends to shareholders	-	(295,000)	-	-	-	-	-	(295,000)	(14,031)	(309,031)
Other movements	-	2,096	46	-	-	(302)	-	1,840	529	2,369
At 30 June 2015	931,055	4,452,674	50,846	1,505	(83,139)	2,632	(15,352)	5,340,221	402,878	5,743,099

The accompanying notes on pages 8 to 19 form an integral part of these interim consolidated condensed financial statements.

Notes on the Condensed Financial Statements (unaudited)

1 Basis of preparation and significant accounting policies

(a) Compliance with International Financial Reporting Standards

The interim condensed consolidated financial statements of the group have been prepared in accordance with IAS 34 'Interim Financial Reporting' ('IAS 34') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the European Union ('EU'). These interim consolidated financial statements should be read in conjunction with the Annual Report and Accounts 2015.

At 30 June 2016, there were no unendorsed standards effective for the half year ended 30 June 2016 affecting these interim consolidated financial statements, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group.

Standards applied during the half-year to 30 June 2016

There were no new standards applied during the half-year to 30 June 2016.

During the period ended 30 June 2016, the group applied a number of interpretations and amendments to standards which had an insignificant effect on these interim consolidated financial statements.

(b) Use of estimates and judgements

Management believes that the group's critical accounting estimates and judgements are those which relate to the impairment of loans and advances, the valuation of financial instruments, provisions and the valuation of intangible assets recognised in business combinations. There was no change in the current period to the critical accounting estimates and judgements applied in 2015, which are stated in the Annual Report and Accounts 2015.

(c) Composition of group

Palestinian Autonomous Area

On 31 December 2015, the bank closed its branch in the Palestinian Autonomous Area (the "PAA"). The bank continued to offer limited securities services in the PAA until 30 June 2016, following which date the bank has ceased all operations in the PAA.

Oman

On 17 September 2015 the Board approved the sale of its entire shareholding in HBON to another HSBC Group entity, HSBC Bank Middle East Holdings BV and completed the disposal on 1 October 2015. The impact of the disposal on the group's results can be seen from the segmental analysis in note 5.

(d) Operating Segments

In the Annual Report and Accounts 2015, the group's segments reported under IFRS 8 Operating Segments were organised into geographical regions comprising UAE, Qatar, Oman and Rest of Middle East. The Rest of Middle East covers Algeria, Bahrain, Kuwait, Lebanon, and the Palestine Autonomous Area.

Following the disposal of HSBC Bank Oman S.A.O.G (HBON) by the group in October 2015, operating segments were reviewed for all reporting periods from 1 January 2016.

The group has revised its operating segments from a geographical view to a business view as follows:

- Retail Banking and Wealth Management;
- Commercial Banking;
- Global Banking and Markets;
- Global Private Banking; and
- Other.

The revised segments are consistent with those reported to the Board, the identified Chief Operating Decision Maker ('CODM') under IFRS 8.

Notes on the Condensed Financial Statements (unaudited) (continued)**(e) Transfer of head office to Dubai International Financial Centre ('DIFC')**

On 17 September 2015, the bank had announced that, subject to regulatory and other applicable approvals, it intends to transfer its place of incorporation and head office from Jersey, Channel Islands, to Dubai International Financial Centre (DIFC), in the United Arab Emirates.

On 30 June 2016, the bank's head office and place of incorporation was moved from Jersey to the DIFC. The bank's new registered office is Level 1, Gate Village Building 8, Dubai International Financial Centre, Dubai, United Arab Emirates.

(f) Future accounting developments

Information on future accounting developments and their potential effect on the financial statements of the group are provided in the Annual Report and Accounts 2015.

(g) Accounting policies

The accounting policies applied by the group for these interim condensed consolidated financial statements are consistent with those described in the Annual Report and Accounts 2015, as are the methods of computation.

2 Dividends*Dividends to shareholders of the parent company*

	Half year to 30 June 2016		Half year to 30 June 2015	
	US\$ per share	Total US\$000	US\$ per share	Total US\$000
Dividends declared on ordinary shares	0.9881	920,000	0.3168	295,000

During the period a fourth interim dividend for 2015 of US\$210 million was declared on 8 February 2016 (paid 22 March 2016), the first interim dividend for 2016 of US\$210 million was declared on 11 May 2016 (paid 23 June 2016) and special dividend for 2016 of US\$500 million was declared on 27 June 2016.

The Directors declared a second interim dividend of US\$75 million in respect of the financial year ending 31 December 2016 on 26 July 2016. No liability is recognised in the financial statements in respect of this dividend.

Notes on the Condensed Financial Statements (unaudited) (continued)**3 Concentration of loans and advances**

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

Gross loans and advances to customers by industry sector

	Gross loans and advances to customers			
	30 June 2016		31 December 2015	
	Total US\$000	As a % of total gross loans %	Total US\$000	As a % of total gross loans %
Personal				
Residential mortgages	2,188,285	9.12%	2,098,996	8.45%
Other personal	2,605,799	10.86%	2,829,173	11.39%
	4,794,084	19.98%	4,928,169	19.84%
Corporate and commercial				
Commercial, industrial and international trade	9,104,167	37.94%	9,424,608	37.95%
Commercial real estate	564,152	2.35%	636,557	2.56%
Other property related	1,479,775	6.17%	1,681,565	6.77%
Government	1,608,655	6.70%	1,616,162	6.51%
Other commercial	4,028,802	16.79%	4,263,839	17.17%
	16,785,551	69.95%	17,622,731	70.96%
Financial				
Non-bank financial institutions	2,416,525	10.07%	2,284,269	9.20%
Total gross loans and advances to customers	23,996,160	100.00%	24,835,169	100.00%
Impaired loans				
- as a percentage of gross loans and advances to customers	6.03%		6.04%	
Total impairment allowances				
- as a percentage of gross loans and advances to customers	4.63%		4.92%	

4 Loan impairment charge/(recoveries) and other credit risk provisions

	Half-year to	
	30 June 2016 US\$000	30 June 2015 US\$000
Loan impairment charges on loans and advances		
- new allowances net of allowance releases	39,484	48,550
- recoveries of amounts previously written off	(11,185)	(17,029)
	28,299	31,521
Impairment charges/(releases) on debt securities and other credit risk provisions	4,900	(1,050)
	33,199	30,471

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

	Banks		Customers	
	Individually assessed US\$000	Individually assessed US\$000	Collectively assessed US\$000	Total US\$000
At 1 January 2016	17,994	950,079	271,098	1,239,171
Amounts written off	(16,395)	(96,293)	(57,766)	(170,454)
Recoveries of amounts previously written off	-	-	11,185	11,185
Charge/(release) to income statement	(1,599)	39,539	(9,641)	28,299
Foreign exchange and other movements	-	2,915	31	2,946
At 30 June 2016	-	896,240	214,907	1,111,147

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

	Banks		Customers	
	Individually assessed US\$000	Individually assessed US\$000	Collectively assessed US\$000	Total US\$000
At 1 January 2015	18,280	1,017,484	239,362	1,275,126
Amounts written off	-	(205,805)	(54,238)	(260,043)
Recoveries of amounts previously written off	-	1,248	15,781	17,029
Charge to income statement	-	20,976	10,545	31,521
Foreign exchange and other movements	(28)	4,643	(563)	4,052
At 30 June 2015.....	<u>18,252</u>	<u>838,546</u>	<u>210,887</u>	<u>1,067,685</u>

5 Segment analysis

With effect from 1 January 2016, the group's operating segments are as described in Note 1 'Basis of Preparation' on page 8. All comparatives have been adjusted accordingly.

Profit/(loss) for the period

	RBWM US\$000	CMB US\$000	GB&M US\$000	GPB US\$000	Other US\$000	Inter Segment US\$000	Total US\$000
Half year to 30 June 2016							
Net interest income	199,337	139,142	113,925	(8)	(112)	12,868	465,152
Net fee income	63,119	96,402	88,287	-	(1,827)	-	245,981
Net trading income	23,250	24,310	118,551	2	1,175	(12,868)	154,420
Other income	15,475	3,181	17,432	(9)	39,267	(19,490)	55,856
Net operating income before loan impairment (charges)/recoveries and other credit risk provisions	301,181	263,035	338,195	(15)	38,503	(19,490)	921,409
Loan impairment (charges)/recoveries and other credit risk provisions	(56,328)	16,573	6,556	-	-	-	(33,199)
Net operating income	244,853	279,608	344,751	(15)	38,503	(19,490)	888,210
Total operating expenses	(164,125)	(118,846)	(111,182)	(230)	(53,239)	19,490	(428,132)
Operating profit.....	80,728	160,762	233,569	(245)	(14,736)	-	460,078
Share of profit in associates	-	-	1,007	-	-	-	1,007
Profit before tax.....	<u>80,728</u>	<u>160,762</u>	<u>234,576</u>	<u>(245)</u>	<u>(14,736)</u>	-	<u>461,085</u>
By geographical regions:							
U.A.E.	71,745	114,369	178,861	1	(13,782)	-	351,194
Oman	-	-	-	-	-	-	-
Qatar	4,897	21,410	32,796	-	(341)	-	58,762
Rest of Middle East	4,086	24,983	22,919	(246)	(613)	-	51,129
Profit before tax.....	<u>80,728</u>	<u>160,762</u>	<u>234,576</u>	<u>(245)</u>	<u>(14,736)</u>	-	<u>461,085</u>

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

	RBWM US\$000	CMB US\$000	GB&M US\$000	GPB US\$000	Other US\$000	Inter Segment US\$000	Total US\$000
Half year to 30 June 2015							
Net interest income	228,813	163,626	127,286	(11)	(129)	11,276	530,861
Net fee income	69,112	116,621	98,844	2	(2,370)	-	282,209
Net trading income	29,225	30,519	95,918	1	(69)	(11,276)	144,318
Other income	11,948	12,613	15,361	200	36,797	(36,227)	40,692
Net operating income before loan impairment (charges)/recoveries and other credit risk provisions	339,098	323,379	337,409	192	34,229	(36,227)	998,080
Loan impairment (charges)/recoveries and other credit risk provisions	(20,906)	(28,047)	18,482	-	-	-	(30,471)
Net operating income	318,192	295,332	355,891	192	34,229	(36,227)	967,609
Total operating expenses	(228,891)	(154,811)	(134,591)	(882)	(57,991)	36,227	(540,939)
Operating profit.....	89,301	140,521	221,300	(690)	(23,762)	-	426,670
Share of profit in associates	3,016	-	441	-	-	-	3,457
Profit before tax.....	92,317	140,521	221,741	(690)	(23,762)	-	430,127
By geographical regions:							
U.A.E.	82,674	75,737	155,253	(609)	(23,042)	-	290,013
Oman	634	14,135	6,743	-	(576)	-	20,936
Qatar	3,758	14,857	35,917	-	(51)	-	54,481
Rest of Middle East	5,251	35,792	23,828	(81)	(93)	-	64,697
Profit before tax.....	92,317	140,521	221,741	(690)	(23,762)	-	430,127

Balance sheet information

	RBWM US\$000	CMB US\$000	GB&M US\$000	GPB US\$000	Other US\$000	Inter Segment US\$000	Total US\$000
At 30 June 2016							
Loans and advances to customers (net)	4,492,228	9,647,717	8,742,488	-	2,580	-	22,885,013
Interest in associates	-	-	78,021	-	-	-	78,021
Total assets	4,502,992	10,292,694	24,853,937	-	1,284,653	-	40,934,276
Customer accounts.....	11,787,619	6,898,028	5,418,431	-	539,738	-	24,643,816
Total liabilities	11,926,533	8,173,570	10,956,670	-	5,687,213	-	36,743,986
At 31 December 2015							
Loans and advances to customers (net)....	4,631,864	10,492,110	8,487,623	-	2,395	-	23,613,992
Interest in associates	3,848	-	78,325	-	-	-	82,173
Total assets	4,650,256	11,238,516	24,248,596	-	1,337,451	-	41,474,819
Customer accounts.....	11,824,225	8,660,073	4,739,648	40	28,093	-	25,252,079
Total liabilities	11,945,310	10,034,092	9,872,641	40	4,876,441	-	36,728,524

6 Financial liabilities designated at fair value

	30 June 2016 US\$000	31 December 2015 US\$000
Debt securities in issue	404,424	848,237

At 30 June 2016, the accumulated amount of change in fair value attributable to changes in credit risk was a gain of US\$5.8 million (30 June 2015: US\$5.8 million loss).

Notes on the Condensed Financial Statements (unaudited) (continued)**7 Debt securities in issue**

	30 June 2016		31 December 2015	
	Carrying amount US\$000	Fair value US\$000	Carrying amount US\$000	Fair value US\$000
Medium term notes	3,898,793	3,897,984	4,149,847	4,151,145
Non-equity preference shares	950,000	845,699	950,000	861,017
	4,848,793	4,743,683	5,099,847	5,012,162
Of which debt securities in issue reported as				
trading liabilities	(1,622,696)	(1,622,696)	(1,443,633)	(1,443,633)
financial liabilities designated at fair value (Note 6)	(404,424)	(404,424)	(848,237)	(848,237)
	2,821,673	2,716,563	2,807,977	2,720,292

8 Risk Management

The group's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk.

The interim condensed consolidated financial statements do not include all risk management information and disclosures required in the annual financial statements, they should be read in conjunction with the Annual Report and Accounts 2015.

There have been no material changes to our policies and practices regarding risk management and governance as described in the Annual Report and Accounts 2015.

9 Fair values of financial instruments

The accounting policies, control framework and the hierarchy used to determine fair values at 30 June 2016 are consistent with those applied in the Annual Report and Accounts 2015.

Financial instruments carried at fair value

	Valuation techniques			Total US\$000
	Level 1 Quoted market price US\$000	Level 2 Using observable inputs US\$000	Level 3 With significant unobservable inputs US\$000	
At 30 June 2016				
Recurring fair value measurements				
Assets				
Trading assets	-	220,902	-	220,902
Derivatives	-	1,272,289	10,421	1,282,710
Financial investments: available-for-sale	-	6,640,305	74,826	6,715,131
Liabilities				
Trading liabilities	-	1,688,748	-	1,688,748
Financial liabilities designated at fair value	-	404,424	-	404,424
Derivatives	-	1,383,496	5,055	1,388,551

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

	Valuation techniques			Total US\$000
	Level 1 Quoted market price US\$000	Level 2 Using observable inputs US\$000	Level 3 With significant unobservable inputs US\$000	
At 31 December 2015				
Recurring fair value measurements				
Assets				
Trading assets	-	129,619	-	129,619
Derivatives	-	990,293	2,222	992,515
Financial investments: available-for-sale	-	7,056,357	102,624	7,158,981
Liabilities				
Trading liabilities	-	1,483,677	-	1,483,677
Financial liabilities designated at fair value	-	848,237	-	848,237
Derivatives	-	1,052,971	20,999	1,073,970

Movement in Level 3 financial instruments

The following table provides a reconciliation of the movement between opening and closing balances of Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs:

	Assets			Liabilities
	Available- for-sale US\$000	Held for Trading US\$000	Derivatives US\$000	Derivatives US\$000
At 1 January 2016	102,624	-	2,222	20,999
Total gains or losses recognised in profit or loss:				
- Gains less losses from financial investments	11,209	-	-	-
- Trading income excluding net interest income	-	-	8,199	(15,944)
Total gains or losses recognised in other comprehensive income				
- Available-for-sale investments: fair value losses	(17,001)	-	-	-
- Exchange differences	4	-	-	-
Purchases	-	-	-	-
Sales	(22,010)	-	-	-
At 30 June 2016	74,826	-	10,421	5,055
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held on 30 June 2016				
- Gains less losses from financial investments	(1,097)	-	-	-
- Trading income excluding net interest income	-	-	10,421	(5,055)
At 1 January 2015	116,348	-	2,508	11,399
Total gains recognised in profit or loss:				
- Gains less losses from financial investments	(4,283)	-	-	-
- Trading income excluding net interest income	-	-	(286)	9,600
Total gains or losses recognised in other comprehensive income				
- Available-for-sale investments: fair value losses	(8,653)	-	-	-
- Exchange differences	(5)	-	-	-
Purchases	39	-	-	-
Sales	(822)	-	-	-
At 31 December 2015	102,624	-	2,222	20,999
Unrealised gains/(losses) recognised in profit or loss relating to assets and liabilities held on 30 June 2015				
- Gains less losses from financial investments	(4,124)	-	-	-
- Trading income excluding net interest income	-	-	3,597	(17,618)

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

For assets and liabilities classified as held for trading, realised and unrealised gains and losses are presented in the income statement under 'Trading income excluding net interest income'.

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

Effects of changes in significant unobservable assumptions to reasonably possible alternatives

The fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data. The following table shows the sensitivity of fair values to reasonably possible alternative assumptions:

Sensitivity of fair values to reasonable possible alternative assumptions

	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes US\$000	Unfavourable changes US\$000	Favourable changes US\$000	Unfavourable changes US\$000
At 30 June 2016				
Derivatives/trading assets/trading liabilities ¹	774	(774)	-	-
Financial investments: available-for-sale	1,010	(1,010)	2,731	(2,731)
At 31 December 2015				
Derivatives/trading assets/trading liabilities ¹	1,161	(1,161)	-	-
Financial investments: available-for-sale	966	(966)	4,165	(4,165)

1 Derivatives, trading assets and trading liabilities are presented as one category to reflect the manner in which these financial instruments are risk-managed.

Sensitivity of fair values to reasonably possible alternative assumptions by Level 3 instrument type

	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes US\$000	Unfavourable changes US\$000	Favourable changes US\$000	Unfavourable changes US\$000
At 30 June 2016				
Private equity including strategic investments	1,010	(1,010)	2,731	(2,731)
Other derivatives.....	774	(774)	-	-
Other portfolio.....	-	-	-	-
At 31 December 2015				
Private equity including strategic investments	966	(966)	4,165	(4,165)
Other derivatives.....	1,161	(1,161)	-	-
Other portfolio.....	-	-	-	-

Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable parameters using statistical techniques. When parameters are not amenable to statistical analysis, quantification of uncertainty is judgmental.

When the fair value of a financial instrument is affected by more than one unobservable assumption, the above table reflects the most favourable or most unfavourable change from varying the assumptions individually.

In respect of private equity investments, in many of the methodologies, the principal assumption is the valuation multiple to be applied to the main financial indicators. This may be determined with reference to multiples for comparable listed companies and includes discounts for marketability.

For other derivatives, principal assumptions concern the value to be attributed to future volatility of asset values and the future correlation between asset values.

Notes on the Condensed Financial Statements (unaudited) (continued)**10 Interest in associates**

On 30 March 2016, the group completed the disposal of its 40% shareholding in Rewards Management Middle East FZ LLC, an associate of the group, and recorded a gain on disposal of US\$13.1 million.

11 Credit quality of financial instruments

The five credit quality classifications set out and defined in the Annual Report and Accounts 2015 describe the credit quality of the group's lending, debt securities portfolios and derivatives. These classifications each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending businesses, as well as the external ratings attributed by external agencies to debt securities. There is no direct correlation between internal and external ratings at granular level, except to the extent each falls within a single quality classification.

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

	30 June 2016							
	Neither past due nor impaired				Past due but not impaired	Impairment allowances		Total
	Strong US\$000	Good US\$000	Satisfactory US\$000	Sub-standard US\$000	US\$000	US\$000	US\$000	US\$000
Cash and balances at central banks	799,792	1,613	-	31,230	-	-	-	832,635
Items in the course of collection from other banks	-	-	46,838	-	-	-	-	46,838
Trading assets	141,428	26,451	51,250	1,773	-	-	-	220,902
- treasury and other eligible bills	-	-	-	-	-	-	-	-
- debt securities	61,061	26,451	20,642	1,773	-	-	-	109,927
- loans and advances to banks	62,364	-	511	-	-	-	-	62,875
- loans and advances to customers	18,003	-	30,097	-	-	-	-	48,100
Derivatives	269,024	256,083	742,451	15,152	-	-	-	1,282,710
Loans and advances held at amortised cost	16,075,040	7,112,198	4,909,881	797,151	832,823	1,447,358	(1,111,147)	30,063,304
- loans and advances to banks	5,678,282	1,109,870	228,500	161,639	-	-	-	7,178,291
- loans and advances to customers	10,396,758	6,002,328	4,681,381	635,512	832,823	1,447,358	(1,111,147)	22,885,013
Reverse repurchase agreements non-trading..	395,079	120,062	-	-	-	-	-	515,141
Financial investments	1,262,177	-	5,377,860	-	-	-	-	6,640,037
- treasury and other similar bills	-	-	1,265,870	-	-	-	-	1,265,870
- debt securities	1,262,177	-	4,111,990	-	-	-	-	5,374,167
Other assets	34,151	223,336	473,784	57,164	29,882	5,469	-	823,786
- endorsements and acceptances	31,009	223,276	321,142	57,164	28,455	5,469	-	666,515
- accrued income and other	3,142	60	152,642	-	1,427	-	-	157,271
Total financial instruments	18,976,691	7,739,743	11,602,064	902,470	862,705	1,452,827	(1,111,147)	40,425,353

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

	31 December 2015							
	Neither past due nor impaired				Past due but not impaired US\$000	Impaired US\$000	Impairment allowances US\$000	Total US\$000
	Strong US\$000	Good US\$000	Satisfactory US\$000	Sub- standard US\$000				
Cash and balances at central banks	519,043	59,369	–	34,001	–	–	–	612,413
Items in the course of collection from other banks	–	–	90,173	–	–	–	–	90,173
Trading assets	77,869	21,863	27,792	2,095	–	–	–	129,619
– treasury and other eligible bills	–	–	–	–	–	–	–	–
– debt securities	66,386	21,863	21,830	2,095	–	–	–	112,174
– loans and advances to banks	11,483	–	–	–	–	–	–	11,483
– loans and advances to customers	–	–	5,962	–	–	–	–	5,962
Derivatives	176,590	222,898	585,919	7,108	–	–	–	992,515
Loans and advances held at amortised cost	14,383,420	9,238,179	5,055,483	847,490	540,695	1,519,010	(1,239,171)	30,345,106
– loans and advances to banks	4,774,909	1,680,948	107,622	165,636	–	19,993	(17,994)	6,731,114
– loans and advances to customers	9,608,511	7,557,231	4,947,861	681,854	540,695	1,499,017	(1,221,177)	23,613,992
Reverse repurchase agreements non-trading	470,608	336,320	–	–	–	–	–	806,928
Financial investments	2,203,968	–	4,852,121	–	–	–	–	7,056,089
– treasury and other similar bills	1,116,602	–	1,663,893	–	–	–	–	2,780,495
– debt securities	1,087,366	–	3,188,228	–	–	–	–	4,275,594
Other assets	30,493	279,643	521,225	72,918	15,609	2,226	–	922,114
– endorsements and acceptances	28,329	279,568	387,219	72,918	14,153	2,226	–	784,413
– accrued income and other	2,164	75	134,006	–	1,456	–	–	137,701
Total financial instruments	17,861,991	10,158,272	11,132,713	963,612	556,304	1,521,236	(1,239,171)	40,954,957

12 Contingent liabilities, contractual commitments and guarantees

	At 30 June 2016 US\$000	At 31 December 2015 US\$000
Guarantees and other contingent liabilities		
Guarantees	14,128,914	14,161,236
Commitments		
Documentary credits and short-term trade-related transactions	481,972	592,827
Undrawn formal standby facilities, credit lines and other commitments to lend	16,685,506	17,848,653
	17,167,478	18,441,480

The above table discloses the nominal principal amounts of contingent liabilities, commitments and guarantees. 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 proportion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not representative of future liquidity requirements.

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

Guarantees and other commitments

The principal types of guarantees generally provided in the normal course of the group's banking business, and other contractual commitments, are consistent with those detailed in the Annual Report and Accounts 2015.

13 Legal proceedings and regulatory matters

The group is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions arising out of its normal business operations. No material adverse impact on the financial position of the group is expected to arise from such proceedings arising in the jurisdictions in which the group operates.

Anti-money laundering and sanctions-related

(Matters relevant to HBME as a subsidiary of HSBC operating in the Middle East)

In October 2010, HSBC Bank USA entered into a consent order with the Office of the Comptroller of the Currency (the 'OCC'), and HSBC North America Holdings Inc. ('HNAH') entered into a consent order with the Federal Reserve Board (the 'FRB') (each an 'Order' and together, the 'Orders'). These Orders required improvements to establish an effective compliance risk management programme across HSBC's US businesses, including risk management related to the Bank Secrecy Act ('BSA') and anti-money laundering ('AML') compliance. HSBC Bank USA is not currently in compliance with the OCC Order. Steps are being 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, among others, the DoJ (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 FCA to comply with certain forward-looking AML and sanctions-related obligations. In addition, HSBC Bank USA entered into civil money penalty orders with the Financial Crimes Enforcement Network of the US Treasury Department and the OCC.

Under these agreements, HSBC Holdings and HSBC Bank USA made payments totalling \$1.9bn to US authorities and undertook various further obligations, including, among others, to continue to cooperate fully with the DoJ in any and all investigations, not to commit any crime under US federal law subsequent to the signing of the agreement, and to retain an independent compliance monitor (the 'Monitor'). In January 2016, the Monitor delivered his second annual follow-up review report. Through his country-level reviews, the Monitor identified potential anti-money laundering and sanctions compliance issues that the DoJ and HSBC are reviewing further. Additionally, as discussed elsewhere in this Note, HSBC is the subject of other ongoing investigations and reviews by the DoJ. The potential consequences of breaching the US DPA, as well as the role of the Monitor and his second annual review, are discussed on page 100 of the Annual Report and Accounts 2015.

HSBC Bank USA also entered into two consent orders with the OCC. These required HSBC Bank USA to correct the circumstances noted in the OCC's report and to adopt an enterprise-wide compliance programme, and imposed restrictions on acquiring control of, or holding an interest in, any new financial subsidiary, or commencing a new activity in its existing financial subsidiary, without the OCC's prior approval.

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

In November 2014, a complaint was filed in the US District Court for the Eastern District of New York on behalf of representatives of US persons alleged to have been killed or injured in Iraq between April 2004 and November 2011. The complaint was filed against HSBC Holdings, HSBC Bank plc, HSBC Bank USA and HSBC Bank Middle East Limited, as well as other non-HSBC banks and the Islamic Republic of Iran (together, the 'Defendants'). 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. The Plaintiffs filed a Second Amended Complaint in July 2016, and the Defendants have indicated that they will be filing an amended Motion to Dismiss in response in due course.

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

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 Limited, as well as a non-HSBC bank, Al Rajhi 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.

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.

14 Transactions with related parties

There were no changes in the related party transactions described in the Annual Report and Accounts 2015 that have had a material effect on the financial position or performance of HSBC in the half-year to 30 June 2016. All related party transactions that took place in the half-year to 30 June 2016 were similar in nature to those disclosed in the Annual Report and Accounts 2015.

15 Events after the balance sheet

On 26 July 2016 the Directors declared a second interim dividend of US\$75 million in respect of the financial year ending 31 December 2016, as described in Note 2.

16 Interim Report 2016 and statutory accounts

The information in this Interim Report 2016 is unaudited and does not constitute statutory accounts. The Interim Report 2016 was approved by the Board of Directors on 1 August 2016. The Annual Report and Accounts for the year ended 31 December 2015 have been delivered to the Registrar of Companies in Jersey in accordance with Article 108 of the Companies (Jersey) 1991, as amended. The auditor has reported on those accounts. Its report was (i) unqualified; (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report; (iii) and did not contain a statement under Article 113B(3) of the Companies (Jersey) 1991, as amended.

Independent Review Report by PricewaterhouseCoopers Limited to HSBC Bank Middle East Limited

Introduction

We have reviewed the accompanying condensed consolidated interim statement of financial position of HSBC Bank Middle East Limited and its subsidiaries (together referred to as the “Group”) as at 30 June 2016 and the related condensed consolidated interim statements of income, comprehensive income, changes in equity and cash flows for the six-month period then ended and other explanatory notes. Management is responsible for the preparation and presentation of this condensed consolidated interim financial information in accordance with International Accounting Standard 34 – Interim Financial Reporting as adopted by the European Union (“IAS 34”). Our responsibility is to express a conclusion on this condensed consolidated interim financial information based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, 'Review of interim financial information performed by the independent auditor of the entity'. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed consolidated interim financial information is not prepared, in all material respects, in accordance with International Accounting Standard 34 “Interim Financial Reporting” as adopted by the European Union.

Anthony Hugh McNaughtan
PricewaterhouseCoopers
Dubai, United Arab Emirates
2 August 2016

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PricewaterhouseCoopers Limited is registered with the Dubai Financial Services Authority.

HSBC BANK MIDDLE EAST LIMITED

Incorporated in the Dubai International Financial Centre - number 2199

Regulated by the Dubai Financial Services Authority.

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